

Warsaw, 28 November 2001

**INFORMATION ON THE MEETING OF THE MONETARY POLICY COUNCIL ON
27-28 NOVEMBER 2001**

The Monetary Policy Council held its meeting on 27-28 November 2001. The Council was submitted the materials prepared by the NBP Management Board and the departments as well as the information and analytical materials of the Ministry of Finance, banks and research institutes. On this basis, the Council discussed the development of the inflation rate; trends in the money supply, lending and interest rates; external conditions and the situation in a balance of payments, real sector of the economy and the public finance sector.

I. Inflation rate, inflation expectations.

1. The annual growth rate of the consumer price index decreased to 4.0% in October 2001 from 4.3% in the previous month.
2. All measurements of the 12-month core inflation also decreased:
 - 15% average cut down from 4.6% to 4.2%;
 - the inflation rate excluding the controlled prices from 4.1% to 3.9%;
 - the inflation rate excluding the most fluctuating prices from 3.6% to 3.2%;
 - the inflation rate excluding the most fluctuating prices and fuels from 4.3% to 4.0%;
 - the “net” inflation rate (excluding prices of food and prices of fuels) from 5.8% to 5.5%;
3. According to the initial data of the Central Statistical Office (GUS), after the growth by 0.3% in July, 0.8% in August and 0.5% in September 2001, the prices of the industrial sales decreased by 0.4% in October 2001 compared with the previous month. In comparison with October 2000, the industrial sales prices decreased by 0.3%.
4. In November 2001, expectations of the individuals pertaining to the inflation rate in the future were considerably improved. A group of the most pessimistic individuals anticipating that the prices would grow faster than at present decreased by 3.2 percentage points and achieved the lowest level in the history of this survey (13.8%). On the other hand, the percentage of the respondents expecting that the prices would be the same as at present grew by 1.8 percentage points and reached the highest level in the history of the

Demoskop'e survey (7.8%). A number of the individuals expecting that the growth rate of prices will be lower than at present was also considerably increased (by 2.6 percentage points to the level of 15.7%).

The inflation rate anticipated by the bank analysts at the end of 2001 decreased to 4.2% from 5.2% a month before. The inflation expected within an 11-month perspective decreased by 0.3 percentage points and was 4.8%.

In October 2001, the consumer price index and all the measurements of the 12-month core inflation decreased. Maintenance of the so called net inflation rate above the consumer price index [CPI] (by 1.5 percentage points) is the evidence of a positive impact of the groups of goods i.e. food and fuels excluded from this index. Declining trends in other measurements of the core inflation show that the observed decline of the inflation pertains to the majority of consumer goods and services and it is not caused only by the temporary factors.

The industrial sales prices were lower than in the previous month and lower than a year before. The expectations of individuals pertaining to the future inflation were significantly improved. The future growth rate of prices anticipated by bank analysts was subject to further decline.

II. Money supply, lending, interest rates.

1. An annual nominal growth rate of the total money supply (M2) was 13.1% (compared with 14.3% in the previous month) in October 2001.
2. The annual momentum of PLN deposits held by individuals dropped to 16.8% from 19.0% in September 2001. The decline of the PLN deposit growth in banks, however, was followed by the growth of individuals' interest in other forms of savings investments e.g. savings bonds.
3. In October 2001, the annual momentum of the total lending decreased to 8.5% from 10.7% in the previous month. The momentum declined both in terms of household loans (to 16.4% from 18.7% in September 2001), and business loans (to 6.2% from 8.4% in the previous month).

Compared with September 2001, the growth rate of monetary aggregates decreased which indicates further decline of the inflation pressure. Introduction of the savings income tax may result in negative effects in the savings tendencies.

III. External conditions.

1. Since the last meeting of the Monetary Policy Council, a number of forecasts indicating the deterioration of the world economy situation compared with the previous expectations has increased. Activation of the world-wide economy is likely to take place no sooner than in the second half of 2002.

