MACROscope
Polish Economy and Financial Markets

March 2002 Nº 32

There should be sunshine after rain

- There are more and more signals confirming the forthcoming improvement in a market situation. Despite the fact that market situation researches still show more pessimists than optimists, the group of persons and companies awaiting the further deterioration in economic standing has been clearly “melting”. The companies advise on a growing portfolio of orders. Although it cannot be translated into the plans for increasing staff numbers yet, the scale of the planned redundancies has decreased. There has been an upward tendency among purchasers and the general assessment of economic climate has significantly warmed up. It seems that Q2 2002 will see a long-lost economy bloom and the early spring will be seen not only in natural environment but in economy as well.

- We hope that the economy will be an arbiter in the dispute between the Government and the Central Bank. It goes without saying that this is a more objective arbiter than the Sejm (Lower House of Parliament), which was evidenced by the recent debate on the monetary policy held due to the draft resolution to amend this policy. The economic revival expected in the forthcoming months, although not so strong as to meet the expectations of politicians, should however allow for avoiding amendments to the NBP Act. Should our expectations come true, this will mean seamless EU accession negotiations, as the EU treats the independence of the central bank as one of the principles of a healthy market economy.

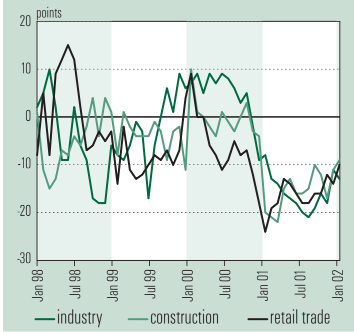
- According to the Minister of Finance the February tax income was excellent. We take the Minister’s word for it as the data will be available only in mid-March. Over the recent several months, the annual tax income growth dynamics was far below the 2002 budget assumptions, and in January the dynamics dived completely in respect of PIT, CIT and VAT. We hope that the “excellent February” is not exceptional and confirms our well-documented hypothesis of the forthcoming revival?

- The expectations for further interest rate cuts still in March are back. Both the valuation at the FRA market and the comments of brokers and dealers indicate the boomeranging expectations for the interest rate cuts in March or April at the latest. The expectations are there despite the quite general projections that the decrease in the inflation rate in Q2 2002 below 3% will be a short-term one and the H2 will see its accelerated growth. It, however, seems that Monetary Policy Council may keep the interest rates at the current level far longer than expected by the markets.

Financial market on 28 February 2002

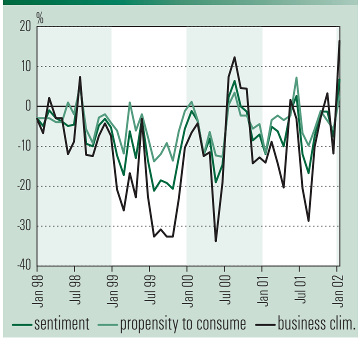
NBP deposit rate	6.50	WIBOR 3M	10.22	PLN/USD	4.2046
NBP intervention rate	10.00	Yield on 52-week T-bills	9.67	PLN/EUR	3.6410
NBP lombard rate	13.50	Yield on 5-year T-bonds	9.25	EUR/USD	0.8684

Business climate YoY



Source: CSO, BZ WBK

Consumer sentiment YoY



Source: Ipsos-Demoskop, BZ WBK

In this issue:

Krzysztof Rybiński
Chief economist
Warsaw (+48 22) 653 46 63
krzysztof.rybinski@bzwbk.pl

Piotr Bielski
Warsaw (+48 22) 653 47 33

Aleksander Krzyżaniak
Poznan (+48 61) 856 55 80

Sławomir Nosal
Poznan (+48 61) 856 55 67

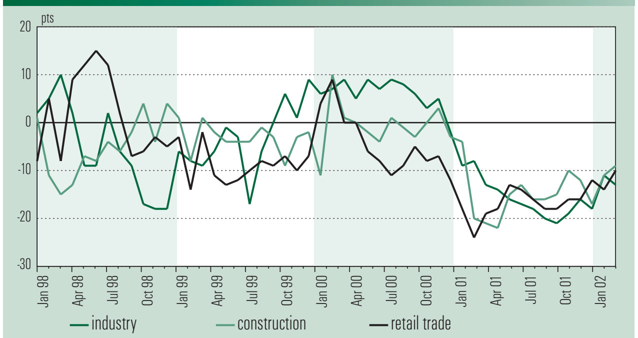
www.bzwbk.pl

Economic early spring

- YoY market situation in industry, construction and retail trade sectors has been improving
- The consumers' optimism and propensity to purchase
- There has been an upward tendency in the prospects for a synchronised revival in the European Union and the USA

"There should be sunshine after rain, these things have always been the same" as one of Dire Straits' songs goes. All in all, based on the assessment of the recent economic ratios one can firmly say that after a few quarters of economic stagnation the revival is on its way. The signals are sent by both business entities and consumers. All market demand researches conducted both in February and March indicated an improvement in the companies' standing and the growth in the orders portfolio. Although there are still more pessimists than optimists, the market demand ratios have been growing which should result in stopping the downward trend in the industrial output in the forthcoming months.

Business climate indicators by CSO YoY change

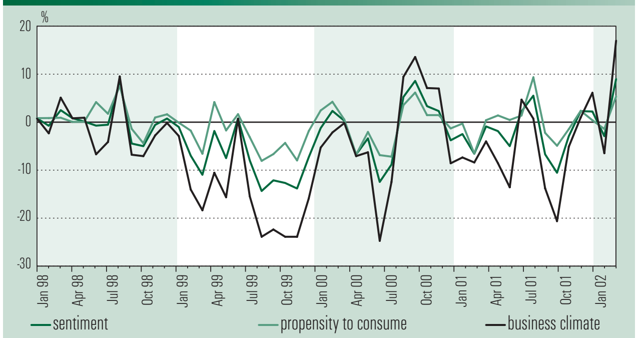


Source: CSO, BZ WBK

Even stronger signals confirming the revival have been recorded in the researches on the optimism of households. The annual **propensity to purchase** has been growing for a long time now and in February there was a significant improvement in the assessment of the economic climate. After all, for two quarters the households have behaved in line with the consumption balancing theory and despite the slowing down income growth dynamics they maintained the high consumption levels. According to the initial CSO data, private consumption went up by over 3% YoY in Q4 2001 and the retail sales data indicate that the relatively high pace of consumption spending was maintained at the beginning of this year.

On top of that, the MF minister announces that the budget revenues, after a very poor January, were much better or even excellent in February. The same way as the last year's miserable budget indicated a forthcoming economic slowdown, the growing tax inflows to the State's vault may confirm the economic revival. Moreover, in February the sales of new cars decreased "only" by 15% YoY despite the avalanche-like growth in the imports of second-hand cars, while the 2001 decrease dynamics was twice as high.

Consumer sentiment YoY change



Source: Ipsos-Demoskop, BZ WBK

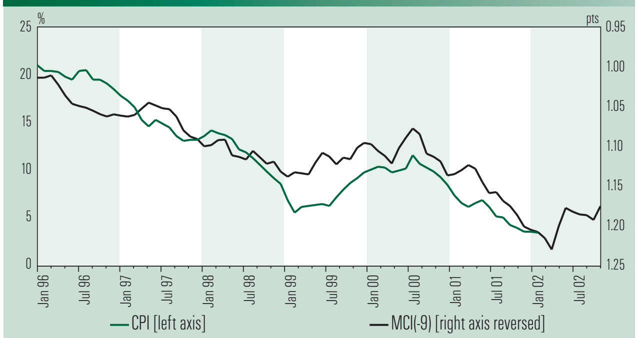
Of course one should not expect fireworks to go off. Entrepreneurs are always prudential in respect of the first signs of revival. They may limit the planned scale of staff redundancies (indicated by the market situation researches). It will take some time, however, before they start to employ new staff in response to a growing demand.

Although leading indicators and market researches clearly point to the forthcoming economic revival, so far the economic data evidence that the end of 2001 and January this year were poor. The decreasing industrial and construction output, a substantial decrease in imports which based on the January payments reflected a low level of the actual imports of goods in November-January, or the January low budget tax income are the snapshot of the miserable economy over the recent months.

It seems that the economic revival prospects are confirmed by information from abroad as well. The economic situation and optimism level have been improving both in the Eurozone and the USA (see our broad elaboration in the international review). In the months to come we are likely to see a synchronised global revival. At the same time one should not forget two risks related to this scenario, i.e. unstable situation in the Middle East and the poor Japanese economy.

It seems that businesses should slowly start preparing themselves for the forthcoming revival so that their response to the growing demand is timely and their market slice does not shrink. This also means a halt to the deflation process and some growth in the current account deficit. As a result, the bonds market should remain strong by the end of Q2, in particular if the inflation rate goes below 3%. However, the planned increases in the prices of electricity and gas (by ca. 10%), the revival and the substantial loosening of the monetary policy measured with MCI should lead to the substantial acceleration of the inflation rate in H2. In H2 the market may be bearish which may lead to the weakening of PLN.

Inflation rate and lagged MCI

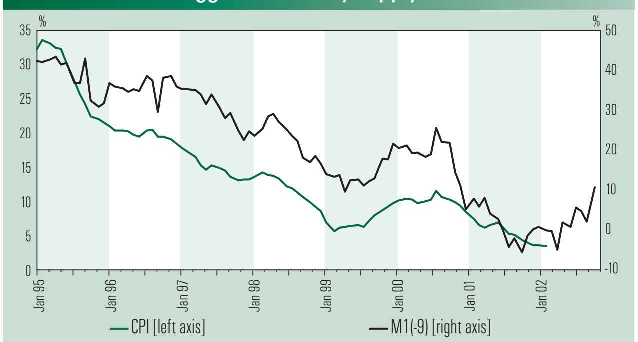


Methodology notice: MCI graph has been moved right by 9 months and indicates the potential growth in the inflation rate in H2.

Source: CSO, BZ WBK

The other issue is the political pressure on the MPC. In the depth of my soul I hope that SLD MPs will not want to change the NBP Act and that they realise the economic cost should the change be materialised. This would obviously lead to complicated negotiations with the EU, could result in the escape of the portfolio capital portfolio and might as well end up with a giant PLN devaluation. Nevertheless, one cannot ignore the statements made by the prominent representatives of SLD, including the new General Secretary, who has put an ultimatum: a 5% cut in the interest rate or the amendment to the NBP Act. Hence, should there be an attempt to limit the independence of the MPC, then the bears on the bonds market and the sellers of PLN will appear sooner than in H2.

Inflation rate and lagged M1 money supply **YoY**



Source: CSO, BZ WBK

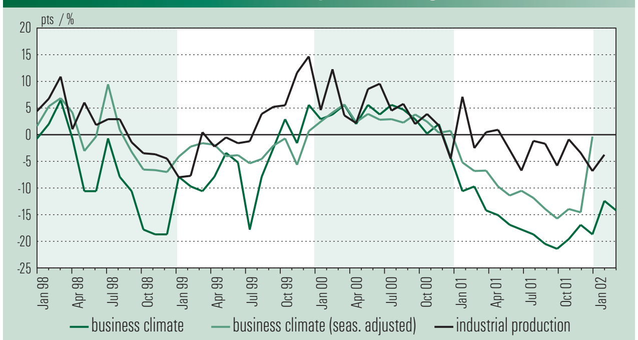
Economic update

- Yet more factors signal economic recovery in second half of the year
- Unemployment remains the biggest problem, and it will grow further
- Record-low inflation, likely to rebound in second half of the year
- Personal deposits decelerate, especially term deposits

It is getting warmer

Is it not strange? The politicians are complaining more and more on the merciless monetary policy that ruins our country, while the entrepreneurs are more and more optimistic. All market situation researches published in recent weeks clearly indicate the forthcoming revival. What is more, after a very poor January, in February the budget tax income was much higher, according to Marek Belka (MoF) almost excellent, and the sales of new cars started to show positive symptoms, despite a substantial imports of second-hand cars from the West. One cannot miss the revival indicating data – they are like an African elephant in the middle of M25. Let us summate the key results.

Business climate indicators and production growth



Source: CSO, BZ WBK

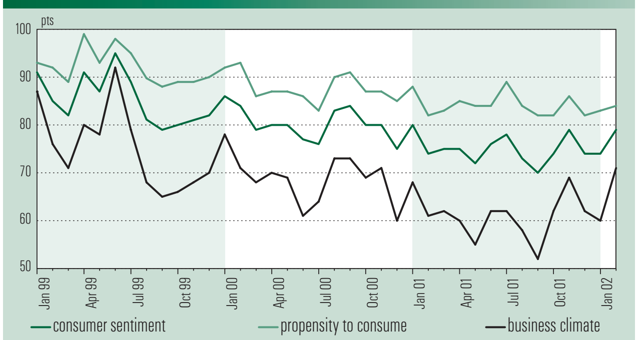
In February business climate indices computed by CSO improved in relation to January, although they remained notably lower than 12 months ago. The more promising feature of this survey, apart from less pessimistic appraisal of present business climate, is the remarkable improvement in companies' expectations about future demand, future orders, and production volume. In industry one should especially notice demand recovery recorded by companies manufacturing motor vehicles, trailers etc. and big optimism in their forecasts for future perspectives. Climate improvement was also recorded in construction. What's interesting, is that for the first time in 6 months construction companies submitted optimistic expectations about future orders. Small improvement was also recorded in retail trade. And again the most promising part of the survey is that future prospects seen as optimistic. Large retail branches forecast huge increase in trade volumes. Furthermore companies selling motor vehicles, durable goods, clothing and footwear all expect significant recovery of demand and anticipate much better prospects than in several past months. Polled companies plan further employment reduction in the following months, although the scale of job destruction is expected to moderate.

