

INFORMATION FROM A MEETING OF THE MONETARY POLICY COUNCIL

Held on 20-21 January 2004

At its first meeting in 2004, the Monetary Policy Council analysed trends emerging in the economy in 2003 which could be of material importance for the inflation level in 2004 and 2005. It was observed that:

- Following its drop to 0.3% reported in April 2003, a gradual growth of the CPI can be observed accompanied by a growth of base inflation indicators.
In December 2003, twelve-month inflation reached 1.7%, thus remaining in line with the goal predicted in *the Medium-Term Monetary Policy Strategy, 1999 – 2003*, which forecast that inflation would fall below 4.0% by the end of 2003 and was slightly below the short-term inflationary goal set for 2003 (3% +/- 1pct. point). Real inflation, which was 0.3% below the bottom limit of the inflationary goal bracket, was reached in the conditions of a planned accelerated growth rate of foodstuffs and non-alcoholic beverages (2.1%), nevertheless markedly lower than the expected growth in the group of goods and services with controlled prices (2.3%).
A 3.6% - 4.8% growth in controlled prices was planned on the grounds of available information on the assumptions underlying the draft budget act for 2003. In real terms, a shift of the effect of increased excise tax on final prices of goods and services remained below the forecast, while the growth in prices of base power carriers, including electricity and heating, was lower than expected,
- Similarly, a gradual increase in the PPI could be observed from August 2003 to reach 3.7% at the end of 2003 on the annual basis i.e. the highest level since the beginning of 2001,
- With continuously stable NBP rates since June 2003, a growth in the market rates and the yield on T-bonds was reported in the second half of 2003. In the period starting 30 June 2003 ending 30 December 2003, market interest rates WIBOR 3 M grew by 28 b.p. and WIBOR 6M grew by 53 b.p., while yield on two-year T bonds grew by 121 b.p., a yield on 5-year T-bonds grew by 169 b.p. and a yield on 10-year T-bonds grew by 139 b.p.
- Contrary to expectations, 2003 saw a rise in monthly average oil prices; from the lowest 2003 level of 24.9 USD/b in April to reach 29.9 USD/b in December 2003, i.e. a rise of 19.9%;
- The PLN/EUR exchange rate (monthly average) depreciated from 4.06 in January 2003 to 4.65 in December 2003, i.e. by over 11%.

Other economic data, which emerged since the previous meeting of the Monetary Policy Council:

I. Indicates: the continuing presence of factors supporting the continuation of low inflation:

- Continued moderate money supply; the annual growth rate of the M3 aggregate increased by 5.5% in December 2003 against 5.7% in November,
- Continued moderate growth of household loans. The annual growth rate in corporate loans reached 2.9% in December 2003 against 3.8% in November, with 14.0% and 13.4% for household loans, respectively.

II. Confirms: upward economic trends growing stronger, increasing inflationary pressures gradually; however, the Council does not see this, as such, as a threat to the achievement of the inflationary goal in 2004.

- Estimates of the Main Statistical Office indicate the GDP growth rate in the 3rd quarter 2003 at 3.9%.
The NBP estimates that the GDP growth rate in the 4th quarter 2003 will remain similar or slightly above its 3rd quarter figure; in consequence, GDP growth for 2003 should exceed 3.5%,
- Compared to December 2002, PPI grew by 13.9% in December 2003, including a growth by 18.7% in the production of the processing industry. After seasonal trends, the rise in the PPI was 11.6% and 15.9% in the processing industry. The growth trend in production became stronger both in the processing industry (with the annual growth rate of the trend exceeding 13.7%) and the PPI (10.6%),
- The results of the December survey on the general condition of enterprises indicated continuing improvement in the general market trends in the processing industry,
- Continuing high growth of the exports with 7.0% growth of the exports denominated in EUR and 28.0% growth of the exports denominated in USD (in accordance with the payment statistics) after eleven months 2003,
- More optimistic forecasts for foreign demand – the USA and Japan when compared to the forecasts in December 2003.

