

Information on the meeting of the Monetary Policy Council on May 28-29, 2002

The Monetary Policy Council held its meeting on May 28-29, 2002. The Council was submitted the materials prepared by the Management Board and departments of the NBP as well as information and analytical materials prepared by the Ministry of Finance, banks and research institutes. On this basis the Council discussed the external conditions of the Polish economy, the situation in the real sector of the economy and tendencies in the area of wages and social benefits, in public finance sector, money supply, lending and interest rates and the formation of prices and inflation expectations.

In reply to the Government proposals, the Monetary Policy Council discussed the principles of the exchange rate system performance in Poland. The Council declared itself for maintaining the exchange rate system without changes.

I. External conditions.

Since the last meeting of the Monetary Policy Council the economic growth forecasts worldwide have not changed. External conditions should be favorable for the economic boom in Poland.

- The symptoms of a boom in the American economy are already visible. The probability of the sustained improvement of the economic situation is enhanced by the data on the increase of orders for durable goods and a better outlook for companies' earnings in April. As a month before, the economic growth in the United States is assessed at 2.2% in 2002 and 3.5% in 2003.
- A boom in the economy of the euro zone will be weaker and slower than in the United States. The economic growth in the euro zone is assessed at 1.2% this year and 2.9% in 2003, and in Germany 0.9% and 2.8%, respectively.

II. Production, economic growth.

A general evaluation of the outlook for the economic activity increase has not changed since the previous meeting of the Monetary Policy Council.

- A lot of information indicate a growing probability of the economic boom:
 - A clear improvement has been noted in case of the earnings of enterprises. In the 1st quarter this year, they generated net profit of PLN 1.7 billion as compared to PLN 15.8 million worth of net loss a year before. The earnings of enterprises can be used for investment financing.
 - In the 1st quarter this year, the inventories of final goods in enterprises decreased by 6.7% as compared to the same period last year.
 - After a 5-month drop, the revenues from export in April this year were bigger by 9.4% than a year before what may confirm the opinions on a growing external demand expressed by entrepreneurs in the economic situation survey. The increase has also been noted in case of payments for import by 7.9% what, in turn, would signal the increase of domestic demand.
 - The growth tendency in retail sales has been maintained. In April this year, retail sales were bigger by 3.1% than a year before and within the period January-April 2002, they were bigger by 5.2% than in the same period in 2001.
 - Within the period January-April this year, tax revenues were higher by 8.3% than a year before. The indirect tax revenues increased by 9.7% (and in April by 21.2% - what, in part, resulted from the implemented systemic changes, especially excise on electric energy), and the income tax revenues from legal persons rose by 14.1%.
 - In April this year, the drop scale of construction and assembling production clearly decreased. After removing seasonal factors, it was lower by 4.8% than a year before as compared to the drop by 13.8% in February and by 13.5% in March this year.
 - In May this year, the results of the economic situation survey were subject to a further improvement. A general evaluation of the economic situation in industrial processing is close to the one expressed in April and better than a year before (although still negative). The assessments of the current production and forecasts for future demand and production are positive. The atmosphere of the economic situation in construction is evaluated positively, better than in April, and in retail sales less pessimistic than a month ago.

- At the same time, the data on the sold industrial output indicate that the economy in this sector has not turned to the boom phase yet. In April this year - when the work time was longer by one business day - the industrial production was higher by 0.2% than a year before. After eliminating seasonal factors, a drop of production by 0.9% has been noted. The stabilization of the sold industrial output trend that has been observed for 13 months is maintained. Moreover, a drop of wage dynamics - although favorable for future inflation - can contribute to the reduction of the growth pace of consumer demand.

III. Wages, social benefits.

1. As compared to the situation observed a month ago, the annualized growth pace of wages in enterprises decreased what may signal a drop of wage pressure in the economy.

In April this year, average gross wages in the enterprise sector were higher by 2.3% than a year before and, in real terms, a drop of 0.6% was noted. Within the period January-April 2002, average wages in enterprises were higher by 4.5% than in the same period last year, and in real terms this increase amounted to 1.2%.

2. The average employment in the enterprise sector decreased in April by 0.3% as compared to March and it was lower by 4.8% than in April 2001. In April this year, a seasonal drop of the number of the registered unemployed was noted. The unemployment rate dropped from 18.1% to 17.8%.

IV. Situation in public finance sector.

Since the last meeting of the Monetary Policy Council, there was no information that would induce to the change of the evaluation of the public finance situation both this and next year.

- The data on the state budget accomplishment indicate that there are no visible bigger threats to the accomplishment of the Act on the State Budget for the year 2002.

The economic deficit of the public finance sector in 2002, however, will be maintained at a very high level (approximately 5% GDP) what adversely affects the economy. A result of a big deficit and small revenues from privatization is a big supply of Treasury securities that is necessary for financing lending needs of the budget, which results in:

- a limitation of possibilities to finance the development of enterprises;
- an inflow of foreign portfolio capital that is invested in Government bonds by which it contributes to the appreciation of the exchange rate of the zloty without strengthening at the same time - as opposed to direct foreign investments - the competitiveness of the economy.

Moreover, the delay in transferring the due contributions to Open Pension Funds by ZUS (within the period January-April this year, only 24.2% of the plan was accomplished, and ZUS announced additional delays in summer) and the situation of the Labor Fund can lead to the increase of the economic deficit this year.

- There is maintained uncertainty concerning the public finance, including especially the scale of the deficit in 2003. The basic task in the construction of the budget should be the reduction of expenses so it would be possible to decrease considerably the public finance deficit.

V. Money supply, loans, interest rates.

As compared to the situation a month before, the evaluation of monetary factors' impact on future inflation has not been subject to explicit changes.