2. In relation with the deterioration of the forecasts of the economic growth in the world, since the last meeting of the Monetary Policy Council, the expectations pertaining to the future development of the oil prices have lowered.

The likelihood that the economic growth rate in the world in 2001 and 2002 will be smaller than previously anticipated has increased. It means worse perspectives for the Polish export. Simultaneously, it is a limiting factor for the inflation pressure. Since the last meeting of the Monetary Policy Council, the expectations pertaining to the future development of the oil prices have lowered.

IV. Balance of payments, exchange rate.

1. In January-September, the Current Account Deficit was US\$ 5.4 billion and was almost US\$ 2.5 billion lower compared with the corresponding period in the previous year. Export was 10.2% higher than in January-September 2000, whereas the import momentum was 1.9%.
2. In October, the PLN exchange rate was reinforced relative to EURO (average exchange rate was PLN 3.74 compared with PLN 3.85 in September 2001), as well as US dollar (PLN 4.13 compared with PLN 4.22 last month).

A considerable improvement of the current balance of payments proves the reinforcement of the macroeconomic equilibrium.

V. Supply, demand, situation in the labour market and income.

1. In October 2001, the industrial sales was 1.4% higher than last year. The level of production in the comparable worktime, however, was approximately 0.8% lower than in October 2000. The construction output was 11% lower than last year (in September, the drop was 11.1%, and in August 2001 – 13.9%).
2. In January-September 2001, financial results of enterprises deteriorated. A net profit was PLN 2.7 billion compared with PLN 6.4 billion last year. Private enterprises recorded a net profit at the level of PLN 3.8 billion (5 billion last year), and the companies within the public sector made a loss of PLN 1.1 billion (compared with PLN 1.4 billion profit last year).
3. The employment in the enterprise sector declined in October by 0.3% compared with September 2001 and was 4.4% lower than last year. The unemployment rate grew to 16.4% from 16.3% last month.
4. In January-October 2001, an average salary in the enterprise sector was 7.3% higher in nominal terms and 1.4% higher in real terms compared with the corresponding period in 2000. Due to the decrease of staff numbers, the salary fund was, in real terms, lower than last year. An average old-age and disability pension in nominal terms was 10.3% higher in January-October compared with the corresponding period in 2000, and its purchasing power grew by 4.3%.

A low level of economic activity remained unchanged. A situation in the labour market should continue to be favourable for the limitation of the salary pressure. Therefore, there is a small inflationary risk derived from the increase of demand.

VI. Situation in the public finance sector.

The Government approved a 2002 draft state budget that generally confirms earlier announcements that the state budget expenditure would be approximately PLN 183 billion, and the deficit would not exceed PLN 40 billion. In the area of public finance, there is still, however, a high uncertainty about the ultimate 2002 budget related to the course of Parliament's work on the budget neighbouring laws.

Even in the present format, the 2002 draft budget evokes some concern about its impact on a future economic growth and the possibility of improving the fiscal and monetary policy arrangement. The rate of real growth of the expenditure of the total public finance sector is only slightly lower than that in the draft prepared by the former government; some limitation of the state budget expenditure in 2002 was achieved by postponing some expenditure or allocating it to other parts of the public finance sector, an economic deficit was assumed at the higher level than it was in the former draft budget.

VII. Decision of the Monetary Policy Council.

1. The 2002 draft Budget Law generally confirms the former announcements of the government pertaining to a format of the budget. This information was taken into account in the decision to reduce interest rates at the last meeting of the Monetary Policy Council and it does not constitute any reason to mitigate the monetary policy.
2. The economic data, however, that have occurred since the last meeting of the Monetary Policy Council indicate further decrease of the inflation policy:
 - In October 2001, all measurements of the core inflation decreased; it indicates that the decline of the inflation rate does not derive only from the impact of the temporary factors but pertain to the majority of goods and services groups.
 - The industrial sales prices decreased; it indicates that their growth in July-September was likely to be temporary. In comparison with October 2000, the industrial sales prices decreased. It means lower pressure on the growth of consumer prices in the future.
 - The individuals' expectations pertaining to the inflation in the future have clearly improved. The inflation expectations of bank analysts were further reduced.
 - The monetary factors developed more favourably for the future inflation:
 - The growth rate of the total money supply per year decreased to 13.1% from 14.3% last month.
 - The total lending momentum in 12 months decreased to 8.5% from 10.7% in September 2001.
 - The expectations concerning the future development of the oil prices have lowered.

