

Information on the meeting of the Monetary Policy Council on August 21-22nd, 2001

The Monetary Policy Council held its meeting on August 21-22nd, 2001. The Council was submitted the materials prepared by the Management Board and departments of the NBP and information and analytical materials prepared by the Ministry of Finance, research institutes and commercial banks. On this basis, before starting the decision-making part of the meeting, the Council discussed inflation processes; tendencies in the area of money supply, lending and interest rates; external conditions and the situation in the balance of payments, real sector of the economy and in public finance sector.

I. Inflation processes.

1. In July this year, consumer goods and services prices lowered by 0.3% as compared to June this year. It mainly resulted from:
 - Seasonal drop of foodstuff prices (by 2.6%), especially prices of vegetables (by 24.6%) and fruit (by 9.3%),
 - And drop of fuel prices (by 1.7%) connected with a favorable situation on the world fuel markets.

The drop of prices in July this year - combined with the fact that in July last year instead of the seasonal drop the prices rose by 0.7% as compared to June - resulted in the decrease of the twelve-month consumer price index to 5.2% from 6.2% a month before.

2. All base inflation measures calculated on the twelve-month scale dropped:
 - 15%-cut average from 6.0% to 5.5%;
 - inflation after the controlled prices are excluded from 6.6% to 5.2%;
 - inflation after the most variable prices are excluded from 5.3% to 4.5%;
 - inflation after the most variable and fuel prices are excluded from 6.2% to 5.4%;
 - net inflation from 6.8% to 6.7%.
3. The sold industrial output prices rose in July this year by 0.1% as compared to June (a month before they dropped by 0.4%). The prices in industrial processing section lowered by 0.3% and the price increase was noted in the section of production and provision of electric energy, natural gas and water by 2.6% and in mining - by 0.6% as compared to June this year.

The twelve-month producer price index amounted to 0.4% (0.9% in June and 2.3% in May this year and 9.0% in July 2000). In industrial processing section prices dropped by 1.7% as compared to July 2000, but the prices of production and provision of electric energy, natural gas and water increased by 11.6%.

The construction and assembling production prices rose by 0.3% as compared to June (as compared to the rise by 0.1% a month before) and as compared to July last year they rose by 3.8% (a year before the price increase amounted to 8.9% annually).

4. The inflation rate expected by bank analysts for December 2001 lowered and currently amounts to 5.9% (as compared to 6.0% a month before). However, inflation expectations of bank analysts in the 11-month horizon slightly increased (from 5.6% to 5.7%).

The drop of the current inflation rate that was known to the surveyed at the moment of the survey caused a decrease of the inflation rate in the 12-month horizon expected by individuals. At the same time, the structure of answers to some questions of the survey worsened.

In July this year, according to the forecasts, consumer goods and services prices lowered as compared to June. It mainly resulted from a typical for that month drop of foodstuff prices and the drop of fuel prices that

was connected with a favorable situation on the world fuel markets. Together with the fact that in July last year - instead of a seasonal drop - the prices rose as compared to June, this resulted in a considerable decrease of the twelve-month consumer price index.

All the measures of base inflation calculated on the twelve-month scale decreased as well. The producer price index decreased again and it is at a very low level what favorably affects the prospects for the prices of consumer goods and services.

II. Money supply, loans, interest rates.

1. In July this year, as compared to June the total money supply (M2) rose by 2.2% (PLN 6.8 billion). A big part of the money supply growth was related to the depreciation of the zloty. The twelve-month nominal growth of total money supply amounted to 13.4%.
2. Favorable developments in the area of deposit growth are maintained. In July this year, PLN-denominated deposits placed by individuals rose by PLN 2.1 billion (i.e. 1.3%) as compared to June this year. Since December 2000 the total PLN-denominated deposits placed by individuals increased by PLN 17.2 billion (i.e. 11.1%) and as compared to July 2000 by PLN 29.1 billion (i.e. 20.5%).
3. In July this year, the amount of loans to individuals and businesses increased by PLN 4.9 billion (2.3%). An essential reason for the growth of this category was the increase of the value in zlotys of foreign currency loans that resulted from the depreciation of the exchange rate of the zloty.

