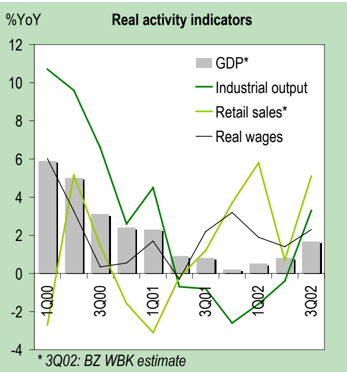
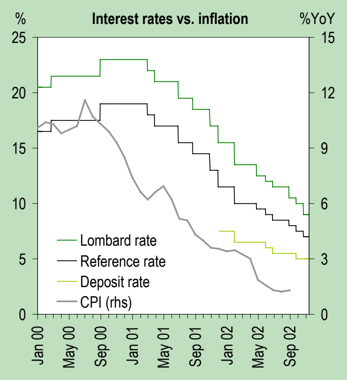
Bank Zachodni WBK

MACROscope

Polish Economy and Financial Markets





The cost of accession

■ **Deferring the inevitable substantial changes in the Polish budget again in 2003, which we wrote about last month would mean a risk of a dramatic cumulating of the problem in the first years of the EU membership.** This makes us wonder if we do not have to face the threat to public finances destabilisation in a year's time. In this issue of MACROscope we try to assess generally the implications of the projected financial conditions of Poland's membership in the EU on the public finances in the first years after the accession. Exceptionally difficult will be the preparation of the 2004 budget because slimmed down domestic budget revenues will be replaced with EU funds dedicated to particular projects and at the same time obligation to pay contribution to the EU budget will put additional burden on the expenditure side of the budget.

■ **After release of September's economic data we can review Poland's economic situation in the third quarter of 2002.** It seems that most of economic indicators recorded in this period support our scenario of gradually improving business climate and steady acceleration of economic growth. Comparison of quarterly economic figures from 3Q02 and two previous quarters clearly shows the improvement in major areas and overcoming the stagnation tendencies. However, still there is no improvement on the labour market, which creates the most significant threat to continuation of positive trends recorded recently. Inflationary pressure remains weak and developments in monetary sector also suggest that despite some improvement of situation, the economic activity still remains subdued. Also, the results of recent business surveys do not provide clear answer whether the continuation of economic recovery is very likely in subsequent quarters. Nevertheless, in our opinion there are no reasons for changing expected scenario of gradual but not very fast economic revival.

■ **In October the MPC cut the official interest rates again.** Lombard rate have been reduced by 100bp to 9%, reference rate by 50bp to 7.0%, and deposit rate remained at 5.0%. As most of financial markets participants expected rate cut in November, the timing of the decision clearly was a surprise. Despite the central bank's officials' statements trying to limit expectations for another reductions, financial markets price-in further monetary easing, and they are quite right. In our opinion, however, the next rates reduction is likely to take place only at the beginning of the next year. Surprising rate cut in October, together with no delays in the EU enlargement process, brought the positive sentiment on the Polish financial market – average monthly exchange rates and yields fell significantly – to the levels we indicated in the MACROscope last month.

In this issue:

Maciej Reluga
Chief Economist
(+48 22) 653 4663

Piotr Bielski
(+48 22) 653 4733
Piotr Bujak
(+48 22) 586 8341
Aleksander Krzyżaniak
(+48 22) 586 8342

Email: firstname.secondname@bzwbk.pl

Financial market on 31 October 2002

NBP deposit rate	5.00	WIBOR 3M	7.02	PLN/USD	4.0324
NBP reference rate	7.00	Yield on 52-week T-bills	6.25	PLN/EUR	3.9793
NBP lombard rate	9.00	Yield on 5-year T-bonds	6.15	EUR/USD	0.9868

Special focus

Is the EU membership going to ruin the Polish budget?

In the previous issue of MACROscope we analysed thoroughly the draft 2003 budget act. Besides some reservations to the reliability and consistency of the macroeconomic assumptions, the main reservation to the next year's draft budget relates to the insufficient limitation of the budget expenditures growth. Moreover, a serious reproach to fiscal policy stems from the fact that the growing and increasingly "fixed" expenditures to a great extent are based on one-off incomes. This is even more probable, much as life can be brutal for the Ministry of Finance, that part of this income will be very difficult to obtain. As far as the next year's budget is concerned, however, the most disappointing is the fact that, despite the ever-mentioned need for restructuring public finances, the adverse structure of government's expenditures is continued. The increasing part of the expenditures is represented by various types of legally determined consumption expenditures, including substantial expenditures on social transfers and staff costs in the public sector. This limits the budget capacity to finance pro-development undertakings as well as it makes decreasing the budget deficit difficult.

The above-mentioned key weaknesses of the 2003 budget, same as in the case of the previous ones, will impinge on the effective future fiscal policy. Unfortunately, the ever-deferred public finances' reform will be even more difficult to effect in the future. This is because from 2004 onwards the budget expenditures will be additionally stretched due to the necessity to pay various contributions and fees as a result of joining the EU. Therefore, deferring the inevitable substantial changes in the Polish budget again in 2003 will mean a risk of a dramatic cumulating of the problem in the first years of the EU membership, in particular in 2004. If Poland joins the EU in 2004, there will not be any possibility of deferring the changes yet another year. This makes us wonder if we do not have to face the threat to public finances destabilisation in a year's time. It goes without saying, that the fact that along with joining the EU Poland will have to accept substantial changes to the structure of budget expenses has been well known for long. Unfortunately, in Poland there is no practice of draft budget planning for a year following the year the budget act is designed. The Minister of Finance has developed a draft budget only for the subsequent year, without working-out at least a draft plan of budget income and expenses for 2004. Let us try to have a look at the fiscal policy in the longer run and assess generally the implications of the projected financial conditions of Poland's membership in the EU on the public finances in the first years after the accession, mainly in 2004.

The European Union sets the financial conditions

On 24-25 October 2002, at the EU summit in Brussels, the heads of the "15" member states finally reached a consensus on the financial conditions of the EU enlargement. The position agreed is similar to the previous proposal of the European Commission (EC). A sole significant change is represented by decreasing the global total of structural[1] and cohesion[2] fund by €2.6bn (i.e. the EU subsidies to poorer regions and states) reserved earlier for the 10 new member states for 2004-2006. Previously the Commission proposed to allocate €25.6bn to this purpose, but following the motion of Germany, supported by France and Great Britain, the Brussels summit reduced this amount to €23bn. The EU's diplomats indicate that the 10 candidates may be able to win back the original amount, which would be a success for them, in the course of the Copenhagen Summit. This amount might as well be allocated to increasing the original subsidies for farmers. However, for the time being, the "15" member states have not agreed for faster phasing-in of the direct subsidies for farmers from the new member states. At the Brussels summit, the Commission's proposal was approved to start with the 25% of the due direct subsidies in 2004, and then to increase annually the percentage up to 30%, 35%, 40%, 50%, 60%, 70%, 80%, 90% up to 100% in 2013. Despite the cuts in the structural funds and maintaining the long period of obtaining the full direct subsidies, the summit in Brussels ensured the future member states that in the first years of membership the net funds from the EU's vault will not be lower than before the accession. The summit in Brussels, however, did not specify the exact calculations of the financial transfers between Warsaw and Brussels in the first years of membership. The unofficial calculations of the EU indicate that its budget liabilities to Poland should total €18.8bn in 2004-2006, including €12.4bn from the structural and cohesion

[1] Structural Funds = European Regional Development Fund (ERDF co-funds actions aimed at limiting the differences in the level of economic development of various regions), European Social Fund (co-funds actions related to the policy of employment and HR development) and the Financial Instrument for Fisheries (support the implementation of a common fishing policy).

[2] Cohesion Fund – co-funding of transport related investments in respect of trans-European routes and in respect of environmental protection.

funds. The balance will be represented by subsidies for farmers (€2.1bn, including market organisation and direct subsidies) and rural areas (€2.5bn), as well as the support for the other "common policies", e.g. science and technology co-operation. The Polish contributions in the first three years of membership would total €7.5bn.

Expected financial flows between the EU and Polish budget in 2003-2006 (euro billions)

Year	Transfers from the EU	Contribution to the EU budget	Balance
2003	0.8	0	+0.8
2004-06	18.8	7.5	+11.3

Note: Balance is positive each year and rising
Source: Rzeczpospolita

How much will the membership cost?

The decisions made by the heads of the EU member states at the Brussels summit indicate that the value of transfers from the EU to Poland is to be higher than the expenses incurred by Poland due to the EU budget contributions. As one can hardly expect the projects, on which the better part of the EU's funds is allocated to, to be carried out already in 2004, in the first year of membership it may turn out that Polish economy will obtain from the EU almost the same amount it will contribute to its budget. Nevertheless, even if we unrealistically assume that Poland would be able to absorb the total funds at its disposal already in the first year of its membership, this will mean serious problems for the Polish budget anyway. The EU transfers may not necessarily be allocated to the state's budget. Even if it is the case, the EU transfers are supposed to be allocated to specific types of expenses and projects (e.g. in the area of road infrastructure or environmental protection). Due to that reason the funds could not be allocated to cover the contributions to the EU. The contributions in turn, in 2004, in the light of the Brussels outcome, will not be less substantial than in the forthcoming years.

The main charge in the Polish budget related to the EU membership will be the necessity to contribute a membership premium to the EU budget. The size of the contribution to be paid by Poland will be estimated based on the general principles prevailing in the EU, i.e. it will depend on the share of the Polish GDP in the GDP of the enlarged European Union as well as the level of VAT inflows. On this basis, the Polish contribution to the EU budget is estimated at ca. €2.5bn. What is more, according to the current decisions, the contribution to the EU budget will have to be paid in advance in twelve monthly instalments, starting already in the first month of membership. From the perspective of the Polish budget liquidity, this solution is less favourable than transfers of lower frequency. Additionally, the Polish budget will lose income from customs duties, as they will flow into the EU budget when Poland has joined the Union. In the case of Poland, the effect of limiting income from customs duties (all EU member states have to allocate income from customs duties to the EU budget) will be substantially offset by a technical subsidy granted to a country collecting customs duties on behalf of the entire EU (although it is only a part of income from customs duties, this is calculated on the customs duties on the entire imports to the EU's member states which cross the Polish borders). Therefore, the estimated lost income from customs duties may reach the maximum of PLN1-2bn.

The additional cost of accession results from the fact that after joining the EU Poland will become a shareholder of the European Investment Bank (EIB). This is related to an obligatory, non-recurring contribution to the bank's equity and reserves. At the end of October, Wolfgang Roth, Vice-President of EIB, advised that according to the bank's calculations, the Poland's contribution to EIB equity and reserves would be €179mln and €459mln, respectively. According to Mr Roth, this issue will not be subject to the accession negotiations and will be finally agreed only after the summit in Copenhagen. He believes, however, that Poland, similarly to other candidates, may not count on any allowances in this respect and will have to contribute the full € 38mln to EIB. Mr Roth mentioned only that there is possibility of splitting the amount over the next 4 years. In 2004, Poland would have to pay one-fourth of the amount, i.e. ca. €160mln. Mr Roth emphasised, that in return Poland would have the much broader access to substantially higher than the existing levels, cheap advances for transport, environmental protection, power and telecommunication infrastructure as well as to SME support. As is the case with the structural funds, these funds will not flow into the budget but to the accounts of entities effecting given undertakings. Apart from the one-off contribution to the EIB, Poland will have to co-fund the operations of two other financial institutions of the EU, i.e. the European Development Fund[3] (EDF) and the European Central

[3] EDF is an instrument for supporting countries which are historically related to the EU's member states. The better part of the countries are the former colonies.

Bank (ECB) as well as co-fund the so-called British discount. In respect of the EDF and the British discount the volume of the Polish contributions can hardly be defined now. In total, however, it should be substantially lower than the contribution to the EIB. The level of our contribution to the ECB equity of €5bn will be set in line with a paradigm including to the same extent the share of a given member state in the total EU population and its share in the EU's GDP. One can estimate that the amount will at least be similar to the level of contribution to the EIB.