Business climate index computed by IBnGR institute for the whole economy increased by nearly 10 points in February, reaching –13.3. The biggest improvement was recorded in industry (+12) and trade and services (+14), while banking sector reported deterioration by 8 pts. Companies' expectations about future perspectives also improved significantly and in all three sectors forecasts of future activity were much better than present assessment. Overall business climate index in February (-13.3) was much better than last year's (-20.9)

According to IRG SGH companies in manufacturing sector reported significant increase of orders in February, both domestic and external, and in future they expect further orders improvement (though mostly domestic). Leading indicator for Polish economy computed by M. Drozdowicz recorded significant hike by 1.9 pts., confirming the hypothesis of diminishing recession trends and pointing to possible economic recovery in 2002.

Polish PMI index called WML (seasonally adjusted) rose in February by 0.8 points to 45.3 points, while reading below 50 suggests that purchasing managers expect situation to deteriorate. Current production index rose to 41.2 from 36.3, new orders index rose to 40.3 from 36.0, export orders rose to 50 from 42, employment component rose to 41.2 from 36 (all figures not seasonally adjusted).

Consumer sentiment indicators



Source: Ipsos-Demoskop

Demoskop's survey among Polish households shows that consumer confidence improved in February. All three indices computed by institute increased, showing much better assessment of economic climate, higher propensity to consume, and better overall consumer confidence.

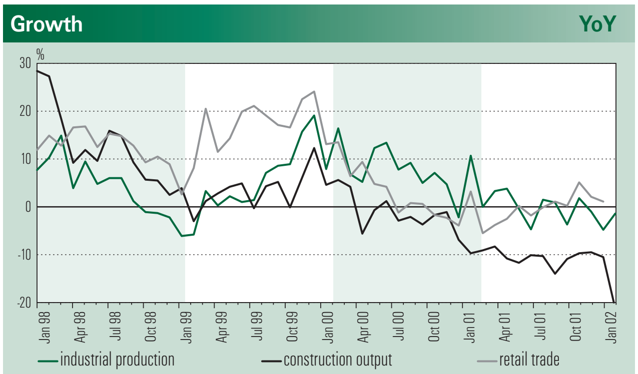
How do you feel about that? It seems that our presumption was correct and first quarter of 2002 will bring (at least) no further deterioration of economic activity. And if entrepreneurs' expectation prove correct we could see small improvement of indices in 2Q02. Improvement that would be promoted mainly by domestic demand, while households' saving propensity seems to be diminishing indeed.

We reiterate that monetary policy has been relaxed considerably in recent months and should influence economy during next several quarters. What is necessary at this stage is the implementation of measures proposed by the government in its "Entrepreneurship first" package and fast amendment of labour code, that would facilitate business operations for private entrepreneurs and encourage them to take risk and invest at this early stage of economic climate improvement. Nevertheless all this takes time, and judging by politicians' impatience expressed in recent weeks, one should not exclude that attacks on MPC and its monetary policy would continue. But attacked or not, MPC also observes all recent economic developments and surely notices these early signs of climate improvement, as well as worrying trends in monetary sphere. That's why we do not see much scope for further interest rate cuts soon. Decision, if any, is most likely at the end of 2Q, if inflation goes below 3% and there is still no proof of improvement...

The January results: it seems we have been going up from the abyss!

Let us now discuss the January economic data. In general the economic performance did not improve on the previous months, i.e. one can hardly find any revival symptoms. However, which is important, the data do not indicate any further slowdown and this may confirm our thesis that the worst phase of the economic cycle has been left behind.

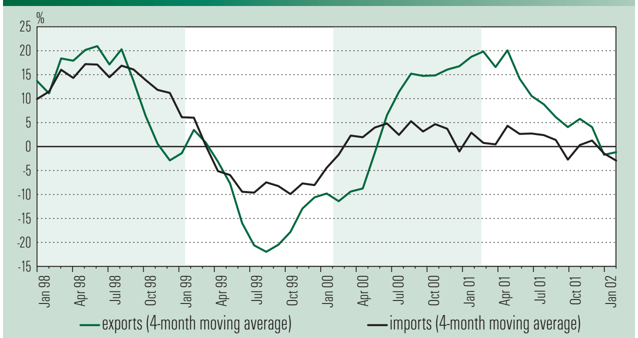
Industrial production figures introduced some confusion. Production declined 5% MoM which was very close to our prediction of –4% MoM, stronger than market consensus forecast and definitely much stronger than average January output fall in last couple of years. At the same time production annual growth rate was lower than suggested by such monthly decline and amounted to –1.4% YoY. It reflected the fact that CSO have revised down production figures for previous months (especially in first three quarters of 2001). It should be noted that monthly decline in January was much softer than usually, despite two factors which probably were dragging production figure down: First, since 1st January there is new regulation reducing standard working hours to 41 per week. Second, recall the weather conditions that paralyzed communication and transport in Poland at the beginning of January. Some of employees were stuck on their way to work, some products ended up in snowdrifts and were never delivered to wholesalers etc. On the other hand output figure was somewhat biased upwards by delaying some ships sale from December. Nevertheless annual growth rate – though still in red – obviously improved in relation to -4.8% recorded in December. Construction output statistics for January were much worse. Construction output plunged -21.2% YoY and 64.2% MoM. But this was by and large due to terrible weather conditions observed in January. With 7-meter high snowdrifts and deeply frozen ground one should not expect any reasonable performance of construction companies. Nevertheless it does not predict well for investment demand growth in 1Q02.



Source: CSO

Above figures were broadly confirmed by foreign trade volumes reported by NBP. Export in January declined much smaller than seasonal pattern suggests, and – though this reflects delayed sale of several ships to some extent – such performance proves that there was no dramatic downturn in January. However on average exports have been falling 5%YoY in the last three months, which suggest that European economic slowdown is taking its toll on Polish exports. At the same time import decline deepened in annual terms, but it was also no big surprise considering deep fall of construction output and continued decline in industrial output, which reflected very weak investment demand. As a result trade deficit was lower than year ago and current account deficit contracted to 3.9% of GDP (though one should not pay too much attention to this figure as it was biased by foreign currency exchange – see box). While economic recovery in subsequent quarters will be driven mostly by domestic consumption growth, it's hard to expect such positive trends in external trade do continue, although during next 2-3 months external balance is likely to improve somewhat due to seasonal factors.

Trade volume growth YoY

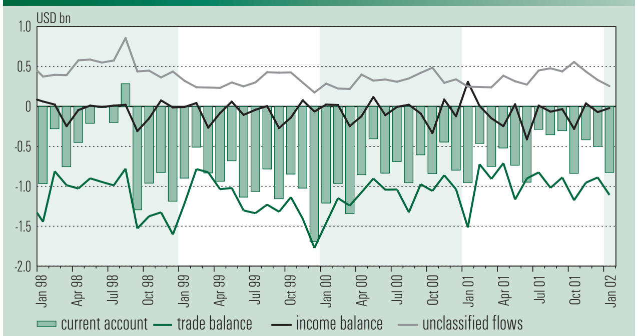


Source: NBP, BZ WBK

Current account affected by currency exchange

Well, it seems that we are right sometimes. Current account figure proved to be strongly affected by foreign exchange transactions connected with euro launch not only before, but also after 1 January. While unclassified flows balance has been reduced by US$737m in December, it has been augmented by US$368m in January, which simply reflected the fact that some people and companies who put Deutschemarks and other EU12 currencies in banking accounts ahead of euro launch, withdrawn the money back after new coins and bills have been issued. Some of them had to rebuild money stock for their business operations (i.e. people importing second-hand cars to Poland and exchange booths that had to accumulate euro cash), some of them were just interested in new currency look-like. This one-time euro demand was quite impressive: without NBP correction unclassified flows balance would have reached –US$113m. NBP announced that it made the effort to eliminate the impact of EU12 currencies exchange correcting unclassified flows balance to make it similar to levels observed in previous years. But such correction had to be intuitive only, because NBP surely does not have enough data to eliminate euro-related transactions. Therefore we recommend not paying much attention on January current account figure, as nobody knows to what extent it reflects reality. Just for the record: C/A deficit reached US$826m, compared to US$500m (revised) in December.

Current account balance



Source: NBP

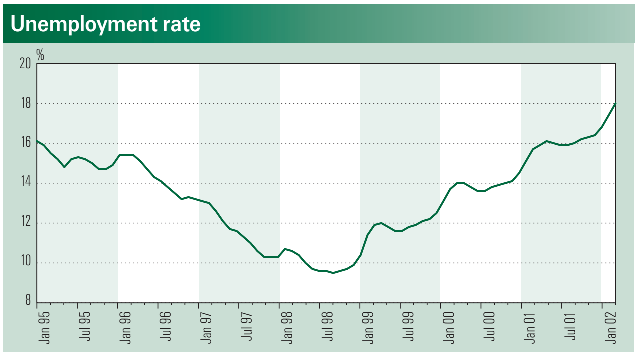
Retail sales up. People do consume.

Retail sales increased 4.7% YoY in January, while it stood at 2.4% in December and November. Strong annual growth was recorded in most product categories, with the biggest surge in clothing and footwear (35.7% YoY). Wholesale trade recorded 6.6% YoY growth (5% in December). Apparently, as we've argued before, there's no recession in consumption demand. Furthermore, contrary to some analysts' predictions private consumption keeps accelerating in the beginning of 2002. During press conference CSO president said that production fall in January was recorded mainly in companies manufacturing investment goods, while production of consumption goods went up by 3%.

Good. If consumers' demand continues for some time, companies will have the incentive to produce more and to invest more and subsequently the economic recovery can become a fact. But at the same time if this consumption revitalisation (it's too early to claim it's a boom) proceeds amid wage bill in corporate sector rather steady in nominal terms and even negative in real terms, it suggests that households' propensity to save must have decreased severely. It does not predict well for economic stability, as everybody knows that public sector dissaving is also growing fast at the same time.

Unemployment rate reached 18%. And it will grow further.

Two things were apparent after CSO published 17.4% unemployment rate for December last month. First, that it would grow further to ca. 18% in January and probably around 18.5% in March 2002. Second, that it would attract huge media attention and could raise social concerns and impatience, being one of the most difficult problems the government would have to tackle during following months.



Source: CSO

Indeed, official unemployment rate reached 18% in January. The number of unemployed increased by 138,200 people, to 3.252m. It constitutes growth by 4.4% MoM and 14.7% YoY. CSO published also unemployment statistics based on Labour Force Survey (LFS), according to which unemployment reached 18.5% in 4Q01, compared to 17.9% in 3Q01. As mentioned above, these figures could be expected, assuming strong seasonal pattern of unemployment time series and recent trends in real sector of economy. Wintertime is the period of smaller activity, especially in construction sector, which fuels unemployment to a large degree.

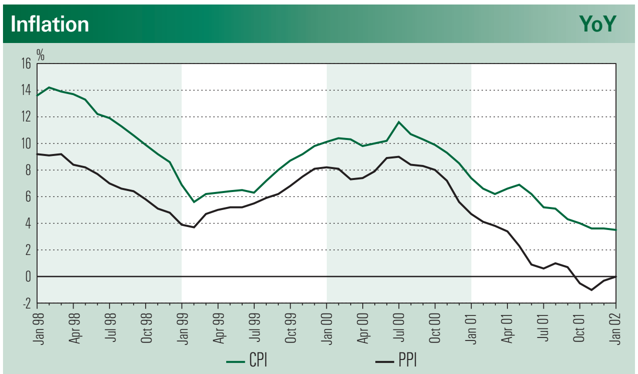
This year we don't expect to see any outstanding progress in unemployment fight, because economic recovery, that we predict in 2H02 will be accompanied by huge inflow of new entrants to the labour market. Some 900,000 of new graduates will join the labour force this year. In the second quarter we could see some unemployment rate decline, nevertheless it should rebound again in 2H02. Therefore it is extremely important to proceed with enhancing labour market elasticity, initiated by the government. If these measures will not pass through parliament quickly, we could see unemployment rate exceeding 19% by the year-end.

Inflation rate declined again. Don't worry, it'll bounce back.

Now that's a surprise. Inflation in January was lower than expected, reaching 0.8% MoM and 3.5% YoY (compared to 3.6% in December). Annual rate fell to another all-time low in Poland's market economy history. Three questions arise immediately:

1. Where we were wrong?
2. Does it influence forecasts for the rest of the year?
3. What are the implications for monetary policy?

Answer to the first question is pretty obvious after examining January price statistics in detail. Two factors contributed to forecast overshooting: slower than expected pass-though of housing costs hike into final prices and deeper than usual seasonal discounts on clothing and footwear. Prices of flat maintenance and



Source: CSO

energy costs increased 1.4% MoM while we expected over 2% hike. Apparently some housing societies were sluggish in rising their rents and didn't manage to do it in January. But it means that these prices will have to rise more in subsequent months, as costs of water supply and sewage output increased significantly since January 1st. On the other hand one could wonder whether price decline in clothing and footwear section signals abating consumption demand or something else. We argue that it rather reflects structural change in retailer's behavior than sudden decline of private consumption. Recall that retail sales and private consumption growth kept really strong in 4Q01. Mind also that together with increasing number of foreign retail branches and supermarkets in Poland there appear new customs like off-season sales and discounts. I recall my friends going to Berlin for special dress discount purchases few years ago. Now they just go to the nearest shopping mall as it offers similar facilities.

What about inflation forecast? No big changes really. As we've wrote few times before main inflationary impulses will concentrate in 2H02. Therefore this year's inflation path could be of the roller-coaster type. Slight increase in February-March up to some 3.8-3.9% YoY, plunge below 3% in May and then rapid climb to more than 5% by the year-end. And it's not only because expected energy and gas price hikes, price acceleration on food and fuel markets and changes to CPI basket weights. For those who still don't believe in inflation rebound in 2002 we recommend looking at charts on the next page displaying more "fundamental" factors behind upward pressure on CPI: narrow money growth and monetary condition index, showing the first effects of monetary easing in recent months (see page 3).

