Warsaw, 26 February 2003

INFORMATION FROM A MEETING OF THE MONETARY POLICY COUNCIL, held on 25-26 February 2003

On 25-26 February 2003 the Monetary Policy Council held a meeting. The Council read materials prepared by NBP Management Board and its Departments 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, in the public finance sector, the money supply, loans and interest rates and the structures of pricing and inflationary expectations, as well as the anticipated rate of inflation.

Decision of the Monetary Policy Council

New economic data which emerged since the previous meeting of the Monetary Policy Council:

a) Indicates. Strengthening signs of a continuing low growth rate in domestic demand:

- Maintenance of a low salary growth rate in the industrial sector,
- a further decline in the employment rate,
- a further declining growth rate in construction, reflecting a continuing very low investment demand,
- the annual growth rate of monetary aggregates – M3 and loans – remains low, the cash growth rate has levelled off,

b) Confirms. That the German economy shows no signs of an upturn: both entrepreneur and consumer optimism have remained low for another month, and the economic results of German industry in January were also poor,

c) Shows. That the current inflation has again been reduced, inflationary expectations of natural persons and bank analysts are lower.

Factors potentially stimulating inflationary pressure include:

- The level to date of interest rate cuts which, allowing for the customary time lag, will gradually stimulate growth in domestic demand in the second half of 2003 and in 2004,

- a probable over-run in the level of economic deficit in the public finance sector as envisaged in the draft 2003 Budget Act and uncertainty underlying the fiscal policy for 2004,
- risk of escalation in oil prices fuelled by the impending military confrontation in Iraq,
- steady growth in the sold industrial production index to 2.5% in January 2003,
- confirmation of a tendency towards a gradual increase in industrial output in January.

The Monetary Policy Council resolved:

- **to reduce the lombard rate from 8.50% to 8.00% p.a.,**
- **to reduce the re-discount rate from 7.25% to 6.75% p.a.,**
- **that the National Bank of Poland will conduct open market operations for 14-day maturities with a profitability rate of at least 6.25% p.a.,**
- **that the interest rate on term deposits taken by the NBP from banks will be held at 4.50% p.a.,**

The Council confirms its neutral approach in respect of monetary policy.

The Monetary Policy Council adopted "The Monetary Policy Strategy after 2003"

The next meeting of the Monetary Policy Council is scheduled for 25-26 March 2003.

I. Assessment of the economic situation

Deterioration in consumer-confidence in the USA and the euro zone.

In January and February 2003, consumer and entrepreneur confidence in the USA and the Eurozone continued to be influenced by political risk. Consumer confidence suffered the most. Both the USA and Europe saw a drop in household confidence indicators (in the USA, the University of Michigan ratio dipped from 86.7 in December 2002 to 82.4 in January 2003 and the European Commission indicators for such countries as France and Great Britain fell from –17 and –6 in December 2002 to –20 and –9 in January 2003, respectively.

No improvement was observed in the optimism of business circles in the USA and the euro zone. Nevertheless, as in the 4th quarter 2002, American entrepreneurs showed more optimism than their counterparts in the Eurozone.

Poor industry performance in the euro zone

The attitude is evidenced by poor results generated by the processing industry in the main economies of the Eurozone (for example, in December 2002, the output of the German processing industry fell by 0.5% in comparison with December 2001 in contrast to a 2.8% increase in November (year on year), similarly, there was no major improvement in the industrial orders portfolio in January).

Poor demand in the production sector delays the long-awaited break-through in the negative investment growth rate in the Eurozone, which had prevailed since the second quarter 2001.

Increase in oil prices

Global oil prices continue to be a big question mark. In January 2003 the average price of Brent crude oil reached USD 31.3 a barrel and was 10% higher than in December 2002 and over 60% higher than in January 2002.

As in January, further growth in oil prices was fuelled primarily by political factors such as a possible war with Iraq and a strike in Venezuela's oil sector, now in its third month. The likelihood of a war in the Persian Gulf results in serious concerns about continued supply of oil from the region. Thus far the political situation has not had impact on oil production levels. In January 2003 Iraqi oil continued its uninterrupted flow (at 2.5m. b/d).

The Venezuela crisis gobbled up oil reserves in OECD countries in January 2003 by 90m. barrels down to 2.5bn barrels, the lowest level in five years. It was compounded by a drop in oil product reserves, in particular heating oil, as a result of the inclement cold weather conditions in the north-eastern part of the USA. The low oil reserves put additional pressure on the increase in oil prices, which are already exposed to political risk.

