

Warsaw, September 25, 2002

**INFORMATION ON THE MEETING OF THE MONETARY POLICY COUNCIL
ON SEPTEMBER 24-25, 2002**

The Monetary Policy Council held its meeting on September 24-25, 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 and tendencies in the real sector of the economy, in the area of wages and social benefits, in public finance sector, in the area of money supply, lending and interest rates, and the formation of inflation expectations, prices and the inflation outlook.

Decision of the Monetary Policy Council

In September, the enhancement of a low inflation level is observed. Factors that reduce inflation growth in future have strengthened:

- the expected within 12 months level of inflation has been subject to further reduction,
- the current inflation rate and all core inflation measures lowered,
- the dynamics of money supply M3 dropped,
- the dynamics of lending to households and businesses lowered significantly,
- a moderate growth of wages – in conditions of a high level of unemployment – does not threaten in a form of the increased inflation pressure,
- the growth forecasts for the world economy lowered, including, in particular, the German economy.

The signals coming from the economy are still not explicit. Positive information on the increase of the estimate value of newly begun investments can forecast a coming improvement of the investment demand. We assess that the data for August on the sold industrial output, although a little weaker than it was commonly expected, confirm that the lowering trend in production has been overcome and the increase of the added value in this sector should be expected in the 3rd quarter. These signals give the evidence that the economic growth pace will increase in the quarters to come. Whether the slow economic growth accelerates considerably and whether this acceleration is permanent will be decided by the demand driven factors and mainly the demand from abroad. The growth forecasts for abroad, however, are not optimistic. The prudence in the assessment of possibilities of the investment demand dynamics acceleration is also prompted by the higher risk of a war with Iraq.

A moderate pace of the economic boom, according to the Council, does not pose a threat to the accomplishment of the inflation target in 2002 and 2003 at the moment, however, it indicates the necessity to be prudent in making decisions on the pace and scale of the monetary policy loosening.

Factors that could threaten the stabilization of inflation at a low level and limit the growth of production potential are still observed:

- the drop of the annualized dynamics of household deposits is getting deeper,
- there is still maintained significant uncertainty related to fuel prices,
- the draft *Act on the State Budget for the year 2003* does not constitute the fulfillment of the Government's earlier declarations to take measures that would permanently improve the situation in public finance. The draft lacks the basic systemic solutions that would affect the reduction of the budget expenses dynamics and change their structure. The outlook of maintaining a high deficit of the public finance sector in the conditions of a forecasted faster economic growth in 2003 means further loosening of fiscal policy.

The Monetary Policy Council acknowledged that, from the point of view of future inflation, factors reducing the inflation pressure have got – on the basis of present forecasts – a bigger impact than factors threatening the inflation stabilization and decided to:

- **cut the minimum yield on 28-day open market operations from 8.0% to 7.5%;**
- **cut the rediscount rate from 9.0% to 8.5%;**
- **cut the lombard rate from 10.5% to 10.0%;**
- **cut the deposit rate from 5.5% to 5.0%;**
- **maintain its neutral position in monetary policy.**

The next meeting of the Monetary Policy Council will be held on October 3, 2002.

I. Evaluation of the economic situation

The economic growth in the 2nd quarter this year as compared to the same quarter of the previous year amounted to 0.8% and at the scale of the first six months 0.6%. The improvement of the economic growth in the 2nd quarter this year mainly resulted from the increase of private consumption (2.9%) and a lower than in the previous quarters drop of gross investments in fixed assets (-8.4%).

a slight improvement of the economic situation in the 2nd quarter this year

The currently available statistical data, however, still do not give the reason for the explicitly positive evaluation of the present economic situation what prompts being prudent about the outlook for a fast growth of the dynamics of GDP in 2003. On one hand, the data on a gradual increase of the activity in the real sector – the dynamics of the industrial production, retail sales, get confirmed. On the other hand, however, the evaluations of the external demand growth that is a basic factor affecting investment decisions worsened. A high level of unemployment reduces both the wage demands and the increase of consumption. Therefore, in the next couple of months, a faster growth of income from hired labor should not be expected. Together with a low growth of income from social benefits, it forecasts a further weakening of consumer demand growth.

symptoms of a gradual increase of the activity in the real sector

limited possibilities of consumer demand growth

The survey of the economic situation of enterprises from the processing industry sector, construction and trade made in August did not reflect firm symptoms of the economic boom. The evaluation of a general climate of the economic situation – considering seasonal fluctuations – is still negative, although a little better than a month before.

