

Warsaw, December 18, 2002

## **INFORMATION AFTER THE MEETING OF THE MONETARY POLICY COUNCIL**

**on December 17-18, 2002**

The Monetary Policy Council held its meeting on December 17-18, 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, in public finance sector, in the area of money supply, lending and interest rates, and the formation of inflation expectations, prices and the inflation outlook.

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

Within the period that passed since last meeting of the Monetary Policy Council there appeared a few data illustrating the development of the economic situation. In November, the 12-month inflation lowered to the level 0.9% from 1.1% in October. The price level in November as compared to October lowered by 0.1% what was mainly affected by the drop of foodstuffs and non-alcoholic beverages prices and the drop of alcoholic beverages prices. It should be emphasized that the mid-year inflation in Poland in October this year calculated according to the methodology used in the European Union (HICP) can be estimated at 2.4% (as compared to 2.0% in the EU).

Good results of the Polish foreign trade got confirmed, but as compared to the previous year the turnover dynamics is slower. The latest survey about the economic situation by GUS indicates the climate improvement in processing industry. These data complement the estimate made a month before about a gradual improvement of the economic activity. After the decisions made at the summit in Copenhagen, finishing Poland's negotiations about the European Union accession, it should be expected that integration processes within the EU would support a further economic boom.

In November 2002, in the economy there were still observed the phenomena that support the enhancement of a low level of inflation:

- inflation expectations of individuals and bank analysts are maintained at a low level,
- a low annualized dynamics of total money supply is maintained, the cash dynamics stabilized, and the annualized lending dynamics is still at a low level,

- a moderate wage increase does not threaten in a form of the inflation pressure growth.

Considering that the effects of the interest rate cuts made so far have not been revealed yet, it is necessary to preserve caution in monetary policy. Moreover, the importance of factors that can impede the stabilization of inflation at a low level has not diminished yet:

- there is a threat in a form of a bigger economic deficit of public finance sector than it was planned in the draft act on the state budget for the year 2003,
- there is still observed a drop of deposits placed by households at banks,
- as a result of a persistent threat of an armed conflict with Iraq and the prolonging strike in Venezuela, oil on the world markets, after price drops in October, gets more expensive again,
- together with the improvement of the economic growth dynamics, the inflation pressure can appear.

**Considering the above mentioned conditions, the Monetary Policy Council decided to maintain the basic interest rates of the NBP at the present level and maintain its neutral position in monetary policy.**

**The work on a medium-term strategy of monetary policy has been continued. Moreover, the Council discussed the balance of payments for 3 quarters of 2002. The Council has also adopted a resolution on principles of conducting open market operations shortening the time frame of basic operations from 28 to 14 days.**

**The next meeting of the Monetary Policy Council will be held on January 28-29, 2003.**

## **I. Evaluation of the economic situation**

In November this year, the atmosphere in the American economy visibly improved (the Conference Board's index measuring consumer confidence increased from the level 79.6 in October to 84.1 in November, while the NAPM index – the purchasing managers index (PMI) increased from 48.5% to 49.2%, respectively). Favorable conditions for investing have been additionally confirmed by: growth trend on the stock market maintained since October, better than expected results in labor efficiency in the U.S. industry in the 3<sup>rd</sup> quarter this year, and a repeated boost in retail sales in November and December.

**Improvement of the atmosphere in the economy of the USA**

However, no signs of the situation improvement in the euro zone have been noted. In November, consumer confidence indices worsened again (the European Commission's index for Germany increased its drop to the level -17 as compared to -11 in October), while the European managers confidence did not change as compared to the results noted in October.

**No signs of atmosphere improvement in the euro zone, especially in Germany**

In October this year, the drop of industrial output in Germany increased (-1.4% as compared to -0.7% in September).

According to market expectations, in December this year, the ECB cut the main refinancing operations rate by 50 basis points to 2.75% - the lowest level in three years. Among the main reasons for this decision there was mentioned the weakening of the economic growth pace and a drop of inflation pressure in the euro zone.

Still a factor associated with a high level of uncertainty is the formation of the world oil prices. In November 2002, the average price for Brent oil lowered by USD 3.4 per barrel as compared to October. In the half of November, it reached its minimum getting below USD 23 per barrel. In the second half of November, the oil prices rose again. At the beginning of December this year, prices stabilized at a relatively high level of USD 26 per barrel. Despite the ongoing UNO inspection in Iraq, the market participants think that the war in the Persian Gulf is inevitable. A high price level is also affected by: a prolonging strike in Venezuela (this

**Repeated increase of oil prices**

country is the third big oil supplier to the American market), the attack of winter in the USA, and the uncertainty about the relationship between supply and demand that results from speculations related to decisions of the December summit of OPEC countries.

The current account deficit in October this year amounted to EUR 578 million (USD 562 million) as compared to EUR 539 million (USD 534 million) in September this year and EUR 923 million (USD 836 million) in October last year. The trade deficit amounted to EUR 1 billion. Exports evaluated on the basis of the information on payments in EUR increased in October this year as compared to the same month last year by 4.9% and imports lowered by 2.8%. Exports denominated in USD increased by 13.6% and imports increased by 5.3%. Therefore, a big dynamics of foreign trade turnover denominated in USD has been in part achieved as a result of exchange rate changes and the appreciation of the euro against the dollar on the international currency market. Good export results are caused by a change of the geographic structure of Polish exports – less exports to Germany, the main trade partner, have been compensated by more exports to the Central and East European countries and some EU countries.

