

Information on the meeting of the Monetary Policy Council on April 25-26, 2002

I. External conditions.

1. The data that have been released since the last meeting of the Monetary Policy Council indicate more clearly than a month ago that the boom in the world economy begins:
 - In the United States, in March this year, the biggest increase since May 2000 of the sold industrial output was noted (by 0.7%), the manufacturing capacity utilization in industry increased, the consumer confidence index increased; the average forecast for the economic growth in the United States in 2002 increased as compared to March this year by 0.5 percentage point (to 2.2% GDP);
 - An insignificant increase (by 0.1 percentage point) was noted in case of the average growth forecast in the euro zone (to 1.2% GDP); in case of Germany it remained on the level 0.9%.

2. Within the recent period the risk of oil prices rise on world markets increased what would adversely affect future inflation and economic boom worldwide. As a result of a bigger political risk in Middle East and Venezuela, oil prices in March and April this year significantly rose. This situation led to the subsequent rise of the forecasted oil price. At present, according to the average market forecast, in 2002 a price per barrel will amount to USD 23 on average (by USD 1.5 more than a month before). It should be emphasized that the present oil price forecasts are very uncertain and they are within a range from USD 19.5 to USD 40 per barrel.

II. Production, economic growth.

1. Signals coming from the Polish economy are not explicit. Some data indicate that a gradual economic boom should take place.
2. An improvement of the situation is signaled by:
 - Strengthening of the growth tendency of retail sales that has been lasting for several months; after the annualized rise by 4.7% in January and by 6.7% in February this year, in March the noted rise amounted to 9.9% (in a way it resulted from the shifting of the Easter shopping from April to March this year);
 - An increase - a second month in a row - of consumer loans dynamics (from 14.4% in January and 14.6% in February to 15.1% in March this year);
 - Higher than a year before were tax revenues of the budget within the period January-March (by 6.2%), including especially income tax from legal persons (by 13.7%) and indirect taxes (by 6.0%) which are the most sensitive to the economic situation;
 - A further improvement of the economic situation survey results in April this year:
 - In the industrial processing the assessments of the current production and forecasts for the future demand and production are positive; better than a month ago - although still negative - are the assessments of the current demand;
 - As compared to March this year, the improvement was also noted in case of the general indicators of the situation in construction (to +7) and in retail sales (to -16), although they are lower than in the same month of 2001.

3. The prudence in forecasting the boom is prompted by:
 - The sold industrial output that in March this year was lower by 3.2% than a year before; although it should be remembered that this year there was one business day less than last year;
 - The construction and assembling production that was lower by 14.4% than in March 2001 (a month ago the drop scale amounted to 13.9%).

III. Wages, social benefits.

1. The situation in the area of employment should reduce the wage pressure in the economy. In March this year, the unemployment rate maintained on the level observed a month before at 18.1%. The average employment in the enterprise sector in March this year was lower by 0.1% than a month before and as compared to the period January-March 2001 it lowered by 4.8%. In the economic situation survey the entrepreneurs forecasted

further reductions of employment within the next months, however, smaller than they forecasted in March this year.

2. Within the period January-March this year, average gross wages in the enterprise sector were higher by 5.3% than in the same period last year and the increase in real terms amounted to 1.8% (as compared to the increase by 5.7% in nominal terms and 2.2% in real terms within the period January-February this year).
3. The March data on employment and wages are convergent with the assumptions that constitute the basis for the forecast of income at disposal according to which in the first quarter this year this income can be smaller in real terms.