Growth in industrial production –further fall in construction and assembly production

No upturn in the industrial production trends was reported for January 2003. Year to year growth in total industrial output fell from 5.1% in December 2002 to 4.2%, while the growth rate in the processing industry dropped from 6.7% in December 2002 to 4.7% in January 2003; however, the drop rather resulted from imponderables connected with severe weather conditions, rather typical of this time of year, than from changes in the key factors affecting output. In January 2003, sales generated by the "electricity, gas and water production and supply" industry grew by 2.6% compared to January 2002, while sales figures for the industry in the consecutive months of the second half of 2002 were not higher than their last year equivalents.

Out of 29 industrial divisions, 18 reported an increase in production and 11 conceded a decline. As in the previous months, the highest production growth was observed in industries with a high and increasing share of export sales.

Cold weather conditions in January contributed to a further decline in construction output. The decline again exceeded 10% compared to January 2002.

Higher growth rate in trade in 4th quarter 2002

December 2002 saw another drop in the current account deficit, by EUR 50m. against December 2001. It came as a result of a growing positive balance of unclassified current account transactions, a decrease in the commodities trading deficit and an increase in the current transfer surplus; at the same time the negative balance of revenues and services increased.

In comparison to December 2001, the commodities trading deficit fell by EUR 76m. in December 2002 (by 14.3% compared to December 2001) as exports growth rate exceeded imports growth rate (compared to December 2001 exports grew by 14.3% and imports by 8.6%). The total receipts from 2002 exports expressed in EUR were 2.9% higher than in 2001, whilst the value of imports payments was 2.4% lower than in 2001.

The 4th quarter 2002 saw markedly accelerated growth in both exports and imports, at 7.4% and 2.7% respectively (viewed against 4th quarter 2001).

Both payment statistics and tangible statistical indicate accelerated exchange at the end of 2002. Preliminary figures after the first 11 months show that exports rose by 6.8% and imports by 3.7% compared to the same period of 2001.

Rise in exports to developed countries

Since the beginning of 2002 the strongest increase in sales has been reported in machinery and transportation equipment. The trend continued in the 4th quarter 2002. At that time, high growth rate of exports in this group stemmed primarily from increased sale of car parts, ships (mainly as part of ship overhaul services) and passenger cars (where an almost 18 month downward trend in the value of exports was finally halted).

Slightly better assessment of economic situation

The upturn in exports observed in 4th quarter was fuelled by continued growth in sales to the developed countries, in particular to European Union member states, Italy and Great Britain. Likewise, high exports rate to France remained stable. By contrast, exports to Germany suffered a decline. Like in the 3rd quarter 2002 there was a considerable slowdown in the growth in exports to the countries of the Commonwealth of Independent States.

According to a Central Statistical Office survey of a sample of six thousand enterprises conducted at the end of January 2003, the general economic situation is not deemed to be good. The same is borne out by negative values of the indicators measuring various aspects of the economic situation (including domestic and foreign demand, orders portfolio, goods sold, output level and the potential for settlement of financial liabilities, payment delays).

Stronger confidence of entrepreneurs from the processing industry

However, it should be emphasised that the prevalence of negative opinions over positive ones is declining, especially in the industrial processing section. The trend is manifest when compared to January 2002 and in some cases, also with January 2001 (e.g. the assessment of the financial situation in the processing industry and in trade and the assessment of demand in the processing industry and the volume of goods sold in the commercial sector).

The forecasts for the next three months indicate that negative indicators continue primarily in the construction industry and in trade, although the same are less negative than in the same month of last year.

On the other hand optimistic forecasts for the future prevail amongst entrepreneurs from the industrial processing sector (with indicators turning positive). In particular, the prospects for demand for this sector's products are deemed to be extremely favourable, and in January the indicator climbed to one of the highest levels in two years. According to this group of respondents, foreign demand should recover. On the other hand, foreign demand-related forecasts are volatile and change from month to month, which is understandable in view of the current political situation around the world.

Good condition of the state budget in January 2003

Entrepreneurs of all industrial sectors share the opinion that downward trends in prices and employment will continue in the nearest future.

II. Situation of public sector finances

In January 2003, the State budget was in a better condition than in January 2001. In addition to tax and non-tax revenues climbing highly above the previous years' levels, expenditures were lower as well. In consequence, the budget deficit remained PLN 2.8 Bn below the January 2002 level at PLN 3.36 Bn.

Economic deficit of the public finances sector in 2003 higher than forecasted by the Monetary Fund

Both receipts from indirect faxes (115.9%) and corporate income taxes (145.3%) showed a very high annual growth. These categories of budget receipts are the most susceptible to economic conditions and their increase, when compared to the same period of 2002, is partially due to the economic improvement. The continuing low growth of receipts from natural persons (102.6%) reflects the employment market conditions. Rise in non-taxable receipts may be attributable to the additional receipts from the restructuring fee.