Let's reiteraet once again that such inflation forecast leaves little scope for further interest rate cuts, especially considering lags in monetary policy transmission. But on the other hand breaking through the level of 3% CPI (even for a while) would trigger another wave of criticism against MPC that could result in 100bps rate cut in mid-year.

Money declined, along with deposits

Broad money declined deeper than usual in January (-2.1% MoM), which brought annual growth rate down to 12% from 13.7% YoY in December. Nevertheless mind that real money stock keeps growing reasonably fast (7.8% YoY in January) especially if you compare it to relatively low GDP growth rate in recent quarters. What's more important personal deposits confirmed our concerns, growing only 0.8% MoM, nearly three times slower than in previous years on average. Real growth rate of personal zloty deposits declined to 5.5% YoY in January from 7.8% in December and more than 14% only 6 months ago.

This troublesome trend was followed also in February. Personal zloty deposits decelerated to 8.8% YoY in first and 8.4% YoY in second decade of February. Let's recall that December, January and February are usually the months of fastest personal deposit growth in whole year. So if it were to be true also this time, banks would hardly see any deposit base expansion this year. There are three possible explanations for the cause of such deposit slowdown: dramatic deterioration of households' disposable income, excessive accumulation of anti-"Belka tax" assets in November that caused households' liquidity squeeze in subsequent months, or consumption-smoothing game that we've mentioned above. Now it's still too early to resolve it, but first two arguments seem rather unlikely. No doubt deposit growth will be one of the major factors in near term preventing MPC from loosening monetary policy much further.

Weak budget data in January, improvement expected in February

Budget deficit reached PLN6.9bn in January, i.e. 17.2% of the plan for whole year. Revenues amounted to PLN10.4bn and expenditures to PLN17.2bn, i.e. respectively 7.2% and 9.4% of the whole-year plan (before latest Sejm amendments!). This does not cerate too rosy picture, as annual growth rates for all revenue categories except for import tariffs declined considerably (see table below). Comparing revenue execution after first month (in relation to budget law assumptions) with average outcome in previous years (in relation to actual outcome in whole year) we find tax income performance rather poor. Nevertheless according to finance minister there has been significant recovery in tax collection in February, not only offsetting weak January resuts, but also allowing for improvement in relation to last year's results. Marek Belka even said that February tax revenue is a "revelation".

Budget revenues and expenditures growth YoY

	Jun 01	Jul 01	Aug 01	Sep 01	Oct 01	Nov 01	Dec 01	Jan 02	plan 2002
Revenues	**21,8**	**5,0**	**0,4**	**6,3**	**2,1**	**-2,5**	**-1,4**	**-10,7**	**2,6**
Indirect taxes	-5,9	8,2	5,6	-0,4	6,2	9,0	11,3	-3,2	10,1
CIT	-46,2	-33,9	-18,9	-22,2	-20,3	-31,4	-13,6	-40,8	4,2
PIT	0,4	3,4	0,7	3,2	2,0	3,8	0,5	-5,0	13,5
Budget entities income	104,9	38,5	-9,7	105,4	-1,2	-36,5	-26,4	-47,3	-36,1
Import tariffs	-17,0	-17,5	-21,0	-22,2	-10,9	-24,2	-16,5	-14,0	-14,9
Expenditures	**2,0**	**5,9**	**-0,6**	**5,0**	**11,9**	**26,9**	**32,1**	**3,1**	**6,4**
Domestic debt service	6,2	-0,3	-32,1	-0,6	18,0	11,8	234,4	6,7	25,1
Foreign debt service	-54,2	14,1	9,0	-26,0	-35,4	10,8	-2,7	-22,9	16,0
Labour fund subsidy	84,7	-18,1	-17,8	-26,4	-52,1	373,7	1390,4	101,9	37,2
KRUS subsidy	-9,0	43,4	-0,5	13,2	7,4	10,3	12,1	7,7	3,5
FUS subsidy	-8,2	24,4	-13,5	16,2	23,4	164,4	-21,9	57,8	27,3
Local government subsidies	7,8	11,6	3,3	9,1	9,9	28,6	12,1	3,3	1,9

Source: BZ WBK calculations based on data from the Ministry of Finance

Central bank watch

- Interest rates unchanged
- Government disappointed, MPs agitated
- NBP encourages banks to lower interest rate spread

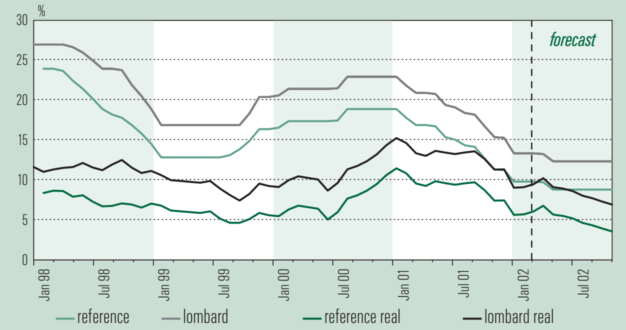
MPC leaves rates unchanged, blasts fiscal policy

The most frequently used phrase after 12 p.m. on 27 February was "as expected". Indeed MPC did not change rates and maintained neutral bias as expected by financial markets. After the meeting market's attention focused on careful analysis of MPC statement and on politicians' reaction to MPC decision (and indeed there was something to look at! – full coverage of politician's quotes is provided in the "Government policy watch" section below).

Let's take a look at the statement first. MPC presented already known evidence that net inflation and inflation expectations in January declined. MPC also stressed that recent inflation decline is broad-based. After reading the first paragraph one could wonder why MPC decided to leave rates unchanged. So far so good but... that is certainly the meaning of the second section devoted to money supply. MPC appears to share our concerns expressed last week, when we showed very troublesome developments in money supply statistics and that MCI index pointing to possible inflation rebound in 2H02. Indeed MPC clearly stated that recent money supply developments – sharp rise in high powered money – might fuel future inflation. This line was continued in section devoted to external developments and MPC pointed to an upward revision of US and German growth forecasts and likely rise in oil prices in 2H02. Sections on money supply and external developments clearly suggest that inflation outlook has significantly deteriorated since January meeting. There was almost a tightening bias between the lines. Then MPC expressed concerns about possible deterioration of the current account balance if domestic demand revival is too strong. But for now there is no threat and MPC pointed to low level of economic activity and low domestic demand pressure. So the tightening bias goes away.

Then comes the public finances' section, which is a well-balanced and fair judgement of the situation in public finances, but could trigger an outrage in the government. MPC simply says that government fiscal policy is not credible. Fiscal rules proposed by finance minister are not implemented (indeed real budget spending will increase by 2.4% in 2002 and not by 1% as desired by the government)

Interest rates monthly average



Notice: Real rates calculated assuming adaptational inflationary expectations (discounted by current inflation rate). *Source: NBP, BZ WBK*

which creates a significant uncertainty about the true shape of the fiscal policy in the future.

What do we make of it? MPC mentioned four components key to forecasting its future decisions. Two of them are suggesting further possible cuts: broad-based inflation decline, low inflation expectations and low domestic demand. Two are pointing to holding rates flat or to a possibility that rates may be hiked in the future. These are sharp increase in high powered money, reduction of term deposits and upward revision of external demand and oil prices. Finally fiscal performance is a risk factor and could prevent MPC from further rate cuts.

Last but not least we point to comment by Janusz Krzezewski, who is a member of the doves' faction. He said that what really matters is the medium term goal and that MPC does not want to fight inflation in 2003. This comment reinforces our belief that the desired inflation path is "around 4%" in both 2002 and 2003. It means that 2002 inflation target centred at 5% is not symmetric, and that MPC is really targeting 4% this year. If you believe that our argument is right, than you will automatically believe that interest rates may not fall at all in 2002. And if they will it may be 100 bp not more and later rather than sooner.

Government disappointed, MPs agitated

The lack of the interest rate cut at the February meeting was not met with the politicians' understanding. Therefore, attacks (this time on the scene of the Lower House) against the NBP and Monetary Policy Council as well as announcements of legislative changes to reduce the independence of the central bank reiterated with double force. You will find a more detailed analysis of these commentaries in the following section of MACROskope.

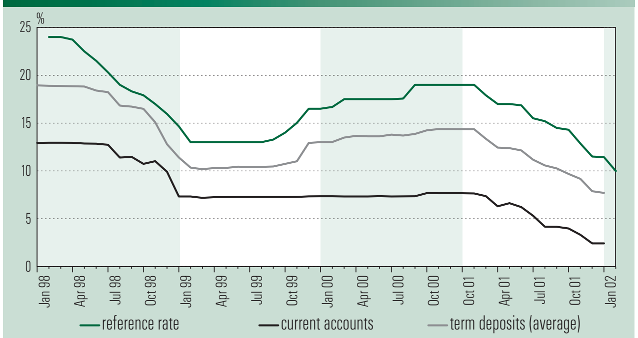
Despite the rising political pressure, we do not change our forecast and project another interest rate reduction by 100bp in May or June depending on the inflation level, i.e. only in the situation if the inflation falls below 3% in a period of time. The markets are expecting the cut in March-

April and the "London consensus" indicates a cut by 200bp by the middle of the year. For those who believe it, we recommend to again look at the two graphs showing the growth of a narrow M1 money aggregate figure and MCI (index of the monetary policy strictness) delayed by 9M, suggesting an inflation rise in H2 2002.

NBP plans to encourage banks to lower spreads

In light of latest monetary statistics one should not be surprised about growing central bank's concern about diminishing deposit growth. NBP finally decided to grant some relief to commercial banks by swapping inflation-indexed bonds that banks had to buy in 1999 (in exchange for lowering reserve requirement) into higher-yielding bonds. The operation completed on 28 February was supposed to improve banks' profits by ca. PLN300-400m. According to NBP deputy governor Jerzy Stopyra this action is supposed to encourage banks to narrow the interest spread between credits and deposits. Although the idea of exchanging low-yielding assets into market-indexed papers seems reasonable per se, we are somewhat sceptical if this could result in significant spread narrowing, as probably market conditions would play much more important role in this subject. Additionally, the biggest retailer PKO BP, which has dominant market position, would not be affected as much by this conversion, as it has already got rid of some of its inflation-indexed bonds during recovery programme.

Personal zloty deposit rates



Source: NBP, waged averages for banking sector

MPC wants to set a path to enter the EMU

Still this year, the Central Bank wants to agree with the Government on a planned way of entering the EMU. We perceive it as a reaction to the government's strategy, where it is assumed that Poland will have a budget deficit close to 4% GDP in 2006, i.e. it will be very far from satisfying one of the Maastricht criteria, which says that the deficit should be below 3%. This means that in their strategy, the government assume early accession to the EU in 2004, however a late accession to the EMU.

The issue of an early or late switch to Euro is a continued subject of a heated debate among politicians, but first and foremost among economists as there are good arguments for and against. For instance, an early switch to Euro brings about the decrease in the costs of enterprises as the FX risk is eliminated, while at the same time the economy is more vulnerable to shocks, as the safety valve in the form of an independent monetary policy disappears and the entire shock is transferred to the real sector and fiscal policy.

It seems that one of the objectives behind the debate will be an attempt to persuade the public opinion the decrease in the budget deficit which would have to be bigger than the one proposed by the Government. In this respect there is nothing to debate – the deficit should be decreased regardless of the date of our accession to the EMU.

Comments of the members of the Monetary Policy Council

Last month the members of the MPC in their comments indicated the risk which would result from a deep cut in the interest rates – the decrease in the foreign investors trust, capital outflow, a sudden and uncontrolled weakening of PLN, incapability of financing the budget deficit and a substantial fall in savings. The impact of the interest rate cuts so far on the economy should be noticeable in the near future.

The turn of February saw a heated discussion between the Government and the MPC. Leszek Balcerowicz, the MPC Governor, was very critical in respect of the presented economic programme of the Government and said it was propaganda, although he expressed positive opinion on the solutions included in the "Entrepreneurship First" programme. All MPC members objected to the brutal attacks of the politicians, presented the potential damages such comments might bring about and were univocal emphasising that they would not surrender to any pressures.

The comments of the MPC members (Janusz Krzyzewski, Leszek Balcerowicz) may lead to conclusions that the Council will aim at the bottom end of the inflation rate projected as at the end of year, i.e. 4%. This is to streamline tackling the inflation next year as well as meeting the medium term objective (under 4% as at the end of 2003). Should this argument be true, this automatically limits the scope of the potential interest rate cuts.

The January decision on the interest rates cut was again made with the votes spread five against five, with the Governor Balcerowicz's vote for the cut. This means that a 5-5 votes spread with the Governor's vote for the cut was identical in case of the last three cuts of 150bp each. We are sure that the NBP Governor does not find any room for subsequent cuts over the next few months. Therefore, in our opinion the votes spread confirms that there may not be any more interest rate cuts this year or the MPC will cut the rates down by 1% in June, after the May inflation rate will go under 3%.

