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Monetary Policy: Goals, Conditions and Limitations

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Monetary Policy: Goals, Conditions and Limitations[1]

Summary

The paper discusses the objectives of the monetary policy in Poland and elsewhere. It also dwells on factors and conditions, which impede the monetary policy in fulfilling its goals. Finally, the author deliberates limitations of the monetary policy with regard to what it can reasonably achieve, and on the contrary, what is normally beyond its reach.

[1] The paper originated from a lecture delivered by Grzegorz Wójtowicz on February 21, 2001 at the Leon Koźmiński Academy of Entrepreneurship and Management in Warsaw.

Goals, i.e. where the policy is heading for? Conditions, i.e. what is impeding it? Limitations, what is the monetary policy capable of or (if someone wishes to say) what should it achieve?

I believe it is worth starting our meeting in this college by looking back at the history of price growth. We can calculate, drawing from many books and publications, that in Poland money had been losing its value for a considerable period of time; as I said it can be calculated although it does not appear in course books. If we consider the course of events in the Middle Ages and Modern Times we can estimate that an annual price growth in Poland amounted to less than 1%. One could say that this is indicative of an utter stability. However, if we take a closer look at this and compare the situation in Poland to what was happening in England, which used to be and still is a haven of stability, it is easily noticeable that an annual price increase in England was two times slower – i.e. it amounted to 0.5% annually. England is the only country that can be used as a handy comparison as far as the stability of the monetary system is concerned, because England's monetary system remained relatively intact from the moment it was introduced in the 9th century until 1971. In Poland, however, practically the denarius, grosz and the Polish złoty quickly lost their purchasing power. Nevertheless, contemporary changes were most drastic. In the Newest Period England saw its prices grow by 5% annually, while in Poland this growth was not even two times but ten times faster. Hence, our contemporary economic situation should make us think profoundly and take decisive steps to look after the monetary stability. The only excuse for a different approach could be the ignorance of history, if such ignorance can serve as an excuse at all.

What happened in the Newest Period? Two catastrophes should be mentioned here. First one, experienced – for most of you here – by our great grandparents and my grandparents, was the inflation disaster that swept through Poland in the first years of the country's regained independence from 1918 to 1924. It could be easily calculated that back then, i.e. between January 1923 and January 1924, the annual price growth index amounted to 70.000%. No wonder that this catastrophe led to the exchange of currency. In April 1924 Polish mark was replaced by zloty, where one złoty was equivalent to 1 million 800 thousands Polish marks. Other countries experienced even a greater hyperinflation. Let me remind you that according to the accepted definition, a hyperinflation starts when prices grow by 50%

during three consecutive months. Back then, we were experiencing this kind of hyperinflation for a long period of time. The fact that hyperinflation was even worse in other countries – e.g. in Germany – should not make us too conceited.

The second instance of such an inflationary catastrophe occurred in our times. Another exchange of national currency where the introduced new zloty was equivalent to 10.000 old złotys is clear evidence of that. This time we did not experience as drastic annual price growth as we did before, but the record set in February 1990 amounted to 1.300%. The prices grew by this percentage during the period of 12 months, through February 1990. And what about recent years? Has it been really improving? What has happened since the year we exchanged and appreciated our currency? We have already lost 57% of its purchasing power, i.e. more than a half, and it has only been 6 years since the introduction of the new złoty.

And this figure, which in my opinion is worth remembering, is about to decrease which means that we will continue to see the purchasing power of our currency drop. This may be the right moment to say that we have nothing to boast about and this is also borne out by statistics. If someone wants to verify it, I recommend any issue of the IMF's International Financial Statistics together with a sheet of paper and a pencil to calculate this. You can find there some data about the inflation in 120 countries. Where is Poland's place on the ranking list? About 90 countries are ahead of us and 30 behind us. If we talked about sports the situation would be far from satisfactory. In inflation this is our standing and it has been this way for years. It's not just a recent phenomenon.

For a couple of years now we have been classified as an emerging market. It would suffice to have a look at any issue of "The Economist" and see that, among 25 countries, Poland is lagging behind and ranks the 21st, 22nd with regard to the price growth ratio.

It is a common knowledge that 12 countries are aspiring to join the EU. How does Poland look among these countries? 9 or maybe 10 countries outpace Poland and we merely exceed 2 or 3 countries with regard to inflation. So, as a result, we can say that our position is rather poor in the face of international competition. In another 'sports event' that was earlier referred to as the history of price growth, our standing is also rather poor. Because of that, having inflation on top of our agenda makes sense, especially in Poland.

