

Information on the meeting of the Monetary Policy Council on February 26-27, 2002

The Monetary Policy Council held its meeting on February 26-27, 2002. 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 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 the public finance sector.

I. Inflation, inflation expectations.

1. The consumer price index on the twelve-month scale lowered in January to 3.5% as compared to 3.6% a month before.
2. According to estimated calculations, in January 2002 the index of the so-called net inflation (excluding foodstuff and fuel prices) was on the twelve-month scale lower by 0.4 percentage point than in December last year and amounted to 4.7%. Within the period December 2001 - January 2002 the difference between "net" inflation and CPI decreased from 1.5 to 1.2 percentage point. Although the level of foodstuff and fuel prices - groups of goods that are excluded from the net inflation index still favorably affects inflation, this positive impact is getting smaller. The inflation reduction results from the drop of growth pace of prices for a big part of goods and services groups.

The remaining measures of core inflation will be presented by the National Bank of Poland after the respective data are made available by the Central Statistical Office.

3. In January 2002, the decreasing tendency of the sold industrial output prices - that lasted for three months - was halted. They were formed at the level noted a year before and as compared to December last year they increased by 0.1% (in December 2001 the sold industrial output prices were lower by 0.4% than a year before and by 0.3% than a month before).
4. In February this year, the future inflation expectations of individuals improved. After a 2-month growth, the percentage of individuals forecasting that the prices will grow faster than now decreased (to 16.6%). Inflation expectations of natural persons, however, considerably depend on current inflation.

The inflation rate expected by bank analysts in the 11-month horizon slightly lowered and amounted to 4.6% as compared to 4.7% in a survey made a month before.

In January 2002, the growth pace of consumer goods and services prices on the twelve-month scale slightly lowered. It amounted to 3.5% as compared to 3.6% in December last year. The index of the so-called net inflation maintained over CPI (by 1.2 percentage point) reflects a favorable impact on inflation of groups of goods excluded from this index, i.e. foodstuffs and fuels. However, the decreasing of the difference between net inflation and CPI proves that the reduction of inflation is not *only* a result of potentially temporary factors but it is also combined with a drop of the growth pace of prices for a big part of goods and services groups.

The improvement of future inflation expectations was noted in case of both natural persons and - although slightly - bank analysts.

The decreasing tendency of sold industrial output prices - that lasted for three months - has been halted. They were formed at the level noted a year before and as compared to December last year they increased by 0.1%.

II. Money supply, loans, interest rates.

1. The nominal growth pace of total money supply (M2) on the twelve-month scale lowered from 13.7% in December 2001 to 12.0% in January this year. So, it is still maintained at a quite high level.
2. In January this year, an annual dynamics of cash in circulation increased again. On the twelve-month scale the growth pace of cash in circulation amounted to 15% as compared to 12% in December and -4.6% in January 2001.
3. At the same time, a further decrease was noted in case of the twelve-month growth pace of PLN-denominated deposits placed by individuals. In January this year, it amounted to 9.6% as compared to 11.7% in December 2001 and 22.5% a year before. One of the factors that caused the decrease of the dynamics of PLN-denominated deposits of households was the lowering of interest rates on deposits. Also a future taxation of interest income from bank placements adversely affects the tendency of the public to place free funds at banks.

However, the dynamics of foreign currency deposits placed by individuals increased. In January this year, it amounted to 16.1% on the twelve-month scale as compared to 13.7% in December and 6.4% in January 2001.

Also the increase was noted in case of the assets of households that are held outside the banking sector - in Treasury securities and open investment funds.

4. Within the latest months, a tendency to stabilize the lending dynamics at a low level appeared. In January this year, an annual dynamics of lending to non-financial sector was at the level of 7.2% (as compared to 7.6% a month before). The dynamics of lending to households amounted to 14.4% (as compared to 14.7% a month before) and the dynamics of lending to businesses was 5.0% (as compared to 5.4% in December last year).
5. Since October last year, a very high annual dynamics of the budget sector net debt has been maintained. In January this year, the net debt was bigger by 41.1% than in the same month in 2001.

