

Information on the meeting of the Monetary Policy Council on January 29-30, 2002

The Monetary Policy Council held its meeting on January 29-30, 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 amounted to 3.6% in December 2001, i.e. it was maintained at the level observed a month before.
2. In December 2001, the following core inflation measures calculated on the twelve-month scale lowered:
 - 15%-cut average from 3.9% to 3.7%;
 - inflation excluding the controlled prices from 3.5% to 3.2%;
 - inflation excluding the most variable and fuel prices from 3.8% to 3.7%;
 - "net" inflation (excluding the foodstuff and fuel prices) from 5.3% to 5.1%.

Only inflation excluding the most variable prices rose insignificantly (from 3.0% to 3.1% in December 2001).

3. In December 2001, the sold industrial output prices were lower by 0.3% than a year ago. The biggest drop (by 19.5%) was noted in case of the production of coke, petroleum refining products and its derivatives what was related to the petroleum prices drop on the world markets.
4. The data on the future inflation expectations of individuals are not explicit. In the survey made in January 2002, the rate of future inflation expected by individuals lowered, although the percentage of individuals forecasting that the prices will grow faster than now increased (to 21.8%).

The inflation rate expected by bank analysts in the 11-month horizon was maintained at the level noted a month before (4.7%).

In December 2001, the growth pace of consumer goods and services prices on the twelve-month scale was maintained at the level noted in November (3.6%). The sold industrial output prices were lower than a month before and lower than a year before.

The index of the so-called net inflation over the CPI confirms the proposition of a favorable influence on inflation of such groups of goods as foodstuffs and fuels that are excluded from this index. In December, the difference between the "net" inflation and the CPI decreased from 1.7 to 1.6 percentage point (a positive influence of foodstuff and fuel prices was insignificantly smaller than a month before). The decreasing tendency of the remaining core inflation measures and their formation at the level close to the CPI indicates, however, that the observed drop of inflation is related to all major groups of consumer goods and services and it is not caused by potentially temporary factors only.

II. Money supply, loans, interest rates.

1. The nominal growth pace of total money supply (M2) on the twelve-month scale increased from 12.1% in November to 13.6% in December 2001. The increase of the money supply dynamics was a result of a growth of cash in circulation and foreign currency deposits of individuals that was connected with the introduction of the euro.
2. The twelve-month dynamics of PLN-denominated deposits placed by individuals lowered from 24.1% in December 2000 and 13.7% in November 2001 to 11.7% in December 2001. On the other hand, the growth pace of PLN-denominated deposits placed by businesses increased from 5.7% in October and 8.6% in November to 12.1% in December 2001.
3. The annual dynamics of loans to individuals dropped from 31.7% in December 2000 and 16.1% in November 2001 to 14.6% in December 2001. The annual growth pace of loans to businesses lowered from 13.5% in December 2000 and 6.1% in November 2001 to 5.0%.

During the year 2001 the dynamics of PLN-denominated deposits placed by individuals dropped on the twelve-month scale. It was caused by the drop of interest rates on deposits at commercial banks and the announcement of the introduction of bank placements income tax.

The dynamics of loans to both businesses and individuals continues to lower.

III. External conditions.

1. Since the last meeting of the Monetary Policy Council there has been released the data that the period of the drop of the economic growth pace in the United States can get closer to its end (the consumer optimism index improved, the results of retail sales appeared to be better than expected). On the other hand, the forecasts that the growth pace of the economy of Germany - the biggest Poland's trade partner - will remain at the low level.
2. The forecasts for the petroleum prices on the world markets did not change. As a month before, a certain growth of prices for this raw material in the 2nd half of 2002 is forecasted.

A boom in the world economy should take place in the 2nd half of 2002. However, a low growth pace of Germany's economy will impede the growth of Polish exports. It is a factor that reduces the inflation pressure. Since the last meeting of the Council the forecasts for the petroleum prices are stable.

IV. Balance of payments, exchange rate.

1. Within the period January-November 2001, the current account deficit amounted to USD 6.4 billion and was lower by USD 2.8 billion than in the same period last year. Exports were bigger by 8.9% than in the period January-November 2000, while the dynamics of imports amounted to 2.4%. However, in November 2001, the trade deficit was higher than a year before.
2. In December 2001, the exchange rate of the zloty strengthened against both the dollar (the average monthly exchange rate amounted to PLN 4.01 for a dollar as compared to PLN 4.09 a month before) and the euro (PLN 3.58 for a euro as compared to PLN 3.64 in November 2001). In January 2002, after a temporary strengthening to a maximum level against the dollar for 2.5 years, the zloty weakened and its exchange rate is within the range PLN 4.10-4.15 for a dollar and PLN 3.54-3.60 for a euro.

A visible in the consecutive months of 2001 improvement of the current account balance is the evidence for the strengthening of the external equilibrium of the Polish economy. Within the latest period, however, it is possible to observe some signs meaning a possible reversal of this favorable tendency.