The bottom line of conclusions drawn by the international community, and which should also be ours, is that we should look after the stability of prices and, what it entails, the monetary stability.

What is the stability of prices?

Practically, there is no single definition but we can base our discussion on what was accepted two years ago by the European Central Bank which supervises the Eurozone. According to the ECB, we deal with the stability of prices when their growth falls within the range of 0% to 2%. This is a way to express distaste for both deflation, which never serves the economic development or any development well, and for inflation. So this is all about the aversion to deflation, when money is deficient and to inflation where there is too much money from the perspective of a well-functioning economy. A 2% growth of prices is justified by history. There was always something wrong, for instance crops could be poor and there was not enough grain. Hence, these insignificant growths of prices served as natural inflation rates in the past.

Nowadays, there are many ways to deal with failed harvests, e.g. by increased imports because the harvests of grain were not so bad all over the world, or by using reserves or grain substitutes. Nonetheless, there is another significant factor these days: technological progress, which makes some products better and better and also causes other new products to emerge, with prices relatively higher than the prices of products we use on a daily basis. These high-tech products used to be radio sets, telephone sets, TV sets or cameras and now these are computers, video cameras and mobile phones. With time these prices will drop but the first reflex is to increase them. So if there were no other price growths the growth resulting from the technological progress would set the level of price growth above zero. This factor alone signifies that inflation may occur – inflation understood as any price growth regardless of its character, which is in a way natural, or which is also referred to as the changes of relative prices. As of today it can be disregarded. Here, we shall not probe into these theoretical intricacies. We want to keep the price growth relatively low.

The world, as I said earlier, or at least most countries have reached the conclusion that the stability of prices should be the most important objective of the monetary policy. Actually, this would be the outline of the answer to the question about the goals of monetary policy. Life turns out to be more complicated, though. The declaration that prices should be stable does not answer the question how to achieve such a goal, what actions should be taken, or – as it is fashionable to say in the monetary policy sector – what strategy to adopt, what to do with exchange rates, how to make sure there is not too much money on the market etc. As a result, we deal with a mosaic of different monetary policy strategies. Taking into account one source, i.e. the International Financial Statistics, we can have a closer look at this mosaic, we can see what is the definition of different strategies adopted to attain the stability of prices in different countries.

Many countries apply the method of exchange rates anchor. We also decided to adopt a stable conversion rate of złoty into US dollar in the period 1990 - 1991. But we have to admit that such a stiff linkage of one currency to another, as to gold or silver in the past, is not the most popular approach nowadays. Some countries, however, still employ the exchange rates anchor method. Stable exchange rates are to curb inflation. Who does it this way? There are few examples of this strategy among developed countries. This is done in Denmark that links its currency to the Euro, because one day it is likely to finally join the Eurozone. Among the emerging markets Argentina, Hong Kong and Turkey also use the exchange rates anchor. Among the countries under transformation Bulgaria, Baltic countries and Hungary use exchange rates anchor.

Another strategy may be monitoring growth of the money stock. The so-called money aggregate is set and it may be defined in a number of ways. In the past there was a tendency to control inflation through monitoring the monetary target. This kind of approach was popularised by Bundesbank, a well-regarded western German bank. It is true that Germany has occupied the lowest positions as far as inflation is concerned in all macroeconomics course books that publish such ranking lists over the last several dozen years. But if we take a look at Bundesbank's achievements with a critical eye, we may observe that during 20 years of planning the amount of money Bundesbank missed 9 times. Why? It is because the money that appears on the market (the supply of money) is inextricably interwoven with the demand for it. The demand for money i.e. the willingness to store it in many different ways, not only in form of cash, as used to be the case, but also in form of bank deposits etc. is a changing phenomenon. Furthermore, the whole array of new financial instruments is emerging, which may encourage us to save money and this, in turn, does not have to be tantamount to inflation. Currently, few countries apply the money aggregate method as a way of controlling the supply of money. Among emerging markets this is China, and among transforming countries this is Slovenia. Conversely, there are many countries that treat the amount of money as one among few goals of their monetary policy.

Following the criticisms of money supply monitoring and fixed exchange rates a new strategy of the monetary policy has emerged in the 90s, i.e. the so-called direct inflation targeting. Countries do not employ indirect goals, do not set exchange rate anchor, do not decide how much money should be present in their economies and inflation becomes the only goal of their monetary policies. Following New Zealand, which applied this approach as early as in late 80s, some developed countries adopted this method – the United Kingdom, Australia, Canada and Sweden and a few countries ranked as emerging markets – Chile, Israel and recently Brazil, Thailand and South Africa as well as some countries under transformation such as the Czech Republic followed by Poland in 1998.