- Financial results of enterprises in January-September were worse compared with the corresponding period in 2000 which may mean lower investment demand in the future.
3. During the last meeting of the Monetary Policy Council some signals occurred confirming earlier trends favourable for the future inflation:
- The economic growth rate in the world in 2001 and 2002 will be lower than expected. It means rougher conditions for the Polish export. It is simultaneously a limiting factor for the inflation pressure.
 - The situation in the labour market should reduce the salary pressure.
4. **In this situation, the Monetary Policy Council made a decision to reduce the NBP interest rates by 1.5 percentage points and maintain a neutral attitude to the monetary policy.**

VIII.

The Monetary Policy Council would also like to emphasise that it made the aggregated interest rate reductions by 7.5 percentage points in 2001. The minimum rate on the 28-day transactions in the open market was reduced from 19% to 11.5%, a bank discount rate from 21.5% to 14%, and a lombard rate from 23% to 15.5%. The ultimate effects of these reductions have not become visible yet.

Simultaneously, there continues to be a serious uncertainty about the situation in the public finance sector in 2002 and 2003, the impact of the savings income tax on the savings behaviours and the scale of the necessary structural reforms that will be implemented.

It should not be expected that this uncertainty be relieved in the nearest future. Both factors: a large scale of the total NBP interest rate reductions in 2001 and incomplete disclosure of their effects and maintenance of significant sources of uncertainty will be a major reason for further decisions of the Monetary Policy Council.

IX.

National Bank of Poland and the Monetary Policy Council consider an option to undertake steps (conversion of the NBP bonds issued in reference to the reduction of the obligatory reserve reduction in 1999 into bonds of a market value) aimed at mitigation of a negative impact of the funds-based income tax on the bank deposit rates.

X.

In compliance with the *2001 Monetary Policy Guidelines*, National Bank of Poland introduces a central bank deposit rate as of 1 December 2001. The deposit rate will determine a price that the central bank will offer to banks for making a short-term deposit. This instrument was introduced to reduce fluctuations of short-term interest rates in the interbank market.

Introduction of the deposit rate is also a step to adapt the NBP instruments to the European Central Bank standards.

The principles for deposit processing and servicing are defined by the resolution of the NBP Management Board on the terms and conditions for opening and maintaining of bank accounts by NBP and agreements concluded with banks. This instrument will be available to all banks holding current accounts in the Payments System Department (DSP). There will be a possibility to make an unsecured deposit before the end of a business day, the return date will be a beginning of the next day. The amount of the accepted deposits will not be limited.

A deposit rate determined by the Monetary Policy Council (a deposit rate) will be lower than a reference rate (minimum rate on the open market transactions with a 28-day maturity). The Council assumes functioning of a symmetrical band of the central bank interest rates which means that the difference (expressed in percentage points) between the deposit rate and the reference rate will equal a difference between a lombard rate and the reference rate level. Moreover, this difference will depend on the NBP interest rates; it may be reduced when interest rates are lower. Thus, it will be possible to adapt a width of NBP rates band gradually depending on the changes in the reference rate level. Maintaining a symmetrical band of interest rates around the reference rate level will require a higher change of the lombard rate and a lower change of a deposit rate compared with the changes in the reference rate. This adaptation will be of a technical nature and will not mean a change of a general direction and the extent of the monetary policy restrictiveness.

XI.

The next meeting of the Monetary Policy Council will be held on 18-19 December 2001.