

Poland's economy – Financial Markets

August 2001

No 25

Main economic trends

- The pace of economic growth is decreasing rapidly. The growth of consumption and investment demand was significantly reduced.
- Financial output of companies is deteriorating. The profitability decreases.
- In June the current account deficit totalled USD 952m. In relation to the GDP, the current account deficit increased to 5.4% from 5.2-5.3% in May. June was a second month in a row of increasing current account gap. In cumulative terms, this year current account deficit and trade deficit are improving.
- June data on industrial output turned out to be much worse than market expected. Compared to June 2000 industrial output decreased by 4.8% and it declined by 2.8% against May this year.
- The situation in the labour market is unfavourable.
- Sold industrial output prices decreased by 0.4% m/m in May. In year-on-year terms, the prices rose by 0.9%, which means a significant fall in producer inflation. In June 2000 it totalled 8.9%.
- After two-month seasonal increase, inflation is again in a downward trend. It amounted to -0.1% m/m and 6.2% y/y in June against 6.9% in May. It was the first case of deflation in June since 1983. All five core inflation indicators decreased, too.
- In the first half of July a strong weakening of the zloty appeared. Starting from 6 July, the zloty rate was subject to sudden fluctuations. On Wednesday 11 July the zloty weakened to the level of 4.55 per US dollar on the market. From 13 July the market is more stable and the zloty rate does not exceed 4.30 per dollar.
- In the period since 22 June the yield curve in bond sector was quite unstable.
- The Monetary Policy Council cut interest rates by 150 bps at the meeting in June, which was substantiated with improvement of most factors impacting inflation. At July meeting the Council did not change rates. Another cut is possible in August.
- The Sejm passed the budget amendment increasing budget deficit by PLN 8.6bn from PLN 20.5bn. The Finance Ministry intends to finance the higher deficit by increasing by 50% the offer of treasury securities in the second half of this year.

Deviation of the zloty from the parity



Source: NBP, own calculations

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Highlights

Recently, there have appeared other symptoms of the weakening of Poland's economic situation. The pace of the economic growth in the second quarter was even lower than in previous quarters. The Finance Minister estimates that the GDP growth slowed down to 0.6-1.1% against 2.3% in the first quarter. According to estimation of the CSO, in the months to come, dynamics of domestic demand will remain low and will continue reducing the growth of the Polish economy.

Forecasts for other countries are disadvantageous from Poland's point of view. Downward verification of the economic development forecast in Germany means that Poland's GDP will also grow more slow. The improvement of the economic situation may occur only in the fourth quarter.

The lowering GDP is accompanied by decreasing inflation. The growth rate of the industrial output prices is astonishingly low - in June 2001 only 0.9% y/y against 8.9% in June 2000.

Profitability of companies is falling due to low domestic demand, weak GDP growth and high interest rates. Capital expenditure is going down. Companies having problems with placing their products on the market try to reduce costs by staff reductions and salary cuts.

The situation on currency market changed completely in July. The weakening of the zloty was caused by: difficult situation in public finance, the crisis in Argentina, political instability, first symptoms of balance of payments deterioration as well as economic slowdown. These factors will impact the zloty rate also in the near future.

As a result of problems continuing in Argentina, a considerable part of speculation capital flew out from Poland. This means that at present the risk of a sudden, strong fall of the zloty is much lower than before 6 July 2001. However, the zloty will probably continue to weaken. Effects of the future interest rate cuts will pose the risk for the zloty. The real interest rates are still high. If July inflation – as expected - will amount to slightly more than 5%, then the real interest rates will increase again to more than 10%. Then, the decision on interest rate cuts would not mean the loosening of the monetary policy, but would adjust interest rates to inflationary trend.

Other strong arguments for the interest rate cut are as follows: significant deterioration of industrial output results and investments going down rapidly.

It should be highlighted that the Polish economy is less and less liable to crises on emerging markets. We are still included in that group of countries, but we are perceived as a more and more secure country – we have high level of currency reserves and short-term debts are maintained at a moderate level. The proximity of the European Union and the steps undertaken to join the EU also work for our benefit.

Investors still show considerable interest in Polish debt securities. At present, it does not seem there should be problems with the sale of the increased issue of debt securities due to financing the budget deficit. Foreign investors accept the source of higher deficit in the form of the slowdown in the GDP growth, observed generally in the world economy. Problems of the Polish economy result from economic cycles and not from bad fundamentals.

Tab. 1. Inflation indicators

	02 2001	03 2001	04 2001	05 2001	06 2001	07 2001 P
Consumer Price Index (m/m, %)	0.1	0.5	0.8	1.1	-0.1	-0.3
Consumer Price Index (y/y, %)	6.6	6.2	6.6	6.9	6.2	5.1
Producer Price Index (m/m, %)	-0.1	0.2	0.2	0.0*	-0.4	0.0
Producer Price Index (y/y, %)	4.1	3.8	3.4	2.3*	0.9	0.3
Average monthly FX rate (USD, y/y, %)	-1.0	-0.7	-5.1	-11.5	-9.7	-

Tab. 2. Activity indicators

	01 2001	02 2001	03 2001	04 2001	05 2001	06 2001
Retail Sales Index (m/m, %)	-27.6	-1.7	17.5	4.0	1.7	-1.3
Retail Sales Index (y/y, %)	10.9	-0.2	0.1	1.9	4.3	0.2
Household loans (y/y, %)	31.3	29.4	25.7	25.0	22.1	-1.3
Industrial Output (m/m, %)	-8.9	-2.5	14.7	-7.7	3.1*	-2.8
Industrial Output (y/y, %)	10.1	0.1	2.9	3.6	-0.9*	-4.8
Exports, current prices (in payment terms, y/y, %)	27.4	17.9	10.3	26.2	2.7*	6.5
Imports, current prices (in payment terms, y/y, %)	16.8	-1.9	-2.5	5.3	10.2*	-0.8
Foreign Trade Balance (NBP, USD m)	-1499	-724	-907	-708	-1165*	-857
State Budget Balance (PLN m)	-5.1	-12.0	-15.1	-18.4	-20.4	-18.7

Tab. 3. Poland's Economy

	1997	1998	1999	2000	2001 P
Gross Domestic Product (fixed prices, y/y, %)	6.8	4.8	4.1	4.0	2.4
Individual Consumption (y/y, %)	6.9	4.9	5.4	2.4	2.2
Gross expenses on fixed assets (y/y, %)	21.7	14.5	6.5	3.1	2.0
Exports, constant prices (y/y, %)	13.7	9.4	-2.6	16.0	6.5
Imports, constant prices (y/y, %)	22.0	14.6	1.0	7.6	3.2
Inflation (average annual, %)	14.9	11.8	7.3	10.1	6.1
Inflation (year end, y/y, %)	13.2	8.6	9.8	8.5	6.0
Unemployment Rate (year end, %)	10.3	10.4	13.1	15.0	17.0
Current Account Balance / GDP (%)	-3.2	-4.2	-7.5	-6.2	-5.9
Public debt / GDP (%)	47.2	43.2	43.0	38.7	40.0

y/y – year on year; m/m – month to month; F - forecast
* corrected data

Source: CSO, NBP, own forecasts and estimations

Medium term forecast of Poland's economy



Tab. 4. Poland – medium-term forecast (average in period unless otherwise stated)