III. Nevertheless, the importance of factors adversely affecting the stabilisation of inflation at a low level remained unchanged. The Council upholds its opinion that such a factor is the uncertainty with respect to the current and future condition of public finance.

The medium-term prospects for public finance are obscure. The high budget deficit, the growing credit needs of the state, difficulties in implementing a programme for downsizing current expenditure and its effective restructuring may cause some disruptions on financial markets leading to an increase in the yield on treasury securities and depreciation of the zloty exchange rate.

Against this background, the Council re-emphasises the necessity for in-depth, swift and effective reforms leading to recovery of the public finance to prevent public debt build-up and a debt loop. Abandonment of some in-depth changes in 2004 resulting in a long-term recovery of public finance would swiftly bring the debt closer to the limit set out in the Constitution, thus preventing rapid economic growth and reduction in unemployment levels.

Current estimates of the NBP indicate that, in 2003, public debt exceeded 50% of the GDP, i.e. was higher than the first prudential threshold and it is likely to exceed the second prudential threshold i.e. 55% of the GDP in 2004.

IV. Other possible factors creating inflationary pressure include:

- a high growth rate of cash in circulation. In December 2003, the annual growth rate of the aggregate reached 17.1% (and 18.2% in September),
- A possible increase in oil prices. In January 2004, the forecast annual average oil price in 2004 rose from 27.9 USD/b. to 28.3 USD/b.,
- A possible significant increase in the prices of foodstuffs in 2004 indicated by current forecasts,
- A distinct deterioration in inflationary expectations.

Decision of the Monetary Policy Council:

After a discussion, the Monetary Policy Council resolved to **leave the monetary policy parameters unchanged and maintain its neutral approach to monetary policy**

The next meeting of the Council is scheduled for 24-25 February 2004

External factors

December 2003 saw a consolidation of revival signals in the global economy; in particular, growth ratios in the USA economy improved. A strong domestic demand was reflected by a growing rate of retail trade payments and a high growth of real estate transactions accompanied by a distinct PPI growth.

Stronger revival signals in the global economy

In December 2003, current activity ratios in the euro-zone still indicated a weakness in domestic demand with no improvement in the key indexes of consumer and enterprise confidence.

December 2003 showed an increasing depreciation of the dollar on the global market as had been observed for a period coming close to two years. The depreciation was the most clearly noticeable in the EUR/USD exchange rates (in December, the monthly average EUR/USD exchange rate gained 0.6% against the rate in November 2003), the trend continues in January 2004.

High oil prices on global markets

The average price of Brent was equal to 29.9 USD/b in December 2003, translating to a 1.1 USD increase in the price as compared to November 2003 and USD 1.4 increase as compared to the corresponding period of 2003. Oil prices continued to grow in the first days of January, exceeding 32 USD/b on 9 January 2004, which is the highest price reported since the outbreak of the Iraqi war in March 2003. The growth in oil prices is mainly caused by the continued depreciation of the dollar, the cold winter in the USA and the country's low oil reserves.

At the beginning of January 2004, the Department of State for Energy increased the forecast of the annual average oil price in 2004 up to 28.3 USD/b i.e. by 0.4% beyond the projections made in December 2003.

Stabilised GDP growth

Economic situation in Poland

In accordance with the estimations of the Main Statistical Office, the GDP growth rate in the third quarter of 2003 reached 3.9%, with a continued high rate in the increase of the added value in industry (8.2%) and a slowing of the falling trend in the construction industry (-2% against -7.4% in the second quarter of 2003).

After nine quarters of consecutive fall in the gross outlay on fixed assets, the third quarter of 2003 saw their growth of 0.4%. As a growth of stock remained below the level reported a year ago, their annual gross accumulation dropped by 0.3%, with the individual consumption rate above expectations (3.4%), despite the continuingly low growth in wages and salaries. The net export input into the GDP growth remained high and positive (1.5% against 1.8% reported in the second quarter of 2003).

