

Information on the meeting of the Monetary Policy Council on September 25-26, 2001

The Monetary Policy Council meeting on September 25-26th, 2001 was held in special circumstances. The Monetary Policy Council analyzed the factors affecting future inflation in conditions of even bigger than usual uncertainty. First, it is connected with possible consequences of terrorist attacks in the USA to the world economy. Second, it results from the fact that the meeting was held directly after parliamentary elections and due to this the uncertainty about the shape of a future economic policy, mainly including the state budget for 2002.

I. Inflation processes.

1. In August this year, consumer goods and services prices lowered, as a year before, by 0.3% as compared to July this year. Similarly to June and July, this price drop mainly resulted from:
 - Drop of foodstuff prices (by 1.4%), especially prices of vegetables (by 15.6%),
 - And drop of fuel prices (by 0.6%).

The twelve-month consumer price index lowered to the level 5.1% from 5.2% a month before.

2. All base inflation measures calculated on the twelve-month scale dropped:
 - 15%-cut average from 5.5% to 5.0%;
 - inflation after the controlled prices are excluded from 5.2% to 4.8%;
 - inflation after the most variable prices are excluded from 4.5% to 4.2%;
 - inflation after the most variable and fuel prices are excluded from 5.4% to 4.9%;
 - "net" inflation (after the foodstuff and fuel prices are excluded) from 6.7% to 6.5%.
3. The sold industrial output prices rose in August this year by 0.5% as compared to July (a month before they rose by 0.3%). It was the biggest monthly rise of industrial output prices since October 2000 and bigger than expected. The prices in industrial processing rose by 0.5% (as compared to the drop by 0.1% a month before).

In August this year, for the first time since July 2000, the twelve-month producer price index rose, but it is still at a very low level (0.8% as compared to 0.6% a month before). In industrial processing sector prices dropped by 1.3% as compared to August 2000 (as compared to 1.5% drop a month before).

4. In September this year, the structure of answers to questions of a survey of inflation expectations of individuals did not explicitly change.

The inflation rate for December 2001 expected by bank analysts lowered and now it amounts to 5.6% (as compared to 5.9% a month before). Inflation expectations of bank analysts in the 11-month horizon also lowered by 0.3 percentage point and amounted to 5.4%.

In August this year, the same as last year and according to expectations, consumer goods and services prices dropped as compared to July. As in June and July, the price drop mainly resulted from the drop of foodstuff and fuel prices. The twelvemonth consumer price index lowered insignificantly. The decrease was also noted in case of all the measures of base inflation calculated on the twelve-month scale and inflation expectations of bank analysts.

It is worth noting, however, that in spite of the drop, the "net" inflation index at the level 6.5% is materially higher than the current inflation rate. It indicates that the considerable decrease of consumer price index observed within previous months mainly results from positive developments, i.e. the drop of petroleum and foodstuff prices. However, these factors can be temporary and they can affect the inflation rise in future.

In August this year, the higher than expected and the highest since October 2000 monthly rise of the sold industrial output prices was noted. The twelve-month producer price index rose for the first time since July last year. However, it is still at a low level and output prices in industrial processing on the twelve-month scale lowered (although the scale of this drop was smaller than a month before).

II. Money supply, loans, interest rates.

1. The total growth of money supply in August this year as compared to the end of July this year amounted to PLN 3.9 billion. One of the elements of this growth was over 90%-growth of deposit value. A part of deposit growth resulted from the increase of the value in zlotys of foreign currency deposits as a result of the depreciation of the zloty. A nominal pace of money supply growth on the twelve-month scale increased to 14.6% from 13.5% a month before.
2. The total PLN-denominated deposits placed by individuals rose in August this year as compared to July this year by PLN 1.6 billion and as compared to August 2000 by PLN 29.1 billion (i.e. 20.3% as compared to the rise by 20.2% a month before).
3. In August this year, total loans to individuals and businesses rose by PLN 4.5 billion as compared to July this year. The increase of the value in zlotys of foreign currency loans as a result of changes of the exchange rate of the zloty constitutes approximately 35% of the total loan growth. The dynamics of total loans on the twelve-month scale rose from 11.6% in July to 12.1% in August this year.