Within the latest months, relevant changes in the structure of money supply appeared that might pose a threat to inflation processes in future. On one hand, a clear drop of the dynamics of PLN-denominated deposits of individuals is observed, on the other hand, however, a relevant increase of the dynamics of cash and demand deposits is noted.

At the same time, a low dynamics of lending to businesses and households is accompanied by a very fast growth of the budget sector net debt what is not favorable for the increase of economic activity.

III. External conditions.

1. Since the last meeting of the Monetary Policy Council the forecast of economic situation worldwide improved a little. Especially it is related to the American economy. In January this year, in the United States, inflation still lowered, a growth of unemployment was halted, and the retail sales volume increased considerably more than expected by the market. Actually, investment banks forecast that the GDP growth in the United States in 2002 can amount to 1.3 to 1.9% (as compared to forecasts 0.1-1.5% in January this year). A slight improvement has also been noted in forecasts of a growth pace of Germany's economy - Poland's biggest trade partner. However, they are still at a low level 0.5-0.9% (as compared to 0.2-0.9% in January this year).
2. Due to the upward verification of the economic growth forecasts - especially in the United States, higher prices for oil are expected. In the first six months a stabilization of prices for this raw material at the current level should be expected. However, since the 3rd quarter this year, together with the expected decrease of oil reserves, its prices can start rising.

Since the last meeting of the Monetary Policy Council there have appeared signals that the boom in the world economy, which may be expected in the second half of 2002, can be stronger than expected a month before. It is also related to Germany's economy - Poland's biggest trade partner.

Since the last meeting of the Monetary Policy Council the forecasts for oil prices have been verified upward. In the second half this year a probable rise of prices for this raw material can contribute to the increase of inflation pressure.

IV. Balance of payments, exchange rate.

1. In 2001, the current account deficit amounted to USD 7.0 billion and was lower by USD 2.9 billion than a year before. The revenues from exports were bigger by 7.2% than a year before. The dynamics of imports amounted to 1.3%.

The growth pace of both export and import weakened during the year. In December 2001, for the second month in a row the revenues from exports lowered as compared to the same month last year. This drop amounted to 7.7% (as compared to 3.7% a month before). The trade deficit in December 2001 decreased as compared to December 2000 as a result of a drop of import expenses by 9.5%.

2. In January 2002, the appreciation tendency of the Polish currency reversed. The exchange rate of the zloty weakened against both the dollar and the euro. In January and February (to February 26) an average monthly rate amounted to PLN 4.06 and 4.19 for a dollar (as compared to PLN 4.01 in December last year) and PLN 3.60 and 3.64 for a euro (as compared to PLN 3.58 in December 2001), respectively.

A visible in the consecutive months of 2001 improvement of the current account balance is the evidence for the strengthening of the macroeconomic equilibrium. However, there is a considerable uncertainty about the

current account balance in future. The increase of the domestic demand can, in conditions of a weak economic situation in the world, contribute to a repeated growth of external imbalance.

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

1. In January this year, the sold industrial output decreased as compared to the same period last year by 1.4%. The construction and assembling production was lower by 21.3% than in January 2001. The bigger drop of construction output was affected by a more severe winter than in January last year.
2. In January 2002, the employment in the enterprise sector decreased by 0.2% as compared to December 2001 and it was lower by 4.7% than a year before. The biggest drop of employment during the whole year took place in the construction sector (by 11.8%). The unemployment rate rose from 17.4% a month before to 18.0% in January. The number of the unemployed increased by 4.4% as compared to December 2001 and by 14.7% as compared to January 2001 and it amounted to 3.253 million.
3. In January this year, average gross wages in the enterprise sector were higher by 5.7% in nominal terms than in the same period last year. After taking into account the inflation the rise of wages in the enterprise sector amounted to 2.1% in the whole year, i.e. the most since January 2001. However, as a result of the drop of employment, the wage fund was lower in real terms than a year before. The average pension and disability benefit in January this year was bigger by 14.6% than a year before. Its purchasing power increased in the whole year by 10.7%. A high valorization of pensions and disability benefits in 2001 will result in a high dynamics of these payments until June 2002, i.e. the next valorization of pensions and disability benefits.