High growth of receipts from export

In November 2003, the current account deficit reached EUR 286 million dropping by EUR 470 million as compared to the corresponding period of 2002 and by EUR 3.9 billion for the period from January to November 2003 when compared to the corresponding period of 2002.

As in the preceding months, a reduction of the current account deficit was caused by a decrease in the negative balance of commodity payments. November 2003 saw a drop of the balance by EUR 450 million (i.e. the largest drop since the beginning of 2001) and by EUR 2.4 billion within eleven months of 2003, which mainly stemmed from a continuing strong growing trend in the export receipts. In November 2003, their value grew by 12.1% as compared to November 2002 (the third consecutive month of double-digit growth) and by 7.0% since the beginning of 2003, concurrently to a decrease in the import debits, with their value falling by as much as by 2.2% below the level reported in November 2002 and since the beginning of 2003 lower by 0.5% than in the corresponding period of 2002.

December 2003 saw a 13.9% increase in industry production as compared to December 2002. The higher industry production growth rate can be partially attributed to a higher number of working days when compared to December 2002 (one day extra) and a difference in their spread (the spread of working days in December 2003 was less favourable for making holiday decisions). A particularly high growth was reported in the processing industry (a growth of 18.7%).

Data published on the sectoral structure of growth in the processing industry indicates a continuation of existing trends. Again the highest growth in sales was reported in the

continuation of existing trends. Again, the highest growth in sales was reported in the mechanical vehicles, trailers and semi-trailers production sector (49.1%). The economic groups predominately exporting their production (production of furniture, machines and equipment, metal products, electrical machines and devices, rubber products) widened to include the production of other non-metal goods.

State budget deficit in 2003 lower than planned

Condition of the public finance sector

In 2003, the state budget deficit reached PLN 37 billion i.e. PLN 1.7 billion (2.3%) below the amount planned in the Budget Act. As it was projected, due to lower inflation and some differences in the economic growth structure, the state budget revenue amounted to PLN 152.2 billion, remaining below the figure forecast in the Budget Act (a shortage of PLN 3.5 billion), chiefly due to a failure to be paid expected receipts in all tax categories. Due to some overoptimistic expectations as to an increase in the wages and salaries fund and employment, the highest shrinkage in receipts was reported from personal income tax (6.1%).

In 2003, expenditures of the state budget were realised at PLN 189.2 billion i.e. 97.3% of the figure set forth in the Budget Act, reporting an increase of 3.4% as compared to 2002. A PLN 5.3 billion reduction in state budget expenditure was primarily caused by considerable savings on the cost of servicing the public debt, both domestic and external (by approx. PLN 3 billion) as well as unrealised conditional expenditures.

2003 state public debt exceeding the 1st prudential threshold

Despite the state budget result at the end of 2003 being more favourable than planned, it is likely that the public finance sector deficit will be higher than that reported for 2002. In consequence of a shortage of revenue over expenditure in other public sector components, including in particular the Social Security Fund and the Labour Fund, the deficit will grow to approx. 5.2% of the GDP.

Yet another year of continued high disequilibrium of the public finance sector led in 2003 to the first prudential threshold set forth in the Public Finance Act being exceeded. It is estimated that, at the end of 2003, the state public debt (including the expected payouts under sureties and guarantees) will reach nearly 51% of the GDP. The absence of any deep-reaching changes in the fiscal policy in 2004 and subsequent years and, primarily, moving away from the solutions listed in *the Program for Creating a Clear Structure of the Public Expenditures and their Reduction* will swiftly lead the debt closer to its constitutional limit.

Money supply, loans, interest rates, exchange rate

Figures presented in forward information indicate a PLN 3.5 billion (1%) growth in the M3 money supply against November 2003. Changes in the money supply were materially affected by the fluctuations in the price of the zloty. After the exchange rate fluctuations, the M3 aggregate grew by approx. PLN 5 billion (1.5%). The annual growth rate of M3 in December 2003 reached 5.5%.

