Information on the meeting of the Monetary Policy Council on October 24-25, 2001

The Monetary Policy Council held its meeting on October 24-25, 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, banks and research institutes. On this basis, before starting the decision-making part of the meeting, the Council discussed inflation; 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, inflation expectations.

1. In September this year, consumer goods and services prices rose by 0.3% as compared to August this year - a considerably smaller number than in the previous years and than it was expected. Among other things, it resulted from a considerably smaller rise of foodstuff prices. Such low rise of prices in September this year resulted in a considerable drop of the twelve-month consumer price index to 4.3% from 5.1% a month before.
2. All base inflation measures calculated on the twelve-month scale have also significantly dropped:
    - 15%-cut average from 5.0% to 4.6%;
    - inflation after the controlled prices are excluded from 4.8% to 4.1%;
    - inflation after the most variable prices are excluded from 4.2% to 3.6%;
    - inflation after the most variable and fuel prices are excluded from 4.9% to 4.3%;
    - "net" inflation (after the foodstuff and fuel prices are excluded) from 6.5% to 5.8%.
3. According to the initial data published by GUS , the sold industrial output prices in September this year rose by 0.4% as compared to August (a month before the prices rose by 0.8%). The twelve-month producer price index amounted to 0.6%. The acceleration of the growth pace of sold industrial output prices within recent months should be noted.
4. In October this year, the structure of answers to questions of a survey of future inflation expectations improved what indicates that the expectations of individuals at the present moment are more optimistic than a month before. In October this year, inflation expectations of bank analysts also decreased.

In September this year, consumer goods and services prices, as compared to August this year, grew slower than expected. The twelve-month consumer price index lowered to 4.3% from 5.1% in August this year. Since the last meeting of the Council, the future inflation expectations of both individuals and bank analysts have improved.

All the measures of base inflation calculated on the twelve-month scale significantly dropped as well. The so-called "net" inflation index higher than CPI (by 1.5 percentage point) indicates a favorable impact on inflation by the groups of goods excluded from this index, i.e. foodstuffs and fuels. However, the decreasing tendency of the remaining base inflation measures indicates that the observed inflation drop is related to the majority of consumer goods and services groups and it is not caused only by temporary factors.

The acceleration of growth pace of sold industrial output prices within recent months should be noted.

II. Money supply, loans, interest rates.

1. In September this year as compared to the end of August this year, the total money supply (M2) increased by PLN 2.8 billion. A nominal pace of money supply growth on the twelve-month scale amounted to 14.5% (as compared to 14.6% a month before).
2. PLN-denominated deposits placed by individuals rose by PLN 1.3 billion as compared to the end of August this year and by PLN 28 billion as compared to September last year. The pace of deposit growth on the twelve-month scale, although lower than a month before, is maintained at a high level 19.3% (19.9% in August this year).
3. In September this year, the total loan dynamics dropped to 10.8% from 11.7% a month before. The drop of the dynamics has been noted in case of both the loans to households (to 18.9% from 20.4% in August this year) and to businesses (to 8.5% from 9.2% a month before).
4. As a reaction to two last NBP interest rate cuts in June and August this year (by 2.5 percentage points), commercial banks made a bigger cut of interest rates on deposits (by approximately 2 percentage points) than loans to businesses (by approximately 1.2 percentage point). The average interest rate on loans to households even insignificantly rose. The banks' behavior diminishes the threat of a considerable growth of consumer loans.

The data that have appeared since the last meeting of the Council indicate that there is no visible threat to future inflation by monetary factors.

III. External conditions.

1. Since the last meeting of the Monetary Policy Council, the forecasted data for the economic growth worldwide have been decreased again. According to the latest forecasts, in Germany, the economic growth will amount to approximately 0.7% GDP (as compared to 1.6%-2% planned earlier and as compared to 3% in 2000). It is possible that the GDP drop will be noted in the 4th quarter in the USA (during the whole year GDP will grow by 1% as compared to 4.1% in 2000). According to the latest analyses, a boom in the world economy can be expected only in the 2nd half of 2002.
2. The fuel market reaction to terrorist attacks and their military effects was quieter than expected. The stabilization and even a drop of petroleum prices are probable.

Since the last meeting of the Monetary Policy Council, the forecasts for the economic growth worldwide have been lowered what decreases the risk of inflation impulse of the demand nature by the export sector and of the supply nature related to changes of the world prices for petroleum and other raw materials.

IV. Balance of payments, exchange rate.

1. Within the period January-August, the current account deficit amounted to USD 5.0 billion and was lower by approximately USD 2.2 billion than last year. It mainly resulted from a big increase of exports (by over 12% as compared to the same period of 2000) and a low dynamics of imports (3% as compared to the period January-August 2000).
2. The average exchange rate of the zloty against the dollar amounted to PLN 4.22 in September this year (as compared to PLN 4.25 a month before) and against the euro to PLN 3.85 (as compared to PLN 3.82 in August this year).

