

Warsaw, 17 December 2003.

INFORMATION FROM A MEETING OF THE MONETARY POLICY COUNCIL, held on 16-17 December 2003

On 16-17 December 2003 the Monetary Policy Council held a meeting. The Council read materials prepared by the NBP and also information and analyses furnished by the Ministry of Finance, banks and research institutes. The Council then discussed the external environment of the Polish economy as well as real trends, trends in payments and social welfare benefits, matters involving the public financial sector, the money supply, loans and interest rates and the structures of pricing and inflationary expectations, as well as the expected rate of inflation. Until the meeting of the Council the November figures relating to the industrial and construction sector output, retail sales, the PPI, the unemployment rate, base inflation and inflationary expectations were not disclosed.

Decision of the Monetary Policy Council

In November 2003, the annual CPI reached 1.6% as compared to 1.3% reported for October 2003.

Other economic data, which has emerged since the last meeting of the Monetary Policy Council indicates:

I. The continuation of factors encouraging low inflation:

- Continuing strict corporate salary discipline. Between January and November 2003, the average monthly salary in the corporate sector grew by 2.6% in nominal terms comparing to 3.5% on a year-to-year basis. After eleven months 2003, a real growth in salaries was equal to 1.9% compared to 1.5% year-on-year. The higher growth of salaries in November 2003 (4.1% in nominal terms and 2.5% in real terms) is related to the low growth of salaries reported for November 2002 (the base effect),
- Despite an increase in the annual growth rate of the money supply at 5.7% in November against 4.7% in October 2003, its level remains moderate,
- Despite its growth in November, the low annual growth rate of corporate credit continues. The annual growth rate of corporate loans in November 2003 reached 3.6% against 3.5% in October and loans to households grew up to 13.5% and 12.2%, respectively.
- Confirms: upward economic trends are growing stronger, increasing inflationary pressures gradually. However, the Council does not see this as a threat to the attainment of the inflationary goal in 2004.
 - The preceding months saw a growing trend in the PPI, improvement in the financial results of enterprises, increasing capital expenditure by enterprises and growth in retail sales,
 - The figures received after the Council's meeting held in November. A high growth in the exports continues: after ten months of 2003, the euro-denominated exports grew by

6.5% and dollar-denominated exports grew by 27.7%, year-on-year (in accordance with the payment statistics),

- In addition, more optimistic forecasts regarding foreign demand were reported: November 2003 witnessed an improvement in consumer and entrepreneurial moods in the USA and the euro system,

III. Nevertheless, the significance of factors inhibiting the stabilisation of inflation at a low level remained unchanged. The Council maintains its opinion that one of these is the uncertainty with respect to the current and future condition of public finance.

Increasing budget disequilibrium, the rapid growth of public debt and the deteriorating mid-term public finance perspective result in a growing yield from treasury securities and depreciation of the zloty exchange rate

The uncertainty as to the zloty exchange rate may be additionally increased by diverging from the announced *The Public Debt Management Strategy for 2004 – 2006*: shortening of the average debt redemption term and financing of a part of the budget deficit from foreign sources as planned by the government.

IV. Other possible factors creating inflationary pressure include:

- the high and increasing growth rate of cash in circulation. In November 2003, the annual growth rate of the aggregate reached 18.2% (and 17.0% in September),
- A possible increase in oil prices. In December, the forecast annual average oil price in 2004 was subject to a considerable rise from 25.9 USD/b. to 27.9 USD/b.,
- A possible increase in the price of foodstuffs in 2004 indicated by current forecasts.

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

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- In addition, the Council adopted the Resolution on accounting principles, the structure of assets and liabilities of the balance sheet, profit and loss account of the National Bank of Poland and the Resolution on the principles for creating and releasing a reserve for the risk of the zloty to foreign currency exchange rate fluctuations at the National Bank of Poland. A summary of the resolutions will be published in the Official Journal of the NBP.
- The Council adopted *The financial plan of the National Bank of Poland for 2004*. In accordance with the predictions of the financial plan, the NBP should close 2003 with PLN 4.189.6 m. and 2004 with 4,869.6 m.
- Moreover, the Council adopted the Balance of Payments of the Republic of Poland for the first 3 quarters of 2003.

