

Warsaw, July 19, 2002

**INFORMATION ON THE MEETING OF THE MONETARY POLICY COUNCIL
ON JULY 18-19, 2002**

The Monetary Policy Council held its meeting on July 18-19, 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. 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 and the inflation outlook.

Decision of the Monetary Policy Council

The latest economic data enhance a little the signals of the economic boom:

- *Industrial production grew by 2.2%,*
- *Higher than expected were budget revenues coming from indirect taxes and CIT,*
- *The drop of employment in the enterprise sector has been halted,*
- *Higher than a year before were the revenues from export.*

The importance of factors indicating the need to be prudent in monetary policy has not been decreased. The most important among them are the following:

- *An outlook of a high public finance sector deficit in conditions of the planned economic growth in 2003 constitutes a basic limitation of the playing field for monetary policy; an additional risk factor for the public finance stability are the forecasted write-offs of tax arrears, guarantees and tax allowances;*
- *A further drop of the annualized deposit dynamics and the saving tendency of households in conditions of the increased individual consumption;*
- *The maintaining of a high dynamics of cash in circulation;*
- *A considerable depreciation of the exchange rate of the zloty, especially against the euro, within the recent weeks increases the uncertainty about the exchange rate of the zloty in future;*
- *Full results of interest rate cuts by 10.5 percentage points in total made since February 2001 have not been revealed yet.*

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

The next meeting of the Monetary Policy Council will be held on August 27-28, 2002.

I. Evaluation of the economic situation

A general evaluation of the economic situation has not changed since the previous meeting of the Monetary Policy Council. In the 2nd quarter the economy grows at the pace of about 0.5% GDP and the unemployment growth has been halted.

The GDP growth pace in the 1st quarter 2002 was insignificantly accelerated to about 0.5%

According to the data by GUS, in the 1st quarter 2002 the annualized dynamics of domestic demand was at the level of 0% (as compared to -2.9% in the 4th quarter 2001) and the GDP growth pace in the 1st quarter 2002 was insignificantly accelerated to about 0.5% (0.2% in the 4th quarter 2001).

In June, the sold industrial output increased by 2.2%. The drop of production in mining and quarrying was smaller in June than within the recent months, higher was the growth pace of the section production and supply with electric energy, gas and water. For several months the tendencies in particular sections of the processing industry have not been changed. Clear growth tendencies are observed in industries producing mainly consumer goods and, at the same time, with big share of exports (e.g. manufacturing of radio and TV equipment, rubber and plastic goods, metal goods). Drop tendencies are maintained in sections manufacturing consumer goods that cannot face the price competition from cheap imports (clothing, leather) and supply goods (production of metals, coke and oil refining products).

In June, the sold industrial output increased

After two months when the drop scale of construction output decreased, in June again the output decrease by more than 10% was noted. However, it did not change the tendency, observed in previous months, of a slow halting of a drop trend of construction and assembling production.

The dynamics of the sold industrial output and the construction and assembling output within the last three months indicates that the growth dynamics of the gross added value in the economy in the 2nd quarter this year is

maintained at the level of about 0.5%.

The forecasted acceleration of the economic growth in the euro zone will support the boom in the Polish exports, and then the improvement of the investment climate. Observed in April and May this year annualized exports growth, together with the results of the economic situation survey by the Institute of Economic Development of SGH made in June indicating the increase of export orders, proves an increasing foreign demand for Polish goods.

The improvement of the economic situation worldwide should support a gradual economic boom in Poland

The latest data confirm that in the enterprise sector there has been noted a moderate wage growth. Within the period January-June this year, the average wages in enterprises were higher by 4.4% than in the same period of 2001. The wage growth in real terms amounted to 1.6% and was higher than a year before. June this year is the first month since February 2001 when the average employment in the enterprise sector did not decrease as compared to the previous month.

A moderate wage growth is noted in the enterprise sector

The situation on the labor market indicates, however, that a material acceleration of the wage growth should not be forecasted in the next couple of months.

II. Situation in public finance sector

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. However, there is a threat that the economic deficit will be higher due to the situation of earmarked funds. The economic deficit of the public finance sector will be maintained on a very high level in 2002 (5% of GDP), adversely affecting the economic growth perspectives. A big supply of treasury securities that is necessary to finance the borrowing needs of the budget limits the possibilities to finance the development of enterprises and constitutes a source of the capital inflow that may result in the appreciation of the exchange rate of the zloty although it does not contribute to the competitiveness improvement of enterprises.

