

Warsaw, August 28, 2002

INFORMATION ON THE MEETING OF THE MONETARY POLICY COUNCIL

ON AUGUST 27-28, 2002

The Monetary Policy Council held its meeting on August 27-28, 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, money supply, lending and interest rates, in public finance sector, and the formation of inflation expectations, prices and the inflation outlook.

Decision of the Monetary Policy Council

In August, the enhancement of a low inflation level was observed. As compared to the situation observed a month before, factors that reduce inflation growth in future have strengthened:

- the expected level of inflation has been subject to a further reduction;
- all core inflation measures lowered;
- the dynamics of money supply M3 dropped to the level of 1.2%;
- the dynamics of lending to households lowered significantly, a low dynamics of lending to businesses is maintained;
- a moderate growth of wages does not threaten in a form of a growth of inflation pressure;
- a limitation of labor market stiffening – thanks to a partial liberalization of the labor code – will support the maintaining of inflation at a low level;
- the outlook of an accelerated growth in the USA and the European Union got more distant.

With less optimistic growth outlook for the world economy, in Poland, the signals of the economic boom got confirmed:

- the output in industrial processing grew in July by 7.8%;
- budget revenues from indirect taxes have been bigger than expected;
- export revenues have increased again;
- a material growth has been noted in newly begun investments;
- retail sales in current prices grew in July by 8.6%.

A moderate pace of the economic boom, in the Council's opinion, does not pose a threat to the accomplishment of the inflation target at the moment.

Factors that could threaten the stabilization of inflation at a low level are still observed:

- a drop of the annualized dynamics of household deposits takes place while at the same time a high dynamics of cash in circulation is maintained;
- an outlook of a high public finance sector deficit within the conditions of the planned economic growth in 2003, together with the forecasted increase of the scale of extended guarantees and allowances, means a further loosening of fiscal policy; so far there is no substantial proposals of reforms in the system of public expenses that would enable a sustained and effective reduction of a present high level of budget deficit;
- there is still maintained uncertainty related to the supply driven factors, especially fuel prices.

Considering these arguments, the Monetary Policy Council decided to:

- **cut the minimum yield on 28-day open market operations from 8.5% to 8.0%;**
- **cut the rediscount rate from 10.0% to 9.0%;**
- **cut the lombard rate from 11.5% to 10.5%;**
- **maintain the deposit rate at the unchanged level (5.5%);**
- **maintain its neutral position in monetary policy.**

The next meeting of the Monetary Policy Council will be held on September 24-25, 2002.

I. Evaluation of the economic situation

A general evaluation of the economic situation, as compared to the one performed a month before, has slightly improved.

in the 2nd quarter 2002, the economic situation improved

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 -3.9% in the 4th quarter 2001) and the GDP growth pace in the 1st quarter 2002 accelerated to 0.5% (0.2% in the 4th quarter 2001). It is assessed that in the 2nd quarter the economy grew at the pace exceeding 0.5% of GDP what is indicated by the dynamics of the sold industrial output and construction and assembling production.

A high output growth in July (by 6.0%) is the evidence of an improvement of the situation in industry. Positive dynamics that was noted in the two recent months led to the overcome of a stagnation trend of production that had been maintained for 15 months. The acceleration of the growth pace in industry was related to a high dynamics of production in industrial processing (increase by 7.8%). Out of 22 sections of the processing industry, the level that was

in July this year, the growth pace of industrial output accelerated

lower than in July last year has been noted only in three of them. Among sections with a high production dynamics the majority are industries with a big share of exports in their sales. The improvement has been noted in the situation of those sections the considerable part of production of which is made by provision goods for construction and investment goods. Besides the improvement of the situation in construction (decrease of the drop scale, increase of the portfolio of orders) and a considerable increase of the number of tasks and estimated value of the begun investments, a gradual improvement in investment industries can be the evidence of a halted drop tendency in investment activity.

symptoms of investment boom appeared

Despite the expectations, in July and August this year, the indicators of a current and expected economic situation in the economies of the euro zone and the USA worsened considerably. It is forecasted that the improvement of the external economic situation will take place later than it was assumed earlier, and its effects for Poland's economy will probably be perceptible only in the 2nd half of 2003. The expectations concerning the increase of interest rates abroad also weakened significantly.

more distant is the outlook for the improvement of the economic situation worldwide, and, thus, its stimulating impact on the economic boom in Poland

In the enterprise sector, a moderate growth of wages is maintained. Within the period January-July this year, the average wages in enterprises were higher by 4.4% than in the same period of 2001. The real growth of wages was higher than a year before and it amounted to 1.9%.

a moderate growth of wages is noted in the enterprise sector

The situation on the labor market indicates, however, that a material acceleration of the wage growth in the next couple of months should not be forecasted. In July this year, the average employment in the enterprise sector lowered by 0.3% as compared to the previous month and as compared to July last year it was lower by 4.2%.

the situation on the labor market indicates no risk of a material acceleration of the wage growth

II. Situation in public finance sector

The situation of the state budget in 2002 is evaluated as stable, there is no threat of exceeding the legal level of the budget deficit, however, the economic deficit of the public finance sector will probably be at a considerably higher level than it was planned.

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

There is maintained uncertainty whether the forecasted by the Government maintaining of the limit of expenses according to the formula “inflation + 1 percentage point” does not shift the deficit to other units of the public finance sector. The pressure on the increase of expenses will result from the applicable and developed legal acts.

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

There are still no substantial proposals of reforms in the system of public expenses that would enable a sustained and effective reduction of the present high level of budget deficit.

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. The annualized dynamics of money supply M3 is maintained at a low level, however, at the same time, a high dynamics of cash in circulation is maintained, and the dynamics of deposits drops. Especially alarming are the deposits of households. In June this year, there was noted a drop of total deposits of households as compared to the amount observed a month before, and in July this year, their growth was minimal. The annualized growth pace of deposits lowered in July as compared to June from 0.0% to -2.2%. This drop is the evidence of a weakening tendency to save in banks as a result of a decreased attractiveness of bank placements.

the tendency to save in banks decreases, households are less interested in loans

The annualized dynamics of lending to households lowered from 15.5% a month before to 9.8%. The dynamics of lending to businesses, however, accelerated and after 3 months when a drop was noted, in June this year it was higher by 2.1% and in July by 2.7% than a year before.

In August this year, the depreciation tendency of the zloty, especially visible against the euro, was halted. Together with the appreciation of the American dollar against the common European currency, the exchange rate of the zloty remained stable against the euro and it slightly weakened against the American currency.

in August this year, the depreciation tendency of the exchange rate of the zloty was halted

IV. Prices, inflation expectations

In July this year, mainly as a result of a further drop of foodstuff prices, the annualized consumer price index lowered from 1.6% to 1.3%. A further drop of all core inflation measures was observed.

the annualized
consumer price index
lowered to 1.3%

In July this year, the sold industrial output prices rose. However, it mainly resulted from a big price growth in the section production and supply of electric energy, natural gas and water as a result of the introduction of the excise tax on electric energy.

Inflation on a low level supports the enhancement of low inflation expectations. In August 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 in the 12-month horizon. The inflation rate expected by bank analysts at the end of this year amounted to 2.3% what means its drop by 0.5 percentage point as compared to the forecasts made in July this year.

inflation on a low level
supports the
enhancement of low
inflation expectations