

Warsaw, 29 March 2006

## INFORMATION FROM THE MEETING OF THE MONETARY POLICY COUNCIL

held on 28-29 March 2006

**The Council decided to leave the NBP interest rates unchanged, i.e.:**

**reference rate 4.00 % on an annual basis;**

**lombard rate 5.50 % on an annual basis;**

**deposit rate 2.50% on an annual basis;**

**rediscount rate 4.25% on an annual basis;**

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Since the Council's meeting in February 2006, the forecasts of inflation and economic growth in the euro area for 2006 have been slightly revised upwards. In February 2006 the annual growth rate of consumer prices in the euro area decreased to 2.3% from 2.4% y/y recorded in January, and GDP growth in 2005 Q4 reached 1.7% y/y, falling slightly short of the expectations. In the United States, CPI inflation decreased to 3.6% from 4.0%. From the February meeting of the Council to 27 March 2006, oil prices increased (Brent oil price rose by USD 2.8 per barrel, i.e. by 4.6%). The average Brent oil price in March was by 3.0% higher than in February. March was another consecutive month which saw the rise in the average price of this commodity in 2006 as forecasted by analysts in the Reuters survey (by 1.8% as compared to the previous month's forecasts). Still, uncertainty persists as to the effect of the increase in oil prices on economic growth and inflation.

The data on national accounts in 2005 Q4 confirm that since 2005 Q2 the economic growth has accelerated. GDP growth in 2005 Q4 reached 4.2% y/y and hit its highest level since 2004 Q3. 2005 Q4 saw acceleration in the growth rate of gross fixed capital formation (up to 9.8% y/y) and domestic demand (up to 5.0% y/y) coupled with decreasing contribution of net exports to GDP growth (-0.8 percentage point as compared with 2.1 percentage points recorded in 2005 Q3).

The upward trend in the annual growth rate of industrial output observed for the last seven months points to a strengthening recovery in industry, in particular in the manufacturing sector. In February 2006 the growth of industrial output exceeded the expectations of the majority of external forecasters and the NBP, and amounted to 10.1% y/y. At the same time, GUS (CSO) revised upwards the data on output growth in January 2006 (from 9.5% y/y to 9.8% y/y). In seasonally adjusted terms, growth in industrial output in February amounted to 9.8% y/y as compared to 7.4% y/y in January 2006. The drop in the construction and assembly output was lower than in the previous month (-3.5% y/y as compared with -7.8% y/y in January and 0.6% y/y against -3.7% y/y, respectively, in seasonally adjusted terms). The drop in the construction and assembly output resulted mainly from unfavourable weather conditions. The growth of retail sales – just like in January – exceeded the expectations and amounted to 10.2% y/y in nominal terms. The growth of retail sales in real terms was broadly in line with the nominal growth rate and hit its highest level since April 2004. Higher growth of retail

sales was coupled with increasing growth rate in household lending: consumer loans (increase of 19.3% y/y in February) and housing loans (increase of 42.6% y/y in February). After the period of corporate lending decline in annual terms that was observed between May 2004 and April 2005, the growth of corporate lending is now positive and accelerating (increase of 4.6% y/y in February as compared with 3.5% y/y in January). The growth of corporate lending might be limited by the fact that enterprise hold significant own funds associated with their good financial results in 2005.

The accelerating economic growth increases the demand for labour. Since December 2004 the employment in the corporate sector has been steadily growing. In February the employment in enterprises was 2.5% higher than a year before (as compared with a rise of 2.6% y/y in January). According to BAEL (LFS) in 2005 Q4 there were 2.4% more persons working in the economy than one year before. The growth in the number of persons working outside private farming is soaring (a rise of 3.5% y/y in 2005 Q4 compared with 3.7% y/y in Q3). The rise in the demand for labour is coupled with an increase in economic activity recorded for the past three quarters. In 2005 Q4 the number of the economically active increased by 0.8% y/y. Along with that, unemployment was still declining in annual terms (according to BAEL, the unemployment rate in Q4 was 16.7% against 18.0% a year before, whereas according to the labour office data it stood at 18.0% in February as compared with 19.4% a year before).

The economic recovery is accompanied by acceleration of wages. In February the wage growth in the enterprise sector amounted to 4.8% y/y (against 3.6% y/y in January). The data for 2005 Q4 revealing the accelerating wage growth in the economy and a rise in the number of working persons and GDP confirm that unit labour cost growth in the economy has increased. In industry the joint increase in productivity in January and February 2006 amounted to 8.6% y/y, while the growth of average wage equalled 4.0% y/y. It should be emphasised that a necessary condition for a sustained acceleration of economic growth which would not pose a threat to the achievement of the inflation target is that – in the longer run – the growth in wages does not outpace the growth in labour productivity.

The annual consumer price growth in February was at 0.7%. The impact of medium-term macroeconomic factors on inflation overlapped with the influence of short-term developments. In March the GUS re-estimated the CPI in January in line with a new weight structure used in its calculation. As a result, the growth of consumer prices in January was downward adjusted by 0.1 percentage point (to 0.6% y/y). The low increase in inflation in February 2006 against January resulted from an increased growth of food and alcoholic beverages' prices, which was observed despite a still large food supply. At the same time, the rise in inflation was curbed by a larger-than-expected drop in fuel prices, in connection to the fact that distribution margins were held at a low level. Additionally, the drop in inflation was supported by decreasing prices of clothes and footwear.

Core inflation indicators remained low (in February they ranged between -0.3% y/y and 0.8% y/y). The low level of all core inflation indices confirms continuation of low inflationary pressure. In March, inflation expectations of households remained low (0.6%, i.e. exactly the same as in the previous month).

February 2006 saw an increase in annual growth of producer prices in industry up to 0.7% y/y as compared to 0.3% y/y in January (-0.1% m/m against 0.4% in January). This rise occurred even though the effective exchange rate of the zloty was stronger than a year before.

As a result of both external and internal factors, since the last meeting of the Council the zloty has depreciated by 5.0% against the euro and 3.9% against the US dollar.

Short-term factors may with large probability be conducive to inflation remaining below the inflation target in 2006 Q2 and possibly also in Q3. In turn, in the projection horizon (i.e. in 2007 and 2008) the growth in domestic demand and unit labour costs will be gradually pushing inflation back to the target (2.5%), as it was presented in the January projection. The data significant for the

# NBP

projection (BAEL data for 2005 Q4) and the interest rate cuts in January and February 2006 support this assessment.

The Council maintains its belief that implementing an economic strategy focused on creating conditions which ensure introduction of the euro at the earliest possible date would be most favourable for Poland and would contribute to a higher long-term economic growth.

The next meeting of the Council will be held on 19 April 2006 and will focus on the draft *Inflation Report*. *The Report* will be finally approved at the Council's meeting held on 25-26 April 2006.