The economic deficit of the public finance sector will be maintained on a very high level in 2002

There is maintained uncertainty about the public finance

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situation in 2003 and within the next years. The Government has accepted the Guidelines of the state budget draft for the year 2003 according to which the budget deficit is to grow to PLN 43 billion. In the situation of a forecasted acceleration of the economic growth it would mean a further loosening of fiscal policy that reduces the playing field of the monetary policy.

uncertainty about the public finance situation in 2003 and within the next years

The Monetary Policy Council positively evaluates the statements of the new Minister of Finance that he will tend to reduce the deficit in 2003 and improve the public finances within the next years. A risk factor for the public finance stability is the announced involvement of the state on the microeconomic level (tax arrears write-offs, guarantees for firms, tax allowances) and the increased financing of investments through granting guarantees and warranties. A full evaluation of the Government plans will be possible, however, after they are set forth.

III. Money supply, loans, interest rates, exchange rate

As compared to the situation a month before, the evaluation of the monetary situation did not change fundamentally, although the depreciation of the domestic currency led to the decrease of the monetary policy restrictiveness. The monetary data indicate that despite a low dynamics of broad monetary aggregates, there are in this area some threats to the future inflation.

Despite a low dynamics of broad monetary aggregates, there are risk factors for future inflation: an increase of cash in circulation accompanying the drop of deposits

The annualized dynamics of money supply M3 is maintained at a low level, and as compared to May it lowered from 3.6% to 3.0%, however, there is maintained a high growth pace of cash in circulation (17.8% in May and 17.9% in June). The increase of cash in circulation looks especially alarming *at the background of the lowering saving tendency of households and the related drop of deposits by households*. In June this year, there was noted a drop of total deposits by households as compared to their amount in the previous month, and the annualized growth pace of deposits lowered in June as compared to May from 1.5% to 0.3%. The acceleration of the consumption dynamics connected with the increase of cash and a drop of deposits on bank accounts is an alarming phenomenon proving the decrease of the savings rate of the sector of households what is

undoubtedly affected by the drop of attractiveness of bank placements.

The annualized dynamics of lending to households lowered from 16.3% a month before to 15.3%. Loans to businesses after 3 months of a drop by 1.8%, 1.9% and 0.3%, respectively, in June this year, were higher by 2% than a year before what, in part, result from the depreciation of the zloty.

Within the latest period, the exchange rate of the zloty depreciated against the euro and dollar. The depreciation of the zloty was bigger against the euro what resulted from the appreciation of the exchange rate of the euro that on July 15 this year exceeded the level 1:1 against the dollar. The exchange rate at a higher level constitutes a factor that increases domestic prices of industrial output, e.g. refineries have already raised fuel prices on the domestic market.

In June this year, the sold industrial output prices were higher by 0.1% than a month before, and the annualized dynamics increased from 0.5% in May to 1.1%. For the first time since May last year, the output prices in industrial processing were higher (by 0.1%) than in the same month a year before. The growth of the output price dynamics, and especially in industrial processing, can, however, be, in part, a symptom of the demand growth: enterprises, when the production grows, try to “regain” their original profitability.

If a further considerable depreciation of the exchange rate of the zloty does not take place, the observed so far depreciation of the exchange rate of the zloty should not threaten the accomplishment of the inflation target for this and next years.

IV. Prices, inflation expectations

In June this year, as a result of a further drop of foodstuff prices and the drop of fuel prices, the annualized consumer price index lowered from 1.9% to 1.6%. A considerably smaller drop has been noted in case of all core inflation measures.

Within the latest period, the exchange rate of the zloty depreciated and the maintaining of this trend can increase prices of industrial output

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Inflation on a low level supports the enhancement of low inflation expectations. In July this year, the structure of answers to the questions of the survey on inflation expectations by individuals, in fact, insignificantly deteriorated. However, thanks to a considerable drop of current inflation in May, the measure of inflation expectations of households lowered. Inflation expectations of bank analysts lowered. Now, they forecast that inflation in December this year will amount to 2.8% as compared to 3.3% a month before, and in 11 months – 3.4% as compared to 3.6% a month before.

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