- In April this year, a further drop of the annualized money supply dynamics was noted. The growth pace of money supply (aggregate M3) lowered from 3.5% in March to 3.4%. The dynamics of the aggregate M2 dropped from 8.4% to 7.8%.

- In April this year, the PLN-denominated deposits of households decreased by PLN 0.8 billion. The annualized dynamics of deposits placed by households dropped from 3.2% a month before to 2.2%. The reasons for this phenomenon are the decreasing growth pace of the people's income and a lowering profitability of placing funds in the banking system resulting from the reduction of the interest rates on deposits and the introduction of taxation of bank interest income.
- The amount of cash in circulation increased in April this year by PLN 1.2 billion as compared to March, and the annualized dynamics rose from 15.6% to 16%. There is maintained uncertainty concerning the inflation reasons and results of a high dynamics of cash.
- The annualized dynamics of lending to households, after a significant increase in March this year from 13.9% to 17.7% lowered in April to 15.5%. The growth pace of lending to businesses remains negative the second month in a row. In April this year, the drop on the 12-month scale amounted to 1.3%. The data on lending are probably distorted by banks' errors in loan classification connected with the introduced change of the methodology and they do not fully reflect the economic phenomena.

VI. Prices, inflation expectations.

1. A monthly increase of consumer goods and services prices in April this year was lower than a year before (0.5% as compared to 0.8% a year before). It mainly resulted from a three times lower growth pace of prices for foodstuffs and non-alcoholic beverages (0.5% as compared to 1.5% a year before). A big increase was noted in case of fuel prices (by 3.1% as compared to no changes a year before).

An annualized consumer price index lowered in April this year from 3.3% to 3.0%. Its further, deep drop is forecasted to take place in May. It is possible to expect that in the further part of the year a gradual increase of inflation will take place to the level close to the lower limit of the range of the inflation target for 2002.

The sold industrial output prices in April this year were higher by 0.4% than a year before.

2. All core inflation measures lowered:
 - 15%-cut average from 2.9% to 2.6%;
 - inflation excluding the most variable prices from 2.6% to 2.5%;
 - inflation excluding the most variable and fuel prices from 2.9% to 2.7%;
 - inflation excluding the controlled prices from 3.0% to 2.6%;
 - "net" inflation (excluding foodstuff and fuel prices) from 4.1% to 4.0%.
3. Since the previous meeting of the Council, the forecasts for oil prices have not changed. It is forecasted that in the 2nd quarter this year an average oil price will amount to USD 25 per barrel, and during the whole year 2002 - USD 23. As compared to the situation a month before, a smaller increase of foodstuff prices is forecasted now.
4. Since the last meeting of the Council, the individuals' expectations about the future inflation improved considerably. A significant drop was noted in case of the percentage of the most pessimistic individuals who expect the price growth to be faster than at present. A group of individuals forecasting that the prices will grow at the same pace as so far has also decreased. The increase has been noted in case of the percentages of individuals who are the most optimistic expecting the following: a drop of the price growth pace, that the prices in a year's time will be the same as now and that the prices will be lower than at present.

In May this year, the inflation rate expected by bank analysts lowered. The inflation expected by them at the end of December this year should be at the level 4.1% (drop by 0.3 percentage point as compared to April), and, in April 2003, they expect inflation at the level 4.2% (less by 0.2 percentage point than a month before).

VII. Decision of the Monetary Policy Council.

1. As compared to the situation observed a month before, the following signals indicating the enhancement of factors that are favorable for low inflation appeared:
 - A clear improvement of inflation expectations of individuals took place and the inflation forecasted by bank analysts lowered;

- According to the forecasts, the consumer price index lowered;
 - All core inflation measures decreased, and the annualized dynamics of the sold industrial output prices is maintained at a low level;
 - The dynamics of wages decreased what may signal a drop of wage pressure in the economy;
 - Forecasts of foodstuff prices growth lowered.
2. A general evaluation of the economic activity growth outlook has not changed since the last meeting of the Monetary Policy Council.

A lot of information indicate a growing probability of the economic boom:

- A clear improvement of earnings of enterprises;
- A drop of inventories;
- Maintaining of forecasts indicating that the external conditions should be favorable for the economic boom in Poland;
- An improvement of the dynamics of export and import payments in April this year;
- Maintaining of the growth tendency of retail sales;
- Higher than a year before tax revenues of the budget, especially from indirect taxes and income taxes from legal persons;
- A clear decrease of the drop scale in construction;
- A further improvement of the results of the economic situation research.

At the same time, the data on the sold industrial output indicate that the economy in this sector has not turned to the boom phase yet. Moreover, the drop of wage dynamics - although favorable for future inflation - can contribute to the reduction of the growth pace of consumer demand.

3. The prudence in monetary policy is prompted by:
- Uncertainty concerning the scale of the economic deficit of public finance sector in 2002 and 2003;
 - Uncertainty concerning the oil prices;
 - A drop of the dynamics of deposits placed by households;
 - Maintaining of a high dynamics of cash and the monetary aggregate M1.

It should be also remembered that full results of interest rate cuts by 9.5 percentage points in total made since February 2001 have not been revealed yet.

4. **Considering these arguments, the Monetary Policy Council decided to:**
- **Cut the minimum yield on 28-day open market operations from 9.5% to 9%;**
 - **Cut the rediscount rate from 11% to 10.5%;**
 - **Cut the lombard rate from 12.5% to 12%;**
 - **Cut the deposit rate from 6.5% to 6%;**
 - **Maintain its neutral position in monetary policy.**

VIII.

The next meeting of the Monetary Policy Council will be held on June 25-26.