Loans to households rose as compared to July this year by PLN 1.3 billion of which PLN 0.4 billion resulted from the exchange rate changes, and the growth pace of loans to individuals on the twelve-month scale was maintained at the level observed a month before (20.3%). In case of loans to businesses the growth amounted to PLN 3.3 billion of which PLN 1.3 billion resulted from the depreciation of the zloty, and a dynamics of loans to businesses on the twelve-month scale rose to 9.8% (as compared to 9.2% in July and 7.1% in June this year).

4. A scale of adjustments of interest rates on loans and deposits in commercial banks was smaller than the change of basic interest rates of the NBP. Bigger changes were noted in case of deposit than loan interest rates. However, further cuts of interest rates in commercial banks are possible, especially as a result of the NBP interest rate cut in August.

A high growth pace of PLN-denominated deposits placed by individuals is maintained. In August this year, the lending dynamics increased. An essential reason for this increase were changes of the exchange rate of the zloty.

In August this year, the money supply dynamics on the twelve-month scale increased. The main element of this increase was the growth of term deposits placed by individuals.

III. External conditions.

1. Within the last period, the uncertainty about the future situation of external conditions of the Polish economy that are related to the possible results of terrorist attacks in the United States increased considerably.
2. Even before the attacks the IMF published a revised forecast of economic growth worldwide. It provided for economic growth in the USA this year at the level 1.5% (as compared to 4.1% a year before) and for the euro zone 1.9% (as compared to 3.4% in 2000).

Within the last period, considerable uncertainty related to possible consequences of terrorist attacks in the United States to the world economy appeared. Economic growth forecasts for both the USA and the euro zone indicated a clearly smaller pace of economic growth in 2001 than a year before and smaller than it was forecasted earlier. The latest events can even deepen these unfavorable tendencies. Such a scenario would mean the weakening of external demand for Polish goods, i.e. the worsening of external conditions for the growth of Polish economy, but, at the same time, it would be a factor that affects the inflation pressure decrease.

On the other hand, in the present situation it is not possible to exclude the rise of petroleum prices that would adversely affect the development possibilities of the economy and the inflation in Poland.

IV. Balance of payments, exchange rate.

1. In July this year, the current account deficit based on payments amounted to USD 296 million (as compared to USD 956 million in June this year and USD 690 million in July 2000). The trade deficit amounted to USD 798

million and was smaller than in June this year (USD 902 million) and smaller than in July last year (USD 1,040 million).

The current account deficit in the period January-July amounted to USD 4,679 million and as compared to the same period last year it decreased by USD 1,622 million.

2. The observed increase of export resulted from the increase of export of highly processed goods what may be the evidence for a growing capability of the Polish economy to compete on foreign markets.
3. In August this year, the average exchange rate against the dollar amounted to PLN 4.25 (PLN 4.19 a month before) and against the euro PLN 3.82 (PLN 3.60 in July). The variability of the exchange rate of the zloty in August and at the beginning of September this year considerably decreased as compared to July. During last few days the exchange rate of the zloty was affected by the increase of the euro exchange rate against the dollar as a result of the events in the USA and the information (inflation drop, industrial output growth in August this year) encouraging foreign investors to invest in Poland.

In July this year, the situation in the area of the external balance of the Polish economy improved. Both the trade and current account deficits decreased. As compared to June this year, the income deficit decreased considerably too, and the surplus of unclassified transactions on current account increased.