In 2004, another charge to the Polish budget will be the necessity to assign funds for co-funding the EU's projects as well as to make the prepayments from the EU' budget, which are repaid with a several month long delay (mainly the direct subsidies for farmers). In line with the decisions made by the heads of the "15", in 2004-2006, the structural actions related to the enlargement will consume €23bn, of which €12.4bn is to be assigned for Poland. According to the outcome of the Brussels summit, one third of the funds will be allocated to the Cohesion Fund. At the same time, it has been assumed that the share of the Polish public funds in co-funding domestic structural actions will amount to at least 25% of the undertakings cost in the case of the structural funds and at least 15% in the case of the Cohesion Fund. It seems that the average-weighted share of the Polish public funds in co-funding the structural actions will be 21.7%. Assuming that the balance will be covered only from the EU budget, the share of public funds will amount to €3.4bn. In 2004 itself the amount could exceed €1bn. The total amount of the Polish share and the exact level of co-funding will be defined in the course of work on the National Development Plan (NDP), which will be a starting point for defining the directions of using structural funds after Poland has joined the EU. In October, the consultation stage of the draft document was completed. In line with the schedule, the NDP is to be signed-off by the cabinet and parliament by the end of November 2002. In December, this document is to be sent to the European Commission. Regardless of the document stipulations, in 2004 Poland is very likely to be able to use marginal portion of the structural and cohesion funds assigned for it, which will be related to fact that both the development and execution of the projects co-funded by the EU takes a lot of time. In addition, the costs incurred for the execution of the projects are returned by the EU only after the projects have been completed. As a result, the broader stream of the EU funds will flow into Poland only in the subsequent years of the membership. Funnily enough, it may be favourable for the Polish budget, as in 2004 Poland will not have to make its contribution to co-funding. Unfortunately, it will not be the case in respect of the direct subsidies. Already now it is certain that in 2004 the Polish farmers will be granted at least 25% of the level of the direct subsidies due to the farmers of the existing member states. This represents the amount of ca. € 550mln. As the EU will pay the funds only in 2005, this amount transferred to the Polish farmers in 2004 will have to be allocated from the Polish budget.

In the first years of membership it will also be necessary to assign funds in the Polish budget that will be allocated to co-funding substantial costs of the legal and institutional adjustments we are committed to effect as a result of negotiations – according to the initial estimates, the amount will be higher than the amount in 2002-03 (in particular, this is related to the expenses on the organisation of the agricultural market). This may be the additional PLN 1-2bn of budget expenditures.

Estimated costs of integration for the Polish budget in 2004

Item	PLN billions
Contribution to the EU budget	10
Loss of customs duty revenues	1-2
Contribution to the EIB capital	0.6
Contribution to the ECB capital	0.5
Co-financing of structural funds	0-4
Direct subsidies payments	2
Legal and institutional adjustments	1-2
Total	15.1-21.1

Source: own estimations based on Brussels summit conclusions

Where is money to be found?

Summing up all estimated costs of the integration with the EU and assuming that the decisions of the Brussels summit will be sustained, in 2004 from PLN15bn to PLN21bn would have to be assigned for these purposes in the Polish budget. This amount represents almost half of the budget deficit planned for 2003. Therefore, it is not strange that the growing awareness of such a substantial charge to the Polish public funds raises concerns of the Ministry of Finance and the Polish negotiators. Poland has already started to apply for mitigating the budget pressure right after the Poland's accession to the EU.

Based on the compromise in respect of the financial framework of the enlargement process reached by the existing member states, at the turn of October the final stage of negotiations with candidates was started. At the first meeting, in respect of the chapter "Financial and budgetary provisions", Poland sustained its existing stance, postulating the need for the equal treatment of all new member states both in respect of inflows and expenses in the EU budget and raised the issue of funding the so-called British discount in the first year of membership. In particular, Poland seeks the application of a mechanism adjusting the volumes of contributions to the general EU budget. This mechanism consists in a gradual increase in the contribution starting from the first year of membership. Similar mechanism was applied in the recent enlargements of the European Union (e.g. when Spain and Portugal were integrated in 1986). The proposed reduction indicated by the negotiators is of 90% in the first year and then it subsequently goes down by 20% to 10% in the fifth year of membership. It has been agreed that a consultative meeting with the European Commission will be held and aimed at defining the details and making the methodology of calculating the Polish contribution to the EU's budget realistic. If Poland manages to obtain the reduction in the contribution at the postulated level, then the 2004 budget pressure related to the membership would be decreased by half. For the time being, however, the Brussels decisions of the European Council as of 24-25 October 2002 prevail.

Therefore, one day after the start of the final stage of negotiations with Poland, on 5 November 2002, the MFs of the candidate states invited to the meeting of ECOFIN[4] in Brussels warned the EU's MFs that an excessively tight financial offering of the Union may result in the substantial deterioration in the budgets of the candidates in the first years of membership. They applied for setting the time for paying the full contribution amount equal to the period of direct subsidies for farmers. The Polish MF additionally proposed a more flexible interpretation of the budget discipline obligation in the new member states (i.e. the Maastricht fiscal criteria). He also proposed so that other EU funds could be used to supplement the direct subsidies for farmers as well as to implement a more direct dependence of the membership contribution transfers on the transfers from the EU to the budgets of the new member states (i.e. the settlements between the EU and the new member states should allow for paying contributions from the transfers obtained). One of the requested steps mentioned by Mr Kołodko was the allocation - to the new member states – of advance payments for the future expenses or at least guaranteed credit facilities for maintaining the liquidity of budgets. Kołodko argued that all those postulates result from the fact that due to the EU membership, the budget frames of all new member states will be dramatically changed in respect of both their levels and structure.

Right after the speech of Mr Kołodko, the EU representatives agreed that the better part of the proposals made by the MFs of the candidate countries were completely unrealistic, and raising the proposals was considered an error in the negotiation tactics. At the same time, however, our negotiators were ensured that the EU will not allow for the break down of the Polish budget after the accession. First of all, in 2004 the EU may decide to transfer to Poland several hundred millions of Euro as offsets. According to the assumption made by the heads of the "15", the offsets would be allocated only to these countries which would get lower net transfers after the accession than they had been allocated in the last year outside the EU. The decisions of the "15" indicated that it would not be the case with Poland. This, however, was based on the projections that in 2004 Poland would use ca. €1.5bn of the structural funds. For many months, the European Commission indicated that these assumptions were unrealistic, as even the EU member states would not prepare proposals of using the EU support at that pace. Nevertheless, in particular Germany was interested in adopting this assumption, as it wanted to avoid the payment of offsets at all costs. The charge on the Polish public finances would be substantially reduced if e.g. the assumed level of using the EU funds in 2004 was cut by half. Then we could count on as much as even €500m in offsets. What is important, this money would be transferred to the NBP accounts already at the beginning of the year. Our negotiators have been also trying to negotiate a change in the mode of transferring contributions to the EU. As is now, we should transfer our contributions in monthly tranches of ca. €200m. If the negotiators managed to "win" a right to make contributions after half a year or even after a quarter, then the premium could be generated from the Brussels offsets. If the Polish budget did not survive in 2004 despite all those extraordinary measures, the EU could sanction some specific "bridging loans". In the past the same solution was applied in respect of Greece.

Finally, it may turn out that a solution for above-mentioned problems of the Polish budget in 2004 will be a delay of accession. The EU commissioner Guenter Verheugen has already suggested such a solution. Poland will have to pay full contribution to the EU budget only when it becomes its member since 1 January 2004. If the accession took place later during the year, contribution would be lower while funds for our country would not change. Thus, from the point of view of preparing Polish budget, some delay in the process of accession treaties' ratification would be beneficial.

[4] ECOFIN – a meeting of the EU Council attended by the MFs of the EU member states.

Forced out reform of the public finances

The increase of the expenditures or the limitation of the budget income due to the membership is only one side of the coin. The budget will not lose this money, as, in line with the EU's affirmations, thanks to incurring the membership costs Poland will receive substantial funds from the EU's budget. No matter how delayed the financial stream will be, it will offset the incurred costs with interest. In practice, the problem boils down to the fact that the expenses related to the accession will drain the funds allocated to the purposes financed so far. This will mean the forced out change in the structure of the budget expenditures. This will happen, as the part of the domestic income will be replaced with the EU's transfers in respect of which– contrary to income from taxes – the Polish Ministry of Finance will not have the full flexibility in making the decisions on allocating the money. What is more, these funds could not necessarily be fully allocated to meet the needs of the public sector. From this point of view, the EU funds will be fully "fixed", as they will be allocated to specific projects compliant with the Polish NDP. The budget problems and the forced out change in the structure of public expenditures could be avoided only if all the budget expenditures so far could be fully covered with the EU funds. However, the better part of expenditures financed with the EU transfers are investments which represent a marginal item in expenses line of the Polish budget. Therefore, in practice none of the existing "fixed" expenses of the Polish budget could be financed with the EU transfers, and in particular the social transfers and salaries in the public sector mentioned above.

Summing up, one can say that the construction of the 2004 budget will be exceptionally difficult. One should remember that the government firmly declares its will to meet the Maastricht fiscal criteria already in 2005. This means that in 2004 the Ministry of Finance will not be able to afford to increase the budget deficit. As a result, a portion of the 2004 consumption expenses could not simply be financed with the slimmed down domestic income, while the share of the pro-development expenses will see some growth. From the point of view of the economy, this phenomenon should be perceived as the most favourable, however, it will represent a substantial challenge for the designers of the 2004 budget. Minister Kołodko has announced that he will present the draft project of the public finances reform early in 2003. Presenting the rationale behind the necessary implementation of the reform, he indicated the necessity to make the expenses side of the Polish budget more flexible in order to increase the capacity to absorb the EU funds. Let us hope that the proposals of the Ministry of Finance will meet the challenge in respect of the fiscal policy in 2004. However, first of all let us hope that Mr Kołodko will manage to persuade all these politicians who were so unwilling to decrease and change the structure of the budget expenses in the past to the necessity to implement the public finances reform. We shall not forget that the most important decisions will be made by the parliament. However, nothing will change the fact that in 2004 a part of the society will pay a high price for the implementation of the ever-deferred decision on increasing the flexibility of the so-far "fixed" budget expenditures, including the continuation of this practice in 2003.

Economic update

- **Visible improvement of real activity indices in 3Q02**
- **Situation on the labour market remains tough...**
- **...creating threat to continuation of positive trends in the economy**
- **Inflationary pressure still weak, although downward CPI trend comes to end**

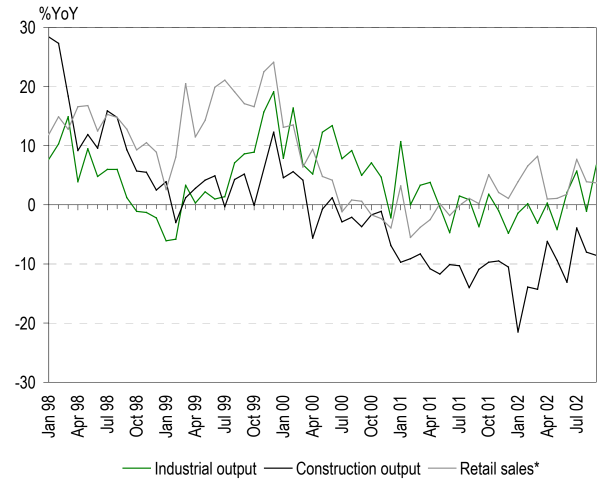
Is this recovery?

After the release of September's economic data we can review Poland's economic situation in third quarter of 2002. It seems that most of economic indicators recorded in this period confirm our scenario of gradual improvement in business climate and steady acceleration of economic growth. Comparison of quarterly economic figures from 3Q02 and two previous quarters clearly shows the improvement in major areas and overcoming the stagnation tendencies. However, still there is no improvement on the labour market, which creates the most significant threat to the continuation of positive trends recorded recently. Inflationary pressure remains weak and developments in monetary sector also suggest that despite some improvement of situation, the economic activity still remains subdued. Also, the results of recent business surveys do not provide clear answer whether the continuation of economic recovery is very likely in subsequent quarters. Nevertheless in our opinion there are no reasons for changing the expected scenario of gradual but not very fast economic revival.

Industrial output growth accelerates...