Category	2000	I kw. 2001	II kw. 2001	III kw. 2001	IV kw. 2001	2001	2002	2003	2004	2005
Interest rates										
1M	18.50	19.03	17.44	15.50	14.85	16.70	12.5	10.4	8.9	7.3
3M	18.78	18.53	17.09	15.30	14.70	16.40	12.3	10.3	8.8	7.2
6M	18.92	18.02	16.49	15.10	14.50	16.10	12.1	10.1	8.7	7.1
12M	19.01	17.61	16.07	14.80	14.30	15.90	11.8	9.8	8.3	6.9
Lombard rate	21.90	22.62	20.95	19.08	18.50	20.29	17.0	14.6	12.8	11.2
(end of period)	23.00	22.00	19.50	18.50	18.50	18.50	15.5	13.5	12.0	10.5
Intervention rate	17.90	18.62	16.95	15.08	14.50	16.29	13.2	11.2	9.4	7.7
(end of period)	19.00	18.00	15.50	14.50	14.50	14.50	12.0	10.0	8.5	7.0
Treasury bonds yields										
2L (bid)	17.37	15.59	14.90	14.50	13.60	14.65	12.3	9.8	8.7	8.2
3L (bid)	16.20	14.54	14.40	14.30	13.30	14.15	11.9	9.5	8.5	8.0
5L (bid)	14.00	13.12	13.40	13.10	12.00	12.90	10.2	9.0	8.2	7.8
10L (bid)	11.79	10.46	11.20	11.50	10.40	10.90	9.2	8.5	8.1	7.6
T-bills yields										
13-week	16.96	17.22	16.20	14.50	14.00	15.50	11.6	9.2	7.0	6.0
52-week	17.77	17.06	15.65	15.00	14.00	15.45	12.0	9.5	7.2	6.2
Exchange rates										
USD/PLN	4.3465	4.0876	3.9895	4.23	4.35	4.19	4.46	4.60	4.76	4.94
EUR/PLN	4.0110	3.7765	3.4884	3.71	3.92	3.75	4.15	4.28	4.33	4.40
EUR/USD	0.9172	0.9240	0.8744	0.878	0.900	0.895	0.93	0.93	0.91	0.89
Average depreciation (currency basket)	-4.2	-3.8	-4.8	11.1	2.6	5.0	4.6	3.1	1.6	1.9
USD/PLN (end of period)	4.1432	4.1000	3.9871	4.32	4.40	4.40	4.50	4.72	4.85	5.00
EUR/PLN (end of period)	3.8544	3.6170	3.3783	3.84	4.00	4.00	4.28	4.34	4.37	4.40
EUR/USD (end of period)	0.9303	0.8822	0.8473	0.890	0.910	0.910	0.95	0.92	0.90	0.88
Macroeconomic indicators										
Real GDP (y/y, %)	4.0	2.3	0.8	2.5	3.8	2.4	3.4	4.0	5.0	5.0
Industrial output (y/y, %)	7.1	4.4	-0.7	3.3	6.0	3.1	4.8	5.8	7.0	6.2
Inflation (y/y, %) (end of period)	8.5	6.2	6.2	5.6	6.0	6.0	5.0	4.5	4.0	3.6
Inflation (y/y, %)	10.1	6.7	6.6	5.5	5.7	6.1	5.7	4.8	4.2	3.7
Unemployment rate (%) (end of period)	15.0	15.9	15.8	16.4	17.0	17.0	16.5	16.0	14.5	13.5
Current account/GDP (%) (end of period)	-6.2	-5.3	-5.4	-5.7	-5.9	-5.9	-6.2	-6.5	-6.5	-6.8
Economic deficit/GDP (%)	-2.0	-	-	-	-	-3.5	-3.0	-2.8	-2.3	-1.9
Public debt/GDP (%)	38.7	-	-	-	-	40.0	37.5	36.5	35.0	34.0

Forecast date: 1 August 2001

Notice: Forecasts based on information currently available. WBK Treasury and International Division cannot guarantee that the indicators will follow the patterns as shown above.

Poland's economy

Deterioration in current account

Current account deficit amounted to USD 952m in June against USD 734m in May and USD 860m in June 2000. Deterioration in current account data resulted from dividend payments to foreign owners of Polish companies. It amounted to USD 300m and drove income balance to USD -400m.

Foreign trade data looks favourable. Trade deficit decreased to USD 857m in June from USD 1165m in May, which is the average from the last couple of months. Export and import figures were close to average values, too, amounting to USD 2.553bn and USD 3.410bn respectively. The strong zloty did not cause deterioration in exports in June. On the other hand, weaker imports point to low domestic demand.

In the first half of 2001 current account gap totalled USD 4.376bn against USD 5.611bn in the corresponding period of previous year. The ratio of C/A gap to GDP rose to 5.4% from 5.2-5.3% in May. Trade deficit amounted to USD 5.880bn against USD 6.871bn a year ago. In the January-June period exports increased by 14.2% y/y to USD 15.021bn and imports rose by 4.3% y/y to USD 20.901bn. In cumulative terms both current account deficit and trade deficit are improving.

From the monetary policy point of view, this data prove that the situation in internal deficit is improving. It should not be an argument against another interest rate cut.

In coming months export figures may worsen because of strong zloty and economic slowdown in Germany – the most important trade partner for Poland. Exports were the major engine of the economic growth last year.

We forecast that current account deficit will reach USD 9.5bn at the end of 2001, i.e. 5.9% of GDP

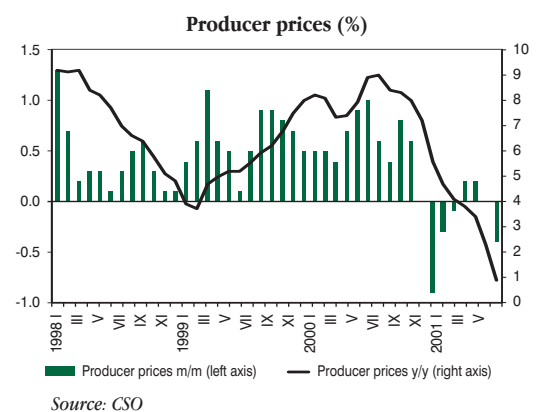
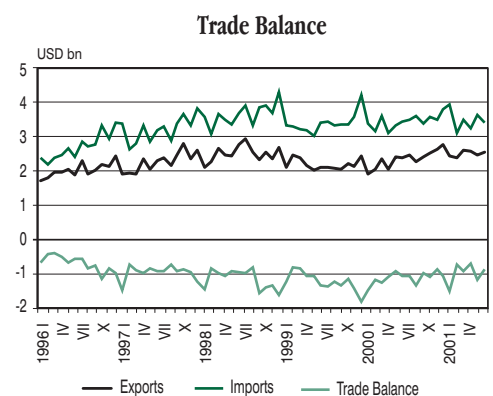
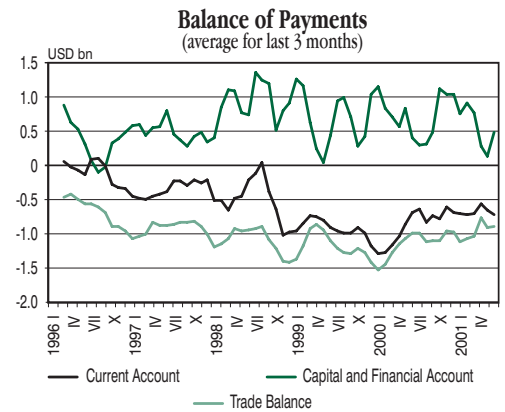
Strong fall in industrial output

June data on industrial output turned out to be much worse than market expected. Compared to June 2000, industrial output decreased by 4.8% and it fell by 2.8% against May this year. In January-June period production increased by 1.5% compared to the same period last year. Construction output fell even more than industrial one. In the first half of 2001 it was 9.5% down against the same period 2000.

An increase in producer prices is extremely low. In June they were 0.4% lower than in May. The annual growth decreased to 0.9% while a year ago (in June 2000) it totalled 8.9%.

The above data points to strong stifling of domestic demand. It suggests that in the second quarter further fall in GDP growth appeared. A maintaining for a year downward trend in producer prices index means that companies having problems selling their production lower prices, which will result in deteriorating profitability. This data increase the pressure towards interest rate cut.

We expect that in 2001 the industrial output will increase by 3.1% against 7.1% in 2000.



Poland's economy



Inflation comes back to downward trend

In June prices of consumer goods and services decreased by 0.1% as compared to May. The June fall in inflation resulted mainly from declining food prices (by 0.6%) and cheaper fuels (by 0.5%). It is worth pointing out, that prices of other groups included in consumer basket increased by only 0.1-0.2%. It was the first case of deflation in June since 1983. Year-on-year CPI amounted to 6.2% against 6.9% in previous month. After two-month seasonal increase, inflation is again in a downward trend. A fall in food prices that began in half of June continued in July. In July, the y/y inflation indicator may decline to 5.2% reaching the historical low since 1977. We estimate inflation at the end of the year at about 6%.