WHO? WHERE? WHEN?	QUOTE
Grzegorz Wojtowicz, MPC member;	
Reuters, PAP, 15 Feb	"January inflation figure must have been influenced by slower growth of controlled prices in first month of the year. [...] Earlier inflation estimates accounted for significant growth of controlled prices." "These are monthly data and we should not get too excited about them." "I think that February and March could bring about some inflation rebound due to tax changes and controlled prices growth."
Cezary Jozefiak, MPC member;	
PAP, 15 Feb	"It's less than market expected. But it could have little meaning for the future, because due to several developments, i.e. increasing tax burden or controlled prices growth, inflation will be a bit higher this year than last year and could reach 5% by the year-end."
PAP, 19 Feb	"Industrial production fall in January was caused mostly by investment demand fall. It's another evidence of poor business climate." "In such situation government should care for investment demand stimulation, mostly by changing tax regulations and labour market regulations."
Boguslaw Grabowski, MPC member;	
PAP, 15 Feb	"I would warn you against being too excited about current inflation figures, because they don't reveal the risk, the possibility of demand rebound after last interest rate reductions and the possibility of reversion of supply shocks, which were observed last year, i.e. low food and fuel prices." "Inflation stabilisation should be expected until summer."
Puls Biznesu, 27 Feb	"Society does not understand monetary policy." "Current monetary policy is more transparent and clear than ever before." "For me political pressure has no significance at all. But it creates bad atmosphere. Finally, market could start to believe that some MPC members bow to such pressure, consciously or not. [...] In reality such pressure tightens monetary policy by the exchange rate appreciation." "MPC enlargement would challenge constitutional rule of central bank independence. EU would interpret such decision as undermining central bank independence. I'm convinced that if our politics consider seriously EU entry perspectives then no changes in MPC will take place." "I haven't received any information about my salary change. If this happens, I would have to react properly." Q: "Would you resign then?" A: "If I see that certain rules are broken, then I would try to appeal to the court first."
Reuters, 6 Mar	„If the cuts were as sweeping as some deputies want, investors would surely lose confidence in Poland, slashing capital inflows and weakening the zloty." „And after capital inflows dwindle, the public budget deficit would become unfinanceable and the already low state expenditures for 2002 would have to be slashed further," „We would have turbulence on foreign exchange markets, serious disturbances in budget spending and most likely the necessity to raise interest rates to fight against inflation. So economic growth would decline even further."
Dariusz Rosati, MPC member;	
Reuters, PAP, 19 Feb	"These figures show there are no signs of recovery in economy, despite some signals that we've received from business polls." "It's too early for forecasts for first quarter. But I don't expect GDP to fall."
interia.pl, 28 Feb	"Sudden interest rate reduction would surely trigger capital outflow from Poland and massive zloty depreciation, endangering with currency crisis." "There is a risk of inflation rebound in 2H02." "More time is needed to asses whether there is a threat of inflation rebound because of increasing retail sales, growing amount of money in circulation and deposits fall." "We would like to agree with government on EMU entry path in six months."
Leszek Balcerowicz, NBP governor;	
Reuters, PAP, 20 Feb	"These [macroeconomic] results are in line with expectations which were made before we ordered the previous [interest rate cut]. This concerns inflation as well as the production fall." "There are reasons to believe this [pickup] could take place in the second quarter. Then, we can expect an impulse from an improving external climate as well as from a series of past rate cuts." "The most likely forecast is that barring unfavourable price shocks, we should be very close to stabilising already achieved inflation around four percent."

	"If political forces try to influence [the zloty], then they don't always reach the goal they want. It would be best if someone who believed the zloty is too strong drew the right conclusions."
	"The best way to weaken the zloty would be to reduce the budget deficit, lowering state debt issuance and curbing foreign porftolio inflows into Poland. Also, privatisation revenues should be kept in hard currency to pay back foreign debt, not exchanged into zltoys to plug budget holes."
Reuters, PAP, 25 Feb	"Poland's EMU entry is the question of when and how, but the question if."
	"This transition period for small open economies can be pretty turbulent. [...] The shorter this period, the shorter the period of turbulence."
	"I think this is unfounded." [saying that entry too early could jeopardise the economic stability of the euro zone]
	"Enlargement makes the case for (EU) institutional reform even stronger, but does not create it."
Reuters, PAP, ISB, 27 Feb	"We've sent our opinion [regarding government strategy] to PM Leszek Miller and finance minister Marek Belka. Now it's up to government whether this opinion will be published."
	"The cabinet's promise to cap the spending rise this year at one percent in real terms was broken. Now spending is set to rise 2.4 percent in real terms."
	"We attach high significance to eliminating legal barriers in job creation. [...] MPC positively evaluates government's package 'Entrepreneurship first'."
	"Government's [economic] assumptions seem realistic."
	„This decision was not unexpected. We signalled it before. We are now focusing on the profitability of savings."
	"The MPC will cooperate with any cabinet that works towards ensuring long-term economic growth."
	"Real interest after rate cut and interest income taxation falls to record low levels, and we have to care for saving incentives."
	"Economy reaction to interest rate cuts could take 6-9, or even 18 months"
"If there is no adverse turbulence, inflation could be close to 4% by the year-end."	
Radio ZET, 28 Feb	„If we look at the government's programme we could conclude that perhaps it is a strategy but not an economic one. Maybe its propaganda."
	"The (government's) pro-growth scenario can only be realised if the national bank changes its policy. This could turn out to be a propaganda trick to blame the bank if growth is slower (than expected)."
	"In this Strategy government applies absurd assumptions from the point of view of economic theory and empirical evidence, or it is a pure propaganda."
	"Budget borrowing needs are very high. Budget limits the firms' access to credit and contributes to high unemployment."
	"We observe a continuing aggression aimed at the MPC and monetary policy in situation when deep rate cuts have been made. "
	"Do you think MPC will make decisions not guided by merits only because certain practices not seen in modern civilisations sneaked into our public life, I mean resorting to public blackmail. This is imposing a systematic public blackmail, dressed in words accusing us of lack of co-operation. We also observe falsification of reality. Do you think that because of such practices we should make decisions which, in our belief, would be against our constitutional mission."
	"These practices were not present in Poland before. Before September - October last year nobody in Poland used public blackmail and threatened that would de facto breach the Constitution because he does not like the policy of the independent central bank."
	"I will not speculate whether Constitution in Poland will be breached. I can only say that violating Constitution is something rarely seen is civilised world. Mounting attacks on central bank as well as violating earlier-signed agreements contributes to higher risk of investing in Poland. "
PAP, 1 Mar	„Monetary policy will not bow to political pressure, because it's destructive."
	"Attacks are harmful, because they fuel speculative inflow of capital in hope for rate reductions and they contribute to zloty fluctuations."
	"As a governor of NBP, which is constitutionally independent, I will make decisions disregarding political pressure."
	"NBP and MPC will support every cabinet which cares for sustained economic growth, but not only temporary economic revival."
	"If it comes to regular meetings between NBP and MPC with finance commission, then if it is done with respect, we can accept this."
Janusz Krzyzewski, MPC member;	
PiG, 26 Feb	"With respect to interest rates, we attach high importance to maintain certain level of deposit rates, because it is worrying that with falling interest rates propensity to save also falls, because it pays less. And we have to take this also into account."
Reuters, 27 Feb	"One should not assume that there would be no [interest rate] movements or they will be only in one direction. For us the most important is medium-term target."
	"We would prefer not to fight inflation next year."
PAP, 6 Mar	"Firm step reducing interest rates by 400-500bps, suggested by MPC's adversaries, means suicide at the moment."
	"After deep rate cut there could be the event that we're afraid of the most, i.e. rapid flee from the zloty."
	"We have banks' behaviour asymmetry when it comes to interest on loans and deposits. If we add interest income taxation, then massive withdrawal of zloty deposits could take place and switch into foreign currency deposits, but held in own drawer."
	"If there was panic and inflation bounced, consequences for the economy could be dramatic."
	"I've voted for the rate cut [in January]. Decision has been made with slight majority due to double vote of NBP governor."

INFORMATION ON THE MEETING OF THE MONETARY POLICY COUNCIL ON FEBRUARY 26-27, 2002

The Monetary Policy Council held its meeting on February 26-27, 2002. The Council was submitted the materials prepared by the Management Board and departments of the NBP and information and analytical materials prepared by the Ministry of Finance, banks and research institutes. On this basis the Council discussed inflation; tendencies in the area of money supply, lending and interest rates; external conditions and the situation in the balance of payments, real sector of the economy and in the public finance sector.

I. Inflation, inflation expectations.

1. The consumer price index on the twelve-month scale lowered in January to 3.5% as compared to 3.6% a month before.
2. According to estimated calculations, in January 2002 the index of the so-called net inflation (excluding foodstuff and fuel prices) was on the twelve-month scale lower by 0.4 percentage point than in December last year and amounted to 4.7%. Within the period December 2001 - January 2002 the difference between „net" inflation and CPI decreased from 1.5 to 1.2 percentage point. Although the level of foodstuff and fuel prices - groups of goods that are excluded from the net inflation index still favorably affects inflation, this positive impact is getting smaller. The inflation reduction results from the drop of growth pace of prices for a big part of goods and services groups. The remaining measures of core inflation will be presented by the National Bank of Poland after the respective data are made available by the Central Statistical Office.
3. In January 2002, the decreasing tendency of the sold industrial output prices - that lasted for three months - was halted. They were formed at the level noted a year before and as compared to December last year they increased by 0.1% (in December 2001 the sold industrial output prices were lower by 0.4% than a year before and by 0.3% than a month before).
4. In February this year, the future inflation expectations of individuals improved. After a 2-month growth, the percentage of individuals forecasting that the prices will grow faster than now decreased (to 16.6%). Inflation expectations of natural persons, however, considerably depend on current inflation. The inflation rate expected by bank analysts in the 11-month horizon slightly lowered and amounted to 4.6% as compared to 4.7% in a survey made a month before.

In January 2002, the growth pace of consumer goods and services prices on the twelve-month scale slightly lowered. It amounted to 3.5% as compared to 3.6% in December last year. The index of the so-called net inflation maintained over CPI (by 1.2 percentage point) reflects a favorable impact on inflation of groups of goods excluded from this index, i.e. foodstuffs and fuels. However, the decreasing of the difference between net inflation and CPI proves that the reduction of inflation is not only a result of potentially temporary factors but it is also combined with a drop of the growth pace of prices for a big part of goods and services groups.

The improvement of future inflation expectations was noted in case of both natural persons and - although slightly - bank analysts.

The decreasing tendency of sold industrial output prices - that lasted for three months - has been halted. They were formed at the level noted a year before and as compared to December last year they increased by 0.1%.

II. Money supply, loans, interest rates.

1. The nominal growth pace of total money supply (M2) on the twelve-month scale lowered from 13.7% in December 2001 to 12.0% in January this year. So, it is still maintained at a quite high level.
2. In January this year, an annual dynamics of cash in circulation increased again. On the twelve-month scale the growth pace of cash in circulation amounted to 15% as compared to 12% in December and -4.6% in January 2001.
3. At the same time, a further decrease was noted in case of the twelve-month growth pace of PLN-denominated deposits placed by individuals. In January this year, it amounted to 9.6% as compared to 11.7% in December 2001 and 22.5% a year before. One of the factors that caused the decrease of the dynamics of PLN-denominated deposits of households was the lowering of interest rates on deposits. Also a future taxation of interest income from bank placements adversely affects the tendency of the public to place free funds at banks.

   However, the dynamics of foreign currency deposits placed by individuals increased. In January this year, it amounted to 16.1% on the twelve-month scale as compared to 13.7% in December and 6.4% in January 2001.

   Also the increase was noted in case of the assets of households that are held outside the banking sector - in Treasury securities and open investment funds.
4. Within the latest months, a tendency to stabilize the lending dynamics at a low level appeared. In January this year, an annual dynamics of lending to non-financial sector was at the level of 7.2% (as compared to 7.6% a month before). The dynamics of lending to households amounted to 14.4% (as compared to 14.7% a month before) and the dynamics of lending to businesses was 5.0% (as compared to 5.4% in December last year).
5. Since October last year, a very high annual dynamics of the budget sector net debt has been maintained. In January this year, the net debt was bigger by 41.1% than in the same month in 2001.

Within the latest months, relevant changes in the structure of money supply appeared that might pose a threat to inflation processes in future. On one hand, a clear drop of the dynamics of PLN-denominated deposits of individuals is observed, on the other hand, however, a relevant increase of the dynamics of cash and demand deposits is noted.

At the same time, a low dynamics of lending to businesses and households is accompanied by a very fast growth of the budget sector net debt what is not favorable for the increase of economic activity.

III. External conditions.

1. Since the last meeting of the Monetary Policy Council the forecast of economic situation worldwide improved a little. Especially it is related to the American economy. In January this year, in the United States, inflation still lowered, a growth of unemployment was halted, and the retail sales volume increased considerably more than expected by the market. Actually, investment banks forecast that the GDP growth in the United States in 2002 can amount to 1.3 to 1.9% (as compared to forecasts 0.1-1.5% in January this year). A slight improvement has also been noted in forecasts of a growth pace of Germany's economy - Poland's biggest trade partner. However, they are still at a low level 0.5-0.9% (as compared to 0.2-0.9% in January this year).
2. Due to the upward verification of the economic growth forecasts - especially in the United States, higher prices for oil are expected. In the first six months a stabilization of prices for this raw material at the current level should be expected. However, since the 3rd quarter this year, together with the expected decrease of oil reserves, its prices can start rising.

Since the last meeting of the Monetary Policy Council there have appeared signals that the boom in the world economy, which may be expected in the second half of 2002, can be stronger than expected a month before. It is also related to Germany's economy - Poland's biggest trade partner.

Since the last meeting of the Monetary Policy Council the forecasts for oil prices have been verified upward. In the second half this year a probable rise of prices for this raw material can contribute to the increase of inflation pressure.

IV. Balance of payments, exchange rate.

1. In 2001, the current account deficit amounted to USD 7.0 billion and was lower by USD 2.9 billion than a year before. The revenues from exports were bigger by 7.2% than a year before. The dynamics of imports amounted to 1.3%.
   The growth pace of both export and import weakened during the year. In December 2001, for the second month in a row the revenues from exports lowered as compared to the same month last year. This drop amounted to 7.7% (as compared to 3.7% a month before). The trade deficit in December 2001 decreased as compared to December 2000 as a result of a drop of import expenses by 9.5%.
2. In January 2002, the appreciation tendency of the Polish currency reversed. The exchange rate of the zloty weakened against both the dollar and the euro. In January and February (to February 26) an average monthly rate amounted to PLN 4.06 and 4.19 for a dollar (as compared to PLN 4.01 in December last year) and PLN 3.60 and 3.64 for a euro (as compared to PLN 3.58 in December 2001), respectively.