Industrial output in September surged by 6.7%YoY and 8.2%MoM. While our expectations of 4.6%YoY growth were above market consensus, the actual data turned out to be even better. Unadjusted annual output dynamic was the highest since the January 2001. It was to some extent positively influenced by higher number of working days, but seasonally adjusted growth in September, which amounted to 4.2%YoY, was also the best result since 1Q01. What is more optimistic, industrial production in manufacturing alone grew by 8.4%YoY. Taking into account September's figures output dynamics (unadjusted, seasonally adjusted and net of working days effect) for the whole 3Q02 is better than in previous quarters of this year (see table on the right).

Real growth, %YoY



Source: CSO, BZ WBK ** 3Q02: BZ WBK estimate*

...and retail sales remain strong

Also retail sales figures improved considerably in 3Q02. In September, retail sales grew by 4.7%YoY in nominal terms after growth of 5.1%YoY and 8.6%YoY in August and July, respectively. While retails sales drop on a monthly basis was deeper than expected (-2.7%MoM) annual figure decelerated only slightly and is still quite strong. The breakdown of the growth was similar as in previous months: the fastest growth was recorded in cosmetics and pharmaceuticals (25.5%YoY), in non-specialised shops selling mostly groceries and tobacco (21.7%). Substantial increase also took place clothing and footwear (10.4%) as well as furniture and house appliances (10.0%). The CSO figures for September implies 6.1%YoY nominal growth in the whole 3Q02, which according to our estimates translates into 5.1%YoY real growth.

Together with good output data, retail sales growth confirms our view that the economic situation is gradually improving. Also MPC member Dariusz Rosati thinks that these figures confirm that "the Polish economy is on a way to gradual recovery".

Indicators of economic activity, real terms %YoY

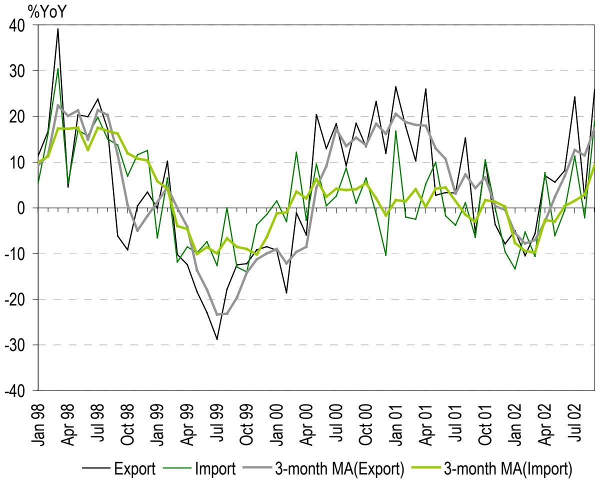
	1Q02	2Q02	3Q02
Industrial output	-1.4	-0.6	3.8
- seasonally adjusted	-0.7	-0.4	2.5
- net of working days effect*	0.1	-0.6	2.1
Retail sales	6.2	1.3	5.1*
Wages in corporate sector	1.9	1.4	2.3
GDP growth	0.5	0.8	1.7*

*Note: * BZ WBK estimate;* *Source: CSO, BZ WBK*

Foreign trade volumes keep growing as well

According to NBP data in September Polish exports reached US$2.877bn and imports US$3.775bn, both growing in nominal terms by 25.8%YoY and 18.9%YoY, respectively. Trade gap, the most important element of the current account, stood at US$900m. As we expected, August's contraction of trade turnover turned out to be one-off phenomenon resulting from the effect of high base in August 2001. On the other hand, September's figures were positively affected by relatively low base in September last year. However, looking at quarterly data ruling out one-off factors (see table below), exports and imports growth rates in 3Q02 are much higher than in previous quarters and deliver another evidence that the Polish economy is accelerating.

Foreign trade turnover (payments-based), %YoY



Source: NBP

Data from CSO (based on invoices) for the first eight months of 2002 also confirm that the growth of foreign trade volume is continuing. In Jan-Aug period export expressed in US dollars and in euros increased by 7.5%YoY and 5.1%YoY, respectively. Both growth rates are higher than after seven months suggesting some acceleration of exports in August. At the same time imports inched up by 4.7%YoY in dollar terms and grew by 2.3%YoY when expressed in euros. The figures are better than in Jan-Jul period and confirm that external demand for Polish products is quite strong, meanwhile gradually recovering import signals some improvement on the domestic market.

In the remainder of the year, we do not expect reversion of the positive trend in foreign trade. Particularly, imports should continue improving along with expected gradual rebound of investment demand. Imports' acceleration may be perceived as an argument against further interest rates cuts but up-to-date experience shows that the MPC largely do not take it into account.

Export and import growth, nominal terms %YoY

	1Q02	2Q02	3Q02
Export	-7.0	6.9	16.9
Import	-10.1	0.1	8.8

Source: NBP

C/A deficit amounted to US$540m being moderately higher than market consensus, but lower than our forecast of US$640m. Once again, unclassified flows surplus was relatively high reaching US$430m, roughly the same as in August (US$490m). On the other hand, as usual in September, payments connected with the service of foreign debt by the government increased negative balance of incomes and the whole current account figure. We estimate that 12-month cumulative C/A-to-GDP ratio increased to 3.6% from 3.5% in August, but the ratio should be stable in coming months. Moreover, a half of the deficit is financed by FDI inflow.

Meanwhile, there is no improvement on the labour market

Unfortunately, after three quarters still no improvement can be seen on the labour market. Although real growth of wages in corporate sector in 3Q02 was the highest since the beginning of year, nevertheless it was accompanied by fast job destruction. In September wages in corporate sector increased 2.2%MoM and 3.8%YoY, while average employment declined by 0.2%MoM and 3.9%YoY. The worrisome trend of labour shedding in corporations continues at broadly unchanged pace and what is more, entrepreneurs still declare personnel reduction in the monthly opinion polls. Wage growth recovered somehow to 3.8%YoY from last month's 2.8%YoY, but it rather represented reversion to long-term trend than some real improvement in companies. In real terms wage growth stays at 2.5%YoY. However, the annual growth of nominal wage bill is still negative (-0.2%YoY compared to -1.3YoY in August), constraining the purchasing power of households.

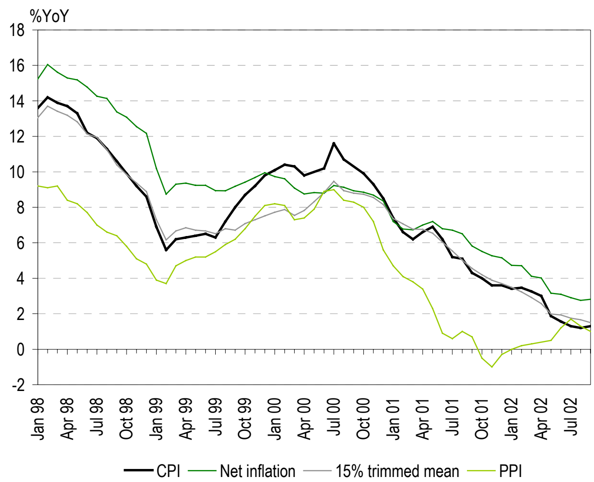
As long as the employment keeps falling and wage growth remains limited one cannot be certain about the stability of private consumption demand. There is a threat that private consumption would weaken in 2H02, adversely affecting GDP growth. Weak labour market data also limit the possibility of inflationary pressure in the medium term, being supportive for expectations for further monetary easing.

Registered unemployment rate increased slightly in September to 17.6% from 17.5% in August. The number of unemployed reached 3.113m rising by 6.6%YoY, which is the lowest increase since the end of 1998, i.e. the beginning of upward trend in unemployment. Quite surprisingly, inflow of graduates is still not seen in the data. Despite the fact that upward trend of unemployment has been diminishing since the beginning of this year the unemployment rate is likely to surge seasonally in the nearest months.

...and inflationary pressure remains very weak

In September inflation increased slightly for the first time in six months. It reached 1.3% compared to 1.2% in August, which was exactly in line with our expectations. It seems that mostly supply factor were responsible for 0.3%MoM increase as food price rose by 0.8% and fuel prices grew by 2.2% bringing the whole transportation prices up by 1%MoM. On the other hand, housing prices, including electricity, increased less than usual seasonal rise in September and alcoholic beverages prices fell by 0.2%MoM, which may suggest that some retailers reacted in advance to the October's reduction of excise tax on these products. However, the whole effect of this change (together with cheaper long-distance telephone calls) will be visible in October.

Measures of inflation, %YoY



Source: CSO, NBP

September's CPI growth is a first indication that downward trend (lasting already for over 2 years) is about to conclude. We expect that consumer price growth will decelerate once more in October (although the decline would be somewhat smaller than earlier thought, see below), and afterwards CPI will increase steadily. Nevertheless inflation will remain at relatively low level – average inflation rate in 2003 should not exceed 2.3% and for December 2003 we forecast ca. 2.7%YoY.

According to CSO preliminary figures food prices increased by 1.2%MoM on average in October (1.3%MoM in first and 1% in second half of the month). Therefore October was the second consecutive month when food prices pushed inflation upwards (after five months of the opposite situation). However there was another significant factor dragging CPI down this time. Since the beginning of October excise tax on alcohol was reduced by 30% for those producers who cut their prices by at least 20%. According to our estimates if this reduction was fully translated into retail prices, this should result in 6.5%MoM decline of prices in "alcoholic beverages and tobacco" section. Meanwhile, CSO's preliminary data showed that those prices declined by 4.5%MoM on average in October. Such 4.5%MoM fall reduces October's inflation by ca. 0.3pp, considering its 6.2% weight in the CPI basket. Possibly the remaining 2pp decline might pass through into November inflation results.

Food prices in October in 1999-2002

% change	1999	2000	2001	2002
1st half against previous 15 days	1.4	1.2	0.5	1.0
2nd half against previous 15 days	0.6	-0.2	-0.1	0.0
1st half MoM	1.7	1.5	0.7	1.3
2nd half MoM	2.1	1.0	0.4	1.0

Source: CSO

Considering reported information on food prices, alcohol and tobacco, we estimate that October's inflation rate declined to 1.1%YoY from 1.3% recorded in September. The Ministry of Finance maintained its forecast of 1% CPI inflation in October, while Grzegorz Wójtowicz from the MPC expects inflation to increase slightly in October.

Core inflation keeps falling

Unlike the headline inflation rate, core inflation measures computed by NBP kept falling in September. Only net inflation (CPI excluding prices of fuels and foodstuff) recorded insignificant growth to 2.82% from 2.75%. Other measures decreased, in two cases the fall was even deeper than in previous month, and all of them are not higher than 1.5%. One of core inflation figures (inflation excluding controlled prices) amounted to only 0.57%. The most closely watched measure, 15% trimmed mean, plummeted to 1.5% from 1.66% in August. Therefore, the data on core inflation are more optimistic than headline inflation figure, which inched up slightly in September, and confirms lack of inflationary pressure in the economy.

Money supply collapsed in September

In September broad money M3 contracted -0.8%MoM and -1.6%YoY. The collapse was driven almost entirely by households' deposits, which fell by 1.3%MoM and 5%YoY. Meanwhile, cash in circulation stabilised after fast upsurge recorded in the first eight months of the year (growing 14.7%YoY in September). Liabilities of the banking sector exhibited quite usual pattern. Credit growth remained rather limited, with loans to households growing 7.8%YoY (down from 8.2% in August) and corporate loans 1.1%YoY (1.8% last month). The last month's collapse of M3 followed – 0.2%YoY decline recorded in August. According to NBP the broad money growth according to 'old definition' (M2) also decelerated to record low level of 2.6%YoY.

In general the monetary figures seem to confirm the weakness of the economy. Such rapid money contraction results from poor real economic activity, leading to weak credit growth and thus insignificant money creation. Of course this may also translate into smaller risk of inflationary pressure. Dramatic fall of households' deposits probably reflects partly fast declining interest rates (alternative cost of holding money), but in part it is a consequence of shrinking disposable income of individuals (see section about wages and employment above).