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

1. In December 2001, the sold industrial output was lower than expected. As compared to December 2000, it decreased by 4.8%. Within the whole year 2001, the sold industrial output lowered by 0.2% as compared to the year 2000. The construction and assembling production was lower by 10.6% than in December 2000.
2. The employment in the enterprise sector lowered in December 2001 by 1.4% as compared to November and it was lower by 4.7% than a year before. The unemployment rate increased from 16.8% a month before to 17.4% in December.
3. In 2001, average wages in the enterprise sector were bigger by 7.1% in nominal terms and by 1.5% in real terms than a year before. The average pension and disability benefit were bigger by 11% than in 2000 and their purchasing power increased by 4.7%.

A low level of economic activity has been maintained. The increasing drop of the sold industrial output is the evidence for a low demand pressure in the economy. Also a difficult situation on labor market should - reducing the wage pressure - be an anti-inflation factor.

VI. Situation in public finance sector.

The economic deficit of public finance sector in 2001 was bigger than it was forecasted yet in December and, according to the preliminary data, it amounted to 5.4% of GDP.

The available information signals that the deficit of the public finance sector, even assuming the reduction of the growth pace of the budget expenses to 1% in real terms, will be maintained at the high level within the period 2002-2004.

From the point of view of an improvement of macroeconomic policy scheme and development conditions for enterprises, it is necessary to take firm actions aimed at lowering of the economic deficit. The maintaining of a big deficit of public finance sector together with small revenues from privatization will result in a further increase of loan needs of the budget. It will contribute to maintaining high interest rates on loans by banks and reduce possibilities to finance the development of enterprises.

VII. Decision of the Monetary Policy Council.

1. The observed drop of inflation is related to all major groups of consumer goods and services and it is not only caused by potentially temporary factors.
2. Since the last meeting of the Monetary Policy Council the data indicating a low inflation pressure in the economy have been confirmed. A high and still growing unemployment, a lack of wage valorization in the budget sector and a low lending dynamics should reduce the pace of price growth. Also the forecasts for the situation in the external conditions of the Polish economy indicate a low risk of the inflation impulse.
3. **Considering these arguments, the Monetary Policy Council decided to:**
 - **Cut the minimum yield on 28-day open market operations by 1.5 percentage point (to 10%);**
 - **Cut the rediscount rate by 2 percentage points (to 12%);**
 - **Cut the lombard rate by 2 percentage points (to 13.5%);**
 - **Cut the deposit rate by 1 percentage point (to 6.5%);**
 - **Maintain its neutral position in monetary policy.**
4. **Since February 2001 until this meeting, the Monetary Policy Council has cut the reference rate from 19% to 10%, i.e. almost by half. The majority of results of these profound cuts will be revealed this year. This basic fact should be taken into consideration in making the analysis of the current and forecasted future level of interest rates of the NBP.**
5. **The Monetary Policy Council wishes to emphasize, in particular, that after considering today's cut and the influence of the introduced taxation of income from savings, the real interest rates on deposits will be formed at a very low level. This fact will be taken into consideration in a future monetary policy.**

VIII. Introduction of modifications into the system of open market operations.

According to the *Guidelines of Monetary Policy for 2002*, since February this year the National Bank of Poland introduces changes in the system of open market operations. The National Bank of Poland will perform the following open market operations:

1. basic ones based on a regular (once a week) issuing of money market bills of the National Bank of Poland of 28-day maturity;
2. fine-tuning ones performed in particular cases (without setting regular dates) based on:
 - issuing money market bills of the National Bank of Poland of 1 to 7-day maturity,
 - providing the banking system with liquidity in a form of purchasing (on a tender basis) treasury securities for the periods of 1 to 7 days ("repo" transactions),
 - ahead of time redeeming the money market bills of the National Bank of Poland.

The principles of performing open market operations are set forth in the resolution of the Monetary Policy Council of January 29, 2002. The operations will be still available to banks that perform a function of a money market dealer.

The yield on both basic and fine-tuning operations will not be lower than the level of a reference rate that is defined by the resolution of the Monetary Policy Council.

The introduction of regular issuing of 28-day money market bills that are the basic type of open market operations is a step towards the adjustment of the system of monetary policy instruments to the standards of the European Central Bank. The regularity of open market operations introduces an element of predictability what should stimulate liquidity planning by commercial banks and support the improvement of inter-bank market effectiveness.

In case of considerable liquidity fluctuations, the NBP can perform additional fine-tuning operations. The purpose of fine-tuning operations is smoothing the impact of liquidity disorders on market interest rates. Such a possibility is also at the disposal of the European Central Bank. So far, fine-tuning operations in the euro zone have been made four times. As far as the principle is concerned, fine-tuning operations will be used in exceptional situations when deposit and credit operations of the NBP available to banks will - according to the central bank - be insufficient in eliminating liquidity disorders.

IX.

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