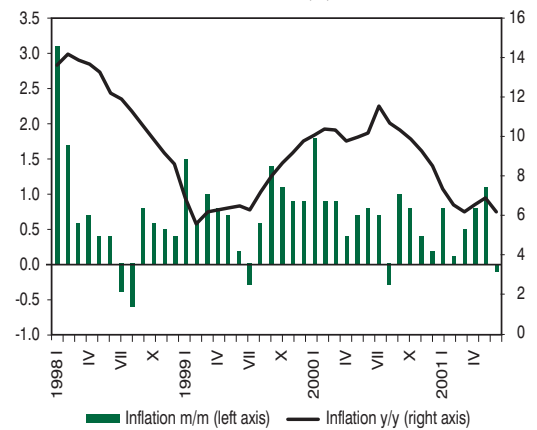
Core inflation is falling too

In June all five core inflation indicators decreased. They were in a band of between 5.3-6.8%. Core inflation with most volatile prices excluded fell most – it totalled 5.3% against 6.5% in May and 10.9% in June 2000. Inflation with most volatile prices and fuel prices excluded decreased to 6.2% from 7.0% in May. The core inflation indicator calculated with controlled prices excluded (prices that mainly consist of excise tax – like fuels or alcoholic beverages, or prices controlled in other way – for example energy) fell to 6.6% in June from 7.0% a month ago. 15% trimmed mean decreased to 6.0% from 6.5% in May. Net inflation is at the highest level among core inflation indicators since it does not contain prices of food and fuel that decreased in June. It fell to 6.8% in June down from 7.2% a month ago.

Economic growth

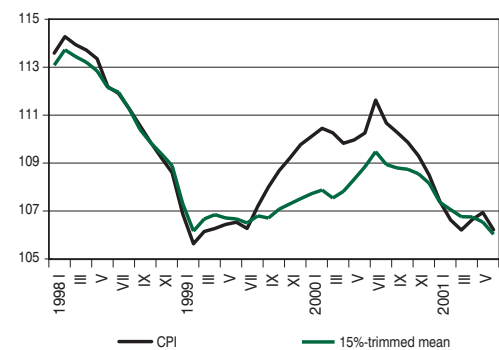
This year the economic growth in Poland will be at the lowest level compared with nine previous years. Since the third quarter 2000, the pace of economic growth has slowed down considerably. The CSO revised down data on GDP growth in 2000. It amounted to 4.0% instead of 4.1% released before. In the first quarter 2001 GDP growth totalled 2.3% against 2.4% in the fourth quarter 2000. Domestic demand was very weak – in the first quarter 2001 it dropped by 1.4% versus 1.8% increase in previous quarter. Within the first three months of 2001 consumption rose only by 1.2% and investments by 1.5%. The forecasts of the GDP growth in the second quarter 2001 are very pessimistic – it was probably below 1% (according to the Finance Ministry 0.6-1.1%). These forecasts follow from weak data on industrial output and construction output in April, May and June. According to our estimations, in the whole 2001 the GDP growth will decrease to 2.4% from 4.0% in 2000. The Finance Ministry estimates that GDP growth will amount to 2.0% in 2000. The forecast of Merrill Lynch is even more pessimistic – it forecasts GDP growth of 1.7%.

Inflation (%)



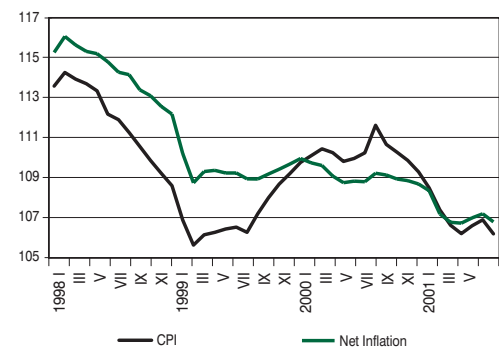
Source: CSO

CPI and 15%-trimmed mean



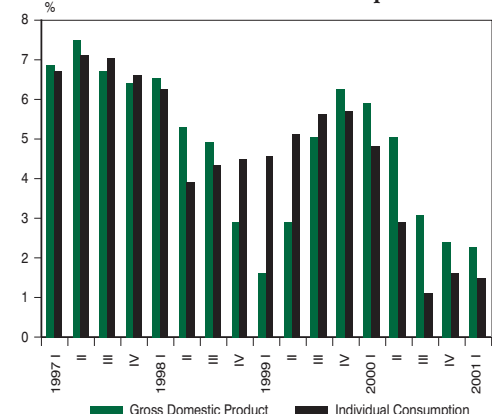
Source: CSO, NBP

CPI and Net Inflation
with food and fuel prices excluded



Source: CSO, NBP

GDP and Individual Consumption



Source: CSO

The zloty

In the first half of 2001, further systematic strengthening of the zloty took place (commenced in October 2000). The variance to the "old parity" increased to the record-breaking level of 15.9% in the middle of June from 7.2% at the end of 2000. On average, in the first half of 2001, the dollar was PLN 4.0383 against 4.2454 in the first half 2000. The average euro rate was PLN 3.6317 in the first half of 2001 against PLN 4.0747 in the first half 2000.

The strengthening of zloty was impacted by a number of factors, primarily: improving balance in the current account, very high (over 10%) real interest rates, expectations for cashflow due to privatisation and compensation payments for the III Reich slave workers.

In July, the situation on currency market changed completely. Starting from 6 July, the zloty rate was subject to sudden fluctuations. The main reasons of the nervous behaviour on the market were as follows: deterioration of the climate around the emerging markets (owing to Argentina) and uncertainty about the government decision on the 2001 budget amendment. On Wednesday (11 July), the market very nervously reacted to the information that the budget deficit may increase by a higher amount than proposed by the Finance Ministry. The zloty weakened to the level of 4.55 per US dollar on the market. The denial of this information and the governmental approval of the Finance Minister's proposal to increase the budget deficit by 8.6bn calmed down the market. From 13 July, the market is more stable and the zloty rate does not exceed 4.30 per dollar.

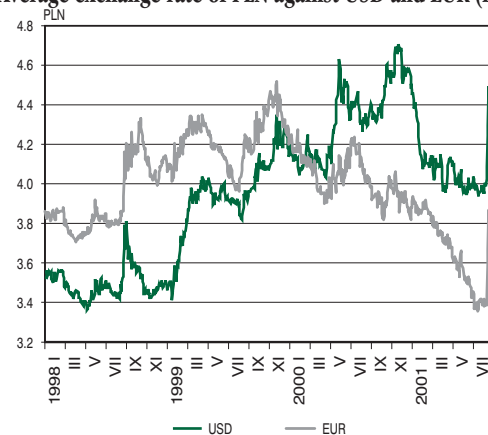
In the weeks to come, higher volatility of the zloty rate may continue on the FX market. For some time, still, the country's political situation and the situation on emerging markets may have a destabilising impact on the market. Deterioration of export and balance of payments figures (this scenario is possible in the second half year) will probably be another negative factor. In addition, it may turn out that not all privatisation enterprises, planned for this year, may come into effect. In the second half of the year, the current account balance may slightly deteriorate. The market stability would be threatened if, after the elections, the independence of the monetary policy was limited – SLD politicians have suggested recently.

The euro

The European currency has been weakening against the American since the beginning of 2001, dropping from USD 0.96 per EUR to USD 0.835 on 6 July. After the interest rate cut by 25 basis points in the USA (the main rate of federal funds is 3.75% now), made by the Fed on 27 June, investors hoped that this year's rate cuts will soon trigger economic growth of the American economy. However, the falling trend of euro against the dollar was stopped at the beginning of July. The euro hiked and strengthened at USD 0.881 on 26 July, and stayed between USD 0.875-0.88 afterwards. The dollar weakening was the result, among others, of the commentaries by the Fed Chairman, Alan Greenspan, who said that the slowdown period in the USA is not yet over, and by the USA President, George W. Bush, questioning the sense of continuing the strong dollar policy.

In the long term, the continuation of the euro upward trend is possible, both taking into account the gap in interest rates between the EMU and the USA (for the benefit of the euro) and still poor macroeconomic figures in the USA, not raising much hope for a quick improvement in the economy.

Average exchange rate of PLN against USD and EUR (fixing)



Source: NBP, Reuters

Deviation of the zloty from the parity



Source: NBP, own calculations

USD/EUR



Source: Reuters



Money and T-bond market

Interest rates

In the period since 22 June money market interest rates have fallen by 90 to 150 bps in the 1M to 12M sector and a bigger fall was observed in shorter terms. A fall in market rates resulted from the MPC's decision to cut NBP interest rates by 150 bps since 28 June. In the second half of July expectations of another interest rate cut by the MPC at August meeting resulted in a certain decrease in money market rates.