One has also remember about substitution effect, as the downfall of households' deposits reflects to large extent the shift from traditional forms of saving money (banking deposits) to alternative, higher-yielding saving vehicles, offered extensively by the financial institutions in recent months.

Inflation and monetary aggregates, nominal terms %YoY

	1Q02	2Q02	3Q02
CPI	3.4	2.1	1.3
PPI	0.2	0.7	1.3
Broad money (M3)	5.9	2.7	-0.2
Banking sector's liabilities	4.8	0.8	-2.3
Banking sector's assets	8.3	8.0	6.1

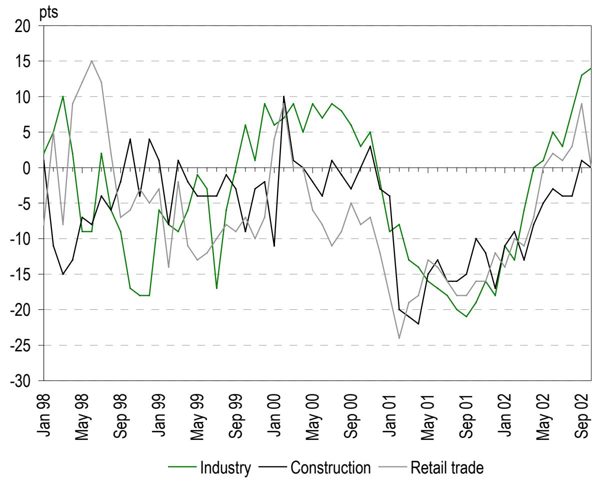
Source: GUS, NBP

Unanimous conclusions from business survey results

Recent results of business climate surveys do not provide clear answer about possible development of economic situation in the subsequent months. While some of the information pointed to the improvement of situation in industry and improving consumer's confidence, other parts suggested that continuation of recovery in subsequent quarters is not certain.

According to CSO in October business climate in industry was much better than last year but slightly weaker than in previous month. This stemmed mainly from deterioration of expectations regarding future demand and production, and weak current and expected financial situation. Again, companies recorded slight deterioration of current demand and again mainly from abroad. However, entrepreneurs still decide to moderately expand production, even despite the fact that the level of inventories is perceived as excessive. Employment reduction is expected to continue at slightly higher pace than in the previous month. Annual growth of overall climate index declined in construction and retail trade. In construction the total portfolio of new orders slightly declined and forecasts of future orders are pessimistic. Also construction companies evaluate their financial stance as bad and expect its deterioration in the future. Entrepreneurs in this sector plan to continue labour shedding process. Deterioration of business climate assessment on a monthly basis was the deepest in retail sales. Companies reported further decrease of current turnover and expected fall of future turnover. Their financial situation is perceived as bad and is expected to worsen in the future. In the nearest months, prices in retail trade are expected to decline slightly.

Business climate, YoY



Source: CSO, BZ WBK

Leading indicator for the Polish economy computed by Maria Drozdowicz from Bureau for Investments and Economic Cycle also deteriorated. Index declined by 0.2 points in September after drop of 0.8 points in August. In the previous months index was rising from

October 2001 to March 2002 and later was stagnant until July 2002. In September, four out of eight components of the index deteriorated and only one improved. The other three remained unchanged. Companies' financial situation, which was continuously improving in previous months, did not changed in September. According to survey results, both domestic and external demand seem to weaken. The inflow of new orders decelerated again after very fast increase in 1H02 and drop in August. Also export orders decreased for the second month in a row. Again, authors of the survey said that its results prove that economic recovery is very uncertain. However, value of the index is higher than last year, which means that gradual improvement of the economic situation is taking place.

The results of latest consumer's optimism survey performed by Ipsos-Demoskop institute in October show significant improvement. The indicator of overall consumers' optimism (WOK) increased by 2 pp in relation to previous month (reaching the level observed at the beginning of last year), while households' propensity to consume remained stable at relatively high level (the highest since mid-2001). The assessment of current economic situation sharply increased for the second consecutive month (this time by 6pp). The 12-month changes of the indices also show a continuation of improvement for all three indicators. The most significant increase was observed for the assessment of overall economic climate (16.1%YoY), while consumers' optimism increased by 8.1%YoY and the propensity to spend by 4.9%YoY. While propensity to consume did not grow comparing to last month, the ratio of respondents planning the purchase of durable goods increased. Inflationary expectations stabilised and the fear of unemployment was lower than last month.

Although tough situation on the labour market described earlier creates a threat that private consumption could weaken in 2H02, but it seems that Grzegorz Kołodko's endless optimism influenced households' perception of the economic situation, which may be positive for GDP growth. However, the fear of unemployment may appear again when we see its seasonal increase in 4Q02.

GDP growth must have increased in 3Q02

After the release of September's economic figures market expectations regarding GDP growth in 3Q02 increased notably, focusing around 2%YoY (compared to forecasted range 0.5-2.2% with average 1.3% at the beginning of October). Also the Ministry of Finance estimates economic growth in 3Q02 at ca. 2% and in 4Q02 at 2.2-2.3%, which contributes to 1.4% total growth for 2002. During the press conference on the economic situation in the third quarter the CSO deputy chief Janusz Witkowski said that statistical data indicate that GDP growth in 3Q02 may be close to 2%. Witkowski said that on the supply side three factors contributed to higher growth – higher industrial production, less significant fall in the construction sector and favourable data of market services (especially in transportation and communication).

Indeed, economic data available after nine months of this year allow for quite optimistic predictions of value added in third quarter. According to our estimates, based on growth of industrial output, construction output and retail sales in Jul-Sep, GDP growth in 3Q02 might reach 1.7%YoY. One should remember, however, that possible investment acceleration could be offset partly by negative contribution of net exports. The latter is likely to stem from increased import demand. It was confirmed by Witkowski during the conference, as he said that the share of investments goods in Polish imports increased, but he added also that investment growth figure in 3Q02 is still unknown. Also, it is difficult to expect very high private consumption growth given difficult situation on the labour market, although it has to be noticed that lower inflation in 3Q02 increased wage bill in real terms comparing with previous quarter.

Central bank watch

- **Reference rate at 7%**
- **...and will fall even further, but not this year**
- **...as MPC suggests no rate cut in November**
- **Medium-term strategy to be published soon**

Interest rates down in third consecutive month

In October the MPC cut the official interest rates. Lombard rate has been reduced by 100bp to 9%, reference rate by 50bp to 7.0%, and deposit rate remained at 5.0%. MPC maintained the neutral bias in its monetary policy. As most of financial markets participants expected rate cut in November, the timing of the decision clearly was a surprise. The fact that not all the interest rates have been cut in the same scale resulted from the desire to narrow the fluctuation band for interbank interest rates, as the absolute level of interest rates declined. The central bank wants simply maintain the same difference between the Lombard rate and reference rate and between reference and deposit rates. This means that more significant Lombard rate reduction should not be perceived as the NBP's willingness to cut rates more significantly in the future.

...and markets will wait for more

But anyway, financial markets are very likely to expect more cuts, and they are quite right. It seems that by cutting interest rates in the moment, when financial markets did not expect it, the central bank may reinforce expectations for another cuts. This would lead to portfolio capital inflow on the fixed income market, which would cause appreciation pressure on the zloty (which we have expected anyway). Stronger zloty means lower inflationary pressure, which again would cause the central bank's decision on rates cut. The NBP seems to expect higher GDP growth in the future driven by domestic demand acceleration. Assuming that prices increase a bit amid higher demand, stronger zloty would neutralise this effect. Well, in the current environment, the zloty appreciation leads to lower inflation, while depreciation of the zloty does not necessarily mean higher prices.

Arguments for and against cut as usual

While almost all markets' participants expected interest rates reduction in November, of course it was not difficult to find arguments for rates' reduction already last month. And the central bank's president listed them during the press conference:

- inflation measures (core inflation, CPI, inflationary expectations of households and financial markets' participants)
- annual fall of money supply and deceleration of cash in circulation and low growth of credits
- moderate wages increase, which would not increase inflationary pressure, as it is accompanied by high unemployment
- worse global economic outlook, especially for German economy

On the other hand arguments, which may limit the scope of interest rates reduction included:

- uncertain fiscal policy
- risk of fuel prices increase
- falling deposits in the banking sector and difficulties with the estimation of lagged effect of interest rates reduction on monetary aggregates

...and they may be repeated once again

The MPC statement and arguments were exactly the same as in September (and the central bank may have opportunity to use it again). NBP president said that there would be no interest rates cut if fiscal policy was a decisive argument. However, financial markets will probably not react on negative comments of the MPC members concerning fiscal policy in the future. In September, the MPC cut rates not taking into account budget proposal despite the fact that the draft was already known. Two weeks after the MPC has criticised the budget in the official opinion, but it does not seem to influence its monetary policy decisions. Since budget draft for the next year was published, the reference rate was cut by 100bp and Lombard rate by 150bp. Interestingly enough, at the same time the MPC members' assessment of the situation in the real economy activity sphere has even improved and GDP growth forecasts increased.

But in the October's statement real economic activity indicators were not listed as arguments for or against rates reduction (again, in September the MPC did exactly the same). The MPC stated that recent industrial production and retail sales figures show some signs of recovery. However, the statement said (text in bold) that the data on investment activity and financial situation of enterprises in 3Q02 are not known yet and therefore it is difficult to assess growth perspectives in the following quarters (although it their comments, central bank's official are talking about higher growth in the future). Data on investment activity and firms' financial situation will be available at the end of next month, just before the MPC meeting scheduled for 26-27 November. But, if according to the MPC these data are so important to assess growth perspectives, why the Council did not wait with the decision until the data are known?

Interest rates at "almost appropriate level"

Market's expectations for another rate cut may be limited by Leszek Balcerowicz statement saying "interest rates are appropriate in current macroeconomic situation". However, he added "almost appropriate", which still leaves some room for manoeuvre. Well, before October's decision we expected 50bp in November and another 50bp at the beginning of the next year (possibly with two 25bp cuts) and it does not seem that we should change this scenario dramatically. We had already the first rate cut and the remaining question is when we will see another one(s). Of course, to assess probability of the rate cut already in November one should have wait for the next month data releases (especially investments and financial results of companies).

...but this is not the end of easing cycle

If the Council decided to cut rates against markets' expectations in October, it is not difficult to imagine they will do it again - rates would remain the same despite expectations for a cut. If we are to judge a timing of the next cut based on MPC members' comments, the November's rate reduction should be ruled out - Dariusz Rosati, who probably voted for a cut, said that decision already in October means lower chances for another reduction in November adding, "such expectations are irrational". Interestingly enough, after the decision only members from the dovish faction in the Council were active in the media (and during press conference), which may suggest that the decision was not unanimous. Is another rate cut possible in December? Preliminarily, the last meeting this year is scheduled for 17-18 December, which means before the publication of sold industrial production, retail sales and core inflation data. In our opinion, this is too considerable lack of information to take a decision about rates' reduction. If the MPC does not change the date of the meeting, this would suggest that we could see another rate cuts as early as next year. And the timing of the first one would be in 1Q03, which would be consistent with our earlier presumptions. However, after the "October's surprise", rates reduction already this year cannot be completely ruled out.

Medium-term strategy for 2004-06

During October's meeting the Monetary Policy Council has also discussed preliminary assumptions of the medium-term monetary policy strategy for 2004-06. In the statement the MPC has emphasised that it is necessary to prepare this document within the nearest few months. Monetary policy in the years of 2004-06 will be conducted by new-appointed Council. However, having regard to the lag of transmission mechanism in the Polish economy, the strategy will provide the basis for the monetary policy in 2003 and will affect the monetary situation in the following years. Of course, the medium-term monetary policy strategy will be based on the assumptions of integration with the Economic and Monetary Union agreed with the government, which stipulate that in 2005 Poland shall meet the nominal Maastricht convergence criteria, including the inflation criterion.

Unanimous rates cut in August

Voting results during the August's MPC meeting were published last month. They confirmed earlier statement of the MPC member Janusz Krzyżewski – August's interest rate cut was approved unanimously. All MPC members, except absent Dariusz Rosati, supported 50bps rate cut. This included Marek Dąbrowski, who is regarded as "ultra hawk" (he voted for interest rate cut only once, during Russian crisis). Although it is hard to guess what was the reason of Dąbrowski's decision (maybe he acknowledged that inflation in Poland is already low and stable), this suggests that further monetary easing may be supported also by "hawks". Although, in our opinion October's decision was not unanimous.