A visible in the consecutive months of 2001 improvement of the current account balance is the evidence for the strengthening of the macroeconomic equilibrium. However, there is a considerable uncertainty about the current account balance in future. The increase of the domestic demand can, in conditions of a weak economic situation in the world, contribute to a repeated growth of external imbalance.

V. Supply, demand, situation on labor market and income.

1. In January this year, the sold industrial output decreased as compared to the same period last year by 1.4%. The construction and assembling production was lower by 21.3% than in January 2001. The bigger drop of construction output was affected by a more severe winter than in January last year.
2. In January 2002, the employment in the enterprise sector decreased by 0.2% as compared to December 2001 and it was lower by 4.7% than a year before. The biggest drop of employment during the whole year took place in the construction sector (by 11.8%). The unemployment rate rose from 17.4% a month before to 18.0% in January. The number of the unemployed increased by 4.4% as compared to December 2001 and by 14.7% as compared to January 2001 and it amounted to 3.253 million.
3. In January this year, average gross wages in the enterprise sector were higher by 5.7% in nominal terms than in the same period last year. After taking into account the inflation the rise of wages in the enterprise sector amounted to 2.1% in the whole year, i.e. the most since January 2001. However, as a result of the drop of employment, the wage fund was lower in real terms than a year before. The average pension and disability benefit in January this year was bigger by 14.6% than a year before. Its purchasing power increased in the whole year by 10.7%. A high valorization of pensions and disability benefits in 2001 will result in a high dynamics of these payments until June 2002, i.e. the next valorization of pensions and disability benefits.

There have been maintained a low level of economic activity and a low demand pressure.
The real growth of wages in the enterprise sector by 2.1% on the twelve-month scale, although the highest since January last year, was concentrated in several sectors and big enterprises.

VI. Situation in public finance sector.

1. In February, the Parliament enacted an Act on the State Budget for 2002. Despite the position of the Ministry of Finance, it provides for revenues higher by PLN 1.2 billion than the Government intended in the project. The expenses have been increased by a similar amount. This way a principle of increasing the state budget expenses by 1 percentage point over inflation that was declared in the economic strategy of the Government has been broken. According to the Act on the State Budget, this year they can be increased in real terms by 2.4%. If the average annual pace of price growth appears lower than it has been assumed by the Government in the construction of the budget, then this growth will be even higher. The amount of expenses set forth in the act will not include the payment of arrears to OFE (Open Pension Funds).
2. Due to the delay in implementing some of the Government proposals increasing tax revenues, the budget revenues may appear lower than set forth in the act.
   In January this year, they were lower than a year before. Budget deficit in January 2002 was bigger by over 34% than in the same month last year. Last year, the state budget received extraordinary foreign revenues at the amount of PLN 1 billion. It should be noted, however, that for the second year in a row the tax revenues in January are lower than the ones noted a year before.
3. .Even though the state budget expenses were increased at the pace of 1% in real terms a year, the public finance sector deficit would be maintained in the period 2002 - 2004 at a very high level. Meanwhile, a forecasted acceleration of the growth pace of the economy should be accompanied by a bigger reduction of public expenses and deficit. A big deficit while the revenues from privatization are small will result in a further increase of lending needs of the budget. It will cause a strong reduction of lending to enterprises.

The public finance area is connected with a high uncertainty. In the Act on the State Budget there have been set forth revenues higher by PLN 1.2 billion than originally assumed by the Government. The planned expenses have been increased by a similar amount. As a result, despite the principle of forming the budget expenses that has been accepted in the economic strategy of the Government, this year, they may be in real terms higher than a year before not by 1% but by 2.4%. The forecasted in the Act on the State Budget a very big deficit of public finance sector may appear even bigger. Big lending needs of the budget will result in a strong reduction of lending to enterprises.

VII. Decision of the Monetary Policy Council.

1. Since the last meeting of the Monetary Policy Council the data indicating a low demand pressure in the economy have been proved. These data is within the range of forecasts that constitute the basis for the last decision of the Monetary Policy Council about interest rates. On the other hand, however, unfavorable changes in the structure of money supply advanced that may constitute a threat to inflation processes in future. There was also maintained a big uncertainty related to the public finance area.
2. Since February 2001 to January 2002, the Monetary Policy Council has cut the reference rate from 19% to 10%, i.e. by almost a half. After inflation is taken into account, so in real terms, the reference rate lowered from 11.6% to 6.3%, i.e. by 5.3 percentage points. So far neither banks nor enterprises fully reacted to these cuts. Especially it is related to the last cut made in January this year. The monetary policy this year has been additionally eased by the depreciation of the exchange rate of the zloty.
3. As a result of, inter alia, the drop of interest rates on deposits, the dynamics of PLN-denominated deposits of individuals on the twelve-month scale lowers. This negative phenomenon got stronger after it has been announced that the bank placement income will be taxed. However, the growth has been observed in case of households' assets held in Treasury securities and open investment funds.

Considering these arguments, the Monetary Policy Council decided not to change interest rates of the NBP and to maintain its neutral position in the area of monetary policy.

VIII. The next meeting of the Monetary Policy Council will be held on March 26-27, 2002.

Government policy watch

- Shame in parliament: debate over monetary policy
- Chances of NBP charter amendment are growing
- Budget bill passed by Sejm, Senate keeps working on it
- President signed tax changes
- Sisagreement in coalition gets more evident

Shame in Parliament

There is an endless list of Scottish jokes, one mentions a Scottish prayer - „Oh Lord, we do not ask you to give us wealth. But show us where it is!". After listening to last Sejm's debate over monetary policy one should probably say "Oh, Lord, we do not ask you to give us wisdom. But show us where it is!".

Few hours after February MPC decision on no rate change deputies representing five parties: SLD, PSL, UP, LPR and Samoobrona (which gives big enough majority to change the Constitution) demanded a deep change in the monetary policy suggesting it should support growth and fight unemployment. Deputies submited a draft of urgent resolution to Sejm demanding radical change of policy from MPC. The debate over the resolution was horrifying. Deputy NBP governor present in Sejm was accused of taking drugs, some deputies made references to NBP governor Leszek Balcerowicz that if "dog bites the owner it should be shot dead". During the second day of the debate more than 30 deputies asked "questions" to Leszek Balcerowicz. A short definition of a question is a list of words ending with a question mark. And we have seen questions such as: is it true one MPC member is mentally ill, you are performing holocaust on Polish nation, you are responsible for so many suicides etc. One can't resist a feeling that even if Lord showed where the wisdom was many would not be able to find it. It is now clear that public debate in Poland has reached the level when merits and knowledge have little to say and decisions are based on emotions, and emotions always lead to very bad decisions.

Real debate took place between Balcerowicz and Belka with the latter arguing that if rates are not reduced further inflation will exhibit inertia and will fall further. He also called monetary policy internally inconsistent, which was probably tit-for-tat move after Balcerowicz called Belka program propaganda.

After the debate Sejm resolution calling for monetary policy change was sent to public finance commission where it will be fine-tuned. There is vast majority supporting the resolution. However as long as no legal changes take place markets behave relatively calm.

The chances of NBP charter amendment are getting bigger...

It appears that there are more than 50%+1 deputies in the parliament to change the NBP law and while SLD caucus did not formally present its stance, newspapers reported that many SLD deputies would support the bill submitted by PSL and UP. Jacek Piechota, economy minister and influential SLD member made it crystal clear that they can prevent more radical SLD members from supporting NBP law amendment, but in two months one of the two has to happen: economy revives or Balcerowicz cuts rates. Marek Dyduch, newly appointed SLD general secretary said in radio interview that he sees growing support for this motion in SLD caucus and that probably it would be necessary to amend central bank charter "if there is no clear sign", i.e. if MPC doesn't lower the rates by 500bps.

...fortunately enough there still are the Senat (the Higher House of the Parliament) and the President

Much as we expect the economic revival to come, we doubt it will be strong enough, at least in Q2, to satisfy the politicians. Of course, one should forget a 5% cut in the interest rates. Given the above, should we still expect any changes in the composition and accountabilities of the MPC in the months to come? Well, not necessarily. Firstly, the legislation process is slowish. Secondly, it is not certain if the amendment finds many believers in the Senat. It may be that in the meantime there will appear the economy revival symptoms and the MPs determination in respect of the amendment will melt. Finally, there still is President Kwa_niewski who has recently affirmed that he will protect the Constitution and will not sign any Act that would be non-compliant.

Budget bill approved, revenues inflated by PLN1.1bn

At the end of February Sejm approved budget bill for 2002, setting budget deficit at PLN40bn and increasing both revenue and expenditures forecast by PLN1.1bn compared to government proposal.

Parliament increased VAT forecasted revenue by PLN625m, although recent developments point rather to the opposite scenario. Mind that finance ministry's calculations were based on several assumptions that have not been met already: VAT hike on some articles is already delayed at least 1 month, Sejm also reduced some VAT increases (i.e. on child's articles 12% instead of 22%) or cancelled them out (on construction). Additional funds were "found" in budgetary units' special funds that were reduced by 20%, and higher forecast of NBP profit. This "extra" money was spent on several targets, of which the biggest were teacher's wages, Food Procurement Agency, roads and motorways.

So you have it. You can see how much attention PM's pay to public finance strategy adopted by the government just few weeks ago and Belka's "inflation +1%" rule regarding budget expenditures. With 2002 spending set to PLN185.1bn we have 7.1% expenditure growth in relation to 2001, exceeding Belka's rule by nearly 2%. If this is the practice to be expected also in the future, we hardly see any "deficit outgrowth" chance, even with high GDP rate.

Senate made only small corrections to the budget, without changing its major parameters. If everything goes as planned President could sign the bill by the end of March.

President signed tax changes

Despite dramatic calls from OPZZ (not mentioning our appeal), Aleksander Kwasniewski signed the amendment to tax law, changing excise tax and VAT. Changes were supposed to bring some PLN2.6bn to the budget. New excise tax on electricity and higher VAT rates will be imposed 14 days after publishing the law. Tax on electricity will transform into higher producer prices, while it will affect energy producers. Pass-through to consumer prices will be probably delayed at least until July, because energy market regulator (URE) said it would not allow for any tariff revisions until 2H02. Nevertheless increased VAT on some product and services will effect in price growth already in next months, though this influence would not be very significant.

ZUS liabilities' repayment arranged

Labour minister Jerzy Hausner said that his ministry and finance ministry agreed on the way to solve problem of ZUS liabilities due to OFE. Let's recall that these liabilities have been estimated at PLN5.5bn plus PLN1.8bn of interest (at the end of 2001). This year Treasury will take over the liabilities from ZUS. Then 80% of these funds will be converted into market-yielding bonds. Maturity structure of these bonds has not been resolved yet. But ministry considers bonds with several maturities that could be assimilated to different bonds already issued. Remaining 20% of liabilities will be repaid next year in cash, because earlier it would be impossible to identify exact amounts owed to particular funds. Labour minister said also that they consider reducing the interest charged on liabilities overdue (20% p.a. at present) to the level close to T-bill yields (ca. 9.5-10%). Additionally, ministry assumes that since mid-2002 there should be no further delays in premium transfer from ZUS to OFE.

Government approved foreign capital flows liberalisation in October

Cabinet accepted new foreign exchange law draft prepared by finance ministry. The bill assumes full capital flow liberalisation with OECD, EU and EFTA countries since 1 October 2002. The bill unifies Polish capital flow restrictions with that of the European Union Treaty (but mind the pension funds restrictions). Nevertheless for other countries that above-mentioned foreign exchange regulations will still apply.

Government plans to encourage people to voluntary pension saving

According to Rzeczpospolita government plans to proceed with legal changes that would facilitate expansion of 3rd pillar of pension system in Poland. They plan to grant tax allowances for people saving voluntarily in private pension funds. In light of diminishing propensity to save among Polish households, declining interest rates and introduction of capital income tax, such initiative seems to be a good idea, especially that it would create the incentive for long-time saving, the most desired for investment financing.

Local elections divide ruling coalition

Apart from budget and taxes in second half of February Sejm also decided on the local elections date and vote counting method on Friday. It might seem less important from economist's point of view, however it might give some hint on ruling coalition's consistency and so on its ability to proceed with hard and disciplined policy ahead of local elections. PSL opposed SLD-UP motion to hurry up with local elections and to impose vote-counting method favoring large parties. Surprisingly new parliamentary coalition emerged while Samoobrona supported the vote-counting method change. Are they hoping to gain such large support until autumn to benefit from d'Hondt method? Wish they were wrong...

EC likes our position on land. Do we?

EU Enlargement Commissioner Gunter Verheugen said that European Commission would recommend EU countries to accept Polish position on land. That – in his opinion – should enable us to close negotiations on free movement of capital by the end of March. Excellent – one might think. But it's definitely not that simple. Although the government accepted the position, it is still pure declaration only. It will become a real fact only after parliament accepts the law, authorising government proposals. And this could rise serious doubts indeed. We wrote earlier that minister Kalinowski would have to convince his colleagues at PSL to support the motion, and this would be the most difficult task. Gazeta Wyborcza reported that there are serious concerns among PSL members in this regard. And one of PSL prominent members answered “We'll see” in TV interview to the question whether PSL would defend its leader Kalinowski against no-confidence motion put by Samoobrona party. Moreover, according to Gazeta Wyborcza, the law prepared in agriculture ministry puts very strict limits on land purchase, contradicting the stance accepted by the cabinet and probably unacceptable for EU. Therefore one should not be too optimistic about our progress in EU negotiations. It's not as simple as that. Mind also that there is this difficult issue of direct subsidies.

EU warns it might reduce structural funds available for Poland

EU15 foreign affairs ministers said that the amount of structural funds granted to Poland for 2004-2006 (ca. EUR15.3bn) might be too high to be employed efficiently by our country. If Polish government doesn't prove that it is able to absorb the funds efficiently, EU might consider reducing them by some 20%. Well, let's hope that it would not happen, because otherwise... Bye-bye infrastructure projects! Bye-bye public finance strategy!...