One-day WIBOR rates have been quite unstable over this period. In the last week of June, they exceeded the level of open market operations. The increase was caused by the lack of liquidity in the market due to approaching term of settlement of mandatory reserve by banks. In the end of July, approaching settlement of mandatory reserve resulted in overliquidity in banking sector and a fall in O/N rate to 10% on 30 July. In the second half of July, due to deterioration in sentiment in emerging markets and uncertainty in financial market daily rates increased above 17%.

Treasury bills

In July the supply of Treasury bills was reduced to PLN 2.9bn compared with PLN 3.2bn offered at regular Monday tenders in June. The supply of 13-week bills rose to PLN 500m from PLN 400m and the supply of 52-week bills increased to PLN 2.4bn from 1.6 bn in June. At July auctions the Finance Ministry did not offer 26-week bills. Compared to auctions in June the yields on T-bills decreased significantly in July given an interest rate cut in June. The average yield on 13-week bills fell by 123 bps, reaching 14.77% and the yield on 52-week bills decreased by 32 bps to 15.10%. The ratio of T-bill demand to T-bill supply improved significantly, totalling 4.81 for 13-week bills, 3.29 for 52-week bills and 3.56 on the average versus 2.00 in June.

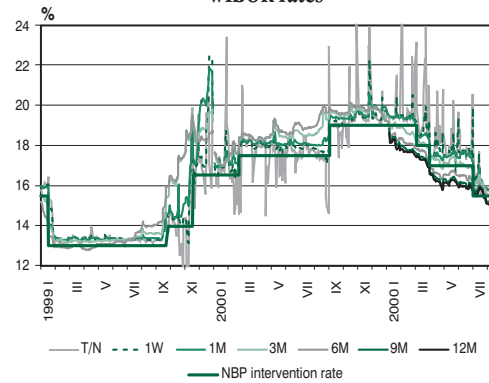
In the period since 22 June the yields on T-bills traded on the secondary market have been quite unstable. After interest rate cut the yields fell strongly, however, in the second half of July, given deterioration in sentiment in emerging markets they increased. In the second half of July the yields were decreasing, after sentiment improved and due to expectations of another interest rate cut. At the end of July, compared to 22 June the yields on T-bills were lower by 30 to 170 bps.

Treasury bonds

The yields on Treasury bonds rose at the tender held on July 4 for the second month in the row. The yield on 2-year bonds (OK 0403) reached 14.99%, up from 14.77% in June, and the yield on 5-year bonds (PS 0506) increased to 13.38%, up from 13.07% in the previous month. The supply of 2-year bonds was reduced to PLN 1.4bn, up from PLN 1.5bn, and the supply of 5-year bonds remained unchanged at PLN 800m. Investor demand was quite high for 2Y bonds but it was record low for 5Y bonds. The ratio of bond demand to bond supply totalled 5.6 and 1.3 respectively. At the auction of 10-year fixed-rate bonds (DS. 1110), that was held on 18 July the offer of bonds totalled PLN 400m. The demand was quite high amounting to PLN 2.7bn. The average yield totalled 11.69%.

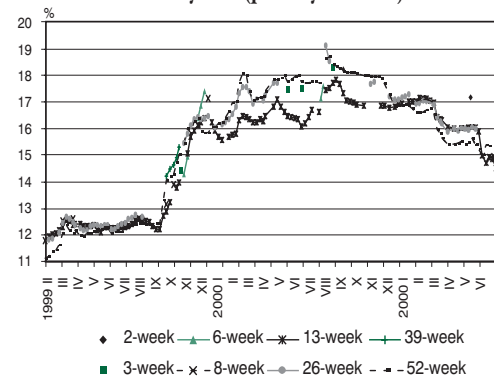
In the period since 22 June the yield curve in bond sector moved up and down like for bills. In case of bonds a fall in yields after NBP rates cut was weaker. In this period the yields on T-bonds fell by 20 to 50 bps.

WIBOR rates



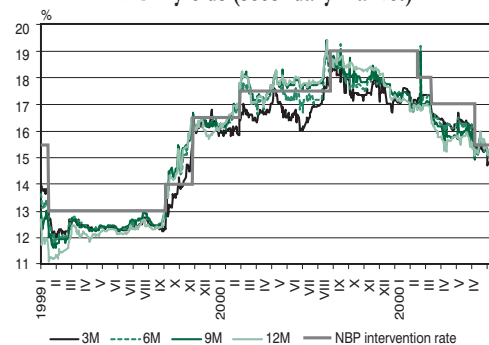
Source: BZ WBK SA Treasury and International Division

T-Bill yields (primary auctions)



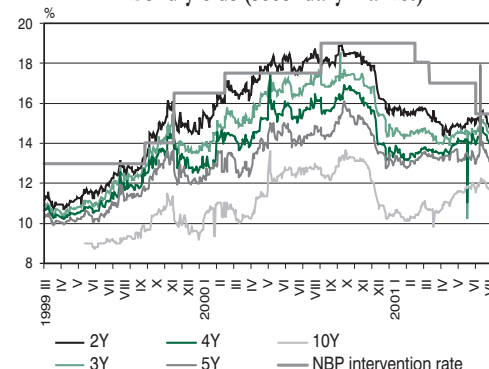
Source: BZ WBK Treasury and International Division

T-Bill yields (secondary market)



Source: BZ WBK Treasury and International Division

T-Bond yields (secondary market)



Source: BZ WBK S.A. Treasury and International Division

Monetary policy

In July no change in interest rates after June cut

From the beginning of 2001, the Monetary Policy Council reduced interest rates three times. Altogether the rates are lower than at the end of 2000 by 350 bps. Cutting the interest rates, the Council pointed to significant falls in inflation and prices of industrial output, to the diminishing deficit in current account and to very small demand pressure. On the other hand, concerns about the size of the budget deficit limited the possibility of further loosening of the monetary policy.

Effective from	Intervention rate	Rediscount rate	Lombard rate
31.08.2000	19.00%	21.50%	23.00%
01.03.2001	18.00%	20.50%	22.00%
29.03.2001	17.00%	19.50%	21.00%
28.06.2001	15.50%	18.00%	19.50%

The last cut took place in June. The Monetary Policy Council cut all three interest rates by 150 bps. From 28 June, the intervention rate is 15.5%, the lombard rate 19.5%, and the rediscount rate 18.0%. The June decision was substantiated with improvement of most factors impacting inflation. Inflationary expectations were favourable. Positive trends in money supply were continued and the demand pressure dropped in the real sector.

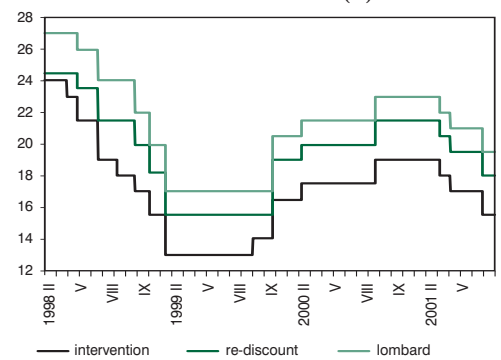
At July meeting (19-20 July), the Monetary Policy Council did not change the interest rates and maintained the neutral stance in the monetary policy. The cut in June, bigger than previous ones, suggested that this would be the Council's decision. Thus, the market players were not surprised. The Monetary Policy Council is of the opinion that the situation related to the current amendment of this year's budget is still uncertain, likewise the assumptions to the 2002 budget bill. According to the Council, the inflation perspectives are still positive and were taken into account in the June decision on the interest rate cut. The MPC also says that structural reforms of the public sector reducing the scale of public expenditure would be necessary for further improvement of the Polish economy.

The next MPC meeting will be held on 21-22 August.

The Finance Ministry says that another interest rate cut by 150 bps is possible as early as in August, after passing the budget amendment. This opinion is shared by a number of economists. Our scenario (table on page 3) was also prepared with the assumption that the rates will be cut in August. At present, the following factors speak for the reduction: deteriorating economic situation (fall in the GDP growth and capital expenditure growth), smaller industrial output, downward inflation trend and decrease in industrial output prices, positive tendencies in the monetary sphere as well as very low domestic demand.