Comments of the MPC members and central bank representatives

Obviously, the most important event for central bank officials (and others) was unexpected by the markets interest rates reduction. As we have mentioned above, after the decision only members from the dovish faction in the Council were active in the media (and present during press conference). This may suggest that their votes were decisive. The most important comments were concentrated on trying to reduce expectations for further rates' reductions. Dariusz Rosati said that October's decision means lower chances for a cut in the next month adding that such expectations would be irrational. Leszek Balcerowicz repeated several times that after 13 reductions, interest rates are appropriate or almost appropriate to the current situation of the economy. NBP chief underscored that the central bank has also to take into account the attractiveness of savings.

In the comments concerning inflation, MPC members have stressed the fact of inflation stabilisation at the very low level. According to NBP president, a significant inflation rebound next year is not very likely and CPI inflation may be below 3% in 2003 (within the target of 2-4%), which is consistent with our forecast. Balcerowicz added that it is difficult to expect that inflation will be always at around 1%. Grzegorz Wójtowicz said that inflation should amount to 1.5-1.8% in December 2002. Janusz Krzyżewski said that price stability observed in recent months is the target of monetary policy. What is interesting, Krzyżewski said that such a stabilisation of inflation rate is not necessarily a reason for further monetary easing adding that „in current circumstances there are no clear arguments for the rate cut". It seems, however, that such arguments were found during the next couple of days. In terms of short-term inflation forecast, director of NBP research department Adam Czyżewski said that inflation would rise in October from 1.3% in September despite lower excise tax on alcoholic beverages, which should decrease annual inflation rate by 0.2pp.

As usual, the MPC members commented the results of sold industrial production and balance of payments. Grzegorz Wójtowicz estimates that C/A deficit should remain stable in the remainder of the year. In his opinion foreign trade figures confirm that an economic recovery is taking place. He expects high exports growth rate to maintain in the nearest months while imports should accelerate as a result of improvement of the domestic economic situation. Wójtowicz said that taking into account all data for Jul-Sep period GDP growth in 3Q02 reached around 2%. He envisages that in the whole year it will amount to 1.2-1.3% and it will accelerate to ca. 3% in 2003. On the other hand, Wiesława Ziółkowska was less optimistic on foreign trade figures. She told that they are in line with expectations with exports growing faster than imports but exports' growth is lower than last year. In her opinion it has resulted from delay of economic situation improvement in the EU countries, particularly in Germany. Industrial production data did not change the MPC's perception of economic situation. Dariusz Rosati said that output growth might suggest upcoming economic recovery, although we have to wait for a confirmation in subsequent months. On the other hand, Wiesława Ziółkowska said that such positive data do not prove that a long-awaited economy recovery has already began. Nevertheless, Bogusław Grabowski stated that strong production growth limits room for monetary policy easing. He expects that the economic growth will pick up to 1.5-2% in 3Q02, and 1.7-2.2% in 4Q02. NBP's research department also revealed its economic growth forecasts, as Czyżewski said that GDP growth will accelerate to 2% in 3Q02 and moderately above this level in 4Q02, which would give the whole year growth of "much above 1%". He said that domestic demand is much higher than the central bank previously expected. This is quite surprising that after such comments with optimistic picture concerning domestic demand and GDP growth, the MPC has decided to cut rates against markets' expectations.

NBP president Leszek Balcerowicz is satisfied with the central bank and the Ministry of Finance co-operation concerning the strategy of euro adoption and meeting Maastricht criteria in 2005. In long interview with Gazeta Wyborcza daily he reiterated that the central bank and the government would like to join the Eurozone as soon as possible and to meet Maastricht criteria (out of which lower budget deficit is the most difficult) in 2005. Balcerowicz said that parity against euro will be based on both market rate of the zloty and long-term equilibrium value. Bogusław Grabowski also commented the possibility of meeting Maastricht criterion saying that low inflation in 2005 will be very difficult, if it will not be supported by public finances reform. In his opinion low inflation and lack of inflationary pressure at the moment do not guarantee it, as we observed cumulating disinflationary factors this year and in 2003 we may see a reverse of this trend. He reiterated that next year budget is not a step towards a reform of public finances sector.

WHO, WHEN, WHERE	COMMENT
Leszek Balcerowicz; NBP governor; PAP, 31 Oct	Many factors indicate that inflation in Poland may be below 3% at the end of 2003, which is in line with our inflation target. We cannot count on inflation to remain around one percent forever. Data on balance of payments are favourable. One cannot rule out that GDP growth in 3Q02 will be higher than it was expected. In 2003 the growth will be higher than this year. It depends on the economic situation in Germany. This was the 13th rate cut (in this cycle). From 19% we have descended to 7%. It can be assumed that after such a huge series of cuts, rates are at an adequate level, or very near the adequate level, for Poland's economic situation. When conducting monetary policy, the central bank has also to take into account attractiveness of saving. We would like to have co-ordinated policy. We try to co-operate, and I welcomed with satisfaction joint agreement of the NBP and finance ministry on the strategy for road to the euro and a declaration that we are going to meet Maastricht criteria already in 2005. This disciplines economic policy, which is very important.
PAP, 23 Oct.	The rationale for this decision is that factors that will limit inflationary pressure in future still, based on the current outlook, outweigh those that could threaten its stabilisation. The current level of interest rates is nearly appropriate for the economic situation and inflation targets. It cannot be ruled out that GDP growth will exceed 1%. This (the zloty level) has not been taken by us as a factor in the decision. If we base interest rates decision on the budget, there would be no such decision. I expect only minor changes on the FX market. The zloty exchange rate changes in the past were not very significant and they allowed for development of export. The fact that interest rates were cut in October and not in November does not mean that more rate cuts will come in the future. Fiscal policy does not lead to lower deficit and therefore there is need for cautious in monetary policy. It is important to have inflation expectations at the low level, which also requires cautious monetary policy. The intention remains the same - the primary mission is to stabilise inflation at the low level but in the decision making process the MPC also takes into account forecasts for the future. However, still the main goal is stabilisation of inflation, not the GDP growth.
Reuters, 17 Oct	In every democratic society exists freedom of word and it also concerns the government. It happens that in western countries politicians speak about their expectations regarding central bank policy. The problem in Poland was that they spoke also about central bank independence. I hope this is the closed chapter. I wouldn't like to speculate on the outcome ahead of the vote [in Irleand] but clearly it is crucial for Poland that we get a "yes" vote. You have to ask the question of what serves long-term growth prospects best and from that perspective I see early entry to the Eurozone as both feasible and more appropriate. If Spain, Portugal and Greece did it, then why not Poland. Let us make those reforms...they are necessary and desirable to speed up economic growth. Polish exports have actually been increasing this year and that tells you something about the appropriateness of the zloty level.

Gazeta Wyborcza, 14 Oct	In terms of inflation we already meet the Eurozone criterion (...) also long-term rates are within the acceptable levels. What is left? Public finance reform, particularly cutting deficit. If we have a public declaration from the government that it wants to meet the Maastricht criteria in 2005, then one should assume that during works on future budget, necessary changes would be implemented. Similarly to other countries which had to agree on the central parity rate, we will definitely have to look at the actual exchange rate. We have conducted research on the long-term equilibrium exchange rate. I think that the actual exchange rate do not have to be necessarily much different from mathematically calculated equilibrium exchange rate.
PAP, 1 Oct	The central bank is not going to abandon free float FX regime. There are no reasons to change our position. Monthly data should not be overvalued. Since April we have observed upward trend in exports, but our export depends on external situation, particularly in Germany, and this not favourable.
Andrzej Bratkowski, NBP deputy governor; PAP, 24 Oct	After this decision, there is very little room for changes in monetary policy parameters. Movements by 0.5-1% are not big and confirms that the MPC decision was right. We have free float exchange rate. Given the weak external economic climate, one cannot expect the recent strengthening of the zloty to be long-lasting. External conditions may be worse, which is seen in forecasts for the German economy but this may be partially offset by domestic situation. The growth of 2-3% next year is possible. The data published so far have shown that export is still quite strong despite worsening of the situation in western Europe. There is a chance that C/A deficit at the end of the year will stay below 4% of GDP. There are little chances for inflation rebound in the next year. It could be possible only if very unfavourable supply shock occurred. However, there is a threat that it may happen in 2004. It is important that it should not be coupled with the zloty weakening.
PAP, Reuters, ISB, 8 Oct	If there is no extraordinary economic turbulence, we would like to enter Eurozone two years after ERM2 accession. Whether we will make it in 2006 is not only up to us, [...] but also on the procedural talks with EU. So we cannot rule out that it would be 2006 or 2007. NBP would prefer 2006. The joint committee did not discuss the issue of entering ERM2. Formally we can do this after EU accession. NBP intends to enter ERM as soon as possible, without any delay. Negotiations [about entering ERM2] would start after entering EU, but informal talks can start earlier. They should not last longer than a couple of months [...] We cannot rule out that the period of presence in ERM2 would be shorter than predicted. Poland could ask for shortening this period if macroeconomic situation justifies it. Presently we are working on the issue what factors should determine the central fixed parity [against euro]. It's too early to say what exactly will be the reference period, but for sure this does not mean pure arithmetic reference rate. NBP does not exclude FX intervention in special circumstances before ERM2 entry. It would depend on situation. If NBP judges the zloty to be overvalued then we cannot rule out intervention [...] but we have very serious concerns over the effectiveness of such action. We have no reasons to believe that such special circumstances would happen on the road to ERM2. Zloty devaluation is not possible under fully floating exchange rate regime.
Bogusław Grabowski; MPC member; PAP, 31 Oct	It seems to me that, having enough data for the third quarter, GDP growth in 3Q02 will pick up to between 1.5% and 2%. In 4Q02 we will have 1.7-2.2%. Exports will have influence on GDP growth through its positive influence on investments, which will be the main driving force behind GDP growth acceleration. Increase of foreign trade will influence GDP growth in the nearest months not through the net exports but through positive influence on investments.
PAP, 25 Oct	The NBP will try to conduct monetary policy in conditions of operational overliquidity but not allowing for its decrease to below PLN7-10bn. It is very likely that the NBP will buy these bonds in 2003. It is also possible that by the end of 2004 we will leave the banking sector without any bond burden and with reserve requirements at EU levels or close.
PAP, Reuters, 21 Oct	So far, we have had cumulating disinflationary factors. Additionally, it was supported by the nominal convergence process causing the zloty appreciation. In 2003 we may see a reverse of this trend. Demand may begin to rise, import, fuel and food prices are likely to accelerate and inflation expectations will probably surge following an increase in CPI. We need many efforts to keep low inflation expectations. Meeting Maastricht criteria on inflation in 2004 and 2005 will not be easy, if it is not supported by public finances' reform. The government broke Marek Belka's "inflation plus 1%" rule and did not lower CIT rate. The next years will be difficult, as budget for 2003 includes one-off incomes. Moreover, it is not sure whether they will be received. In 2004 the budget will have to finance expenditures related to membership in the EU, which will be additional burden. The zloty would be under upward pressure in coming months because of hefty convergence trade inflows into local currency debt. This process may be supported by privatisation and FDI inflows. Poland's five year bond yield in five years, the 5-yr/5-yr interest rate swap, is likely to converge with euro levels in the coming months. Monetary policy will take into account the zloty appreciation and its influence on inflation rate and interest rates level. We have three years for meeting Maastricht criteria and process of nominal convergence may finish within a few months. It will depend on fiscal policy. If nominal convergence happens in the first half of 2003, and fiscal policy (reform) begins drag its feet, then we can have problems. Investors may start ask themselves whether they may have rushed into convergence play. If fiscal policy does not fulfil its pledges, then after rates converge, we may have the reverse trend.
Reuters, 17 Oct	Over the last half a year the MPC has ordered five rate cuts, each by 50 basis points, which indicates serious loosening of monetary policy as the base is getting increasingly lower. I think no-one should now expect that we will continue that policy (of higher reductions in real terms), as the economy is showing strong signals that it has started to gain momentum.
Janusz Krzyżewski; MPC member; PAP, 15 Oct	I do not see clear arguments for interest rates reduction in current situation. Inflation has stabilised, i.e. we have situation that we have expected for long time. The stabilisation shows that this year's inflation will be below 2% [i.e. inflation target]. The situation is stable and such a stability is the target of monetary policy. It would be worse if prices dropped compared to GDP growth, which would require monetary easing. But now we have stabilisation, which we always wanted. There was accident in August that we voted unanimously, which means that we transform very easily from "hawks" into "doves" if there are some reasons for that.
Dariusz Rosati; MPC member; PAP, 23 Oct	Expectations for another rates cut would be irrational. The market exactly knows that if we reduced rates in October, then chances for another cut is automatically smaller. It is better to do it earlier than when the economy will gain momentum. It does not mean „rule of series" as well. Those figures confirm previous data on industrial output. The Polish economy is on a gradual recovery. Long-awaited rebound is coming. However, we should wait another 2-3 months for the final confirmation.
PAP, Reuters, 21 Oct	The Irish referendum should not cause further zloty strengthening. Markets have for a week expected a positive