Social protests take off

Frosty weather is gone for good while more and more social protests take place. In the last few weeks we have seen teachers demanding wage increases, nurses also indicated their determination to get the famous “203 zloty” pay increase stated by the law last year, while 70% of them have not seen their paycheque rising last year. Samoobrona leader also warned about upcoming waves social unrest (we bet he is working hard to make this scenario come true). And bear in mind that Sejm will have to pass a many belt-tightening measures in the months to come.

Comments of the Government representatives

The Government representatives continued their massive attack on the MPC. The economic growth is the most important factor for the politicians, the inflation is less important. The have not bee satisfied with the interest rate cuts so far and they expect further cuts, even by 400-500bp. The MCP has become an unwanted child blamed for any evil in the Polish economy. The governing coalition's support for the amendments in the NBP Act has been growing.

WHO? WHERE? WHEN?	QUOTE
Marek Belka, deputy PM, finance minister;	
Reuters, PAP, 6 Feb	"We think this period between the close of accession negotiations and actual entry into ERM-2 will be the most difficult for Poland and for exchange rate stability. We could be vulnerable to speculative attacks...this is a problem for us." "There may be an up-front devaluation of the zloty. This would not be senseless." "We hear suggestions from western economists and experts that it would be wise for new entrants to devalue their domestic currencies to give more oxygen to their economy."
Reuters, PAP, 7 Feb	"I don't believe that finance minister's comment could have influenced exchange rate so much, it must have been something else. Probably market expectations for fast further rate cuts have diminished." "I didn't say that zloty should be devalued, I only said that I hear from some the people from the West that I talk to that they consider such ideas." "However one cannot rule out the possibility that when Poland joins the ERM, EU could suggest exchange rate adjustment. It's hard to imagine that they would ask for zloty appreciation." "On one hand zloty weakening is profitable for exporters, on the other hand it increases foreign debt servicing costs. But all in all there's nothing to worry about." "Economic growth collapse in recent years resulted, despite several finance ministers' efforts to limit budget spending, in threefold, or at least 2.5-fold growth of economic deficit." "For 2000 we had around 2%, for next year we don't have final estimates yet, but it will approach 6% of GDP." "We are discussing with NBP over the possibility of hurrying the process of lowering obligatory reserve requirement. [...] One has to remember that budget always loses on such operation."
Reuters, 8 Feb	"Economic growth is crucial, even if it would have to be achieved at the cost of other important objectives. Even if it would have to mean some increase of inflation and current account deficit." "We still think that it should not be the reason for monetary policy tightening, we shouldn't face another round of policy tightening." "Without growing economy, we're lost. (...) It's not just about inflation and current account balance. These objectives are important. But without economic growth we will fall in financial problems."
Rzeczpospolita, 16 Feb	"[I'm not happy that] deputies changed VAT revenues estimates so suddenly. [...] It could happen that VAT revenues would be not that bad, but CIT and PIT revenues could be weak at the same time. Such budget manipulating is simply dangerous." "All in all parliament's innovations in this budget are not that big. So if this budget is passed in such shape, I will have no big reasons for disappointment. It's the budget that we could afford this year."
Reuters, 18 Feb	"There were serious misperceptions about the potential weakness of the Polish currency among officials at the ECB and the EU whereas in fact the zloty's strength was the real problem." "A currency crisis for us is that the zloty is too strong." "I think lets discuss, lets do it together, lets weigh the risks." "[The idea that zloty would have to be devalued prior to adoption of the euro] This is not a plan, this is clearly an option." "The CPI index may creep up from 3.5 percent to maybe four percent."
TVN24, Reuters, 25 Feb	"If someone is afraid that inflation could rise to some 5% at the end of this year, then I remind you that it's just MPC inflation target for this year. [...] Then if we have 5% inflation target and now we have 3.5% inflation, please don't tell me there's no room for interest rate cut." "I think that lower rates will lessen the appreciation pressure on zloty. Zloty will not appreciate that much any more, at least in the short term." "Our expectations that first quarter or even first half of the year are weak, stagnant, start to confirm. We expect that it's the bottom of quasi-recession." "If we take leading inductors of business climate for serious, then there are some signals of improving optimism among companies. Second, public finance stabilisation is a signal for entrepreneurs that it's going to be normal."
PAP, 26 Feb	"Realisation of budget this year does not proceed without problems, because it reflects whole economy situation. But close examination suggests that there are really big chances to meet budget deficit limit set by the government without the need of budget amendment. For now I can sleep safely."
Reuters, PAP, ISB, 27 Feb	"I'm not surprised with such decision, because if I kept hearing for a week so many times that MPC would not lower the rates, then it was difficult to be surprised." "It is key for the finance ministry that the MPC takes up discussion with the government on the economic policy plans. We expect a joint strategy to help the cabinet's agenda." "We are on sharp disinflation path. It means that with current monetary policy course inflation will keep falling." "Inflation declines faster than we thought. [...] Good. But isn't it too good? If we reinforce this trend no matter at what cost, our inflation fight could turn out to be a failure too. I think so, otherwise I wouldn't have said that there is scope for interest rate reduction today." "I'm not the high inflation enthusiast, nor inflationary financing of economy." "We're not up to destabilise zloty. We just want the zloty not to appreciate excessively." "We estimate that in 2001 economic deficit increased to 5.5-6.0% from 2.2% in 2000. These are preliminary data, because we don't have the information from local governments." "Economic recovery could take place in 2Q02, but more likely in 3Q02. [...] I would be silly is I assumed any outstanding improvement for the whole year." "Necessary support, though not panacea, for our efforts to revive economic growth is monetary policy loosening." "We've estimated that banks could lower interest rates by 0.1 percentage point [due to exchange of inflation-indexed NBP bonds to 10-year market-yielding bonds]. It's ridiculous. But the Treasury would be hit in the back: it would loose PLN400m."

	"Obviously NBP has the right to lower reserve requirement, it does not have to ask anybody for permission. But is means that powerful fiscal instrument is in NBP's hands, because this way bank will lower budget revenues by PLN800-900m."
ISB, 28 Feb	"President Balcerowicz's opinion is for internal use only, it's confidential and I'm not going to reveal its contents. It wasn't free from negative remarks, pointing to different threats, which I perceive as a starting point for discussion."
	"Elements of this opinion come out in some comments made by Leszek Balcerowicz and Boguslaw Grabowski."
	"Every day I'm more convinced that this budget will be executed. [...] It's cautious budget, but during works in parliament it has been slashed a little, VAT on construction has been cancelled."
	"It's possible to reduce reserve requirement sharply, but it means harm for the budget, which means that NBP has not only monetary policy tools but also fiscal policy tools, and this decisions are not consulted."
	"Finance ministry does not exclude more Eurobond issues, but their timing depends on the situation on global financial markets, which is not excellent now because of Enron case."
	"Now Brady bonds buy back is not too attractive because of the prices."
	"We can't exclude that we would want to use external markets in 2005-2007 in order to smooth our external debt profile. We are preparing for this, we want Polish papers with different maturities to be liquid on the market".
PAP, 1 Mar	"With this statement [that inflation will amount to 4% at the end of the year] NBP governor confirmed that he sees the scope for monetary loosening."
	"Monetary policy impedes export and becomes counterproductive, because of zloty strength."
	Interest rate cut, that government assumed in budget draft, will not disturb disinflation process, nor it will lead to inflation growth."
Marek Pol, deputy PM, infrastructure minister;	
PAP, 14 Feb	"We estimate that credits for house purchase maturing not earlier than in 20-years will have fixed interest rate at 8.5%."
	"This [subsidized credit] program will give a growth impulse not only to the construction sector, but to the entire economy"
	"In case liquidity of the Polish banking system is not big enough, we are also talking to big foreign financial institutions to launch an credit line supporting Polish banks"
Reuters, 27 Feb	"We don't yet have enough votes, but I am sure that future MPC decisions will shift the majority (of deputies) to favour changes in the central bank's charter."
Zbigniew Kuzmiuk, head of PSL caucus;	
interia.pl, 14 Feb	„Let me say it in plain text, although it was not consulted with PSL caucus. In our view if Polish negotiators, sometime in the autumn, would negotiate and would agree to 25 percent direct payments in 2004 and five percent more in subsequent years, then it would be the last day of PSL in this ruling coalition"
PAP, 27 Feb	"MPC does not intend to abandon restrictive monetary policy, conducts mad exchange rate policy and government allows for this to happen"
	"Government will be able to implement its programme only if it regains influence over monetary and exchange rate policy"
Jaroslaw Kalinowski, deputy PM, agriculture minister;	
PAP, 18 Feb	"If there were no full payments, they would have to be compensated otherwise."
	"In government opinion we've underscored that in order to preserve competitive conditions on single market, we have to consider some actions that would allow our agriculture to maintain competitiveness. We've considered the possibility to suspend negotiations concerning further trade liberalization."
	"Just after European Commission proposal publication government suggested clearly that 25% subsidies together with 10-year transitory period are not acceptable for us. [...] In our party opinion that we've submitted last Saturday, we maybe don't go any further but we say it in more principal way."
Leszek Miller, prime minister,	
PAP, 21 Feb	"On that body [MPC] decision depend the pace of reducing unemployment, economic development, creation of good condition for Polish exporters, and conditions for our program realisation."
	"We hope for MPC understanding and their support on that matter."
Reuters, 24 Feb	„The drafts (to change the central bank's charter) are currently in the parliament. ... Now opinions on this issue vary in (the ruling party), but one of them may dominate after the next (council) meeting. Certainly, the nearest meeting will have an impact on the discussion."
	„I hope the (council) opens its eyes to what is happening, including high unemployment, and will act to lower credit costs, improve the situation of exporters and change the exchange rate in such a way so that Poland's economy gets a growth impulse."
Reuters, 27 Feb	"In light of the fact that economic growth is fading, unemployment is rising and exporters suffer due to the zloty exchange rate, the MPC's decision is disappointing."
	"I think that political part of MPC is going to act according to rule 'the worse, the better', independent to what happens next."
PAP, 28 Feb	"I read the resolution draft and I think there are statements which could be supported by the government."
	"It is worth remembering that parliamentary majority which was rejected by the society in last elections, and whose economic programme failed elected part of the MPC."
	"So far the NBP law amendment is not included in the government agenda".
Janusz Lisak, head of UP caucus;	
Gazeta Wyborcza, 28 Feb	"We will not tolerate a situation, when wrong NBP policy ruins our Fatherland and keeps Polish families on the edge of poverty, generates millions of unemployed and undermines branches of the economy"

Market monitor

- The demand for bonds strengthens the zloty
- In the near future the zloty should rather be stable
- Depreciation possible since May-June
- Bears are coming

The demand for bonds strengthens the zloty

Following the period of zloty weakening, which was the effect of Marek Belka's (MF) comment of 6 February on the potential devaluation of the Polish currency before Poland's accession to ERM2 monetary mechanism (applied in the interim period preceding the accession to the Euro zone), the zloty strengthened and returned from the levels of USD/PLN 4.29 and EUR/PLN 3.73 down to 4.15 and 3.60, respectively. After an interim weakening up to USD/PLN 4.24 and EUR/PLN 3.68, as a result of the deeper than expected on the market current account deficit in January, the zloty strengthened systematically as the foreign investors had big appetite for the Polish bonds in the course of the tender held on 6 March. On the tender day, the USD/PLN rate was 4.14 and EUR/PLN was 3.60.

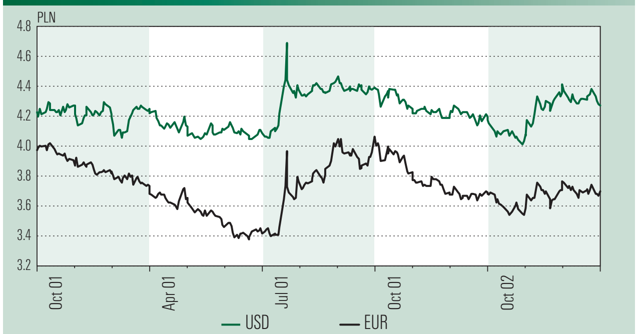
In the near future, the zloty should rather be stable at the FX rate similar to the current USD/PLN and EUR/PLN rate (i.e. ca. USD/PLN 4.14-4.18 and EUR/PLN 3,60-3.65). One of the main drivers for the zloty strength are the continually high real interest rates against other countries, expected further decrease in the inflation rate in Q2 as well as expected interest rate cuts in March-April. The above-mentioned factors mean that the Polish securities still are an attractive way of capital allocation for foreign investors. A group of investors play on the yield curve financing the purchase of bonds with short-term and rolled advances. However, the substantial group has been purchasing PLN for foreign currencies which leads to strengthening of PLN. On the other hand, this year's fiscal expansion represents a macroeconomic risk for PLN in medium term. Moreover, there has been a strong political pressure on weakening PLN. It seems that the PLN strength drivers will be present as long as the MPC maintains high interest rates. Should there be no changes in the operations of the MPC (and this is not fully certain, as it seems that yet another phase of the Government and the MPC war has just begun), the soonest potential cut in the interest rates should take place in May-June. Hence this would probably be the last cut in the entire cycle of loosening the monetary policy, one should expect a gradual PLN depreciation since May-June.

Bears are coming

At the beginning of 2002 the yield curve was slightly below 11% at the short end, ca. 10.3% for a year, 9.65% for 2 years, 9.35% for 5 years and 8.65% at the long end (10 years). In January, the high market expectations for the interest rate cuts pressed the curve down. The lowest level was achieved on 23 January, shortly before the MPC meeting. The short end was below 10%, 9.5% for a year, 9% for two years, 8.75% for 5 years and 8% for 10 years. Then, the yield curve went up and flat with a marginally growing profitability of bonds and substantial adjustment in the bonds sector related to the change in the market expectations for further cuts in the interest rates (the projected scope of cuts substantially decreased and the term of a subsequent cut was postponed to far future). As a result of these movements, at the beginning of February the yield in the sector of 2-5 years went up to ca. 9.5% and was almost ideally flat.