There have been maintained a low level of economic activity and a low demand pressure.

The real growth of wages in the enterprise sector by 2.1% on the twelve-month scale, although the highest since January last year, was concentrated in several sectors and big enterprises.

VI. Situation in public finance sector.

1. In February, the Parliament enacted an Act on the State Budget for 2002. Despite the position of the Ministry of Finance, it provides for revenues higher by PLN 1.2 billion than the Government intended in the project. The expenses have been increased by a similar amount. This way a principle of increasing the state budget expenses by 1 percentage point over inflation that was declared in the economic strategy of the Government has been broken. According to the Act on the State Budget, this year they can be increased in real terms by 2.4%. If the average annual pace of price growth appears lower than it has been assumed by the Government in the construction of the budget, then this growth will be even higher. The amount of expenses set forth in the act will not include the payment of arrears to OFE (Open Pension Funds).
2. Due to the delay in implementing some of the Government proposals increasing tax revenues, the budget revenues may appear lower than set forth in the act.

In January this year, they were lower than a year before. Budget deficit in January 2002 was bigger by over 34% than in the same month last year. Last year, the state budget received extraordinary foreign revenues at the amount of PLN 1 billion. It should be noted, however, that for the second year in a row the tax revenues in January are lower than the ones noted a year before.

3. Even though the state budget expenses were increased at the pace of 1% in real terms a year, the public finance sector deficit would be maintained in the period 2002 - 2004 at a very high level. Meanwhile, a forecasted acceleration of the growth pace of the economy should be accompanied by a bigger reduction of public expenses and deficit. A big deficit while the revenues from privatization are small will result in a further increase of lending needs of the budget. It will cause a strong reduction of lending to enterprises.

The public finance area is connected with a high uncertainty. In the Act on the State Budget there have been set forth revenues higher by PLN 1.2 billion than originally assumed by the Government. The planned expenses have been increased by a similar amount. As a result, despite the principle of forming the budget expenses that has been accepted in the economic strategy of the Government, this year, they may be in real terms higher than a year before not by 1% but by 2.4%. The forecasted in the Act on the State Budget a very big deficit of public finance sector may appear even bigger. Big lending needs of the budget will result in a strong reduction of lending to enterprises.

VII. Decision of the Monetary Policy Council.

1. Since the last meeting of the Monetary Policy Council the data indicating a low demand pressure in the economy have been proved. These data is within the range of forecasts that constitute the basis for the last decision of the Monetary Policy Council about interest rates. On the other hand, however, unfavorable changes in the structure of money supply advanced that may constitute a threat to inflation processes in future. There was also maintained a big uncertainty related to the public finance area.
2. Since February 2001 to January 2002, the Monetary Policy Council has cut the reference rate from 19% to 10%, i.e. by almost a half. After inflation is taken into account, so in real terms, the reference rate lowered from 11.6% to 6.3%, i.e. by 5.3 percentage points. So far neither banks nor enterprises fully reacted to these cuts. Especially it is related to the last cut made in January this year. The monetary policy this year has been additionally eased by the depreciation of the exchange rate of the zloty.
3. As a result of, inter alia, the drop of interest rates on deposits, the dynamics of PLN-denominated deposits of individuals on the twelve-month scale lowers. This negative phenomenon got stronger after it has been announced that the bank placement income will be taxed. However, the growth has been observed in case of households' assets held in Treasury securities and open investment funds.

Considering these arguments, the Monetary Policy Council decided not to change interest rates of the NBP and to maintain its neutral position in the area of monetary policy.

VIII.

The next meeting of the Monetary Policy Council will be held on March 26-27, 2002.