The increase of total loans as compared to July last year amounted to 11.5%.

The favorable tendencies for future inflation in the area of monetary developments are maintained. Households still indicate a strong tendency to save and the growth pace of money supply is under control. In July this year, a considerable growth of loans to individuals and businesses took place, however, an essential reason was the increase of the value in zlotys of foreign currency loans that resulted from the depreciation of the zloty.

III. External conditions.

1. There appear clear signs of the economic slowdown in the euro zone. They are especially visible in Germany where July was the seventh month of the unemployment growth. According to the latest forecasts, the economic growth in Germany will slightly exceed 1% as compared to 3% a year before.
2. The uncertainty related to the American economy outlook increased. In June and July this year, the retail sales in the United States lowered as compared to the same period a year before. The slowdown in the manufacturing sector starts to spread over other sectors.
3. In July this year, petroleum prices dropped on the world markets. Now, they are at the level of approximately USD 25 per barrel. The petroleum producers that are the members of OPEC announce that since September the petroleum production will be decreased by 1 million barrels per day. However, it should not result in a considerable increase of prices for this raw material due to the decreasing demand.

This year, the external conditions are favorable for the inflation lowering. The situation on the world markets of petroleum this year is favorable and the risk of the inflation impulse coming from the fuel market is small. The forecasts indicate that the economic growth in the world will be clearly slower than last year and than it was expected what may adversely affect Polish exports.

IV. Balance of payments, exchange rate.

1. In June this year, the current account deficit based on payments amounted to USD 952 million (as compared to USD 734 million in May this year and USD 836 million in June last year). It should be emphasized that a big current account deficit in June this year mainly resulted from a considerable income deficit (USD 407 million).

In June this year, exports amounted to USD 2,553 million (as compared to USD 2,473 million in May this year and USD 2,397 million in June 2000), and imports amounted to USD 3,410 million (USD 3,638 million in May this year and USD 3,439 million in June 2000). The trade deficit amounted to USD 857 million and was lower than in May this year (USD 1,165 million) and lower than in June 2000 (USD 1,042 million).

In the first six months this year, the current account deficit amounted to USD 4,376 million and as compared to the same period last year it decreased by USD 1,235 million.

2. In July this year, the exchange rate of the zloty depreciated. The average rate against the dollar amounted to PLN 4.19 (PLN 3.97 in June) and against the euro PLN 3.6 (PLN 3.39 in June).

The information on problems with the project of the budget for 2002 triggered the further depreciation of the zloty. The exchange rate of the Polish currency is actually at the level PLN 4.25 - 4.3 for a dollar and PLN 3.9 for a euro.

In June this year, the current account deficit increased. The main reason for this was a considerable income deficit. The trade deficit in June this year was lower than in May this year and lower than in June 2000. It was a result of the bigger export and smaller import.

In July this year, the exchange rate of the zloty depreciated. The information on problems with the project of the budget for 2002 triggered the further depreciation of the Polish currency in August. The insofar depreciation of the zloty should not significantly affect the inflation processes.

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

1. In July this year, the sold industrial output was bigger by 1.1% than a year before (in June this year it dropped by 4.8%). After adjusting the difference of business days, the industrial output in July this year was at the level similar to the one in July 2000. The construction and assembling output was lower by 10.4% than a year before (in June this year the drop amounted to 10.0%).
2. The retail sales in nominal terms, in July this year, were bigger by 1.5% than a year before. In real terms they were at the level similar to the one in July last year.
3. Employment in the enterprise sector in July this year lowered by 0.5% as compared to June this year and it was lower by 3.5% than a year before.
4. The unemployment rate increased to 15.9%. The number of the registered unemployed increased by 22.3 thousand, while a year before the increase of the number of the unemployed amounted to 40.2 thousand.
5. Average wages in the enterprise sector increased by 2.3% as compared to June. As compared to July 2000, they increased in nominal terms by 8.0% and in real terms it increased by 2.9%.

Within the period January-July 2001, average wages in the enterprise sector increased by 7.5% as compared to the same period last year (the growth in real terms amounted to 0.9%).