The next meeting of the Council is scheduled for 20-21 January 2004.

I. Assessment of the economic situation

External factors

November 2003 saw a consolidation of revival signals in the global economy. In the USA, the indices reflecting both current and expected market conditions reached historically high levels, with an increase both in the industrial activity index and the American consumer-confidence ration. A high growth rate in retail sales in the USA confirmed the optimism of households (remaining at 6% to 7% since August 2003).

Stronger revival signals in the global economy.

In the euro system, a gradual improvement in the optimism of enterprise has been noticeable since August 2003. Furthermore, a rise in consumer optimism was signalled, though it is weaker than the trend observed in the USA.

In November 2003, Brent oil prices remained at a high level, periodically rising up to 30 USD/b. The average price of Brent oil per barrel was 28.8 USD/b. High oil prices are sustained as a consequence of another decrease in crude oil reserves. In the end of November 2003, their level in the USA was lower by 9.3 bn b/d compared with the end of October 2003.

High oil prices on global markets

In December 2003, the Department of State for Energy increased its forecast of the annual average oil price in 2004 from 25.9 USD/b. to 27.9 USD/b.

Economic situation in Poland

October 2003 was the second month in a row reporting a positive balance of the current account, with a surplus of the balance of current payments reaching EUR 200 m., translating into EUR 780 m. improvement in the balance of current payments against October 2002. After ten months 2003, a negative balance of the current account amounted to EUR 2.5 bn., indicating a reduction of EUR 3.4 bn. against the period January – October 2003.

October surplus on the balance of current account

The improvement in the balance of the current account stemmed primarily from a reduction in a negative balance of commodity payments caused by a high growth in receipts from exports. The value of receipts from exports increased by 12.1% year-on-year, i.e. the growth was twice as rapid as the growth reported for the whole period from January to October 2003 (6.5%). Compared to October 2002, the value of imports deteriorated by 0.9% and by 0.2% since beginning of the year.

A high growth of receipts from export

Between January and November 2003, the average monthly salary in the corporate sector showed a nominal growth of 2.6% against 3.5% year on year. Over 11 months of 2003, salaries grew by 1.9% in real terms compared to 1.5% year-on-year. The increase in the annual growth of salaries witnessed in November (4.1% in nominal and 2.5% in real terms) is related to the low growth of salaries in November 2002 (the base effect).

II. Situation of public sector finance

After 11 months 2003, the aggregate state budget revenue increased by PLN 6.8 bn (i.e. 5.2%) in nominal terms year-on-year; however, the implementation of the budget plan reached not more than 88.2%, i.e. below the level reported for 2002. Despite increased receipts from income tax reported for the past two months of 2003: increased receipts from personal income tax and indirect taxes, their planned annual volumes will not be realised. Similarly, receipts from corporate income tax

will remain lower than planned. After November 2003, the tax income plan was realised to 87.5% i.e. below its level reported for 2002.

After November 2003, the state budget expenditures amounted to PLN 172.8 bn i.e. 3.2% above their level reported in November 2003 to reach 88.9% of the figure stipulated in the budget act.

As of the end of November 2003, the state budget deficit reached approx. PLN 35.5 bn, translating into a realisation of 91.8% of the annual limit, i.e. below the level reported for 2002. It is estimated that the realised budget deficit will remain within its limits as stipulated in the budget act owing to the adjustment of expenditure that has already been introduced to a forecast lower revenue.

No significant improvement in the condition of the remaining parts of the public finance sector was observed after 11 months 2003. Both the Labour Fund and the Social Security Fund show a deficit and continue to owe high-level debts to the banking sector. Furthermore, the Social Security Office will not transfer the full amount of the insurance premiums planned for 2003, which will cause an increase in the economic deficit of the public finance sector. The National Health Fund is also experiencing difficulties due to receipts from health insurance contributions being below the planned level, which is likely to translate into the continued growth of payable dues by the health sector.

