

INFORMATION AFTER THE MONETARY POLICY COUNCIL MEETING on 22-23 October 2002

The Monetary Policy Council held a meeting on 22nd and 23rd October 2002. The Council reviewed the materials prepared by the NBP Management Board and departments as well as information and analytical materials of the Ministry of Finance, banks and research institutes. The Council discussed the situation in the external environment of Polish economy and trends in the real economy, the scope of employee earnings and social benefits, within the public sector finance, within the money supply, credit and interest rates and also the development of inflation and price expectations as well as inflation prospects.

The Monetary Policy Council decision

A low inflation level is seen to establish in October. Factors containing the inflation growth in the future continue:

- the current inflation rate and core inflation measures stabilised on a low level,
- threats to the future inflation from monetary factors remained low: annual growth rate of total money supply has clearly declined, likewise the annual growth rates of notes and coin in circulation; the pace of credits growth is also slow,
- inflation expectations improved, both of consumer and of bank analysts,
- a moderate increase in employee earnings – at a high unemployment level – does not threaten with an inflation pressure,
- forecasts for global economy growth, of which in particular for German economy, indicate that a slower economic recovery shall be expected.

The picture of macroeconomic situation is not clear. A part of data, primarily on September industrial output and retail sales, indicates that a gradual economic recovery should occur. **However, the figures on enterprises' investment activity and financial standing after three quarters are not available yet. Under such circumstances it is difficult to make a definite assessment of the scale and durability of recovery in enterprises and of prospects for economic growth acceleration in the following quarters.**

Factors that might endanger the inflation stabilisation on a low level and constrain the growth of manufacturing potential have been continuing:

- uncertainty in respect of outcomes of the National Budget this year and – indirectly – next year remains,
- high oil prices in global markets as well as the risk of their increase continue,
- the decline in households deposits at banks became deeper in September,
- despite a very slow pace of monetary aggregates growth it is very difficult to evaluate what will be the deferred response to already taken decisions on cutting interest rates, which as compared to 2001 are on a drastically lower level.

The Monetary Policy Council considered that from the future inflation point of view the inflation pressure constraining factors continue – in the light of current forecasts – to have greater impact than factors threatening the inflation stabilisation and resolved:

- **to reduce the lombard rate from 10.0% to 9.0% per annum;**
- **to reduce the rate on bills rediscounting from 8.5% to 7.75% p.a.;**
- **the National Bank of Poland is going to run 28-day open market operations at the yield not lower than 7.0% p.a.;**
- **the interest rate on time deposits taken from the banks by the NBP stands at 5.0% p.a.;**

The Council continues to hold a neutral stance in the monetary policy.

The Monetary Policy Council has discussed preliminary assumptions of the medium-term monetary policy strategy for the years 2004 – 2006. The MPC has emphasised that it is necessary to prepare this document within the nearest few months to ensure transparency of the monetary policy as – having regard to delays in the economy responses to decisions on NBP interest rates – it will provide the basis for the monetary policy in 2003 and will affect the monetary situation in the following years. The medium-term monetary policy strategy will be based on the assumptions of integration with the Economic and Monetary Union agreed with the government, which stipulate that in 2005 Poland shall meet the nominal Maastricht convergence criteria, including the inflation criterion.

The next meeting of the Monetary Policy Council is to be held on 26-27 November 2002.

I. Economic situation assessment

The trend of gradual improvement in the economic situation in industry observed since June this year continued in September. The industrial output in September 2002 as compared with the corresponding period of the previous year rose by 6.7%. A relatively high growth partly stems from a longer than in September 2001 working time. The output is estimated to rise 3.7%, having considered seasonal factors (including the working time). A particularly favourable phenomenon is the maintenance of a much higher growth rate in the manufacturing (output rise of 8.4%, and having taken into account seasonal differences a rise by 5.2%). The growth was recorded in 22 out of 29 sections of the industry. Like in previous months the industries of high export shares witnessed the highest output increments.

Industrial output growth in September 2002

September has not resulted in the improvement in businessmen and consumer sentiment, both in the USA and in the euro area (for example, the Michigan University index, leading for the American consumer sentiment, declined in October to 80.4, as against 86.1 still in September, while indices reflecting the businessmen sentiment: the American NAPM went down in September to 49.5 as against 50.5 in August, and the German IFO fell to 88.2 as compared with 88.8 in August). Like in previous two months a geopolitical risk remained the main reason for those trends.

Lack of businessmen and consumer sentiment improvement in the USA and the euro area

It is estimated that in Q3, 2002 the economic activity in the USA was supported by the consumer demand, while in the euro area by net exports. The current strong deterioration of businesses sentiment in both regions is likely to slacken the growth of those economies in the fourth quarter of the current year and in Q1, 2003.