	outcome to this vote. The strengthening is moderate as we expected. Bonds prices are rising, yields are declining. We do not expect revolution on the market (because of Irish referendum outcome). The next two months will bring several factors, which may cause fluctuations on the market. Looking at the fundamentals of the Polish economy the zloty should be weaker, but importers could have another view.
Reuters, 17 Oct	Surprisingly high growth of industrial production in September may mean that economic recovery has already begun but of course it should be confirmed in next months. There are chances that GDP growth in 3Q02 will be above 1% and in 4Q02 will stand at ca. 2%. There are chances that in the whole year GDP will grow by 1.2-1.5%.
Grzegorz Wójtowicz; MPC member; PAP, 31 Oct	12-month rolling current account deficit widened to 3.7% of GDP in September from 3.6% in August. At the end of 2002 it should reach 3.7% of GDP. This is quite good result. In my opinion, the deficit is not excessively high. We have high (growth) numbers both in exports and imports, which confirms that an economic recovery is taking place. I think that the figures confirm that 3Q02 was better period for the economy. Balance of payments data suggest economic rebound, exports should remain at the similar level in the nearest months, which will coupled with accelerating imports resulting from gradual economic recovery. GDP growth in 3Q02 probably reached 2% and in the whole year it will amount to 1.2-1.3%, and in 2003 it may pick up to around 3%.
PAP, 23 Oct	So far I do not see any price pressure (but) the period of (monthly) deflation has ended for now. CPI at the end of this year should reach 1.5-1.8%YoY.
PAP, 15 Oct	Probability of inflation rebound in the next year is very low. If it is different, there would not be the last series of interest rates reductions.
Wiesława Ziółkowska; MPC member; PAP, 31 Oct	The C/A deficit is very volatile, mainly trade gap. The figures may be the first signs of improvement of the economic situation related to the weakening of the zloty in July. However, it is too early to state that its influence could be fully visible. One has to wait for it about 6 months. The data are in line with expectations. Exports growth is faster than imports growth. However, exports growth is lower than last year and this resulted, among others, from a delay of economic situation improvement in EU countries, particularly in Germany. The visible sign of a recovery in our economy will be acceleration of imports. If exports will accelerate, it will be a sign of recovery in western Europe but all forecast there for GDP growth in 2002 and 2003 are revised downwards.
PAP, 23 Oct	There are no factors to push the annual inflation rate higher in October. It should be at the level from last month or even lower. Signals from the EU are worrying - all GDP growth forecasts were revised for this and the next year. And this is obvious that our economy in at least 60% depends on the German economy.
Reuters, 17 Oct	It is too early to talk about a recovery. Especially since there are no signs that net exports in gross domestic product are rising.
Adam Czyżewski, NBP Chief Economist PAP, Reuters, 22 Oct	Our forecast assumes acceleration of the economic growth in the third and fourth quarter of this year. In 3Q02 it be around 2%, but the economy is growing faster than we previously expected due to domestic demand, and in 4Q02 the growth rate may be above 2%. The whole year growth may be much above 1%. Our forecast assumes further increase of inflation in annual terms in October. This forecast includes effect of excise tax lowering on alcoholic beverages.

INFORMATION AFTER THE MONETARY POLICY COUNCIL MEETING ON 22-23 OCTOBER 2002

The Monetary Policy Council held a meeting on 22nd and 23rd October 2002. The Council reviewed the materials prepared by the NBP Management Board and departments as well as information and analytical materials of the Ministry of Finance, banks and research institutes. The Council discussed the situation in the external environment of Polish economy and trends in the real economy, the scope of employee earnings and social benefits, within the public sector finance, within the money supply, credit and interest rates and also the development of inflation and price expectations as well as inflation prospects.

The Monetary Policy Council decision
A low inflation level is seen to establish in October. Factors containing the inflation growth in the future continue:
- the current inflation rate and core inflation measures stabilised on a low level, threats to the future inflation from monetary factors remained low:
- annual growth rate of total money supply has clearly declined, likewise the annual growth rates of notes and coin in circulation; the pace of credits growth is also slow,
- inflation expectations improved, both of consumer and of bank analysts,
- a moderate increase in employee earnings – at a high unemployment level – does not threat with an inflation pressure,
- forecasts for global economy growth, of which in particular for German economy, indicate that a slower economic recovery shall be expected.

The picture of macroeconomic situation is not clear. A part of data, primarily on September industrial output and retail sales, indicates that a gradual economic recovery should occur. **However, the figures on enterprises' investment activity and financial standing after three quarters are not available yet. Under such circumstances it is difficult to make a definite assessment of the scale and durability of recovery in enterprises and of prospects for economic growth acceleration in the following quarters.**

Factors that might endanger the inflation stabilisation on a low level and constrain the growth of manufacturing potential have been continuing:
- uncertainty in respect of outcomes of the National Budget this year and – indirectly – next year remains,
- high oil prices in global markets as well as the risk of their increase continue,
- the decline in households deposits at banks became deeper in September,
- despite a very slow pace of monetary aggregates growth it is very difficult to evaluate what will be the deferred response to already taken decisions on cutting interest rates, which as compared to 2001 are on a drastically lower level.

The Monetary Policy Council considered that from the future inflation point of view the inflation pressure constraining factors continue – in the light of current forecasts – to have greater impact than factors threatening the inflation stabilisation and resolved:

- **to reduce the Lombard rate from 10.0% to 9.0% per annum;**
- **to reduce the rate on bills rediscounting from 8.5% to 7.75% p.a.;**
- **the National Bank of Poland is going to run 28-day open market operations at the yield not lower than 7.0% p.a.;**
- **the interest rate on time deposits taken from the banks by the NBP stands at 5.0% p.a.;**

The Council continues to hold a neutral stance in the monetary policy.

The Monetary Policy Council has discussed preliminary assumptions of the medium-term monetary policy strategy for the years 2004 – 2006. The MPC has emphasised that it is necessary to prepare this document within the nearest few months to ensure transparency of the monetary policy as – having regard to delays in the economy responses to decisions on NBP interest rates – it will provide the basis for the monetary policy in 2003 and will affect the monetary situation in the following years. The medium-term monetary policy strategy will be based on the assumptions of integration with the Economic and Monetary Union agreed with the government, which stipulate that in 2005 Poland shall meet the nominal Maastricht convergence criteria, including the inflation criterion.

The next meeting of the Monetary Policy Council is to be held on 26-27 November 2002.

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I. Economic situation assessment

The trend of gradual improvement in the economic situation in industry observed since June this year continued in September. The industrial output in September 2002 as compared with the corresponding period of the previous year rose by 6.7%. A relatively high growth partly stems from a longer than in September 2001 working time. The output is estimated to rise 3.7%, having considered seasonal factors (including the working time). A particularly favourable phenomenon is the maintenance of a much higher growth rate in the manufacturing (output rise of 8.4%, and having taken into account seasonal differences a rise by 5.2%). The growth was recorded in 22 out of 29 sections of the industry. Like in previous months the industries of high export shares witnessed the highest output increments.

September has not resulted in the improvement in businessmen and consumer sentiment, both in the USA and in the euro area (for example, the Michigan University index, leading for the American consumer sentiment, declined in October to 80.4, as against 86.1 still in September, while indices reflecting the businessmen sentiment: the American NAPM went down in September to 49.5 as against 50.5 in August, and the German IFO fell to 88.2 as compared with 88.8 in August). Like in previous two months a geopolitical risk remained the main reason for those trends.
It is estimated that in Q3, 2002 the economic activity in the USA was supported by the consumer demand, while in the euro area by net exports. The current strong deterioration of business sentiment in both regions is likely to slacken the growth of those economies in the fourth quarter of the current year and in Q1, 2003. Main analytical centres adjusted down their GDP growth forecasts for 2002: for the euro area on average from about 1.0% to 0.8% (of which for Germany from 0.6% to 0.4%) and for the USA from 2.5% to 2.4%. The growth forecasts for 2003 were also reduced: from 2.4% to 2.0% for the euro area (for Germany from 2.2% to 1.6%) and for the USA from 3.0% to 2.8%.

The development of world oil prices remained to be highly uncertain. The increase in political risk made that in September 2002 the upward trend in oil prices in global markets continued. In the third quarter of 2002 the average price of Brent oil stood at USD 27 per barrel, i.e. nearly 2 dollars more than in Q2, 2002. Market analysts estimate that similarly high oil prices are likely to remain also in the fourth quarter of this year.

II. Situation in the public finance sector

The situation of the National Budget in September this year was less favourable as compared with the previous month. In the month reviewed the tax revenue recorded a slow pace of growth connected with relatively low revenue on indirect taxes, and also with narrowed revenue on personal income tax. Revenues on indirect taxes are very likely to be much lower in the last quarter of the current year than the average revenue achieved in previous months. This will result from implemented systemic changes, i.e. the elongation of the VAT refunding period by revenue offices, the possibility of quarterly VAT settlement by small enterprises (shifting part of revenue to 2003), and the reduction in the excise duty on alcoholic beverages. This creates a threat that the performance of the National Budget revenue in 2002 may be lower than that stipulated in the Budget Act. The origination of deficit in the central government revenue in 2002 will imply a difficult situation on the expenditure side. This may be connected with the need to contain part of expenditure this year and to shift it to the next year.

The financial standing of other entities in the public finance sector in August and September this year shows that their deficit, consistent with recent NBP forecasts, will amount to 1.4% of the GDP, i.e. 0.1 pct. point higher than that predicted by the MoF. According to the NBP forecasts the economic deficit of the public finance sector will most likely equal 5.8% of the GDB, i.e. 0.3 point above the MoF estimates. This means that in another consecutive year the actual course of the fiscal policy will deviate from that planned at the beginning of the year.

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

M3 broad money supply in September this year is 1.6% lower than a year ago. The M3 decline in September as against August 2002 end resulted primarily from a fall (by 2.76bn zloty) in household deposits. On the other hand the value of bonds and funds units in households portfolios has been dynamically increasing, however, in September it did not offset the drop in savings at banks. The annual growth rate of notes and coin in circulation went down from 18.5% in August 2002 to 14.1% in September this year; also the M1 aggregate (cash + demand deposits) in August – as compared to the balance as of July end – shrank by 2bn zloty, what may prove an expiry of a strong upward trend in the transaction money. The growth rate for corporate deposits remains stable at around 10%. Counterparts to changes in money stocks witness a permanent slowdown of the pace of claims on households' increase (from 8.5% in August to 7.8% in September this year), however the quarterly growth figures show a reversal in the downward trend. To the contrary, the growth rate of claims on corporates seen in June and July 2002 was currently retarded. In September this year it amounted to 1.1%, against 2.1% in June and 2.7% in July this year.

In September this year the zloty exchange rate slightly appreciated; this trend was most visible against the US dollar, while the zloty against euro exchange rate has been continuing since July this year on a stable level: on average 4.07-4.08 PLN/EUR. The weak appreciation trend has been confirmed also by real effective exchange rates, in particular the rate adjusted with movements in industrial producer prices.