There are also countries that have more than one goal. Countries that face or faced economic crises, e.g. Korea, Mexico, Russia and Romania, use a multiple goal methods.

Finally, there are countries that can afford to heed different indicators and to adjust their monetary policies with more flexibility. However, these countries are among those that decide about the state of world affairs through their money. Different indicators are used by the Eurozone, though two major ones could be distinguished here (i.e. inflation and money), the United States and Japan and among smaller countries different indicators are used by Norway and Switzerland. Countries that have not worked out their own monetary policy strategy yet or which believe that a flexible system is the best solution under certain conditions also belong to this group. Among large countries that would be India and among smaller ones that would be Slovakia.

All the countries mentioned above constitute 90% of the world economy. It gives a certain idea of the differentiation of monetary policy. It is obvious that there is no single rule, there are many strategies which stem from different histories, which were born when a given approach had to be dumped because it turned out fruitless or when examples and achievements of other countries were strong incentives etc. In Poland our inflation was shrinking fast in the beginning of the transition period. Then, over next 8 years we had a double-digit inflation. We held on to different goals while designing our monetary policy and we were often inconsistent but at the same time we had a chance to observe other countries' experiences. Finally, we chose the strategy of the direct inflation target. Numerous consequences followed this choice. Particularly, the exchange rate has been liquid since April 12, 2000. Increase of money, as specified by the Central Bank, serves solely as an estimate forecast. In the era of globalisation and open economies (and the Polish economy is almost an open one) and robust flows of capital, it would be pointless to monitor exchange rates. Moreover, our experiences from 1998 of Asian and later Russian and Brazilian crises were additional factors indicating that it was impossible to keep one steady exchange rate.

How to implement monetary policy, what conditions it, i.e. what impedes monetary policy? I think that the so-called inflationary climate is crucial here. Is it a common goal to eradicate inflation or maybe nobody seems to be bothered by the issue of inflation? The inflation climate constitutes a combination of several factors. First of all these are the so-called inflationary expectations. Households, companies, banks, foreign investors never cease to have certain expectations of the future. We all project potential price growth. In principle, everyone will confirm that there are no sound bases for such projections, and it does not refer to Poland only. Different studies, especially questionnaires, are carried out and they enable to perform certain measurements of inflation expectations of households, companies or banks. Under present conditions studies confirm that inflation expectations are inert i.e. we look back at inflation and we do not believe that the future will be any brighter. After a year with inflation on the decrease, the expectations, at least in some circles, become more adaptive. We look at what has happened recently and we tend to slightly change this inaction. The fact is that we do not observe what is broadly discussed by the theory, i.e. rational expectations aimed at what should really take place taking into account the implemented anti-inflation policy. On the whole, everyone is trying to consume the inflation on the basis of his or her expectations.

Let me briefly touch upon the group of foreign investors. They possess a good instrument, because they look closely at the profitability of securities they invest in, what is the outlook for long-term interest rates but it is not enough to decide about inflation and predict its decrease. Rates vary because of the domestic inflation but also because of changes in interest on similar securities throughout the world, for example interest on German securities. Actually, the difference between interest on securities in Poland and Germany does not tell us everything about the inflation, because it tells us not only about the situation in Poland but also what is happening in the German economy or even globally. This is a kind of measurement that does not have to give a crystal clear picture.

Another result of inflation expectations is something commonly known, i.e. indexation, the second important component of the inflationary climate. Salaries and wages, social benefits, costs and producer prices are still determined by inflation expectations, and much more by what has already happened than by what will happen. Generally, under such circumstances, everyone tries to maximise their earnings. Budget policy and monopoly position of several companies evidently support such a situation. Our privatisation was partly turning state-owned monopolies into private ones. That is why we have oil and telecommunication markets on which market forces are less powerful than the position of big enterprises.

