

June 27<sup>th</sup>, 2001

## **Release of the Monetary Policy Council**

The Monetary Policy Council held its meeting on June 26-27<sup>th</sup>, 2001. The Council was submitted the materials prepared by the Management Board and departments of the NBP and information and analytical materials prepared by Ministry of Finance, research institutes and commercial banks. On this basis, before starting the decision-making part of the meeting, the Council discussed inflation processes; tendencies in the area of money supply, lending and interest rates; external conditions and the situation in the real sector of the economy and in public finance sector.

### **I. Inflation processes.**

1. In May this year, consumer goods and services prices rose by 1.1% as compared to April this year (as compared to 0.7% increase a year before). As a main reason for a considerable increase of prices there should be considered the influence of seasonal factors and single decisions:
  - fruit prices increase (by 25.8%),
  - increase of the phone subscription fee by Telekomunikacja Polska S.A. (by 40%),
  - medications price increase (by 2.8%).

These 3 groups, in spite of the fact that they amount in total to only 5.5% of the basket of goods and services used for calculating CPI, they contributed in approximately 80% to the price increase in May. It should be emphasized that the influence of temporary factors ceased and in the 2<sup>nd</sup> half of May the foodstuffs prices dropped (by 0.4% as compared to the 1<sup>st</sup> half of the month).

The twelve-month consumer price index rose in May this year to the level of 6.9% from 6.6% a month before.

2. In May this year, three base inflation indices calculated at the twelve-month scale lowered:

- 15%-cut average to the level of 6.5% (as compared to 6.8% a month before),
- inflation after the most variable prices are excluded to 6.5% from 6.8% in April this year,
- inflation after the most variable and fuel prices are excluded to 7.0% from 7.2% a month before.

The two remaining measures of base inflation calculated at the twelve-month scale rose:

- “net” inflation to the level of 7.2% (as compared to 7.0% a month before),
- inflation after controlled prices are excluded to 7.0% annually (from 6.6% in April this year).

Base inflation was more favorable in May this year than a month before when the growth of all indices was noted except for the 15%-cut average that did not change.

3. The sold industrial output prices rose by 0.1% as compared to April this year (by the same amount as in April this year). In May 2000, a similar growth amounted to 0.9%. The twelve-month PPI dropped to the level of 2.5% (as compared to 3.4% in April this year and 7.9% a year before).

A clear decrease, and to a very low level, has been noted in case of the producer price index in the industrial processing section (to 0.8% annually from 1.5% a month before and 7.9% in May 2000).

The data of May also indicate the termination of impulses increasing prices in the section of production and provision of electric energy, natural gas and water (prices in this section rose in May, as calculated at the monthly scale, by 0.3% as compared to 1.6% in April and 3.5% in March).

Moreover, according to the survey among entrepreneurs, PPI will be held at a low level in the nearest months what will create favorable conditions (lack of pressure posed by industrial output prices) for the future formation of CPI.

4. In surveys of inflation expectations of individuals made at the beginning of June this year, despite the increase of the current inflation, the percentage of people expecting that the prices will rise slower than now rose by 5 percentage points and it is the biggest within the last few years. It may reflect the improvement of the way of formulating inflation expectations by individuals.

The expected by banking analysts inflation rate in 11-month horizon dropped by 0.3 percentage points (to 5.6%) as compared to a survey made a month before. A small increase, however, was noted in banks' expectations as far as the amount of CPI in December this year is concerned (to 5.9% from 5.8% in April this year).

**The price growth noted in May, in the opinion of the Council, does not constitute a threat to the inflation target achievement and it is a temporary development.**

**Moreover, the analysis of base inflation measures, sold industrial output price index and inflation expectations indicates that the signals enhancing favorable outlook for the inflation decrease appeared.**

## **II. Money supply, loans, interest rates.**

1. In May this year, money supply (M2) increased by 0.6% as compared to April this year (a year before a similar growth amounted to 1.1%). The annual growth pace of money supply decreased to 13.5% (as compared to 14.0% in April this year and 15.2% in May 2000).
2. Favorable for future inflation processes tendencies in deposits and lending growth are being confirmed:

- the growth pace of PLN-denominated deposits placed by individuals is maintained at a high level – in May this year the total of PLN-denominated deposits placed by individuals was bigger than in May 2000 by 21.3% (i.e. by PLN 29.4 billion), and as compared to the end of December last year this total amount rose by 8.7% (i.e. by PLN 13.4 billion);
- a decrease tendency of lending dynamics started in the second half of last year has been maintained; total amount of extended loans calculated at the twelve-month scale rose by 11.3% (as compared to 12.6% a month before), since December 2000 it increased by PLN 5.0 billion (i.e. only by 2.4%), and only in May dropped by PLN 107 million (i.e. by 0.1%) as compared to the amount as of the end of April this year (as compared to 0.2% growth in April this year and 1.3% growth in May 2000);
- the growth pace of lending to individuals dropped (to 22.1% annually from 25% a month before) and to businesses (to 8.3% from 9.4% annually in April this year).

**In May this year, the favorable for future inflation processes tendencies in the area of monetary developments were enhanced. According to analyses, now there is no threat to the process of lowering inflation that could be posed by monetary factors which are the most dependent on decisions of the Monetary Policy Council.**

**Despite the decrease of loan and deposit interest rates in commercial banks (as a reaction to decisions made this year by the Monetary Policy Council), a high growth pace of PLN-denominated deposits placed by individuals and a decrease tendency of the loan dynamics are maintained.**

### **III. External conditions.**

1. Since the last meeting, in the opinion of the Council members, signals being the evidence of a change of economic growth outlook in the USA this year, and especially in the euro zone, did not appear. The growth pace of the development of

these economies will be definitely slower than last year and smaller than it was earlier forecasted. It is now forecasted that the economic growth pace in the United States will decrease from 5.0% in 2000 to 1.7% and in the countries within the euro zone from 3.4% in 2000 to 2.2% this year (in Germany from 3.0% to 1.8%).