At present, it seems that August cut (if any) may be the last this year. In the fourth quarter, the downward trend in both inflation and producer prices will be slowed down. There may appear effects of previous rate reductions, such as higher interest in borrowing or diminishing tendency to save. The Council will want to wait to be certain that these trends will be still under control. Moreover, the fourth quarter is usually the period of increased consumer demand, and consequently, additional stimulation will not be so necessary for the economy as it is at present.

NBP Interest Rates (%)



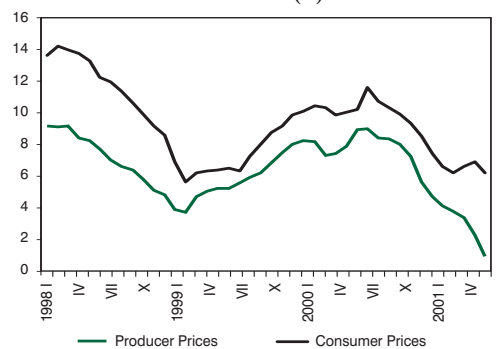
Source: NBP

Real Interest Rate
(based on intervention rate)



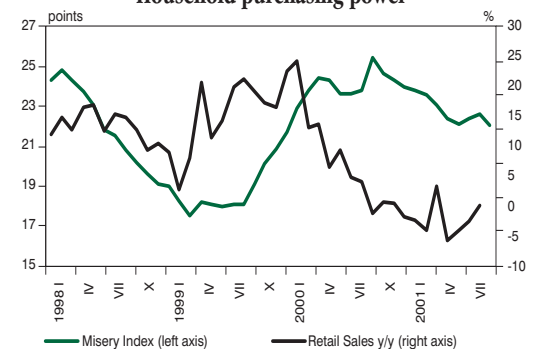
Source: NBP, CSO, own calculations

Inflation (%)



Source: CSO

Household purchasing power



Source: CSO, own calculations



Decrease in budget deficit after June

After the first half of 2001, the State's budget deficit was PLN 18.705bn, which accounted for 91.1% of the deficit planned originally in the budget for the whole year (the deficit after 5 months was 99.3% of the plan). For comparison, in 2000, the deficit after June accounted for 69.9% of the plan, however, in the same period of 1999, difficult due to commencement of 4 reforms, it accounted for 88.4% of the plan. Such difficult situation in fiscal policy this year, being the result of lower economic growth than the budget act assumed, forced the government to present the budget amendment to the Sejm.

At the end of June, total budget revenues were PLN 67.751bn, i.e. 42.1% of the annual plan compared to 32.7% a month ago. The budget expenditures amounted to PLN 86.457bn, i.e. 47.6% of the plan against 40.2% after May. In June, revenues were highest of all the months in 2001, on the other hand, expenditures were lower than the average of the previous months.

There were two factors on the side of revenues that resulted in the decrease in the budget deficit in June, as expected. As each year, in June, the NBP paid most of its profits for 2000 (PLN 4.87bn) to the budget. In addition, in June, the payment of the second instalment for UMTS telephone licences (PLN 1.08bn) was made. Tax revenues are still at a low level in relation to plan and compared to previous years. However, the expenditure level is close to the ones of previous years and there seems to be no threat to the performance of the budget act on that side.

After July, the deficit will probably be close to 100% of the old plan, which will account for ca. 70% of the deficit in the amended budget.

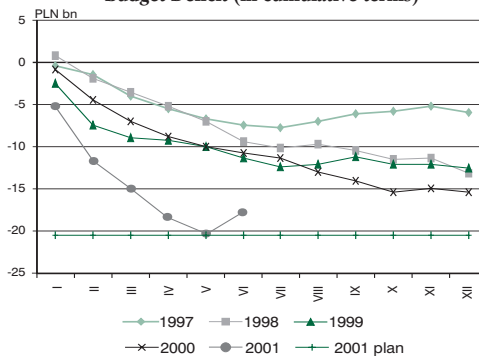
Amendment to budget act

In the middle of July, the cabinet sent a draft of the budget act amendment to the Sejm. In line with the Finance Ministry's proposal, the government proposed to increase the budget deficit by PLN 8.6bn from PLN 20.5bn. This means the increase in the deficit related to GDP from 2.6% to 3.9%. However, the draft does not include the amount of reductions in expenditures, though the ministry recommended cutting them by PLN 7.5bn. The government announced that decisions on reducing budget expenditures will be taken on an on-going basis. The Monetary Policy Council positively assessed the proposal to increase the deficit, emphasising that PLN 8.6bn is the maximum amount by which it can be increased without excessive increase in yield on Treasury papers.

The Finance Ministry intends to finance the increased budget deficit with T-bills, savings bonds and wholesale bonds, mainly 2Y zero-coupon. The Ministry will refrain from increasing the issue of 5Y securities as there considerable debt repayments planned for 2006. In the second half of 2001, the supply of treasury securities will go up by 50% in relation to the original intentions. Moreover, in the case if proceeds from privatisation were at risk, the ministry will consider the possibility to issue Eurobonds of EUR 500m.

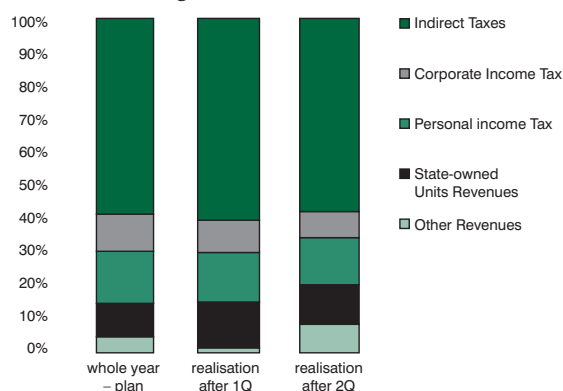
During the Sejm debate, majority of MPs firmly required the government to present the plan of expenditure reductions, which did not happen and which may lead to conflicts in the future when decisions on cutting expenditures of individual ministries will be taken. Finally, on 27 July, the Sejm passed the budget amendment as proposed by the government. On 2 August, the Senate approved the amendment without adjustments. For the act to become effective, it must yet be signed by the President. The President has 7 days to sign the act.

Budget Deficit (in cumulative terms)



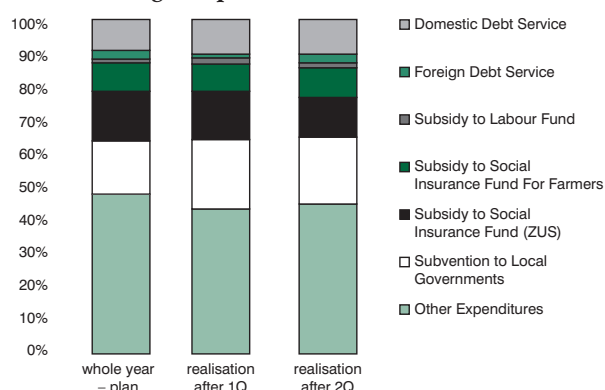
Source: Finance Ministry

Budget Revenues – structure



Source: Finance Ministry, own calculations

Budget Expenditures – structure



Source: Finance Ministry, own calculations

Money supply

June saw the strengthening of tendencies in monetary sphere, favourable for future inflation processes. Money supply rose by 0.9%. After 6 months 2001, the growth in money supply is 4.5% against 8% in the same period last year. Annual variance fell to 8% from 13.5% in May. However, one should remember that in June last year there was intensive lending activity for personal customers in relation to public offer of PKN Orlen shares. Considerable personal credit growth in June 2000 (by 25.2%) resulted in monthly growth in money supply by 6%. Large statistical base from June 2000 is the reason for considerable drop in annual variance with regard to money supply and personal loans in June 2001. In July, the annual variance in money supply should come back to the level of ca. 13-14%.

Between August 2000 and May 2001, annual variance in money supply did not vary much and ranged 13.5-14.9% (apart from December 2000 when the variance fell to 11.9 %).