IV. Prices, inflation expectations

In September this year the year-on-year inflation stabilised on a low level and amounted to 1.3%. In August it equalled 1.2%. A slightly faster pace of annualised prices growth in September 2002 was driven by a rise in prices of fuel for transport vehicles and – occurring after five months of decline – an increase in food and non-alcoholic beverages prices. In September this year producer prices in industry, as against the corresponding period of the previous year, went up by 1.0%. The sections where limited market mechanisms operate: electricity, gas and water supply as well as mining and quarrying witness the largest price increases, by 7.0% and 0.6%, respectively. Prices in manufacturing have not changed. The manufacture of coke and refined petroleum products witnessed the highest year-on-year price rise – by 3.3%.

Inflation continuing on a low level is favourable to making low inflation expectation permanent. In October this year inflation expectations both of consumer and of bank analysts declined, where the drop in inflation expectations refers equally to the inflation rate expected in December 2002 and in a 12-month horizon. The annual inflation rate expected by bank analysts as at the year end was equal to 1.5%, what stood for its drop by 0.3 pct. point as compared with declarations made in September this year, while the expected rate of annual inflation (September 2003) amounted to 2.5%, what meant its decline by 0.4pct. point.

Government and politics

- **Budget in the parliament – gap in revenues?**
- **Faster privatisation has its opponents**
- **Blackmail against the central bank again**
- **Local elections – various coalitions possible**

Debate on the budget draft began

On 11 October, the first reading of the budget draft took place in the parliament. Finance minister Grzegorz Kołodko presented justification of the bill. He said that the main goal of the next year's budget is to revive the economy in a permanent way without fuelling inflation. In his opinion the budget draft for 2003 is difficult and based on ambitious, but realistic macroeconomic assumptions. We have already presented a detailed analysis of the budget draft in MACROscope for October.

In his speech to the deputies Kołodko confirmed that he is aware of the need to reform public finances and announced that he will present a plan of the reform at the beginning of 2003. Programme of public finances stabilisation will be aimed to change the structure of the budget and to lower the share of fixed spending. It will be necessary especially, as spending side of the budget will be affected by some fixed expenditures on co-financing the EU projects.

In the meantime the parliament discusses budget for the next year. Rzeczpospolita daily reported that PSL deputies would like to find additional sources for expenditures. Well, such plans are not very surprising. Again, the idea of import tax returned, but fortunately Grzegorz Kołodko rejected such a proposal. However, other plans include changes in the corporate income tax bill connected with the costs of business activity, which would give PLN1.2bn. The second reading of the budget draft is planned for 21 November.

...and some revenues may disappear

President Aleksander Kwaśniewski announced his decision to send tax abolition bill accepted by the parliament to the Constitutional Tribunal instead of signing it. The final decision of the Tribunal is expected at the end of November. If the bill is rejected as inconsistent with the Polish Constitution, this would mean revenues shortage of PLN600m in the next year budget – an amount which creates no problem for budget realisation. Especially, as chief of parliamentary Public Finances Commission announced that commission plans to cut next year's budgetary spending by PLN700-800m.

Revenue shortage connected with tax abolition does not represent the whole problem. At the beginning of November deputy finance minister Irena Ożóg informed that the Ministry is not satisfied with the realisation of the corporate debt restructuring programme aimed at healing Polish ailing enterprises and reviving corporate sector, admitting that FinMin's proposals have attracted little interest so far. She said also that up to date FinMin received nearly 5000 applications from companies interested in restructuring, mostly from small entrepreneurs (companies could apply for this programme only until 15 Nov). Total sum of debt to be forgiven that corresponds to those submitted applications is less than PLN1.5bn, while the total amount of arrears that could be restructured according to budget draft for 2003 equals PLN10bn. Initially FinMin planned to reach as much as PLN1.3bn revenue only from the restructuring fee paid by companies in exchange of debt release. While according to Ożóg it is too early to say that planned budget revenues from debt restructuring are at risk, we reiterate our view that this is one of the areas where next year's budget revenues are clearly overestimated.

Does privatisation accelerate?

Last month, the Treasury Ministry gave some details concerning privatisation plans in the near future saying that most of next year's revenues would come from public offers – insurance company PZU, state-owned retail bank PKO BP and companies from energy, alcoholic beverages and other sectors, possibly also telecom TP SA. For the next year the government assumed PLN9.1bn revenues, out of which PLN7.4bn will finance the budget deficit. The Treasury Ministry plans also to finish privatisation projects started this year, for example privatisation of G-8 group from the energy sector worth some PLN4bn, which means that it is possible that privatisation incomes may be even higher than assumed in the budget draft. Treasury minister Wiesław Kaczmarek said that realised revenues may exceed plan by even 50-70%.

However, not all privatisation deals will be postponed until 2003. The Treasury Ministry also informed that 85% of STOEN (energy distributor in Warsaw) will be sold for German energy company RWE this year. The transaction is worth PLN1.5bn, but the impact on the foreign exchange market should be limited, as revenues from the transaction would most likely go through the special FX account in the central bank.

As we said in the last MACROscope edition, delay of some privatisation revenues until next year does not create problems for financing budget deficit. However, STOEN privatisation came across a different problem – deputies from opposition parties of Samoobrona and the League of Polish Families. The Lower House speaker had to stop the parliamentary session, which reopened after local governments' elections. After these events, the relations within ruling coalition have worsened, as part of PSL wanted to support confidence vote against Lower House speaker Marek Borowski. The confidence vote against Lower House speaker Marek Borowski was the first thing on the agenda, and two weeks earlier a part of PSL wanted to support confidence vote, they have changed their mind and the coalition survived.

Blackmailing NBP begins again?

Since the appointment of Grzegorz Kołodko on the post of finance minister, the ruling coalition entirely changed its approach to the MPC and stopped to criticise its monetary policy. Kołodko talked about very good co-operation between finance ministry and the NBP. Nevertheless, it seems that not the whole ruling coalition shares deputy PM's point of view. Deputy chief of Public Finance Committee Stanisław Stec announced that the Committee will continue work on the NBP charter amendment (constraining the central bank independence), which was interrupted at the end of June. Moreover, chief of the Committee Mieczysław Czerniawski explicitly blackmailed the central bank saying that if the NBP behaves in such a way as it treated budget draft for the next year, he would immediately begin work on the NBP charter amendment. Changes would also include lower salaries for the MPC members. Also infrastructure minister Marek Pol spoke about monetary policy. He said that he expects rate cut next week, as the central should support the government's economic policy.

Well, it seems that our scenario presented in the summer realised – closer to the local governments' elections, politicians were more active in criticising the central bank. But they should remember about the last European Commission's report, which stressed that the central bank has to be independent. Also, the fact that the MPC cut rates against markets' expectations, and in line with politicians' view, may suggest that co-operation between two institutions may not be harmed in the near term.

Local elections – various coalitions possible

The National Polling Committee announced the official results of local elections in Poland. In the first round the turnout reached 44.23%. Coalition SLD-UP gained the highest number of seats in local governments among all registered electoral committees. Nevertheless in most cases they did not reach the supremacy that would allow them to govern alone (without other parties). As regards local parliaments, SLD-UP won in 13 out of 16 voivodships, while PO-PiS won in two and League of Polish Families in one case. The results of major electorate committees are summarised in the table below. At present there are ongoing talks between parties in most of the regions, aimed at forming local ruling coalitions.

Results of local elections

	Local parliaments		*Total*	
	No. of seats	*%*	*No. of seats*	*%*
SLD-UP	189	33.7%	6 644	14.2%
Samoobrona RP	101	18.0%	1 530	3.3%
PO-PiS	94	16.8%	515	1.1%
LPR	92	16.4%	1 065	2.3%
PSL	58	10.3%	4 986	10.6%
Other committees	27	4.8%	32 093	68.5%
Total	**561**	**100.0%**	**46 833**	**100.0%**

Source: National Polling Committee

In most of major cities the second round of elections was necessary to decide on presidential post, and it was held on 10 November. The turnout was merely 35%. In the second round candidates of the right wing parties won in 11 out of 14 big cities. SLD will have 26 presidents in 106 cities, but at the same time the party will be relatively strong in the local councils. Also, the SLD will have the higher numbers of mayors. Nevertheless, SLD officials, including deputy chief of the party Krzysztof Janik and general secretary Marek Dyduch, called the results of the elections as the warning signal for the SLD. It is to be seen whether this would result in a modification of government's policy or some personal changes.

Comments of the government members and politicians

At the end of October economy minister Jacek Piechota presented quarterly report including economic forecasts. In Piechota's opinion accelerating GDP growth, increase of industrial output and exports show "a breakthrough of the stagnation period in the economy". He thinks that it creates „solid base" for 3.5% GDP growth assumed by the government for the next year. Of course, finance minister Grzegorz Kołodko has no doubt that economic recovery is coming. He said that GDP growth in 3Q02 amounted to around 2% and will accelerate in the next quarter, which means that whole year growth will be 0.2pp higher than 1.2% previously assumed. What is more, Kołodko said that better economic results are the effect of his restructuring plan. Well, the data presented by deputy finance minister Irena Ożóg are rather in contrast with the above statement, as they rather admitted that FinMin's proposals have attracted little interest so far.

The most important issue for government's representatives, aside economic upturn, which we have been noticing in the past couple of months, was progress in negotiations with the EU. European integration minister Danuta Huebner and foreign affairs minister Włodzimierz Cimoszewicz underlined the Polish government determination to finish negotiations with the EU until the Copenhagen summit, stressing that Poland will try to get the best financial conditions possible. Prime Minister Leszek Miller was not satisfied with the financial proposal accepted by the EU countries in Brussels. He announced tough negotiations, but at the same time he said also that financial offer does not represent the whole important process of integration.

Treasury Ministry gave some details concerning privatisation plans in the near future saying that most of next year's revenues would come from public offers – insurance company PZU, state-owned retail bank PKO BP and companies from energy, alcoholic beverages and other sectors, possibly also telecom TP SA. The Treasury Ministry plans also to finish privatisation projects started this year, which included Warsaw energy distributor STOEN. Especially, this last transaction met strong disagreement of some opposition parties. Lower House speaker had to stop the parliamentary session, which reopened after local governments' elections. After these events, the relations within ruling coalition have worsened, as part of PSL wanted to support confidence vote against Lower House speaker Marek Borowski. However, the story had the happy end - Lower House speaker maintained his post and PSL remained in the ruling coalition.

As after positive results of Irish referendum and EU summit in Brussels the zloty sharply appreciated, politicians have started to be more active with their verbal intervention on the FX market, as usual without success. The day before Nice Treaty referendum, finance minister Grzegorz Kołodko said he was optimistic about its outcome. Probably, in order to offset positive effect of "yes" vote on the FX market Kołodko decided to verbally intervene saying that the zloty exchange rate is overvalued and the weakening would be positive for the economy. Also, in one of regular Thursday's interviews with Polish Radio he expressed expectations for further rates reduction, which could weaken the zloty. Asked about the zloty exchange rate, minister Piechota also said that it is still regarded by the government as overvalued but there are no plans to weaken the zloty. Kołodko also reiterated that there is a need of co-operation with the central bank. PM Miller is not satisfied with the scope of rates' reduction, but recent politicians' comments suggest that the ruling coalition does not intend to limit the independence of the NBP. Although, in the section above we gave examples of blackmailing from the Public Finances Committee's side (see the comments below).