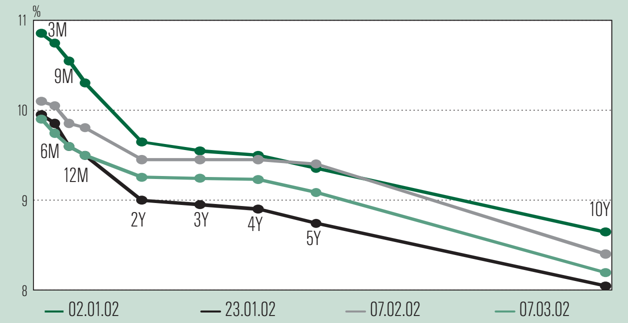
Despite a substantial supply of bonds at this year's tenders, there has been a substantial demand for the bonds on the market which decreases their profitability. Investors, and in particular the foreign ones, anticipate a soon and relatively deep cut in the interest rates (the London consensus indicates a cut of ca. 200bp in H1). As a result, following the March auction the yield curve was ca. 20-30bp down on the last month and evidenced a negative bend along its entire length.

Zloty FX rate



Source: BZ WBK

Yield curve

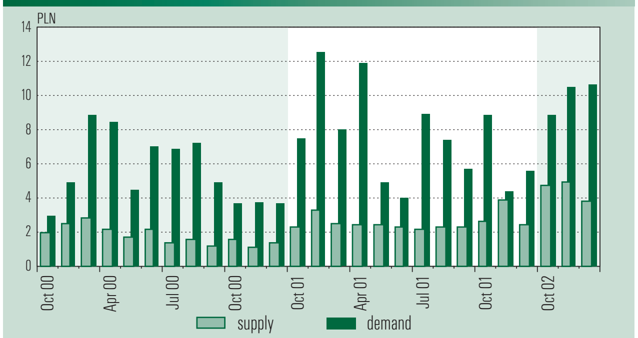


Source: BZ WBK

High appetite for bonds does not surprise us as we forecast inflation to fall temporary below 3% in 2Q02, which will allow to make last quick buck on fixed income market in Poland before bears take over.

Many forecasters still expect Poland to exhibit near-zero or even negative growth, at least in 1H02. We disagree and we expect recovery and near 2% growth for the full year. And you can't miss it because evidence is like elephant standing in the middle of the road. Almost every day we report in Eyeopeners new information supporting our recovery scenario. So bond market bulls can sleep well in the next three months amid expected temporary decline of CPI below 3% in May. But in 2H02 bond bears will take over. And it will be polar bears enjoying long polar winter on the Polish bond market.

Auctions of 2- and 5-year T-bonds



Source: BZ WBK

T-bill offer in March (PLN m)

Date of auction	13-week	26-week	52-week	Total
04.03.2002	-	400	800	1200
11.03.2002	-	300	900	1200
28.03.2002	-	200	1000	1200
25.03.2002	100	-	1300	1400
29.03.2002	100	-	1000	1100
Total	**200**	**900**	**5000**	**6100**

Source: Finance Ministry

T-bond auctions in 2002

No	1st auction					2nd auction		
	date	T-bonds	sale (PLN m)	T-bonds	sale (PLN m)	date	T-bonds	sale (PLN m)
January	09.01	OK1203	2 800	PS1106	1 900	16.01	DS1110	1 800
February	06.02	OK1203	2 000	PS1106	2 900	13.02	DZ0811	495,5
March	06.03	OK1203	2 000	PS1106	1 800	20.03	DS1110	–
April	03.04	OK0404	–	PS1106	–	10.04	DZ0811	–
May	08.05	OK0404	–	PS0507	–			–
June	05.06	OK0404	–	PS0507	–	12.06	DZ0811	–
July	03.07	OK0404	–		–	17.07	DS1110	–
August	07.08	OK0804	–	PS0507	–	14.08	DZ0811	–
September	04.09	OK0804	–	PS0507	–	18.09	DS1110	–
October	02.10	OK0804	–	PS0507	–	09.10	DZ0811	–
November	06.11	OK0804	–	PS1107	–	20.11	DS1112	–
December	04.12	OK1204	–			11.12	DZ0811	–

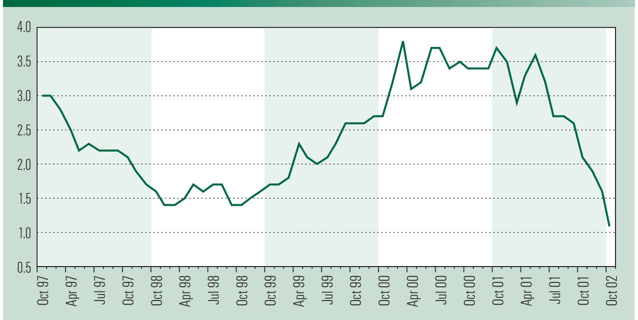
Source: Finance Ministry

International review

- US economy slowly recovers
- ECB still awaits
- German economy remains in recession…
- …however IFO index increased for the forth time in a row indicating upcoming recovery
- Activity indicators in USA and Euro-zone went up

US inflation in January amounted to 0.2% MoM, which was the first price growth after three months of deflation. The main reason for this growth were higher energy prices. In year-on-year terms CPI fell to 1.1% from 1.6% in December. Core inflation excluding food and fuel prices amounted to 0.2% MoM and 2.6% YoY.

US inflation YoY



Source: Reuters

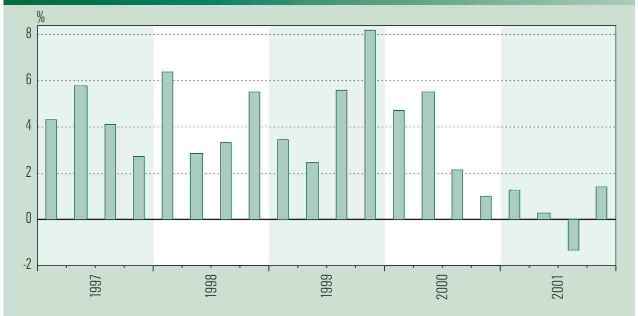
US industrial production declined 0.1% in January after 0.3% decline in December. Capacity utilization decreased to 74.2% from 74.4% last month. Data were close to market expectations.

In 4Q01 productivity in American economy increased by 3.5%, after 1.1% growth in 3Q01. Figure was stronger than expected (2.9%). For the whole 2001 productivity growth amounted to 1.8% and was the lowest since 1995. On the other hand unit labour costs declined by 3.9% in 2001, i.e. deepest since 1990.

Fed chairman Alan Greenspan told in his testimony that US recovery was coming but it would be more moderate than previous recoveries.

US GDP growth in 4Q01 was much better than initial estimates suggested. It reached 1.4% rather than 0.2%. This figure confirms last Alan Greenspan's comment that recession phase has already finished. Economic growth was fuelled mainly by government expenditures and private consumption. American's private spending increased 6%, the fastest since 2Q98. GDP growth for whole 2001 has been revised up from 1.1% to 1.2%.

GDP growth in USA QoQ



Source: Reuters

US retail sale declined by 0.1% in January due to fall of new car sales. Excluding motorization sector sales increased by 1.2%, which was the strongest result since March 2001. Mostly it was the effect of higher fuel prices – sales at gasoline stations increased by 5.1%. December figures were revised up from –0.1% to +0.2% (+0.7% excluding cars). Figures were stronger than market expected – forecasts averaged at 0.3% decline.

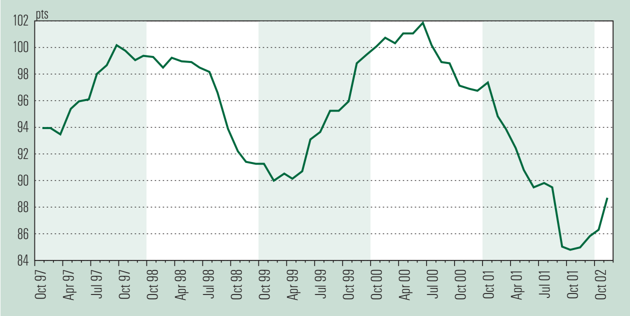
ECB announced that it maintains wait-and-see stance on interest rates and assessed that rates are at correct level at the moment. Furthermore ECB sustained its medium-term forecast assuming price stabilisation.

German GDP declined by 0.3% QoQ and 0.1% YoY in 4Q01. It was the first GDP fall in annual terms since the beginning of 1996. This figure proves that Germany is still in recession phase (GDP growth in 2Q2001 was ca. zero, in 3Q it decreased by 0.2% QoQ). In the whole year 2001 German economic growth amounted to 0.6%.

IFO index, reflecting business climate in German economy, increased to 88.7 in February from 86.2 last month. It was the fourth consecutive growth (from 84.7 reached in October), much higher than market expected – forecasts pointed to ca. 87.3. Especially significant is improvement in business expectations for the future – index in this segment increased to 101.0 from 94.8 last month. It indicates that the recovery of German economy is likely to be observed in near future. Meanwhile, assessment of present situation on the market is worse than last month – index in this segment fell to 76.8 from 78.0. It confirms ECB's hypothesis that European economy experiences the lowest point of economic cycle at present, but soon it is going to improve. Therefore it seems unlikely that ECB would change interest rates (refinance rate stands at 3.25% at present). Sentiment improvement in European's biggest economy is a positive signal for Poland too, because it means improvement of external demand and better perspectives for Polish exporters.

Preliminary estimates show that French GDP declined 0.1% QoQ in last quarter of 2001. It was the first decline

German; IFO index



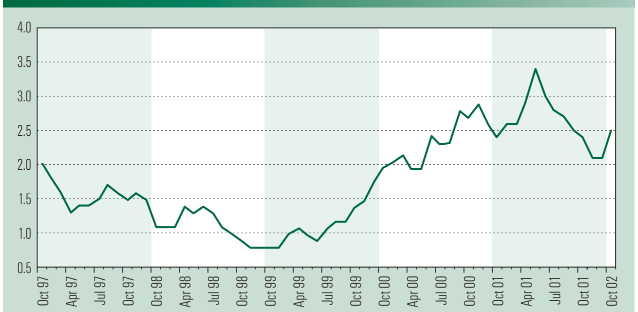
Source: Reuters

in last 5 years. GDP increased 1% on annual basis. In 2001 economic growth in France decreased to 2.0% from 3.6% in 2000.

Eurozone industrial production increased 0.8% MoM and declined 4.1% YoY in December. It was the first monthly growth since August 2001.

Money supply (M3) in Eurozone increased 7.9% YoY in January compared to 8.0% in December. Three-month average increased to 8.0% from 7.8% last month. Broad money growth is faster than reference level 4.5% YoY considered by ECB as non- accelerating inflation, but lately ECB officials commented this phenomenon as the result of bias due to portfolio investments inflow amid uncertain global economic situation.

Inflation in Euro-zone **YoY**



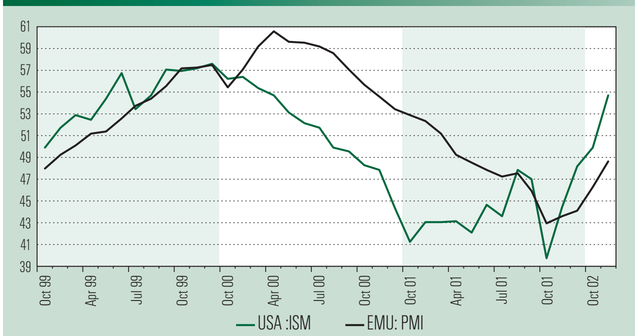
Source: Reuters

January inflation rate in Eurozone has been corrected to 2.7% YoY from 2.5% estimated earlier. According to Eurostat EU12 currency exchange into euro fuelled inflation by some 0.0-0.16 percent MoM. Other issues like recalculation of foodstuff prices of excise taxes on cigarettes could have increased inflation by ca. 0.34 percent.

In February Eurozone PMI index increased for the fourth consecutive time, to 48.6 from 46.3 last month, reaching the highest level for 10 months. The figure was stronger than expected (47.2). This outcome suggests that Eurozone is close to leaving recession phase. Index growth was the result of increase of production and orders, though further employment fall and weak profitability didn't allow for breaking through the level of 50, being the frontier between growth and recession phase. Nevertheless PMI index for Germany crossed the threshold and reached 50.8 compared to 46.7 last month.

In US activity index ISM (former NAPM) also increased stronger than expected, crossing the level of 50. In February index reached 54.7, compared to 49.9 recorded in January and expectations pointing to 50.9. It was the first month of activity growth after 18 months of decline.