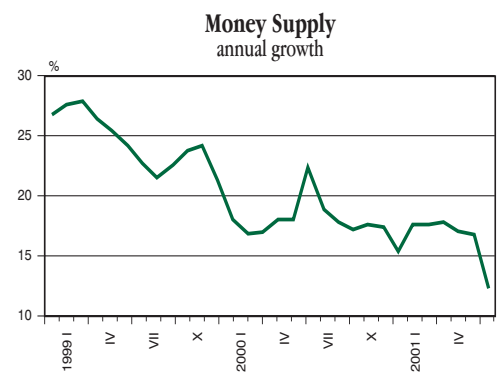
From the beginning of 2000, the slowdown in lending activity variance has continued. In June, loans for non-financial sector increased by 1.1%. In the period January – June 2001, the growth was 3.6%. Personal loans increased by 1.3% and the value of loans drew down by business customers grew by 1%. In June, annual business loan growth dropped to 7.2% from 8.4% a month ago and 19.7% in May 2000.

In June, annual variance in personal deposits decreased below 20% and was 19.7%. Between October 2000 and May 2001, annual variance ranged from 20.0 to 22.6%. However, still, inclination to save is high. On a month-to-month basis, personal savings increased by 1.5%, i.e. the biggest increase from March. Still high real interest rates (despite 3 cuts this year) and low consumption increase the savings tendency.

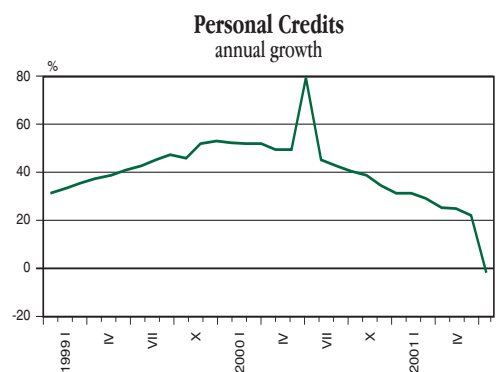
June saw the reduction in budget sector debt by 3.4%. The reason for the reduction in the budget debt was budget surplus resulting from the inflow of NBP profits to the budget and payment of another instalment for UMTS licences. In the coming months, the increase in debt of the budget sector will probably take place.

Banks will be able to sense the effects of previous rate cuts in the second quarter. A radical change in existing trends is, however, unlikely as present low interest in loans is the result of a number of factors, not only high interest rates but also social and economic situation.

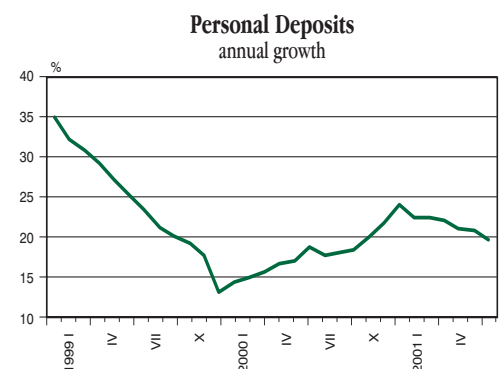
Slower economic growth means poorer business performance and thinner personal wallets. And this, in turn, may deteriorate the quality of banks' loan portfolios. It can already be observed in performance figures published by banks. On the basis of data from 42 commercial banks as at the end of 2000, the share of non-standard receivables in total receivables was 13.7%. In May 2001, this ratio went up to 15.9%.



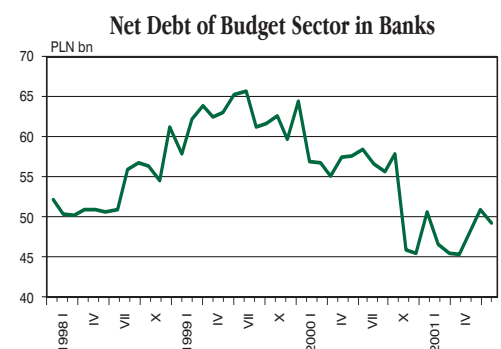
Source: NBP, own calculations



Source: NBP, own calculations



Source: NBP, own calculations



Source: NBP



Wages / Unemployment

Average gross wage in the corporate sector in June went down the second month in a row and was PLN 2148 against PLN 2163 in May. Compared to June 2000, it was higher by 4.8%. The annual growth in real terms dropped by 1.3%. It is the second month this year with a negative real growth.

Between January and June this year, the average salary was PLN 2130 against PLN 1984 in the same period last year. Thus, the nominal increase was 7.3%.

From the beginning of 2000, the salary growth rate is falling, which results from lower rate of economic growth. Salary reduction is one of the most often applied ways of cutting costs in the context of decreasing demand, which forces reductions in production. In the months to come, low variance in salary growth will probably remain unchanged.

Staff reduction is another way of cutting costs in companies. The unemployment rate in June was 15.8% against 15.0% in December 2000 and 13.5% in June 2000. The upward trend has continued from 1998.

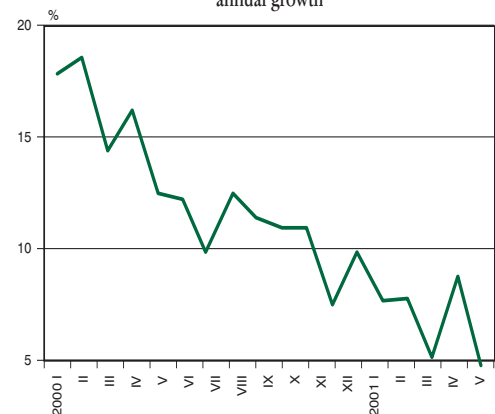
In the months to come, further increase in unemployment should be expected. Companies' difficult situation and lower economic growth are not the only reasons for this unfavourable phenomenon. This is also the effect of population boom on the market and continued restructuring of the economy.

The Finance Ministry forecasts the increase of the unemployment rate to 17.3% at the end of 2001. The 2001 budget act assumes this ratio at 15.4%

Privatisation - the latest information

1. Consortium of France Telecom and Kulczyk Holding did not take the call option on Telekomunikacja Polska S.A. shares. Tuesday (31 July) was the validity date of the option for France Telecom to purchase 10% TP S.A. shares at ca. PLN 40 per 1 share, i.e. significantly higher than the Stock Exchange price, which on Tuesday closed at PLN 15.9. This high price was the reason for not taking the option. However, the consortium is still interested in the purchase of TP SA shares to continue as the strategic investor in the company. They are ready for further negotiations on increasing their share with a prospect for holding majority share package. The Treasury Ministry informed earlier that the issue of TP S.A. convertible bonds for foreign investors might be the alternative if the agreement with the French is not concluded.
2. The Cabinet's Economic Committee accepted PKO BP S.A. privatisation strategy presented by the Treasury Minister. It assumes that 30% of the Bank's shares will be sold by way of public offer for personal customers, residents of Poland. The State Treasury is to maintain control over the Bank, holding 50% plus 1 share.
3. Nafta Polska prolonged the 'exclusive' period for Rotch Energy Ltd until 20 August 2001 in negotiations on privatisation of Rafineria Gdańska. If the talks turn out unsatisfactory, the 'exclusive' period may be shortened. Maximum 75% of refinery's shares assessed at USD 250m are to be sold.

Wages in Corporate Sector
annual growth



Source: CSO, own calculations

Unemployment Rate



Source: CSO

The United States

Recently, we have got a dose of negative US macroeconomic data. The American economy still seems to be far from recovery. Industrial production fell ninth months in a row. The recession in manufacturing sector may remain in the third quarter. US GDP rose by 0.7% in the second quarter (it's the worst for 8 years) against 1.3% in the first quarter.

Business investment still seems firmly in the doldrums. In the second quarter firm's capital spending plummeted by an annualised 13.6% (the biggest drop for 19 years). Consumer spending rose slowly. After 2-month increase, consumer confidence deteriorated.

Published on 1 August NAPM index fell to 43.6 points in July, showing that manufacturing remains firmly in recession. NAPM index has been staying in the downward trend since the beginning of 2000.

Orders for durable goods – a somewhat volatile guide for future business investment and manufacturing activity – dropped by 2% in June.

Profits for major companies are forecasted to drop again. A strong US dollar has hurt American exports. But US administration confirmed that strong dollar policy would be continued.

Market stayed under a large influence of Greenspan's testimony. In his opinion, US economy has to defeat many obstacles to recover. Greenspan (Fed president) does not rule out further interest rate cuts.

International markets prepare for another interest rate cut (FOMC meeting is due on August 21). Despite six interest rate cuts – which have lowered short-term rates by 2.75 percentage points to 3.75% – the latest crop of statistics does not look good.