Our budget policy is what it is. The scale of deficit is not that important, because it is not so big when compared to other countries, but as everywhere in the world deficit stimulates the demand and in order to finance the deficit privatisation is carried out and as a result of a helter-skelter privatisation state-owned monopolies are sometimes turned into private ones. Despite the above, regulatory measures applied to prices and taxes in order to increase budget revenue are nothing else but a process that stimulates further inflation. I also think that as far as the protection of our agricultural market is concerned we can boast some successes, which do not have to be beneficial from the inflationary perspective. It is always possible to find supporting arguments, especially ones of political nature, but facts remain obvious. I dwell longer on this issue because in Poland each monetary unit has a significant bearing on inflation, because in Poland we deal with a relative shortage of money, in other words the level of monetization in our economy is low. Disregarding the reasons for such state of affairs it should be noted that the amount of money in Poland corresponds to 40% of its GDP. Worldwide it is, on average, 70% so in Poland it is almost two times lower. This means that in other countries it would take two currency units to cause the same demand-wise and inflation-wise commotion that is caused by a single currency unit in Poland. In short, money in Poland has a doubled impact.

A short level of monetization and the hitherto level of market reforms all contribute to the reduced size of our financial markets. If our financial markets are small, then the influence of the monetary policy, which operates through financial markets, is also limited and this should be taken into account. In other words, markets like to be dictators themselves instead of being dictated to.

Finally, as I have mentioned earlier, we are an open economy and, as a result, we follow trends that are present on financial markets. Because the capital pours in, because certain operations related to the złoty can be carried out on different markets thanks to derivative instruments, because Poland is considered an emerging market and at the same time a future EU member and consequently we are regarded a worthy partner of various operations. Under these circumstances it would suffice if any large company borrowed a large amount of money abroad, e.g. USD 1 billion, which makes PLN 4 billion. Whatever the standards, this is a lot of money and there is immediately a certain deal of commotion on the market. So, a small country but with big problems. These are the situations that have to be taken into account in the monetary policy. It should be made clear here that in the monetary policy not all information is at hand and the Monetary Policy Council not always knows more than others do. We are not yet capable of successfully predicting the future, which does not refer only to Poland, and such a skill is very important to pursue any monetary policy. So inflation projections should be made. The so-called core inflation, i.e. a kind of inflation that refers to products that are not subject to seasonal fluctuations or price regulations, should be researched. Prices of assets should be examined, which refers not only to shares but also to real estate prices etc. because this may create the impression of affluence and the situation is likely to seem better than it really is. And this may be the reason why inflation may be even stronger. Inflation expectations mentioned earlier have to be examined. The monetary policy transmission has to be examined, i.e. what is happening and how does it influence inflation when interest rates change, because we know so little about this. We should also investigate the relations between money and inflation because we also know very little about this. This is a whole research field where we observe some progress but progress has one unpleasant feature: it is evolutionary so, in short, slow.

Another important issue is credibility. Our attitude is different towards a credible central bank and still different towards a central bank that is not considered credible. Generally, we could say that the Polish Central Bank is a fairly credible institution but this is a too general opinion. If we take a closer look at details, however, we have to admit that central bank's credibility could not have been built on a long years of double-digit inflation or on many emergency solutions the bank had to resort to. Banks still remember credit ceilings, i.e. limitations on the amount of granted credits that had to be applied a couple of years ago, and people still remember that the central bank used to collect deposits which is a behaviour typical of commercial banks.

All these factors and especially applying different objectives and solutions for the monetary policy have made this credibility what it is today. This credibility is not of the worst kind but, surely, it is not enough to effectively fight inflation. And finally there is one more important element that I include in conditions but it could as well be a part of limitations. This is the issue of shocks, i.e. extraordinary situations. We have gone through many such shocks: Russian crisis, oil prices growth and agricultural production drop in Poland. This all renders the monetary policy ineffective, inadequate to these crises. Certainly, some solutions are being tried. Probably the most advanced method of fighting crises from the perspective of the objectives of monetary policy, i.e. low inflation, is studying the restrictiveness index of the monetary policy. What is this? This is all about adding interest rate to exchange rate provided that the weight of the two components of the aforementioned index. New Zealand tested the method. Unfortunately, we still know too little about this. The example of New Zealand is encouraging and it is likely that this index, which nowadays is perceived in theoretical or cognitive terms, will become an effective instrument of the monetary policy to satisfy those ill-disposed towards the floating rate or high interest rates.

Now it is time to consider limitations. What is the monetary policy capable of and what should it achieve? It can make use of available instruments. If the exchange rate is floating, i.e. nobody can fix it and only the change of interest rates may make it stronger or weaker, then the exchange rate is not the goal but rather the result of a monetary policy and operating market forces. Therefore, the only instrument available is the interest rate and so is the case in Poland. There are, of course, some ways of withdrawing money surpluses from the market or, in other words, fighting the so-called over-liquidity, which is present in Poland. First are the reserve requirements. Banks are obliged to transfer a certain percentage of our deposits to the central bank. Second is refinancing. If a bank does not possess enough money it borrows some from the central bank. Third, open market operations. Nevertheless, all the above are only auxiliary instruments. The most important one used to fight inflation is the interest rate established by the central bank. If there is one instrument there should be one goal: the inflation.