IV. Situation in public finance sector.

1. The insofar state budget accomplishment, a forecasted gradual improvement of the economic situation and additional revenues resulting from tax changes that come into force indicate that there is no visible bigger threats to the accomplishment of the Act on the State Budget for the Year 2002.
2. However, it does not change the fact that the public finance deficit will be maintained in 2002 at a very high level (approximately 5% GDP). It will adversely affect the economy. In the situation of a big deficit and small revenues from privatization the Government - in order to finance high lending needs - has to issue a considerable amount of Treasury securities. In the first quarter this year, the total of new issues of Treasury bills amounted to PLN 6.7 billion (by 116.1% more than in the same period of 2001), and of Treasury bonds - PLN 12 billion (by 128.7% more than in the 1st quarter of 2001). This situation contributes to the maintaining of a high level of long-term market interest rates and limits the possibilities to finance the development of enterprises. Moreover, the inflow of foreign portfolio capital invested in Government bonds is a factor that affects the strengthening of the zloty exchange rate without the strengthening of the economy competitiveness at the same time.
3. There is maintained uncertainty concerning the shape of the state budget and of other parts of the public finance sector in 2003. The basic task while constructing the budget should be the reduction of expenses in order to enable a considerable decrease of the public finance deficit and - thanks to this - reduce the intensity of the unfavorable impacts for the development of the economy that have been mentioned above.

V. Money supply, loans, interest rates.

1. As compared to the situation of the previous meeting of the Monetary Policy Council, the scale of threats to the future inflation by monetary factors decreased:
 - The annualized growth pace of money supply (aggregate M3) lowered from 7.2% in February to 3.1% in March this year; the decrease was also noted in case of the dynamics of the insofar basic measure of money supply (M2) (from 11.5% to 8.6%);
 - The annualized dynamics of cash in circulation dropped as well (from 16.7% a month before to 15.6%);
 - The growth pace of lending to businesses on the twelve-month scale lowered from 4.4% a month before to 2.0%.
2. At the same time, a decreasing tendency of the annualized dynamics of deposits placed by households is maintained (from 5.4% in February this year to 3.5%). Moreover, March was the second month in a row when the annualized dynamics of loans to individuals increased (from 14.4% in January and 14.6% in February to 15.1%).
3. In March this year, in reaction to the interest rate cut by the Monetary Policy Council in January banks made further cuts of interest rates on loans. With the simultaneous maintaining of interest rates on deposits at the level noted a month before it means the reduction of commercial banks' margins. An average interest rate on loans to businesses was decreased by 0.5 percentage point as compared to February this year. Significantly - by 1.2 percentage point as compared to February this year and by 2.8 percentage points since December 2001 - banks also lowered interest rates on consumer loans to individuals. An average interest rate on PLN-denominated deposits placed by individuals did not change.

Since February 2001, in total, in reaction to the cut of the reference rate by 9 percentage points by the Monetary Policy Council, banks cut the average interest rates:

- On deposits placed by individuals by 7.7 percentage points to 6.7%;
- On loans to individuals by 4.9 percentage points to 18%;
- On deposits placed by businesses by 6.8 percentage points to 7.1%;
- On loans to businesses by 6.8 percentage points to 14.1%.

VI. Prices, inflation expectations.

1. The annualized consumer price index in February this year amounted to 3.3%, i.e. by 0.2 percentage points less than a month before. Within the next months a further drop of consumer price index is probable. The lowest level should be reached in May this year. In the remaining part of the year, a gradual increase of the consumer price index is forecasted that will result from, inter alia, the rise of controlled prices.
2. The role of potentially temporary factors in the drop of inflation is getting smaller. The evidence for this is the fact that in March this year all the annualized core inflation measures lowered, with the "net" inflation measure the most:
 - "net" inflation (excluding foodstuff and fuel prices) from 4.7% to 4.1%;
 - inflation excluding the most variable and fuel prices from 3.3% to 2.9%;
 - 15%-cut average from 3.2% to 2.9%;
 - inflation excluding the most variable prices from 2.8% to 2.6%;
 - inflation excluding the controlled prices from 3.1% to 3.0%.
3. In March this year, the sold industrial output prices were higher by 0.4% than a year before. In the 4th quarter of 2001, a decreasing tendency of the sold industrial output prices maintained, and since January 2002 a slight increasing tendency of the PPI has been observed.
4. Prices in industrial processing were still lower than a year before (by 1.0%), but the scale of the drop decreased (in November 2001 the drop amounted to 3.1%). A still high increase of prices takes place in the provision of electric energy, natural gas and water (by 6.4%) and in mining (by 5.2%). These are sections where the wages constitute the highest in the enterprise sector (in the 1st quarter this year they amounted to PLN 3501.7 in mining and PLN 2933.7 in production and provision of electric energy, natural gas and water as compared to the average in all enterprises at the level PLN 2211.0). Additionally, in the 1st quarter this year, the annualized dynamics of wages in these enterprises was higher than the average in enterprises in general (7.5% in mining and 6.4% in the provision of electric energy, while the average wage increase in enterprises amounted to 5.3%).