2. According to the actual forecast of petroleum prices, in conditions of a global demand decrease in 2001 the petroleum prices will not rise as compared to 2000 and they will remain at an average level of USD 26.7 per barrel as compared to USD 28.6 in 2000. In the 4<sup>th</sup> quarter this year – due to a bigger demand (as a result of an accelerated pace of economic growth in the USA and factors of seasonal nature) – the increase of petroleum prices is probable (but they should be below the prices noted in the same period last year).

**The forecasts of a slower pace of economic growth in the USA and within the euro zone remain effective.**

**Like a month ago, the situation on the world raw materials markets (mainly petroleum) indicates that the risk of a strong inflation impulse coming from external prices at a scale comparable to 1999 and 2000 is small.**

#### **IV. Supply, demand, situation on labor market and income.**

1. Gross domestic product in the 1<sup>st</sup> quarter this year increased in real terms by 2.3% as compared to the same period of 2000. The domestic demand was lower by 1.4% than in the 1<sup>st</sup> quarter last year. In the 1<sup>st</sup> quarter 2001, the individual consumption and gross fixed assets expenditures each rose by 1.5% as compared to the 1<sup>st</sup> quarter 2000.
2. In May this year, the industrial output (in real terms) rose by 2.9% as compared to April this year, and as compared to May last year it decreased by 1.0%. Within the period January – May this year, the industrial output was bigger by 2.5% than in the same period of 2000. The drop of construction and assembling output deteriorated. In May this year, the construction and assembling output was smaller by 11.9% than in May 2000 (as compared to 10.8% drop in April this year).

3. It is estimated that in May this year the retail sales volume was still smaller than a year before, however this drop was smaller than in the period February – April this year.
4. In May this year, a seasonal drop of unemployment was noted. The unemployment rate decreased to 15.7% from 15.8% a month before.
5. However, the decrease tendency of employment in the enterprise sector has been maintained. As compared to April this year, employment decreased by 0.4% and as compared to May 2000 by 3% (in April the decrease amounted to 0.3% and 2.7% respectively).
6. After a drop of an average salary in real terms in the enterprise sector in April this year (by 1.3% as compared to April 2000), in May the real increase by 1.9% took place.
7. In May this year, an average pension in real terms was smaller by 1.4% than in May 2000. However, due to the started valorization of disability benefits and pensions, since June this year a very big increase of purchasing power of pensions will be noted.

**The latest data related to the real sector signal a clear drop of demand pressure. This opinion is additionally enhanced by the results of surveys made among entrepreneurs and a probable weakening of the growth pace of exports (as a result of a weaker economic situation of the major trade partners).**

**The situation on labor market reduces the pressure on salaries growth, and by that it decreases the inflation pressure.**

**The uncertain factor is still a probable increase of demand pressure on inflation as a result of payoffs of compensations, reparations and the valorization of disability benefits and pensions despite the extension of these payoffs in a bigger time frame.**

## **V. Situation in public finance sector.**

1. In May this year, the budget deficit increased by PLN 2 billion. After five months the deficit of the budget amounted to PLN 20.4 billion what constitutes 99.3% of the plan for the year.
2. According to forecasts, in June this year the situation in the area of the budget deficit achievement will be improved (inter alia, due to the payment of the next installment for the third generation cell phone communication license (UMTS) and the earnings by the NBP).
3. The revenues from privatization are still small (PLN 1.9 billion as compared to the planned PLN 18.0 billion for the whole year).

**After five months the budget deficit planned for the whole year 2001 has been already achieved in 99.3%.**

**A big deficit of public finance sector limits the playing field in the area of monetary policy and it is not favorable for a long-term development of the economy.**

#### **VI. Decision of the Monetary Policy Council.**

1. In the Council's opinion, the majority of factors affecting inflation have improved:
  - Three measures of base inflation at the twelve-month scale lowered as compared to April this year. Moreover, two of them were below CPI again. It enables expecting the return of the consumer price index to a decreasing path.
  - Inflation expectations of both households and banking analysts were favorable what supports the achievement of the monetary policy targets.
  - Favorable from the point of view of the future inflation, tendencies in the area of monetary developments have been enhanced. Analyses indicate that there is no visible threat to the process of inflation reduction posed by monetary factors.
  - The situation in the real sector of the economy signals the decrease of the demand pressure.

- A clear drop of sold industrial output prices, especially in industrial processing – and to a very low level – indicates the lack of pressure for the increase of consumer price index posed by industrial output prices.
- 2. At the same time, the threats in the area of public finance, which were signaled many times by the Council, come true.
- 3. Considering all factors affecting future inflation, and especially the fact that the majority of them got improved, the Council decided to lower the basic interest rates of the NBP by 150 basis points and maintain its neutral position in the area of monetary policy.

**The Council will treat threats in the area of fiscal policy as a limitation for the future monetary policy that is aimed at the achievement of the mid-term inflation target. The role of this limitation will be as much bigger as the scale of public finance deficit reduction smaller. It should be emphasized that the decisions of Sejm according to which the future expenses of the state would be considerably bigger, threaten in a form of a bigger imbalance in public finance sector in the nearest years.**

The next meeting of the Monetary Policy Council will be held on July 19-20<sup>th</sup>, 2001.