December 2003 saw a marked growth in deposits in the banking system, with corporate deposits increasing by PLN 4.6 billion (7.2%); after elimination of foreign exchange rate fluctuations, the growth was equal to PLN 4.9 billion (7.7%). At the end of 2003, the annual growth rate of corporate deposits reached 24%. Household deposits noted a growth of PLN 1.6 billion (0.9%) and after foreign exchange fluctuations, the growth amounts to PLN 2.8 billion (1.5%) and was mainly attributable to the movement of funds from investment funds to bank deposits. On the annual basis, household deposits dropped by 2.0%.

Low growth in corporate loans and moderate growth in household loans

A PLN 0.4 billion (-0.8%) decrease in the cash in circulation was reported in December 2003 as compared to November 2003, with the annual growth rate of the category at 17.1%.

In December 2003, household loans increased by PLN 1 billion (1.0%). After foreign currency fluctuations, the category grew by PLN 1.2 billion (1.2%) and its annual growth rate reached 14% at the year-end. The upward trend in the household loans came as a consequence of a rapid growth of housing loans. Corporate loans dropped significantly in December 2003 by PLN 4.5 billion (-3.2%) i.e. PLN 3.9 billion (2.8%) after foreign exchange differences. The annual growth rate of corporate loans reached 2.9% at the end of December.

In the period between the meetings of the MPC (the analysed period 1 December 2003

until 16 January 2004), two periods can be distinguished on the currency market: in December 2003, the zloty stabilised. In general, the stable trend in the foreign currency market came as a result of a surplus in the current payments of the balance of payments reported in September and October, which appeared positively different from the analysts' expectations. January 2004, and in particular the end of the analysed period, saw a rebound of the depreciation trend of the zloty resulting from diminishing trust in the possible adoption and implementation of the plan prepared by the Deputy Prime Minister, Jerzy Hausner, in its proposed form and, to a lesser degree, the influence of the Hungarian financial market.

Zloty depreciation and growth in T-bonds yield in January 2004

A falling trend in bond yield could be observed in December 2003. The T-bond market stabilised when informed on a markedly lower supply of treasury securities as compared to the previous assessment of market players. The prospectus for the issue of the T securities in the first quarter 2004 published at the beginning of December assumed more extensive use of foreign markets in order to finance the credit needs of the budget.

In the period following 13 January, a significant cut in bond prices (growth of yield) occurred, triggered by the fears of investors connected with the ability to implement the plan for limiting public expenditure, as was also the case on the currency market. The highest growth of nearly 50 b.p. was reported for long-term T-bonds. A yield margin on a 10-year bond reflecting the investment risk in comparison to the euro-zone bond increased again to approx. 270 b.p. (2.7%).

The annual CPI at 1.7%

The annual PPI at 3.7%

Prices, inflationary expectations

In December 2003, the twelve-month CPI reached 1.7%. Compared to December 2002, the highest growth was reported due to increased prices of apartment rents (2.7%) caused predominantly by a growth in the prices of power carriers (3.3%), prices in the transport sector (2.9%) and fuel prices in particular (4.4%) as well as prices of foodstuffs and non-alcoholic beverages (2.1%), while prices of clothing and footwear remained below the level reported for December 2002.

Increase in inflationary expectations

December 2003 saw a stable trend in the PPI, with PPI growing by 3.7% the corresponding period of 2002, as in November 2003. A high value of the PPI as at the end of 2003 stems from continuously high prices of industrial raw materials (industrial metals, oil, coal) on global markets in 2003.

In January 2004, a price growth rate expected within the next 12 months by individuals was 2.1%, i.e. 0.5% above the result indicated last month and 1.2% above the November 2003 level. According to the Ipsos survey, deterioration in general consumer confidence is caused by some fears connected with price increases after Poland joins the European Union. The NBP believes the fears to be unjustified. Another reason for the deterioration of inflationary expectations is the growth in current inflation.

Similarly, in January 2004, bank analysts increased their expectations, with a predicted inflation rate of 2.6% for December 2004 i.e. 0.1% above the rate indicated in December 2003.