still negative evaluations of a general climate of the economic situation

The next month did not bring the improvement of feelings of enterprises and households both in the USA and in the euro zone. In the American economy, the indices illustrating both the business climate of households and the activity in the manufacturing sector are getting lower. In Germany, the leading for the manufacturing sector index of the institute Ifo lowered from 91.6 in May to 88.8 in August this year.

no improvement of business climate of enterprises and households in the USA and in the euro zone

The factor that is the most uncertain is the formation of oil

prices worldwide. The increase of political risk resulted in the situation that in the 1st half of September 2002 an average oil price amounted to almost USD 28 per barrel, so it was higher by USD 1 than in August this year. It is estimated that at present the risk of the war affects the increase of oil prices by at least USD 5 per barrel.

uncertainty related to oil prices

II. Situation in public finance sector

The situation of the state budget in 2002 as compared to the situation analyzed last month did not change. In August, the state budget accomplishment was according to the plan what gives the evidence that there is no threat of exceeding the defined level of budget deficit. There is a possibility, however, that the revenues from indirect taxes will be smaller in the 4th quarter this year than it would result from tendencies observed in previous months. It results from systemic changes that will become effective and the most important of which is enabling small businesses to file their value added taxes quarterly what will result in the shift of some of such due receivables to the year 2003. Due to the above mentioned, at the end of this year there may be a necessity to reduce expenses in order to meet the defined deficit limit what, in practice, would mean carrying forward some of the reduced expenses for the year 2003 and thus a bigger burden for the budget next year.

the economic deficit of the public finance sector in 2002 will be maintained at the higher level than it was planned

The economic deficit of the public finance sector this year will probably be at the significantly higher level than 4.8% of GDP that is set forth in the Act on the State Budget, mainly as a result of big shortages of earmarked funds. The guidelines of the draft act on the state budget for the year 2003 presented by the Minister of Finance indicate that when cyclical factors are considered, the fiscal policy would be loosened. This situation will not be supported by increased budget revenues through the assumption of too optimistic macroeconomic forecasts, as well as single measures bringing additional revenues such as tax abolition and restructuring fees. The Government did not fulfill the principle of the real growth of central budget expenses by 1% as it declared, since the expenses are to increase in real terms by 2.2% and to amount to PLN 193.5 billion.

uncertainty about the situation of public finance in 2003 and in the next years is maintained

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

The annualized dynamics of money supply M3 lowered, and at the same time, the dynamics of cash stabilized, but the dynamics of deposits drops what is the evidence of a weakening tendency to save at banks as a result of the drop of attractiveness of bank placements.

the tendency to save at banks decreases, the households are less interested in lending, the dynamics of lending to enterprises weakens

A low dynamics of lending to households is maintained; its annualized pace amounted to 8.5% in August this year. The data for August did not confirm the increased activity in financing the enterprises by banks as it was observed in the previous months. The annualized pace of lending to enterprises amounted to 1.8% as compared to 2.7% in July this year.

In August and the 1st half of September, the tendency to the depreciation of the zloty was halted. It was mainly related to the halted appreciation of the euro on the world market. Due to the above mentioned, in August this year, the indices of the effective exchange rates of the zloty: the nominal one and the real ones practically stabilized at the level noted in July this year.

the depreciating tendency of the exchange rate of the zloty has been halted

IV. Prices, inflation expectations

In August this year, as a result of a further drop of foodstuff prices, the annualized consumer price index lowered from 1.3% to 1.2%. All core inflation measures lowered as well, although not as much as last month.

the annualized consumer price index lowered to 1.2%

According to the expectations, in August this year as compared to July this year the sold industrial output prices rose. The annualized dynamics of these prices will probably be higher than in case of consumer prices within the next couple of months, and the factors affecting this dynamics will be high oil prices and a delayed effect of the zloty depreciation within the recent months.

Inflation on a low level supports the enhancement of low inflation expectations. In September this year, inflation expectations by both individuals and bank analysts lowered, and the drop of inflation expectations is related to both the expected inflation rates in December 2002 and

low inflation expectations

in the 12-month horizon. The inflation rate expected by bank analysts at the end of this year amounted to 1.8% what means its drop by 0.5 percentage point as compared to the declarations made in August this year, and the expected annualized inflation rate (August 2003) amounted to 2.9% what means its drop by 0.2 percentage point.