The hopes on economic revival are placed in consumption. In the nearest two months Americans will get USD 13,9bn as a return of tax rebate. It is good reason to expect stronger domestic demand.

The Fed revised its GDP 2001 forecast to 1.25-2.0%. Economic revival is expected in 2002. GDP may rise by 3.0-3.5 % then.

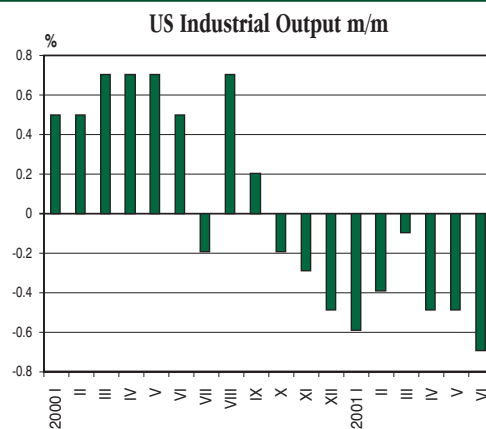
In Greenspan's opinion lower energy prices, return of tax rebate and interest rate cuts should help US economy to improve at the end of this year.

The Euro-zone

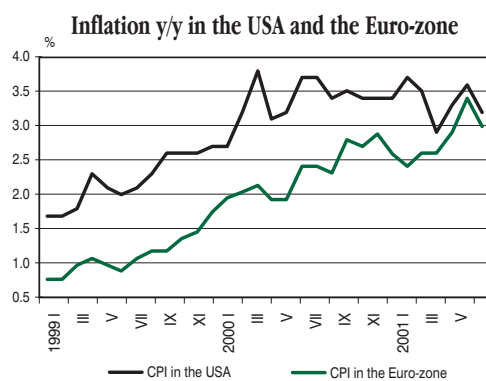
The euro-zone economy is in a poor condition, too. Economic sentiment indicators deteriorate. Ifo index, showing German business climate, dropped to 89.5 points in June (from 90.8 points in May), i.e. to the lowest level in the last 4 years. Industrial production and economic growth decline. Retail sales falls – it means that domestic demand is slower and slower.

The inflationary pressure in the euro-zone (the major reason for ECB not to cut interest rates) decreases. Germany July CPI is expected at 2.7% y/y against record level 3.5% in May. Investors think about date of interest rate cut. The ECB left interest rate at the same level after meeting August 2. The ECB representatives declared that before cutting rates they must make sure CPI decline is durable. The next ECB meeting is due at August 30. Market expectations on interest rate cut will escalate.

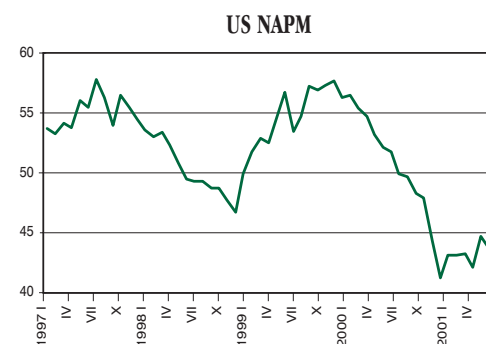
German economic institute IFO decreased EMU CPI forecast for 2001 to 2.75% from 2.9% and increased economic growth forecasts to 2.0% from 1.9%. However, German GDP forecast is maintained at the level of 1.2%. Economic revival is expected in 2002. GDP may rise by 2.5%.



Source: Reuters



Source: Reuters



Source: Reuters



Source: Reuters



Economic Release Calendar August 2001				
Monday	Tuesday	Wednesday	Thursday	Friday
30 July	31 POL: Balance of payments (June) POL: Foreign trade on a cash basis (June) FRA: <i>Unemployment (June)</i> FRA: <i>Producer prices (June)</i> ITA: <i>Producer prices (June)</i> USA: <i>Consumer sentiment (July)</i>	1 August EUR: <i>Unemployment (June)</i> EUR: <i>Retail sales (May)</i> USA: <i>NAPM (July)</i>	2 POL: Food prices (2nd half of July) EUR: <i>ECB meeting</i> EUR: <i>Business climate indicators (July)</i> EUR: <i>Producer prices (June)</i> USA: <i>Industrial orders (June)</i>	3 POL: Economic trends in industry, construction and retail trade (July) EUR: <i>GDP (1Q)</i> USA: <i>Unemployment (July)</i>
6 GER: <i>Factory orders (June)</i>	7 POL: Balance of NBP (July) POL: Official reserve assets (July) GER: <i>Industrial output (June)</i> GER: <i>Unemployment (July)</i>	8	9 ITA: <i>GDP (2Q)</i> ITA: <i>Industrial output (June)</i>	10 GER: <i>Current account (June)</i> GER: <i>Trade balance (June)</i> USA: <i>Producer prices (July)</i>
13	14 POL: Money supply (July) POL: Employment and wages in corporate sector (July) FRA: <i>Inflation (July)</i> USA: <i>Retail sales (July)</i>	15 Assumption Day	16 POL: Inflation (July) POL: State budget (July) USA: <i>Inflation (July)</i>	17 POL: Industrial output (July) POL: Producer price index in industry and construction (July) FRA: <i>Industrial output (July)</i> ITA: <i>Inflation (July)</i> EUR: <i>Inflation (July)</i> USA: <i>Foreign trade (June)</i>
20 POL: Unemployment (July)	21 POL: MPC meeting EUR: <i>Industrial output (June)</i> USA: <i>FED meeting</i>	22 POL: MPC meeting (decision) GER: <i>Business climate IFO (July)</i>	23 POL: Food prices (1st half of Aug)	24 USA: <i>Durable goods orders (July)</i>
27	28 GER: <i>GDP (2Q)</i>	29 EUR: <i>Foreign trade (June)</i>	30 EUR: <i>ECB meeting</i>	31 POL: Balance of payments (July) POL: Foreign trade on a cash basis (July) FRA: <i>Unemployment (July)</i> ITA: <i>Producer prices (July)</i>