6. In June this year, the valorization of pensions and disability benefits was performed. As a result of the valorization, the average pension and disability benefit in nominal terms was bigger by 14.5% than a year before and its purchasing power increased by 8.1%.

The situation in the real sector of the economy indicates a small threat of a considerable inflation impulse in the nearest period. However, there can be expected an increase of demand as a result of a considerable increase of the purchasing power of pensions and disability benefits and the payoffs of compensations and reparations. As compared to June this year, the industrial enterprises' evaluations of the future demand and production got improved and trade enterprises reported a considerable decrease of sales reductions.

VI. Situation in public finance sector.

1. In July this year, the budget deficit increased by PLN 672 million up to PLN 19.4 billion (94.3% of the plan for this year before the amendment to the act on the state budget). The Sejm approved the amendment to the act on the state budget, increasing the deficit by PLN 8.6 billion (up to PLN 29.1 billion).
2. The uncertainty concerning the revenues from privatization is maintained. Within the period January-July, they amounted to only PLN 2.1 billion what constitutes 11.8% of the planned PLN 18 billion.

The economic deficit this year is supposed to amount to approximately 4% of GDP. Therefore, it will be considerably higher than it was originally planned and higher than last year.

VII. Decision of the Monetary Policy Council.

1. In July this year, the favorable for inflation lowering tendencies were enhanced and forecasts were confirmed:
 - Consumer goods and services prices lowered as compared to June this year - what combined with the fact that in July last year instead of a seasonal drop the prices rose - resulted in a significant lowering of the twelve-month consumer price index.
 - All measures of base inflation decreased.

- A lower growth of sold industrial output prices and the situation in the real sector of the economy indicate a small threat of a considerable inflation impulse in the nearest period. There can be expected, however, an increase of demand as a result of a considerable increase of purchasing power of pensions and disability benefits and payoffs of compensations and reparations. As compared to June this year, the industrial enterprises' evaluations of future demand and production got improved and trade enterprises reported a considerable decrease of sales reductions.
- The situation in the external circumstances of the Polish economy this year supports the inflation lowering and the risk of an inflation impulse coming from the fuel market is small.
- A strong tendency to save by households is maintained.

2. The main source of uncertainty is the situation in public finance sector connected with the budget for 2002.

This uncertainty was partially decreased by the decision of the Council of Ministers that the state budget deficit in 2002 will not exceed PLN 40 billion and by considering this amount as the deficit border level by the representatives of the opposition. However, only a fast introduction of a pack of structural changes in the economy and public finance will enable the accomplishment of these declarations. In the Council's opinion, changes in public finance should be based, first of all, on the rationalization of expenses and not the increasing of a tax burden.

According to the Council, a clearly lower level of the state budget deficit would be more favorable for the macroeconomic stability and the development of the economy.

The Monetary Policy Council states that the assumptions to the budget for 2002 presented by the Ministry of Finance in a generally appropriate way present the scale of threats in the public finance sector and define the directions of the necessary actions for their improvement.

In opinion of the Monetary Policy Council, after considering the uncertainty connected with the budget, the situation in the real sector of the economy and favorable tendencies in the area of monetary factors set the conditions for the interest rates cut. In this connection, the Council decided to lower the basic interest rates of the NBP by 1 percentage point and maintain its neutral position in monetary policy.

VIII. Setting the short-term inflation target for 2002 at the level 5% (with tolerance limits +/- 1%).

The Monetary Policy Council will tend to achieve in 2002 the inflation target at 5%- consumer goods and services price growth as compared to the end of 2001. The tolerance limits for the inflation deviation from the target set by the Council amount to +/- 1 percentage point.

The inflation target for 2002 has been set as a punctual target with defined tolerance limits. The change of the way to set the target is a result of the view that when the inflation level gets lower, it gets more important to set explicitly the inflation level that the Monetary Policy Council intends to achieve. The definition of tolerance limits applied at the punctual target setting results from the existing inevitable uncertainty related to the conditions for the inflation target achievement that are independent from monetary policy.

The inflation target set for 2002 is coherent with the mid-term monetary policy target set at the level below 4% until the end of 2003.

The next meeting of the Monetary Policy Council will be held on September 25-26th, 2001.