Activity indicators in USA and Euro-zone



Source: Reuters

What's hot this month

Monday	*Tuesday*	*Wednesday*	*Thursday*	*Friday*
4 March POL: T-bill auction (PLN 1.2bn) *EMU: Producer prices (Jan)* *EMU: Economic sentiment (Feb)*	**5** *EMU: Unemployment (Jan)* *EMU: Business climate (Feb)*	**6** POL: T-bond auction OK1203 & PS 1106 (PLN 2.0 and 1.8bn) *GER: Industrial orders (Jan)* *GER: Unemployment (Feb)*	**7** EMU: ECB meeting	**8** POL: Food prices (2H Feb) ITA: GDP (4Q) USA: Unemployment (Feb)
11 POL: T-bill auction (PLN 1.2bn)	**12** *FRA: Inflation preliminary (Feb)* *EMU: GDP (4Q)*	**13** *USA: Retail sales (Feb)*	**14** POL: Wages & employment (Feb) POL: Money supply (Feb) FRA: Industrial output (Jan) ITA: Industrial output (Jan)	15 POL: Inflation (Feb, Jan) POL: Budget deficit (Feb) ITA: Inflation final (Feb) USA: Producer prices (Feb) USA: Industrial output (Feb)
18 POL: T-bill auction (PLN 1.2bn) POL: Industrial output (Feb) POL: Producer prices (Feb) *EMU: Inflation final (Feb)*	19 *USA: Fed meeting* *USA: Foreign trade (Jan)*	**20** POL: T-bond auction (DS1110) POL: Business climate (Mar) POL: Unemployment (Feb)	**21** POL: GDP (4Q2001) USA: Inflation (Feb)	22 FRA: Inflation final (Feb) EMU: Foreign trade (Jan)
25 POL: T-bill auction (PLN 1.4bn)	26 POL: MPC meeting *GER: IFO business climate (Mar)*	27 POL: MPC meeting (decision) POL: Food prices (1H Mar) *EMU: Industrial output (Jan)*	28 POL: Balance of payment (Feb) EMU: Money supply (Feb) EMU: Inflation preliminary (Mar) USA: GDP (4Q) GER: Industrial production (Jan)	29 POL: T-bill auction (PLN 1.1bn)

Source: CSO, NBP, Finance Ministry, Reuters

Data release calendar

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
MPC meeting	29-30	26-27	26-27[a]	23-24[a]	28-29[a]	25-26[a]	30-31[a]	27-28[a]	24-25[a]	29-30[a]	26-27[a]	17-18[a]
CPI	15	15[b]	15[c]	15	15	17	15	16 lub 19	16	15	15	16
PPI	18	19	18	18	20	19	17	20	18	17	20	18
Industrial output	18	19	18	18	20	19	17	20	18	17	20	18
Gross wages, employment	15	14	14	15	17	18	12	14	13	14	18	13
Trade	about 50 working days after reported period											
Balance of payments	31	28	29	30	31	-	-	-	-	-	-	-
Money supply	14	14	14	12	14	-	-	-	-	-	-	-
NBP balance sheet	7	7	7	5	7	-	-	-	-	-	-	-
Business climate indices	7[d] i 22[e]	20	20	18	20	19	18	20	19	18	20	19
Food prices, 1-15	-	8[e] i 27[f]	27	26	27	27	26	27	27	25	27	30
Food prices, 16-30	3	8	8	5	7	6	5	6	6	7	6	6

a according to the preliminary schedule, the final date of the meeting is determined a month before it b preliminary data, c final data (January, February), d December 01, e January 02, f February 02 *Source: CSO, NBP*

Monthly indicators

	unit	Jan 01	Feb 01	Mar 01	Apr 01	May 01	Jun 01	Jul 01	Aug 01	Sep 01	Oct 01	Nov 01	Dec 01	Jan 02	Feb 02	Mar 01
															forecast	
GDP	% YoY	x	x	2,3	x	x	0,9	x	x	0,8	x	x	0,6	x	x	1,5
Industrial output	% YoY	10,1	0,1	2,9	3,6	-0,9	-4,8	1,1	0,7	-3,8	1,4	-0,6	-4,8	-1,4	-0,7	-4,4
Retail sales***	% YoY	10,9	-0,2	0,1	1,9	4,3	0,2	1,5	3,0	1,3	5,8	2,4	2,4	4,7	x	x
Unemployment rate	%	15,7	15,9	16,1	16,0	15,9	15,9	16,0	16,2	16,3	16,4	16,8	17,4	18,0	18,3	18,5
Gross wages**	% YoY	9,9	7,7	7,9	5,2	8,8	4,9	8,0	6,9	6,2	7,8	6,6	5,3	5,2	5,0	5,0
Exports (acc. to NBP)	USD m	2 430	2 392	2 614	2 559	2 472	2 477	2 556	2 616	2 287	2 778	2 555	2 546	2 348	2 360	2 596
Imports (acc. to NBP)	USD m	3 946	3 116	3 522	3 269	3 638	3 379	3 382	3 635	3 176	3 953	3 509	3 436	3 455	2 937	3 377
Trade balance (acc. to NBP)	USD m	-1 516	-724	-908	-710	-1 166	-902	-826	-1 019	-889	-1 175	-954	-890	-1 107	-577	-782
Current account	USD m	-956	-463	-751	-520	-737	-948	-287	-354	-304	-838	-417	-500	-826	-215	-452
Budget deficit	PLN bn	-5,1	-12,0	-15,1	-18,4	-20,4	-18,7	-19,4	-21,0	-21,8	-24,6	-27,7	-32,6	-6,9	-14,0	-19,0
Inflation	% YoY	7,4	6,6	6,2	6,6	6,9	6,2	5,2	5,1	4,3	4,0	3,6	3,6	3,5	3,7	3,6
Producer prices	% YoY	4,7	4,1	3,8	3,4	2,3	0,9	0,6	1,0	0,7	-0,5	-1,0	-0,4	0,0	0,5	1,1
Money supply	% YoY	14,6	14,6	14,9	14,0	13,5	8,0	13,5	14,6	14,3	13,0	12,1	13,6	12,3	11,7	10,1
Deposits	% YoY	17,5	17,1	16,8	16,1	15,5	9,1	15,4	16,3	15,5	13,7	12,4	13,8	12,0	11,2	9,5
Credits	% YoY	16,1	15,6	14,6	12,7	11,3	5,0	11,6	11,7	10,7	8,7	8,4	7,2	7,3	7,6	7,7
USD/PLN	PLN	4,1108	4,0925	4,0599	4,0175	3,9807	3,9705	4,1859	4,2459	4,2185	4,1332	4,0943	4,0144	4,0609	4,1867	4,19
EUR/PLN	PLN	3,8648	3,7689	3,6952	3,5904	3,4856	3,3894	3,5998	3,8218	3,8450	3,7425	3,6389	3,5829	3,5896	3,6427	3,65
Intervention rate*	%	19,00	19,00	17,00	17,00	17,00	15,50	15,50	14,50	14,50	13,00	11,50	11,50	10,00	10,00	10,00
WIBOR 3M	%	18,97	18,61	18,01	17,17	17,22	16,88	16,01	15,35	14,73	14,01	13,91	12,29	11,04	10,60	10,10
Lombard rate*	%	23,00	23,00	21,00	21,00	21,00	19,50	19,50	18,50	18,50	17,00	15,50	15,50	13,50	13,50	13,50
Yield on 52-week T-bills	%	17,23	16,97	16,85	15,80	15,67	15,61	15,38	14,61	14,01	12,64	11,80	10,66	9,62	9,68	9,45
Yield on 2-year T-bonds	%	15,68	15,48	15,60	14,59	14,92	15,22	15,13	14,40	13,57	11,36	11,00	10,70	9,11	9,37	9,10
Yield on 5-year T-bonds	%	13,08	12,92	13,33	13,47	13,38	13,29	13,85	13,50	12,92	11,32	10,13	9,91	8,91	9,26	8,90
Yield on 10-year T-bonds	%	10,44	10,23	10,68	10,61	11,30	11,74	11,87	11,97	11,57	10,31	9,19	8,92	8,25	8,34	8,15

** at the end of period ** in corporate sector *** nominal*

Source: CSO, NBP, BZ WBK

Quarterly and yearly

	unit	1997	1998	1999	2000	2001	2002 forecast	2003 forecast	1 Q 2001	2 Q 2001	3 Q 2001	4 Q 2001	1 Q 2002 forecast	2 Q 2002 forecast
GDP	% YoY	6,8	4,8	4,1	4,0	1,1	1,9	3,5	2,3	0,9	0,8	0,6	1,5	1,0
Industrial output	% YoY	11,5	3,5	3,6	6,8	-0,2	2,4	3,4	4,1	-0,9	-1,2	-2,3	-2,1	0,6
Real retail sales	% YoY	6,8	2,6	4,0	1,0	0,4	x	x	-3,1	-0,2	1,2	3,5	x	x
Unemployment rate*	%	10,3	10,4	13,1	15,1	17,4	18,5	18,8	16,1	15,9	16,3	17,4	18,5	18,1
Real gross wage	% YoY	5,9	3,3	4,7	1,0	2,5	0,5	1,5	2,5	0,8	2,5	4,0	1,5	2,0
Exports (acc. to NBP)	USD m	27 229	30 122	26 347	28 256	30 282	32 260	34 000	7 436	7 508	7 459	7 879	7 300	7 574
Imports (acc. to NBP)	USD m	38 549	43 842	40 727	41 424	41 961	44 270	47 000	10 584	10 286	10 193	10 898	9 770	10 528
Trade balance (acc. to NBP)	USD m	-11 320	-13 720	-14 380	-13 168	-11 679	-12 100	-13 000	-3 148	-2 778	-2 734	-3 019	-2 460	-2 955
Current account	USD m	-4 309	-6 862	-11 558	-9 946	-7 035	-8 016	-9 150	-2 170	-2 205	-945	-1 715	-1 851	-1 559
Current account	% of GDP	-3,0	-4,3	-7,4	-6,3	-4,0	-4,4	-5,0	-4,9	-5,2	-4,2	-4,0	-3,8	-3,5
Budget deficit*	PLN bn	-5,9	-13,2	-12,5	-15,4	-32,6	-40,0	-42,0	-15,0	-18,8	-21,9	-32,6	-20,0	-28,0
Budget deficit*	% GDP	-1,2	-2,4	-2,0	-2,2	-4,5	-5,2	-5,1	x	x	x	x	x	x
Inflation	% YoY	14,9	11,8	7,3	10,1	5,5	3,6	4,5	6,7	6,6	4,9	3,8	3,6	2,9
Inflation*	% YoY	13,2	8,6	9,8	8,5	3,6	4,8	4,0	6,2	6,2	4,3	3,7	3,6	2,8
Producer prices	% YoY	12,2	7,3	5,7	7,8	1,6	1,5	2,5	4,2	2,2	0,8	-0,6	1,0	1,9
Money supply	% YoY	30,3	25,8	23,2	14,9	13,4	8,9	11,0	14,7	11,8	14,1	12,9	11,4	9,7
Deposits	% YoY	33,0	28,8	24,7	17,0	14,9	8,7	10,5	17,1	13,6	15,7	13,3	10,9	9,2
Credits	% YoY	44,6	29,3	28,3	23,0	11,1	9,4	15,0	15,4	9,7	11,3	8,1	7,5	8,3
USD/PLN	PLN	3,2808	3,4937	3,9675	4,3465	4,0939	4,23	4,50	4,0876	3,9895	4,2168	4,0805	4,15	4,23
EUR/PLN	PLN	3,7055	3,9231	4,2270	4,0110	3,6685	3,75	4,00	3,7765	3,4884	3,7551	3,6549	3,62	3,72
Intervention rate*	%	23,50	15,50	16,50	19,00	11,50	9,00	9,00	18,00	15,50	14,50	11,50	10,00	9,00
WIBOR 3M	%	23,93	21,34	14,73	18,78	16,08	9,56	9,20	18,53	17,09	15,37	13,45	10,45	9,40
Lombard rate*	%	27,00	20,00	20,50	23,00	15,50	12,50	12,00	22,00	19,50	18,50	15,50	13,50	12,50
Yield on 52-week T-bills	%	23,44	18,59	12,95	17,77	14,77	9,40	9,20	17,02	15,70	14,67	11,72	9,60	9,30
Yield on 2-year T-bonds	%	23,47	18,08	12,41	17,37	13,91	8,70	8,60	15,59	14,91	14,37	10,83	9,20	8,60
Yield on 5-year T-bonds	%	21,03	15,83	10,87	14,00	12,59	8,60	8,50	13,12	13,38	13,43	10,45	9,05	8,50
Yield on 10-year T-bonds	%	x	x	9,60	11,79	10,74	7,90	7,80	10,46	11,22	11,81	9,48	8,25	7,80

** at the end of period*

Source: CSO, NBP, BZ WBK

Bank Zachodni WBK S.A.

TRESURY DIVISION

plac Gen. Władysława Andersa 5, 61-894 Poznań
tel. 0 61 856 58 35 secretary, fax 0 61 856 55 65

This analysis based on information until 8.02.2002 has been prepared by::

ECONOMIC ANALYSIS UNIT

Krzysztof Rybiński – Chief Economist
tel. 0 22 653 46 63
e-mail: krzysztof.rybinski@bzwbk.pl

Piotr Bielski – tel. 0 22 653 47 33
Aleksander Krzyżaniak – tel. 0 61 856 55 80
Sławomir Nosal – tel. 0 61 856 55 67
fax: 0 61 856 55 65
e-mail: ekonomia@bzwbk.pl

Web site (including Economic Service web page): http://www.bzwbk.pl

TRESURY SERVICES DEPARTMENT

Paul Polaczek – tel. 0 61 856 55 73

Poznań

pl. Gen. W. Andersa 5, 61-894 Poznań
fax 0 61 856 55 65

Piotr Kinastowski

tel. 0 61 856 58 22, fax 0 61 856 55 65

Juliusz Szymański	0 61 856 58 25
Grzegorz Głowacki	0 61 856 58 25
Katarzyna Kamińska	0 61 856 58 25
Marzenna Urbańska	0 61 856 58 25
Waldemar Polowczyk	0 61 856 58 14
Robert Król	0 61 856 58 14
Zbigniew Mańke	0 61 856 58 14
Hanna Nowak	0 61 856 58 14
Żaneta Czerniak	0 61 856 58 14

Warszawa

Al. Jana Pawa II 25, Atrium Tower, 00-854 Warszawa
fax 0 22 653 46 79

Maciej Jędrzejak	0 22 653 46 70
Tomasz Dziedzic	0 22 653 46 67
Piotr Żagań	0 22 653 46 66

Wrocław

ul. Ofiar Oświęcimskich 38/40, 50-950 Wrocaw
fax 0 71 370 26 22

Krzysztof Pietrkiewicz

tel. 0 71 370 25 87, fax 0 71 370 26 22

Maciej Błęcki	0 71 370 26 63
Jerzy Rybczak	0 71 370 24 26
Aleksandra Skiba	0 71 370 24 86
Anna Tarnacka	0 71 370 26 24