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

1. The gross domestic product in the 2nd quarter this year increased by 0.9% as compared to the 2nd quarter of 2000 (in the previous quarter this year the increase amounted to 2.3%) and the domestic demand decreased by 1.2% in this period (in the 1st quarter this year the domestic demand dropped by 1.4%).
2. The sold industrial output in August this year was bigger by 0.7% than a year before (in July this year it increased by 0.9%, and after adjusting the difference of business days, it was at the level close to July 2000). It should be added that in August last year the industrial output increased by 7.8%, i.e. it constituted a relatively high basis for the output growth calculations this year.
3. In August this year, the retail sales were bigger by 3% than in August last year (as compared to the increase by 1.5% a month before). The retail sales in real terms in August this year increased on the twelve-month scale by approximately 1.5% (in July this year they were at the level close to July 2000).
4. In August this year, average employment in the enterprise sector dropped as compared to the previous month by 0.5% (as in July this year). The reduction of employment calculated on the twelve-month scale amounted to 3.7% (in July this year the drop amounted to 3.5%). The unemployment rate in August increased to 16% from 15.9% a month before.
5. In August this year, average wages in the enterprise sector increased by 6.9% as compared to August 2000 (by 1.7% in real terms). Within the period January-August 2001, the wage growth amounted to 7.4% (1% in real terms) as compared to the same period last year.
6. Within the period January-August, the average pension and disability benefit was bigger by 9.2% than a year before (the growth in real terms was 2.7%).

In general, the results of the 2nd quarter confirmed the earlier forecasts of a drop of the development dynamics of the economy. However, faster growth of industrial output with a considerable share of consumer goods sold on the domestic market in August this year, growth of retail sales, further decrease of sales reductions signaled by trade enterprises and better than a month before assessments of the current demand and production by industrial enterprises can signal the beginning of a gradual stimulation of the domestic demand leading to the acceleration of economic growth.

The situation on labor market should still support the reduction of pressure for the increase of wages and inflation.

VI. Situation in public finance sector.

1. In August this year, the state budget deficit increased to the level PLN 20.9 billion and constituted 71.9% of the plan for this year after the amendment introduction (102.1% of the plan before the amendment introduction).

As compared to the situation of the previous meeting of the Monetary Policy Council, the level of uncertainty about the shape of the budget for 2002 did not lower. On the contrary, additional areas of uncertainty connected with the amount of the deficit and possible increase of taxes appeared. The Monetary Policy Council will present its opinion on the project of the budget for 2002 after its next meeting.

VII.

The accumulated internal problems (situation in public finance sector, increase of unemployment and slower economic growth) and possible worsening of external conditions for Poland's economy strengthen the need for structural reforms, systematically signaled by the Monetary Policy Council, such as:

- Labor market reform,
- Rationalization of public spending,
- Completion of privatization and strengthening of a market mechanism in the areas where it is limited.

VIII. Decision of the Monetary Policy Council.

1. In general, the previous month forecasts were confirmed and the observed earlier tendencies in both monetary and non-monetary areas of Poland's economy were maintained. There appear some signs of a possible stimulation of demand and growth of the economy, however the situation on labor market should prevent from a material wage increase that could result in the inflation impulse.
2. Within the last period, there appeared a considerable uncertainty about possible consequences of terrorist attacks in the United States to the world economy. On one hand, a further slowdown of the economic growth worldwide is possible. It would mean the weakening of the external demand for Polish goods, i.e. the worsening of external conditions for the growth of Poland's economy, but, at the same time, it would be a factor affecting the decrease of inflation pressure.

On the other hand, in the present situation, it is not possible to exclude the rise of petroleum prices that would adversely affect the growth possibilities of the economy and inflation in Poland.

At the moment, it is not possible to give an explicit assessment of the probability and eventual scale of these changes and, in this connection, their joint impact on the future inflation in Poland.

3. At the same time, the uncertainty connected with the situation in public finance sector increased. In the Council's opinion, a permanent recovery of public finance should be mainly focused on the reduction of budget expenses as a result of the acceleration of structural reforms in public finance and the economy. Increasing tax burden imposed on enterprises and the population will be the factor that halts the development of the economy and it may increase the inflation pressure.

The Council wishes to emphasize that it will evaluate the plan of public finance recovery by observing the economic deficit of the public finance sector.

Accepting the amount of PLN 40 billion as a border level of the budget deficit in 2002 was connected with the planned reduction of the economic deficit.

4. **Considering all the above-mentioned paragraphs, the Monetary Policy Council decided to maintain the monetary policy parameters at the existing level, i.e. maintain the basic interest rates of the NBP and its neutral position in monetary policy.**

The next meeting of the Monetary Policy Council will be held on October 3rd, 2001 and it will be focused on the assessment of the project of the state budget for 2002.