Main analytical centres adjusted down their GDP growth forecasts for 2002: for the euro area on average from about 1.0% to 0.8% (of which for Germany from 0.6% to 0.4%) and for the USA from 2.5% to 2.4%. The growth forecasts for 2003 were also reduced: from 2.4% to 2.0% for the euro area (for Germany from 2.2% to 1.6%) and for the USA from 3.0% to 2.8%.

Decreasing forecasts for economic growth in the USA and in the euro area

The development of world oil prices remained to be highly uncertain. The increase in political risk made that in September 2002 the upward trend in oil prices in global markets continued. In the third quarter of 2002 the average price of Brent oil stood at USD 27 per barrel, i.e. nearly 2 dollars more than in Q2, 2002. Market analysts estimate that similarly high oil prices are likely to remain also in the fourth quarter of this year.

High global oil prices

II. Situation in the public finance sector

The situation of the National Budget in September this year was less favourable as compared with the previous month. In the month reviewed the tax revenue recorded a slow pace of growth connected with relatively low revenue on indirect taxes, and also with narrowed revenue on personal income tax. Revenues on indirect taxes are very likely to be much lower in the last quarter of the current year than the average revenue achieved in previous months. This will result from implemented systemic changes, i.e. the elongation of the VAT refunding period by revenue offices, the possibility of quarterly VAT settlement by small enterprises (shifting part of revenue to 2003), and the reduction in the excise duty on alcoholic beverages. This creates a threat that the performance of the National Budget revenue in 2002 may be lower than that stipulated in the Budget Act.

The origination of deficit in the central government revenue in 2002 will imply a difficult situation on the expenditure side. This may be connected with the need to contain part of expenditure this year and to shift it to the next year.

The financial standing of other entities in the public finance sector in August and September this year shows that their deficit, consistent with recent NBP forecasts, will amount to 1.4% of the GDP, i.e. 0.1 pct. point higher than that predicted by the MoF.

According to the NBP forecasts the economic deficit of the public finance sector will most likely equal 5.8% of the GDB, i.e. 0.3 point above the MoF estimates. This means that in another consecutive year the actual course of the fiscal policy will deviate from that planned at the beginning of the year.

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

M3 broad money supply in September this year is 1.6% lower than a year ago. The M3 decline in September as against August 2002 end resulted primarily from a fall (by 2.76bn zloty) in household deposits. On the other hand the value of bonds and funds units in households portfolios has been dynamically increasing, however, in September it did not offset the drop in savings at banks. The annual growth rate of notes and coin in circulation went down from 18.5% in August 2002 to 14.1% in September this year; also the M1 aggregate (cash + demand deposits) in August – as compared to the balance as of July end – shrank by 2bn zloty, what may prove an expiry of a strong upward trend in the transaction money. The growth rate for corporate deposits remains stable at around 10%.

Counterparts to changes in money stocks witness a permanent slowdown of the pace of claims on households increase (from 8.5% in August to 7.8% in September this year), however the quarterly growth figures show a reversal in the downward trend. To the contrary, the growth rate of claims on corporates seen in June and July 2002 was currently retarded. In September this year it amounted to 1.1%, against 2.1% in June and 2.7% in July this year.

Situation of the National Budget worse than in previous month, low growth rate of tax revenue in September

Economic deficit in the public finance sector higher than planned in 2002

Households deposits at banks continue to slacken, households interest in loans diminishes, corporate loans growth rate declines

In September this year the zloty exchange rate slightly appreciated; this trend was most visible against the US dollar, while the zloty against euro exchange rate has been continuing since July this year on a stable level: on average 4.07-4.08 PLN/EUR. The weak appreciation trend has been confirmed also by real effective exchange rates, in particular the rate adjusted with movements in industrial producer prices.

**Zloty exchange
rate apprecia-
tion**

IV. Prices, inflation expectations

In September this year the year-on-year inflation stabilised on a low level and amounted to 1.3%. In August it equalled 1.2%. A slightly faster pace of annualised prices growth in September 2002 was driven by a rise in prices of fuel for transport vehicles and – occurring after five months of decline – an increase in food and non-alcoholic beverages prices.

**Stabilisation of
year-on-year
CPI on a low
level**

In September this year producer prices in industry, as against the corresponding period of the previous year, went up by 1.0%. The sections where limited market mechanisms operate: electricity, gas and water supply as well as mining and quarrying witness the largest price increases, by 7.0% and 0.6%, respectively. Prices in manufacturing have not changed.

The manufacture of coke and refined petroleum products witnessed the highest year-on-year price rise – by 3.3%.

Inflation continuing on a low level is favourable to making low inflation expectation permanent. In October this year inflation expectations both of consumer and of bank analysts declined, where the drop in inflation expectations refers equally to the inflation rate expected in December 2002 and in a 12-month horizon. The annual inflation rate expected by bank analysts as at the year end was equal to 1.5%, what stood for its drop by 0.3 pct. point as compared with declarations made in September this year, while the expected rate of annual inflation (September 2003) amounted to 2.5%, what meant its decline by 0.4pct. point.

**low inflation
expectations**