The economic situation survey by GUS indicate that in November 2002 as compared to October this year the evaluations and forecasts for the processing industry and construction (seasonally adjusted data) improved. The evaluations became optimistic and in forecasts a considerable improvement of generally optimistic expectations was observed. In case of the processing industry it means a considerable improvement of the expectations related to the climate of the economic situation as compared to the same month of 2001, and in construction – reaching the level noted a year before. In sales, the climate of the economic situation is evaluated as negative, although better than a year before.

### **Good foreign trade results in October**

### **Improvement of the economic situation climate in processing industry and construction**

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

The NBP data on the state budget accomplishment

after November this year indicate that the budget deficit will be accomplished at the level planned in the act on the state budget for the year 2002, i.e. PLN 40 billion (5.4% of GDP). Current forecasts of the state budget revenues are slightly below the level accepted in the act. A revenue shortage will be compensated by the adequate reduction of state budget expenses. The convergence of indices illustrating the accomplishment of the plan of both revenues and expenses of the state budget within a recent couple of months this year indicates that expenses are under control and adjusted to the revenue situation.

**Budget deficit in 2002 at a level planned in the act**

Available information on funds and agencies do not basically change the picture of the financial situation of these entities as compared to the picture drawn within previous months.

According to the NBP forecasts, the economic deficit of the whole public finance sector in 2002 will be at the level of approximately 5.8% of GDP and 5.4% of GDP in 2003.

**Economic deficit of the public finance sector in 2002 bigger than planned**

### **III. Money supply, loans, interest rates, exchange rate**

According to the interim information from commercial banks in November 2002 – as compared to the situation as of the end of October this year – the M3 money supply decreased by PLN 3.1 billion. However, in fact this drop was smaller by about PLN 1-1.1 billion and amounted to about PLN 2 billion. This difference is a result of the incomplete taking into account of the resources gathered by banks due to the issue of bonds (about PLN 1-1.1 billion). After the bond issue program is completed, this amount will be finally booked accordingly and it will increase the M3 aggregate.

**Drop of money supply;**

**Drop of deposits and loans of households**

The decrease of deposits placed by households and deposits placed by businesses by PLN 3.6 and 1.0 billion, respectively, contributed to the drop of the M3 aggregate. A considerable drop of deposits of households is a result of the matured one-year placements that were not eligible for the interest

income tax and were made in November last year. A considerable part of the deposited funds (about PLN 2 billion) flowed out of banks to investment funds (PLN 1.4 billion), Treasury bonds (PLN 0.6 billion), and approximately PLN 1.3 billion has been placed in bank bonds (of which only PLN 0.3 billion has been reflected in M3).

**Funds from anti-tax placements shifted from bank accounts to other forms of savings**

The annualized dynamics of cash stabilizes at the level of approximately 15% (14.9% in November this year). As far as the annualized dynamics of M3 and deposits of households are concerned, their jump growth observed in November this year (from -2.5% to -1.0% and from -5.6% to -1.6%, respectively) is exclusively a result of the statistical effect of a low base. At the same time, the base effect is a reason for a rapid drop of the annualized dynamics of deposits with maturity over 2 years from 156.7% in October this year to 15.6% in November this year.

The second month in a row, a drop of loans to households is noted. However, the loans to businesses rose. The annualized dynamics of these categories in November this year amounted to 7.7% and 1.2% respectively, while in October this year it amounted to 8.3% and 0.5%.

In November this year, a visible appreciation tendency of the zloty took place. The exchange rate of the Polish currency appreciated against both the dollar (by 4.6%) and the euro (by 2.9%). A stronger appreciation of the zloty against the dollar resulted from the depreciation of the dollar on the world market.

**Appreciation of the exchange rate of the zloty in November**

#### **IV. Prices, inflation expectations**

In November this year, the 12-month inflation lowered to the level 0.9% as compared to 1.1% in October this year. At the 12-month scale the biggest growth has been observed in case of prices for goods and services connected with transportation (by 4.3%), housing (by 4.1%), healthcare (by 3.7%), and education (by 2.5%).

**Annualized consumer price index at a record low level 0.9%**

The consumer price index lowered in November as compared to October by 0.1% the main contributor to

which was the drop of prices for alcoholic beverages by 1.4%, tobacco products by 0.4%, foodstuffs and non-alcoholic beverages by 0.3%, and fuels by 0.3%.

Inflation on a low level supports the enhancement of low inflation expectations. In December this year, the annualized inflation rate expected by bank analysts by the end of this year lowered by 0.4 percentage point as compared to November declarations and amounted to 1.1%. The annualized inflation rate expected by bank analysts by the month preceding the same month next year (i.e. November 2003) remained at the level 2.5%, while the mid-year inflation rate for 2004 amounted to 2.6% what means its decrease by 0.1 percentage point as compared to the expectations expressed in November this year.

In December this year, inflation expectations of individuals lowered as well. The inflation rate expected within the year to come amounted to 0.8% what means its decrease by 0.1 percentage point as compared to the measurement made in November this year.

### **Low inflation expectations**