

INFORMATION FROM THE MEETING OF THE MONETARY POLICY COUNCIL

held on 30-31 January 2007

The Council decided to keep the NBP interest rates unchanged, i.e.:

- **reference rate 4.00% on an annual basis;**
- **lombard rate 5.50% on an annual basis;**
- **deposit rate 2.50% on an annual basis;**
- **rediscount rate 4.25% on an annual basis.**

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Since the Council's meeting in December 2006 the inflation forecasts for 2007 for the euro area and the United States have remained unchanged. However, forecasts of euro-area economic growth for 2007 has been slightly raised, while forecasts for the United States have been slightly lowered. In December the annual inflation in the euro area remained unchanged (at 1.9%), but in the United States it increased (from 2.0% y/y in November to 2.5% y/y). Since the December meeting of the Council, current price of oil has dropped by USD 8.3 (i.e. 13.3%), while the prices of this commodity forecast for 2007-2008 has declined only slightly.

Preliminary GUS data on the GDP in 2006 have confirmed that the Polish economy is currently undergoing a strong and constantly consolidating recovery, which extends to all sectors of the economy. The real GDP in 2006 grew by 5.8% y/y, which was slightly higher than assumed in the January projection.

Monthly GUS data for 2006 Q4 on industrial output, construction and assembly production and retail sales indicate that strong economic activity has continued. The rise in industrial output in December 2006 was slightly lower than the expectations of NBP analysts and external forecasters reaching 5.7% y/y (compared with 12.0% y/y in November). However, the growth in construction and assembly output was slightly above the expectations of NBP analysts at 17.9% y/y (compared with 23.3% y/y in November). The annual growth of industrial and also production and assembly output was reduced by the fact that December 2006 had fewer business days than December 2005. In seasonally adjusted terms, industrial output grew by 10.5% y/y (compared with 10.2% y/y in November) and construction and assembly output -- by 26.0% y/y (versus 25.0% y/y in November). Retail sales continued to grow strongly (by 13.3% y/y in nominal terms as compared to 13.6% y/y in November).

The growth of lending to non-financial sector has been rising steadily and in December 2006 it reached 23.8% y/y. Since the middle of 2005 growth in consumer loans has been running high (a rise of 21.5% y/y in December). Also the housing loans have been rising quickly (an increase of 54.1% y/y in December). Since 2006 Q2 an acceleration in the growth of corporate loans has been observed (a rise of 14.5% y/y in December). This growth in corporate lending, combined with substantial own funds of enterprises resulting from their very good financial results in the first three quarters of 2006, may indicate that the currently high investment growth will be sustained in the future.

Strong economic growth is accompanied by a rapid increase in labour demand. Since December 2004 the employment growth in the corporate sector has been accelerating – in December 2006 the growth of employment in enterprises amounted to 4.1% y/y, compared to 3.8% y/y in November, and was the highest since the beginning of the 1990s. According to the data from Labour Offices the unemployment rate in December 2006 was 14.9% (against 17.6% one year earlier).

Economic growth is also accompanied by a high growth of wages. In December 2006 the rise in nominal wages in enterprises stepped up to 8.5% y/y from 3.1% y/y in November. This rise in annual wage growth primarily resulted from shifts in one-off components of wages in certain sections. In line with the NBP's estimates, adjusting for the impact of these shifts, the rise in wages in December amounted to 6.2% y/y compared to 5.7% y/y in November. Strong economic growth which would not pose a threat to the achievement of the inflation target can only be sustained on the condition that the growth in wages does not outpace the growth in labour productivity. This requires strong and productivity-oriented corporate governance in enterprises, which is usually more easily achieved in the conditions of private ownership. This also calls for wage discipline in the public sector.

In December 2006 the annual growth of consumer prices did not change in relation to the previous month and amounted to 1.4%. The indicators of core inflation did not change significantly in relation to the previous month (in December they remained in the range of 1.1-1.6% y/y, while "net" inflation was 1.6% y/y). In January 2007 inflation expectations of households amounted to 1.5% y/y (compared with 1.0% in December and 1.7% y/y in November). According to GUS business tendency surveys, since the beginning of 2006, the expected prices in retail sales, prices of industrial production as well as construction and assembly output have been gradually increasing.

In December the annual growth of producer prices in industry reached 2.8% compared with 2.5% in November (which represented a drop of 0.3% m/m compared with a drop of 0.7% m/m in November), while in manufacturing it was 1.7% (versus 1.1% in November). In December the nominal effective exchange rate of the zloty appreciated 3.4% in year-on-year terms.

The Council got acquainted with the projection of inflation and GDP prepared by NBP staff, which will be presented in the January *Inflation Report*. In line with the projection, the annual GDP growth will be -- with a 50-percent probability -- in the range of 4.9-6.7% in 2007 (compared with 4.1-6.2% in the October projection), 3.6-6.4% in 2008 (compared with 4.5-7.0%) and 3.5-6.5% in 2009.

According to the January inflation projection consumer price growth will in the short term be lower, and in the longer term – close to that expected in the October *Report*. Under constant interest rates, there is a 50-percent probability that inflation will be within the range of 2.1-3.8% in 2007 Q4 (as compared with 1.9-3.8% in the October projection), 2.2-4.5% in 2008 Q4 (as compared with 2.2-4.6%) and 2.4-5.2% in 2009 Q4.

The Council got also acquainted with the results of other forecasts conducted at the NBP.

In the Council's assessment, in the short term CPI inflation will be considerably lower than in the January projection, as the oil and food prices will most probably be lower than in the projection. The core "net" inflation may also be markedly lower than in the projection.

In the medium term, despite the fact that economic growth is expected to slow down somewhat, the growth of wages may gradually increase, thus leading to higher inflation. The Council believes that this increase in inflation will be probably moderate if the strong productivity growth and low growth of external prices associated with globalisation and the ensuing increased competition in the market of internationally traded goods and services continues.

The Council judged that the current level of NBP interest rates is conducive to keeping inflation close to the target of 2.5% in the medium term. However, maintaining inflation close to target and thus creating conditions for sustainable long-term economic growth may require monetary policy tightening. Future decisions of the Council will depend on the incoming information about economic developments in Poland and the world and also on their impact on the inflation outlook in Poland.

In the opinion of the Council, the currently observed strong economic growth creates convenient conditions for the implementation of reforms which would permanently reduce the public finance imbalance. The Council maintains its belief that it would be the most favourable for Poland to adopt an economic strategy focused on creating conditions that would guarantee the introduction of the euro at the earliest possible date. The constraining of public finance imbalance would be conducive, both *per se* and by creating conditions for the introduction of the euro, to accelerating the long-term economic growth.

In the *Monetary Policy Guidelines for the Year 2007* the Council announced that it would try to give a more extensive account of the arguments raised during discussion at its meetings. In compliance with this announcement, starting from the January *Inflation Report* the Council will present a modified format of the Chapter "Monetary policy". It will offer a more detailed account of discussions and problems considered at its decision-making meetings than in the past. Starting from May 2007 such record of discussion at a decision-making meeting (minutes) shall be published before the next decision-making meeting of the Council. Simultaneously, the format of the *Information from the meeting of the Monetary Policy Council* will be modified.

The Council approved *The Balance of Payments of the Republic of Poland in 2006 Q3*.

The next meeting of the Council will be held on 27-28 February 2007.