The current condition of the public finance sector units indicates that in 2003 the economic deficit of the overall public finance sector will reach approx. 5.4% of the GDP, i.e. 0.3% above the figure reported for 2002.

Deficit of the public finance sector in 2003 will remain at 5.4% GDP

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

Figures presented in the advance information indicate PLN 0.05 bn (0.0%) growth in the M3 money supply in November 2003 as compared with the end of October 2003. After elimination of exchange rate differences, the M3 aggregate rose by PLN 0.6 bn (0.2%). The annual M3 growth rate reached 5.7%; however, predominantly in consequence of the base effect. In November 2002, purchase of bank bonds, the outflow of funds from bank deposits to investment funds and exchange rate differences caused a deterioration in the M3 monetary aggregate. In November 2003, the situation was reversed due to the redemption of a part of the bank bonds issued last year and some funds were withdrawn from bond funds and transferred to bank accounts.

The M3 growth reported for November 2003 stemmed predominately from a growth in the deposits of non-monetary financial institutions by PLN 1.5 bn (18.7%). The growth reflected a rise in the short-term deposits made by non-banking brokerage offices and investment funds from the funds collected from subscriptions for investment certificates, redemption of bank bonds issued one year ago and from other sources.

In November 2003, the monthly growth in household deposits rose by PLN 0.3 bn (0.1%) and by PLN 0.7 bn (0.4%) after elimination of FX differences. The increase in the value of the zloty-denominated deposits was connected with redemption of participation units in bond funds and redemption of bank bonds. In November 2003, a drop in the net assets of all investment funds was reported at approx. PLN 1.0 bn, including PLN 0.5 bn in consequence of fund outflow. A negative annual growth rate of household deposits continued, reaching – 3.3%.

The value of corporate deposits reported its first fall since March 2003 (of PLN 0.3 bn. i.e. by 0.5%); however, the annual fluctuation rate in this category remained high at 25.1%.

Compared to the cash in circulation status as at the end of October 2003, a growth of PLN 0.6 bn (1.2%) was reported for cash in circulation outside banks, while the annual growth rate of the aggregate reached 18.2%. The growth in cash was connected with the maturity of 2-year bank term deposits opened in November 2001 in order to avoid a tax payable on interest income, redemption of bank bonds issued in 2002 as well as withdrawal of funds from bond funds by private individuals.

On the money creation side, November 2003 saw an increase in total dues by PLN 3.2 bn (1.2%) in nominal terms. Dues from corporates grew by PLN 1.4 bn (1.0%). The annual growth rate in this category reached 3.6%. A growth in household dues amounted to PLN 1.2 bn (1.2%) and stemmed chiefly from an increase in loans for real-estate purchase. The annual growth rate of this category reached 13.5%.

Following the period of high fluctuation, the zloty exchange rate has stabilised since the beginning of December. A surplus in the balance of current payments reported for September and October has a stabilising effect on the currency market (compared to the status reported on the last day of October 2003, the zloty exchange rate gained 0.3% against the euro and 5.9% against the dollar (a change in the exchange rate of 31 October 2003 against 12 December (Reuters – mid)).

The volatility of T-bond prices remains very high. The subsequent drastic falls and increases in T-bond prices indicate continuing uncertainty with respect to the public finance condition, while continued demand from foreign investors resulted in their stabilisation.

IV. Prices

In November 2003, the twelve-month CPI reached 1.6% against 1.3% reported in October 2003. A growth in the twelve-month inflation rate stems from a rise in the prices of apartment rents (3.2%), stipulated mainly by an increase in the prices of media (3.3%), prices in transport (2.8%) and particularly fuel prices (4.0%) as well as the prices of foodstuffs and non-alcoholic beverages (2.1%). However, the prices of clothes and footwear remained below their November level.

A moderate growth in household loans; low growth in corporate loans

Consolidated and stabilised zloty exchange rate

High volatility of T-bond prices

The annual CPI at 1.6%