The state budget expenditures incurred in January 2003 remained below the level of the previous years and reached PLN 15.7 Bn, i.e. by 8.7% below their total for January 2002. The plan was followed in 8.1%, which is considerably below the percentage reported in the past two years.

Drop in money supply

The estimated economic deficit of the whole public finances sector should amount to about 5.2% of GDP, constituting a slight diminution when viewed against the previous year's figure.

in January

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

In January 2003, the M3 money supply fell by PLN 3.7 Bn (1.1%) below that of December 2002. The annual growth rate of the M3 aggregate amounted to –1.4% in January 2003. Such a low growth rate of M3 comes as statistical outcome of shifts in the deposit structures caused by the introduction of the interest income tax in November 2001. The drop in the M3 aggregate in January 2002 was mainly caused by the decrease in deposits from enterprises by PLN 2.6 Bn (4.7%), which is a normal January action on the part of enterprises. Compared to the January drops in previous years, this year's drop was definitely smaller, as was the decrease in the amount of cash in circulation (by PLN 0.6 Bn – 1.3%). Decrease in cash, a January standard, was not as strong as such decreases in previous years. The annual cash growth rate remains at about 14%, as it has been for the past five months. Household deposits typically grow in January in consequence of seasonal payment of additional fees and salaries, but in the current year dropped by PLN 0.9 Bn (0.5%). The annual growth rate of household deposits included in the M3 aggregate declined to –5.5% and to about 1% including deposits with maturity dates of over 2 years.

Low growth rate of loans

On the money-creation side, the annual growth rate of the amounts due from households has remained stable at about 8.% for six months (and 8.7% in January 2003) in parallel to the continuously low annual growth rate of the amounts due from corporations at 1% (1.1% in January).

High volatility of zloty exchange rates in January

In January 2003, the zloty showed high volatility. A slight appreciative trend prevailed in the first half of the month, supported by investors' expectations with regard to the interest-rate reduction, only to decline in the second half of January. General deterioration of market conditions and a drop in the zloty exchange rate at that time was affected by the currency interventions by the Bank of Hungary in order to weaken the forint. Uncertainty on the currency market and the increasing volatility of the Polish currency were additionally undermined by verbal interventions made by the Ministry of Finance aimed at weakening the zloty.

The annual consumer price index at 0,4%

IV. Prices, inflationary expectations

In January 2003, prices of consumer commodities and services grew by 0.4% (against 0.1% in December 2002 and 0.8% one year ago). For 12 months, growth in consumer prices deteriorated further to 0.4% in consequence of decrease in the price of food and non-alcoholic drinks (by 3.5 percentage point at the annual level), alcohol and tobacco (by 3.4

percentage point) as well as a drop in the prices of clothes and footwear (by 1.4 percentage point). On the other hand, prices increased in transportation (by 5.7 percentage points) primarily as a result of a considerable increase in fuel prices and in the cost of residential flats and the consumption of primary sources of power (by 3.9 percentage points) throughout the year.

Production prices in January at 2,5%

Due to annual changes in the weighting system (weightings adapted to the household expenditures structure of the preceding year), the presented CPI figures for January 2003 should be regarded as provisional. The announcement made on CPI for January by the Main Statistical Office comprises no specific price indexes, either. In consequence, base inflation indicators cannot be calculated.

A twelve-month sold-product price growth ratio for industry increased by 2.5%. Prices rose most steeply on the part of producers in those sectors where market forces have not yet taken effect. Electricity, gas and water supply-sector production prices rose 6.4% and in mining and quarrying the same rose by 3.2%. In industrial processing, prices grew by 1.9%. January was the fifth subsequent month of deteriorating prices in the construction and assembly production. The reported drop was equal to 0.6% compared to December 2002 and to 0.4 % over the twelve-month period.

In February 2003 the structure of replies to questions from an Ipsos-Demoskop survey, based on which the analysis is conducted of individuals' inflationary expectations, improved slightly in terms of the impact on the quantification of the expected inflation rate. At the same time, February witnessed a further decline in the current rate of inflation. Owing to these two factors, the quantified measure of inflationary expectations of individuals declined in comparison with the replies of a survey conducted in January 2003, reaching a level of 0.6%.

Meanwhile, the inflation rate expected by banking analysts in the month preceding the same month of next year (i.e. December 2003) fell by 0.3 percentage points to reach 2.3%, whilst the average annual inflation rate for 2004 is estimated to be 2.5%, or 0.2 percentage point below January's forecast. The expected 2003 year-end inflation rate was 2.3%.