This is an important statement which indicates that one gun cannot be used to shoot at two different targets simultaneously. The major target in Poland is the inflation below 4% in three years. Nevertheless, if we select only such a medium-term objective, we would deprive ourselves of any guidelines regarding our actions before that aim is achieved. Hence, short-terms goals are being set as well. The goal for this year is to bring inflation down to 6%-8%. With one instrument on agenda the monetary policymakers should closely watch the transmission, which I have mentioned earlier. What happens if the instrument is utilised**? In other words, what happens if there is an impulse such as an increase or decrease of the interest rate?** The increasing number of studies provides us with rather pessimistic conclusions. It is often said that the monetary policy may achieve any goals only after 18 months and that is why inflation goals should be established for such a period. I do not really approve of this. I am of the opinion that the even the very atmosphere evoked by expected interest rate alterations entails certain reactions, potential changes are being discounted beforehand on different markets and therefore I think that emotions that are stirred up once the signal has been sent makes the effects of the monetary policy much swifter. I think that as early as between the 2nd and the 3rd quarter significant changes occur in terms of demand development and inflation pressure, and this process influences the inflation. This is, of course, a highly subjective judgement. Science has always attempted to be a part of the monetary policy and has always reached the conclusion that the monetary policy is more of an art than a science. Therefore, neither course books nor computers will replace people involved in decision-making processes. Human knowledge, experience and intuition (a collective one, in this case) are indispensable. Let me point to the fact that the Monetary Policy Council operating in Poland and its collective decisions are the solutions recognised worldwide. The studies I am aware of quote that 90% of decisions made by central banks are collective ones and only the remaining 10% are individual.

Still dwelling on monetary policy's limitations I think that a European perspective, i.e. the integration with the EU is also a limitation. We should embrace ourselves for the fact that all commonly known criteria will have to be fulfilled: low inflation and preferably low long-term interest rates, relatively stable exchange rate in relation to the Euro, which means that at a certain point we will have to bind our currency to the Euro for two years and, last but not least, fiscal criteria of relatively low budget deficit and public debt should be met. The prospects of low inflation and the strong złoty are tantamount to the replacement of złoty with the Euro. It calls for mighty efforts to replace the national currency with a European one. Probably we are still getting too emotional about this. Maybe we will lose our sentiment when we consider that proud Germans gave up their proud Deutschmark and recently Greeks abandoned their drachma that goes back to the Antiquity, whereas our złoty is only half a millennium old. All this is likely to make us more pragmatic when we consider what awaits us, money users, in the nearest future.

In Poland, as in many other countries, we use the Consumer Price Index. Unlike many countries, however, Poland applies a 12-month index (January to January, February to February and finally December to December). If memory fails, and it does fail many monetary policy observers, then they should refer themselves to statistical bulletins and see what was their viewpoint, what they said during the periods when these indexes were drastically swaying. When in February 1999 a 12-month index was 5.6% the problem of inflation was non-existent in Poland. It was two years ago. On the other hand, when following July 2000, i.e. in August2000 the index soared to 11.6%, it sparked off some kind of a discussion, not always based on intellectual reasoning. I want to point out to the fact that using a 12-month

CPI is a little treacherous. Operating this index and relating it to interest rates may lead to accusations of demagogy. After all, it is hard to compare an index that changes by 1.1 points within a month, and this was the case as of January when compared with December. I am talking about a recently announced inflation. The average annual index is applied worldwide. In 1999 it was 7.3%, a single digit index for the first time in years. I would like to point out that this average annual index reached 10.1% last year, which means it returned to double digits. This average annual index, calculating 12 months in comparison with the previous 12 months was rising throughout the year except for December.