A glance at the economy

Category	unit	August	September	October	November	December	January	February	March	April	May	June	July
PRICES													
Consumer price index (y/y)	%	10.7	10.3	9.9	9.3	8.5	7.4	6.6	6.2	6.6	6.9	6.2	-
Consumer price index (m/m)	%	-0.3	1.0	0.8	0.4	0.2	0.8	0.1	0.5	0.8	1.1	-0.1	-
Production price index (y/y)	%	8.4	8.3	8.0	7.2	5.6	4.7	4.1	3.8	3.4	2.3*	0.9	-
Production price index (m/m)	%	0.4	0.8	0.6	0.0	-0.9	-0.3	-0.1	0.2	0.2	0.0*	-0.4	-
Price index of assembly and construction production (y/y)	%	8.7	8.1	7.8	7.6	6.9	6.8	6.5	5.7	5.0	4.5*	3.9	-
Price index of assembly and construction production (m/m)	%	0.5	0.2	0.5	0.4	0.2	0.4	0.4	0.1	0.3	0.3*	0.1	-
Exchange rate USD/PLN (y/y)	%	10.3	10.1	12.8	7.2	3.5	0.2	-1.0	-0.7	-5.1	-11.5	-9.7	-3.2
Exchange rate USD/PLN (m/m)	%	0.8	3.0	3.3	-1.6	-5.4	-4.7	-0.4	-0.8	-1.0	-0.9	-0.3	5.4
Exchange rate EUR/PLN (y/y)	%	-5.9	-8.7	-9.8	-11.2	-8.1	-7.1	-7.7	-6.5	-10.3	-14.5	-18.8	-11.5
Exchange rate EUR/PLN (m/m)	%	-2.9	-0.8	1.4	-1.7	-0.6	-0.4	-2.5	-2.0	-2.8	-2.9	-2.8	6.2
Real gross wages in enterprise sector (y/y)	%	1.1	0.4	0.5	0.8	-1.9	2.4	1.1	1.6	-1.3	1.8	-1.3	-
ACTIVITY INDICATORS													
Gross domestic product (y/y)	%	-	3.3	-	-	2.4	-	-	2.3	-	-	-	-
Industrial output (y/y)	%	9.2	5.0	7.1	4.7	-2.2	10.1	0.1	2.9	3.6	-0.9	-4.8	-
Industrial output (m/m)	%	6.1	5.0	2.1	-3.1	-1.4	-8.9	-2.5	14.7	-7.8	3.1	-2.8	-
Construction and assembly production (y/y)	%	-2.1	-3.7	-1.7	-1.1	-6.9	-9.7	-9.1	-8.2	-10.8	-11.7	-10.1	-
Construction and assembly production (m/m)	%	7.2	7.0	6.6	-17.6	40.3	-59.3	7.4	18.6	-2.9	15.5	13.7	-
Retail sales of goods ^a (y/y)	%	11.2	10.4	7.2	5.8	3.2	10.9	-0.2	0.1	1.9	4.3	0.2	-
Retail sales of goods ^a (m/m)	%	1.4	-0.8	1.5	-3.4	20.8	-27.6	-1.7	17.5	4.0	1.7	-1.3	-
Exports on a customs basis (y/y)	%	29.4	24.4	27.9	24.0	18.6	29.9	13.4*	17.7*	8.0	0.3	-	-
Exports on a customs basis (m/m)	%	-3.1	10.5	10.0	-3.6	-8.5	1.0*	-0.5*	9.5*	-14.5	-3.2	-	-
Imports on a customs basis (y/y)	%	15.9	8.2	16.2	3.7	3.7	14.5*	-3.2*	2.8*	0.7	-13.6	-	-
Imports on a customs basis (m/m)	%	-6.1	8.1	14.0	-7.0	-2.9	-11.0*	-4.2	16.1*	-9.9	0.0	-	-
LABOUR MARKET													
Number of unemployed	thous.	2 496	2 529	2 548	2 613	2 703	2 836	2 877	2 899	2 878	2 841	2 849	-
Unemployment rate	%	13.9	14.0	14.1	14.5	15.0	15.6	15.8	15.9	15.8	15.7	15.8	-
Average employment in corporate sector	thous.	5 271	5 269	5 274	5 247	5 199	5 184	5 189	5 170	5 156	5 135	5 121	-
Average monthly gross wages in corporate sector	PLN	2 051	2 088	2 089	2 160	2 350	2 069	2 075	2 149	2 176	2 163	2 148	-
Nominal increase in wages (y/y)	%	11.9	10.7	10.4	10.2	6.4	9.9	7.7	7.9	5.2	8.8	4.9	-
STATE BUDGET													
Budget revenues	PLN bn	86.2	98.0	110.5	123.0	135.7	11.6	21.0	31.6	42.4	52.6	67.8	-
Budget expenditures	PLN bn	99.2	111.9	125.9	137.9	151.1	16.7	32.9	46.7	60.8	73.0	86.5	-
State budget deficit	PLN bn	-13.0	-14.0	-15.4	-14.9	-15.4	-5.1	-12.0	-15.1	-18.4	-20.4	-18.7	-
Domestic government debt	PLN bn	-	153.4	-	-	146.0	-	-	154.8	-	-	-	-
Foreign government debt	PLN bn	-	134.2	-	-	120.8	-	-	118.2	-	-	-	-

A glance at the economy



Category	unit	August	September	October	November	December	January	February	March	April	May	June	July
BALANCE OF PAYMENTS													
Current account	USD m	-961	-592	-852	-416	-816	-932	-461	-749	-519	-734*	-952	-
Trade balance	USD m	-1 324	-972	-1 058	-858	-1 038	-1 499	-724	-907	-708	-1 165*	-857	-
Exports	USD m	2 271	2 424	2 520	2 654	2 759	2 448	2 393	2 615	2 564	2 473*	2 553	-
Imports	USD m	3 595	3 396	3 578	3 512	3 797	3 947	3 117	3 522	3 272	3 638*	3 410	-
Services: net	USD m	-119	-90	-100	-104	-155	-111	-85	-82	-62	-68*	-84	-
Unclassified transactions: net	USD m	350	420	485	295	340	248	243	239	385	315	274	-
Capital and financial account	USD m	725	357	2 192	528	351	1 359	964	-33	-143	525*	1 017	-
Direct investments	USD m	169	242	4 653	537	570	486	383	343	535	321*	562	-
Portfolio investments	USD m	-234	-72	-345	504	135	788	699	891	-177	-471*	-297	-
MONEY SUPPLY													
Money supply	PLN bn	278	281	287	291	294	293	296	301	303	305	308	-
Money supply (y/y)	%	14.9	14.1	14.6	14.4	11.8	14.6	14.6	14.9	14.0	13.5	8.0	-
Money supply (m/m)	%	0.3	1.0	2.4	1.3	1.1	-0.6	1.0	1.9	0.6	0.7*	0.9	-
Total deposits (y/y)	%	17.1	16.1	17.4	17.0	15.5	17.5	17.1	16.8	16.1	15.5	9.2	-
Total deposits (m/m)	%	0.5	1.1	3.0	1.7	1.1	0.1	0.9	1.7	0.4	1.0	0.5	-
Household loans (y/y)	%	42.9	40.9	38.9	34.8	31.7	31.3	29.4	25.7	25.1	22.1	-1.3	-
Household loans (m/m)	%	2.5	3.0	2.3	1.2	2.1	0.2	-0.3	0.4	1.1	1.3	1.3	-
Corporate loans (y/y)	%	18.2	17.4	16.1	14.0	13.5	12.2	12.0	11.7	9.5	8.4*	7.2	-
Corporate loans (m/m)	%	1.4	2.3	1.4	0.4	-1.9	1.2	0.9	0.6	0.0	-0.4*	1.0	-
FINANCIAL INDICATORS													
Average deviation from the central parity	%	-3.8	-2.8	-0.6	-2.4	-5.0	-7.4	-8.8	-10.1	-11.8	-13.7	-15.0	-9.9
Average exchange rate USD	PLN	4.3593	4.4900	4.6369	4.5606	4.3143	4.1108	4.0925	4.0599	4.0175	3.9807	3.9705	4.1859
Average exchange rate EUR	PLN	3.9486	3.9152	3.9696	3.9035	3.8802	3.8648	3.7689	3.6952	3.5904	3.4856	3.3894	3.5998
Average exchange rate DEM	PLN	2.0189	2.0018	2.0296	1.9958	1.9839	1.9761	1.9270	1.8893	1.8357	1.7822	1.7330	1.8405
Average WIBOR T/N	%	17.31	18.84	19.74	20.07	19.50	19.73	19.82	19.33	18.56	17.91	17.78	15.99
Average WIBOR 1M	%	18.24	19.39	19.47	19.65	19.83	19.44	19.33	18.36	17.45	17.50	17.38	16.11
Average WIBOR 3M	%	19.12	19.55	19.68	19.75	19.67	18.97	18.61	18.01	17.17	17.22	16.88	16.01
Average 3M T-bill yield	%	17.38	18.17	17.53	17.44	17.60	17.12	17.29	17.20	16.44	16.24	16.12	15.28
Average 6M T-bill yield	%	17.92	18.47	17.83	17.78	17.84	17.43	17.09	17.16	16.36	16.21	16.03	15.30
Average 9M T-bill yield	%	18.28	18.55	18.11	17.97	17.91	17.40	17.15	17.01	16.11	15.84	15.81	15.33
Average 12M T-bill yield	%	18.34	18.65	18.41	18.31	18.01	17.23	16.97	16.85	15.80	15.67	15.61	15.39
Average 2Y T-bond yield	%	18.27	18.11	18.54	18.23	17.20	15.68	15.48	15.60	14.59	14.92	15.22	15.14
Average 5Y T-bond yield	%	14.53	14.50	15.53	15.10	13.93	13.08	12.92	13.33	13.47	13.38	13.29	13.87
Average 10Y T-bond yield	%	12.72	12.40	13.24	13.06	11.50	10.44	10.23	10.68	10.61	11.30	11.74	11.88
MONETARY POLICY INSTRUMENTS													
Intervention rate	%	19.0	19.0	19.0	19.0	19.0	19.0	19.0	17.0	17.0	17.0	15.5	15.5
Rediscount rate	%	21.5	21.5	21.5	21.5	21.5	21.5	21.5	19.5	19.5	19.5	17.0	17.0
Lombard rate	%	23.0	23.0	23.0	23.0	23.0	23.0	23.0	21.0	21.0	21.0	19.5	19.5

* data officially corrected, * in current prices

Sources: CSO, NBP, Finance Ministry, Reuters, own estimations



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