A considerable improvement of the current account balance indicates the strengthening of the macroeconomic balance.

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

1. In September this year, the sold industrial output was smaller by 3.8% than a year before. After adjusting the difference of business days, the production drop in September this year amounted to approximately 2%. The construction and assembling production was smaller by 11% than a year before (in August this year, the drop amounted to 13.9%).
2. In September this year, the retail sales in real terms were on the level similar to the one noted in September 2000.
3. The employment in the enterprise sector dropped by 0.3% in September this year as compared to August this year and it was lower by 4% than a year before. The unemployment rate increased to 16.3% from 16.2% a month before.
4. Within the period January-September this year, average wages in the enterprise sector were bigger by 7.2% in nominal terms and by 1% in real terms than within the same period last year. The average pension and disability benefit, within the period January-September this year, were bigger by 9.8% in nominal terms than within the same period in 2000, and their purchasing power increased by 3.5%.

The data on production and retail sales that were obtained between the meetings of the Council indicate that a low level of economic activity is maintained and there is a little inflation threat resulting from the demand growth.

VI. Situation in public finance sector.

1. In September this year, the budget deficit increased by PLN 0.8 billion and after 9 months it amounted to PLN 21.7 billion (i.e. 74.7% of the plan after the amendment introduction).

As compared to the situation a month before, two new elements appeared:

- **The Government's decision to block the budget expenses in 2001 at the amount of PLN 8.5 billion,**
- **The Finance Minister's declaration that the ceiling of the state budget expenses in 2002 will amount to PLN 183 billion and the deficit will not exceed PLN 40 billion.**

The Council assumes that these declarations will be accomplished.

VII.

The Monetary Policy Council wishes to emphasize that the problems accumulated in Poland, first of all, the drop of employment and the increase of unemployment, and the drop of the economic growth pace mainly result from:

1. Blocking of some structural reforms
    - Labor market reform,
    - Deeper rationalization of public expenses,
    - Bigger arrangement of taxes,

2. Insufficient pace of other reforms
    - Privatization, especially in such areas as power engineering, natural gas, transport, mining, metallurgical engineering,
    - Introduction of competition where it is not sufficient (fuel sector, telecommunications).

More difficult external conditions than it could have been forecasted before September 11th additionally increase the need to unblock a big development potential of the Polish economy through the mentioned structural reforms.

The monetary policy is not able to replace these reforms. It also has to consider the threats to price stability that are made by the situation in public finance. The Council will closely observe the Government actions aimed at the improvement of public finance condition and the trends in the dynamics of budget revenues and expenses. Without a clear improvement of the budget situation, the monetary policy instruments will not be able to deliver impulses that will stimulate the economic growth.

VIII.

The recovery of the situation in public finance requires structural reforms that will permanently reduce the state budget expenses. In this connection, the Monetary Policy Council thinks that the introduction of savings income tax is not the appropriate way of solving budget problems.

The introduction of this tax would be an anti-development action. It would decrease the substantive profitability of placing money at banks, and, additionally, it would have a negative psychological impact on households' tendency to save. Both factors could lead to the drop of savings in the situation where the economy needs the increase of savings in order to be able to finance its investments in a safe way.

IX. Decision of the Monetary Policy Council.

Since the last meeting of the Monetary Policy Council, the balance of factors affecting inflation has been clearly improved.

The observed earlier favorable for future inflation tendencies in the monetary area (a big dynamics of households' deposits) have been maintained. The situation on labor market and a small income dynamics reduce the inflation threat resulting from the demand increase.

Additionally, as compared to the situation a month before, new, positive for the future inflation, information, appeared, although some of them mean the worsening of conditions for economic growth:

- A considerable drop of CPI and all base inflation measures which indicates that the drop of inflation does not only result from temporary factors,
- Improvement of expectations by individuals and bank analysts concerning future inflation,
- Lowering of economic growth forecasts worldwide what means a smaller risk of the inflation impulse of demand nature,
- Improvement of forecasts concerning petroleum prices,
- Data on production and retail sales which indicate that a low level of demand pressure is maintained,
- Government decision to block budget expenses in 2001 at the amount of PLN 8.5 billion,
- Finance Minister's declaration that the ceiling of the state budget expenses in 2002 will amount to PLN 183 billion and the deficit will not exceed PLN 40 billion.

In this situation, the Monetary Policy Council decided to cut the interest rates of the NBP by 1.5 percentage point and maintain its neutral position in monetary policy.

X.

The next meeting of the Monetary Policy Council will be held on November 27-28, 2001.