This is a completely different view of inflation. If one is seeking specific measurements for calculating inflation, including the so-called core inflation, the analysis of the average annual inflation is a good thing to start with. The average annual inflation is mentioned usually at the very end of popular two-sentence long interviews about inflation with many people. And this is the index used in the European Central Bank and elsewhere and the one that serves us as a comparison platform with the world. In future we have to switch to the average annual index. This index was also rising in the EU last year. In Ireland it even leapt to 5.7%. The index, which we mention as an inflation goal should not be too ambitious. It has to be feasible: 4% index in future and 6%-8% index today. We used to have an ambitious index in 1999 and we did not manage to achieve it, so let us forget about ambition. My point is we should achieve a given index and keep it on a steady level. So if we talk about 4% as at the end of 2003 it should never re-occur later on unless there are some serious shocks. It is all about keeping inflation at a certain level.

I suggest that we give up describing anything it terms of “ambitious” or “non-ambitious” but rather use the notion “feasible” and not feasible for a while but feasible in the long run and maybe then the level below 4% could be referred to as European one. Back when the Eurozone was to be formed a country was greenlighted as a member thereof if it had inflation below 2.7%. However, after the previous year it would be 3.4% rather than 2.7%. This and other criteria were established in Maastricht in 1992. But these criteria are political rather than economic. Why the budget deficit cannot be 3.5% of a given country’s GDP and has to be lower than 3%? Because something has to be agreed upon and if we are talking agreements we are talking politics. Are these criteria going to accompany us when we join the Eurozone? I do not know. This also refers to the low inflation criterion. Low inflation, but how low?

I want to say that we take into account the core inflation when specifying the inflationary goal. Some countries set the core inflation as the inflation goal. There are neither clear viewpoints nor coherent rules regarding this issue. The whole world has problems with that, not only us. The same is the case with the monetary policy transmission. I am saying that there has to be the sense of comfort in the monetary policy. When do we have the sense of comfort in place? When everything is written down, made public and it works out. What should be written down? Not only annual inflation or inflation for 18 months but also quarterly inflation, changes of exchange rate and interest rates. In this way we can achieve such a transparency of a policy that everybody "leaps with joy". But it turns out to be unattainable. Please note that there are double ranges for the inflation goal, even in most developed countries.

The problem is that December 31 is a 'sacred date' in Poland. This is a consequence of our Polish intellectual and planning tradition. This is our reality. We use the Consumer Price Index because this is the only one calculated by the Central Statistics Office. In many countries there are no time frames for inflation goals. There are no deadlines for inflation. The co-ordination of the fiscal and monetary policy is also very important. There is no order in the fiscal policy. The most important thing, i.e. the economic deficit that stands for trimming domestic savings we always lack is always worse from what has been announced. After all, we do not have the 2% promised last year but 2.7%. This year we hear 1.8% (it was supposed to be 1.6%) and even the most pro-governmental economists talk about 2.3%. What is happening? What is hidden behind these projections? What are the hidden differences as far as credit needs of the governmental sector are concerned? What is the planned timing? What happened to the deficit in January? Of course, the monetary policy does not have to deal with January but the monetary policy has to bear in mind that ¼ of the annual deficit has been consumed in January – within one month only – so relatively much was consumed, three times more than what is suggested by the calendar. So these are all the elements of the chaos that makes the monetary policy rough, sometimes, maybe even too restrictive.

Export is another important matter. Domestic demand influences export in 20%. The influence of the external demand amounts to 40%. Exchange rate amounts to 30%. Export prices amount to 10%. As far as the changes of exchange rate are concerned, their first echo can be observed in the first quarter and the second, with a certain delay, in the third quarter after a more drastic exchange rate alterations. In my opinion export is mainly determined by demand and labour costs that have become relatively high in

Poland. Labour costs are becoming ever more crucial element with a great impact on the competitiveness of our exports. As far as high interest rates are concerned, this problem is strongly connected with the issue of capital and savings. Inflation is not exactly the most important problem of our economy. In Poland, where inflation is fomented not only by expectations or indexation but also by consumers' aspirations, it is the domestic savings that constitute the main problem.

After all, Poles try to spend as much as the Western Europeans whereas their average income constitute 40% of the average income in the West. The issue of asymmetry should be mentioned here. Raising interest rates does not help too much to keep demand at bay but decreasing interest rates surely enhances demand. 1999 yielded enough evidence. One word on indexation. Let us look at those yellow pages in the "Rzeczpospolita" daily and note all those announcements made by the Central Statistics Office about price changes due to particular rises. Indexation makes the Central Statistics Office deal with calculation of numerous indexes. As far as reserve requirements lowered to 5% are concerned, they are becoming a more outdated instrument but they still help to keep the liquidity on an appropriate level. They will have to be lowered to 2% once we join the EU.

The last sentence. The level of monetization in a healthy economy rises when savings grow.