It results from the fact that in these sections a state ownership dominates and there is no competition. Instead of the effectiveness improvement, the enterprises shift the excessive and growing costs onto clients. Such actions result in the increase of costs in enterprises what weakens their competitiveness. Moreover, they reduce consumers' spending on the purchase of other goods and services. Both are not favorable for a permanent development of the economy.

5. Changes that took place in the structure of answers to the questions of the survey made by Demoskop in April this year indicate a further improvement of individuals' expectations about the future inflation. A percentage of individuals who expect the prices to grow slower than now increased (by 0.5 percentage point) or that they will be maintained on the existing level (by 2.3 percentage points). The number of people in the remaining groups of the surveyed decreased, including those most pessimistic who expect that prices will grow faster than so far (by 0.8 percentage point). The observed improvement and then the stabilization of a favorable structure of inflation expectations took place in the situation of a gradual decrease of inflation. There is a threat that if the inflation impulses appear they may lead to the reverse of this favorable tendency for future inflation.

The inflation rate expected by bank analysts both in December this year and in the 11-month horizon lowered by 0.2 percentage point (to 4.4%) as compared to the situation observed a month before.

VII. Decision of the Monetary Policy Council.

1. As compared to the situation noted a month before, the following signals indicating the weakening of inflation threats appeared:
 - The consumer price index lowered further;
 - All core inflation measures lowered, and the "net" inflation measure the most what indicates that the role of potentially temporary factors in inflation drop decreases;
 - An improvement of inflation expectations by both bank analysts and individuals took place;
 - A scale of threats to future inflation posed by monetary factors decreased: the dynamics of money supply decreased significantly and the growth pace of cash in circulation and lending to businesses decreased;
 - A difficult situation on labor market is maintained that should reduce the wage pressure.

2. Signals concerning the growth of Poland's economy are not explicit. Some data indicate that a gradual economic boom should take place. For a long-term development of basic importance is the improvement of public finance condition, restructuring of the existing sector of public enterprises, and a labor market reform.
3. The prudence in monetary policy is prompted by:
 - An increase of oil prices on the world markets and further increase in the forecasts about the prices for this raw material;
 - A drop of dynamics of deposits;
 - An increase - the second month in a row - of the dynamics of lending to individuals;
 - A strengthening of - lasting for several months - growth tendency in retail sales;
 - A risk of the maintaining of a too lax fiscal policy and unfavorable impact of this situation on future economic processes, including inflation ones;
 - An improvement of the outlook for the economic situation worldwide, which - although favorable for the Polish exporters and economic growth - will affect the inflation less favorably than was forecasted earlier.

It should be also remembered that full results of the interest rate cuts by 9 percentage points in total made since February 2001 to January 2002 have not been revealed yet.

Considering these arguments, the Monetary Policy Council decided to:

- **Cut the minimum yield on 28-day open market operations from 10% to 9.5%;**
- **Cut the rediscount rate from 12% to 11%;**
- **Cut the lombard rate from 13.5% to 12.5%;**
- **Maintain the deposit rate on the same level (6.5%);**
- **Maintain its neutral position in monetary policy.**

VIII.

The next meeting of the Monetary Policy Council will be held on May 16, 2002 in order to accept the *Report on the Performance of Monetary Policy Guidelines in 2001* and the *Report on NBP Operations in 2001*, and the next one on May 28-29, 2002.