WHO, WHEN, WHERE	COMMENT
Aleksander Kwaśniewski; President; Reuters, 18 Oct PAP, 14 Oct	If parliament was unable to carry out its work, then I believe that the parliamentary majority would take a responsible decision and hold early elections. After analysing experts' opinions I decided to refer tax amnesty bill to the Constitutional Tribunal for review. Today, I talked to the Constitutional Tribunal chairman, who informed me that the Tribunal will everything to work out sentence as soon as possible. And there is a chance that it will take place in the last week on November. My doubts concern the possibility of violating the constitution and the principles of equality and fairness of taxation. This concerns tax abolition. With regard to tax declarations there are doubts whether the bill would violate the constitutionally enshrined right to privacy. Here [CIT rates] I do not see any constitutional doubts. The tax can be 2pp higher or lower. I know that the government wanted to reduce this tax deeper but calculations showed that this is impossible and only 1pp reduction is possible in the next year.
Marek Borowski; Sejm speaker; Reuters, 17 Oct	This [situation in parliament] definitely does not help decision-making and may delay the privatisation process, but the coalition has a majority and should be able to carry out its programme.
Leszek Miller; Prime Minister; PAP, 31 Oct PAP, 30 Oct	Of course, we will not break it off [an agreement with RWE Plus on Warsaw's energy distributor sale]. All trade unions and management of STOEN want privatisation and regard it as a chance for their company. I received a letter from them and this assured me in our decision. The results of elections confirm that the left wing is the strongest and the most stable political force in Poland. This also confirms that also in local authorities SLD-UP has strong support. We are able to create coalitions in local governments with every political group, which will confirm readiness for co-operation for prosperity of local societies. We will begin talks on possible coalition after the official results of the elections. In Warsaw, "Law and Justice" has certainly succeeded. But 160 km away from here, in the second largest city in Poland, in Łódź, they completely failed.
PAP, 28 Oct	My imagination is unlimited and I can imagine it [only 25% of direct subsidies for Poland] as well. However, the initial level of direct payments and their transition period to phase them in cannot be regarded as satisfactory. The key priority for us will be to get the best conditions we can get. One has to remember that we talk about a great project, about great vision of the future of Europe, When focusing on financial issues one has to remember that is not the only issue. December 13 will cease to be related only to events in 1981 and will begin to be related to a historic decision leading to the enlargement and with a chance for Poland. There are also other countries, which do everything to meet the enlargement schedule, and during negotiation process we have to remember positions of these countries. If the Accession Treaty will be signed in April, then May is a good month for the referendum in Poland. At least to give clear signal to EU members that Poles want the accession.
PAP, 26 Oct	I think everything goes into direction of stabilisation of parliamentary work in the future.
PAP, Reuters, 23 Oct	We see the decision as a step in the right direction, but still too timid and cautious. There are conditions for the MPC to lower rates further without worrying about the negative impact of their decisions.
PAP, 20 Oct	We will propose another taxes cuts in the budget for 2004, but the path of reduction will depend on macroeconomic situation. The lack of co-operation with the central bank is a failure of my cabinet. GDP growth could be higher and enterprises could have better conditions for activity, if monetary policy is different.
PAP, 19 Oct Reuters, 18 Oct	From the start of the parliamentary term the PSL has been divided about our coalition. There are those who view the coalition as a good thing and others who are fighting against it with all their might. The PSL must first answer the question: Does it want to be in this coalition? This will depend on the vote for Borowski's removal.

Grzegorz Kołodko; deputy PM, finance minister; PR1, 31 Oct	GDP growth in 3Q02 stands at around 2%. Today, we have the last day of first month in 4Q02 and the growth is even higher, it may be at 2.2-2.3% against only 0.2% in last year. I think that this is a recovery. Higher than expected growth of exports, production and GDP and higher employment in many voivodships is an effect of Restructuring Act. Not in the sense that enterprises have already restructured but in the sense that enterprises anticipate it in their strategies. It will surely transfer, assuming wise economic policy of the government and the central bank and co-ordination of their actions, on good strategy for Poland.
PAP, 25 Oct	In September, there will be significant wage increases for academic teachers. Assistants will get 286 PLN more and professors above 1000 PLN.
PR1, 24 Oct	Everyone was surprised by the rate cut, which was not only delayed but also still not sufficiently radical There is still plenty of room for rate cuts. The zloty is still overvalued. If there was any zloty reaction to the rate cut, it could be weakening. GDP growth in 3Q02 jumped to 2% (...) I think that in 4Q02 it may be even above 2%, which will bring the whole year growth to 1.4%.
PAP, Reuters, 18 Oct	Over the longer-term, it is important that the zloty weakens because it is overvalued. The zloty exchange rate is a result of speculation. I think that the tendency is that the zloty will weaken along with interest rates reductions. Our approach to financing public debt is flexible and therefore we prepared issuance of t-bond in euros. Now, we finalise issuance in pounds and we are considering issuance of samurai bonds. However, everything will depend on the situation on global markets. Average annual inflation in 2002 may be below 2.1%. In 2003 it may be lower than 2.3% due to the starting point. CPI in October should fall to 1.0-1.1%YoY.
PR1, 17 Oct	In this quarter the pace of GDP growth reaches 1.8% and a year ago it was only 0.2%. We do not want to exceed to this limit [50% of GDP], although in 2003 we will exceed it, as we still have high budget deficit. Exceeding this limit implies introduction of some restrictive procedures constraining possible level of expenditures. I hope that there will be money from abolition (...). There are still PLN600m written in the budget draft from tax abolition. We expect fast sentence of the Constitutional Tribunal (...). At this stage we assume that we will receive revenues from tax abolition in the next year.
PAP, 15 Oct	I was asked [by the EU commissioners] about the budget of stabilisation and development, about chances of achieving 3.5% of GDP growth. I think that both here in Brussels and in Warsaw we do not only believe that it is possible but we know that it is possible. We can count on, we can be sure that in the first year of our membership, in 2004, we will surely receive at least €870m more that we will have to transfer to the EU.
Marek Pol; infrastructure minister; PAP, 16 Oct PAP, 14 Oct	Our expectations are known by the central bank, which under law must support the (government's) economic policy. So far we have not yet received this support, but there is a chance that it may come after the next MPC meeting. I can assure that road fees will not be taxed with VAT. Presently, we carry out consultations with finance ministry in order to find a solution.
Jarosław Kalinowski; Agriculture minister; PAP, 25 Oct	Further restructuring and privatisation cannot be based on sell-off of the Polish energy sector for foreign companies. This was stated in the coalition agreement and in PM expose and this is a fundament to realise our tasks concerning privatisation, especially in the energy sector.
Jacek Uczkiewicz; deputy finance minister; PAP, 28 Oct	We understand these needs but the public debt is approaching 50% of GDP. In this situation we cannot agree to do it [increase limits of indebtedness for local governments].
Halina Wasilewska-Trenkner; deputy finance minister; PAP, 15 Oct	One has to wait for the Constitutional Tribunal sentence. There is no alternative plan because I believe that everything is all right and I doubt that this is inconsistent with constitutions. If the Tribunal's sentence will be different we will inform the Lower House, which expenditures should be reduced by PLN600m.
Jacek Krzyślak; head of FinMin's research department PAP, 25 Oct PAP, 16 Oct	We estimate that CPI will amount to 1.0% in October and to 1.3%YoY in December. Our estimations of PIT revenues are based on the assumption of no deductions for housing, which gives PLN1bn. Also, revenues from savings tax are estimated on PLN1.4bn, while this year the plan is PLN800m. Unchanged tax brackets for individuals gives another PLN600m giving the total sum of PLN2.2bn.
Włodzimierz Cimoszewicz; foreign affairs minister, PAP, 22 Oct	Understanding how difficult are problems, which have to be discussed within the group of member countries, including Germany and their European partners, I deeply believe that they we will be able to celebrate the great success in a few weeks. In recent days, understanding that the enlargement project has not only historical meaning but also it is one of the most complex international undertakings, we have to go forward with determination till the end.
Jerzy Hausner, labour minister; PAP, 24 Oct	It seems that in October the unemployment is still rising. I think that at the end of the month the unemployment rate will reach 17.6%.
Danuta Huebner; European affairs minister; PAP, 30 Oct	We think that in PHARE 2000 programme, mostly due to savings, the unemployed funds would not exceed 5% out of EUR484m total funds. It will be better than last year, when 91% was exploited. On 23 and 25 of October we presented to European Commission the proposition (with FinMin's approval) to move those unused funds to the programmes that proceed well, i.e. the support of SMEs. Most likely the Commission would agree to that.
PAP, 29 Oct	The intention is to do a review of problems and to begin pointing out differences in our positions regarding the final financial conditions. The procedure of negotiations is going to be much more flexible. So far, the government has not stance on the proposal from Brussels. I think that the EU is the least flexible in direct subsidies. Both in this issue [the initial level of direct subsidies] and in the other one [shortening of the period of phasing in full subsidies] there is some flexibility possible but I do not think it is much.
PAP, 25 Oct	Finally we have the decisions and the EU kept promises (from Seville summit) that candidate countries will have financial proposal before November. We start negotiations now and surprises are possible. Starting point of direct subsidies (25% of subsidy in EU countries) is not satisfactory and we will try to receive more and to shorten the transitory period (to receive 100% of subsidies). EU summit in Brussels does not mean the end of discussion over CAP. We will start the discussion when Poland is in the EU and this will affect the debate over the next EU budget. There is money for enlargement. It was decided by the EU member countries. Our most serious enemy is the time.
PAP, 22 Oct	Both sides have to do everything in order to have green light for the enlargement after Brussels summit but the most important decisions are likely to be made not earlier than at the EU summit in Copenhagen. At the moment, the most important is to not loose dynamics of the whole process after the referendum in Ireland, which was a

PAP, 15 Oct	positive signal. We want the EU members to agree with each other. We know that there are some issues (particularly Common Agricultural Policy and its reform), which still divide the EU members. We have been waiting for quite a long time. We understood that the EU needs more time and the final stance will be presented at the beginning of November and we hope that the EU will hold its obligation. It is quite surprising that the country (Netherlands), which was one of the biggest supporters of EU integration, has so many doubts. I hope this situation is rather temporary and will not lead to delay in enlargement.
Wiesław Kaczmarek; treasury minister; PAP, 18 Oct PAP, 17 Oct PAP, 16 Oct PAP, 15 Oct	The project of Stoen privatisation will be continued in line with the preliminary agreement. I was assured that the project is supported by the management and workers of the company and I was asked to continue the privatisation. This sort of action will not change our approach to privatisation but I am concerned that foreign investors may be discouraged. There is no need to stop privatisation projects in the energy sector, i.e. Stoen or G-8. There is a chance to show better standards in this sector. I acted in line with the government’s will. I do not think that the government makes decisions, which are against coalition agreement. For God, it is not a process, which lasts one day. I do not see any inconsistency with coalition agreement or the governments’ decisions. We have had no major public offering for three years. The treasury wants to be more active in launching public offers next year. Projects, which were to bring PLN9.1bn of revenues included mostly PZU, PKO BP, Southern Energy Concern, Polmos Białystok, Ruch, WSiP, Petrobaltic and energy group connected with Kozienice and Ostrołęka. We have tried to plan next year’s revenues from privatisation in such a way so as to have 75% margin. The actual revenues may be lower than assumed in the budget. It [TP S.A. shares] can be treated at liquid assets for ailing companies or it can be sold in the best moment for the State Treasury. We assume that it can happen in 2003. One can assume that privatisation of Rafineria Gdańska will be finished in this year. We do not know if LOT privatisation will be possible in 2003.
Mariusz Łapiński; health minister; PAP, 30 Oct PAP, 25 Oct PAP, 15 Oct	The point of view that prevailed was that we have severe financial problems and it is hard to raise the social security premium at the moment. Therefore we have to get along with those funds that we have. Those funds are not small, they amount to PLN30bn. It is a lot, but we have to spend this money in a rational way. After nine months of this year health-care funds spent on medicines less than planned. The difference is PLN514m. It allows us to introduce solutions, thanks to which we will be able to assure all people older than 65 to have possibility to make use of “medicines for a penny” program. At this moment we estimate that it will cost PLN80m. If this solution will be successful, if there will not be misuses, we will expand the list of medicines. Maybe it will concern other groups such as pregnant women or handicapped persons.
Jacek Piechota, economy minister; PAP, 28 Oct	The systematic, even though slow, growth of GDP, industrial output and exports shows a breakthrough of the stagnation period in the economy. In order to achieve 3.5% in the whole next year we hope for above 2% in the first quarter. I would not like to be overly optimistic but this is the fact that we have a chance to exceed 1% in this year and create solid foundations for 3.5% of GDP growth in 2003. The government has consistently said the zloty is overvalued, but we are not preparing any steps or solutions to this problem. We are pointing out that monetary policy is not helping to rekindle exports.
Mieczysław Czerniawski; chief of Public Finance Committee; PAP, 25 Oct PAP, 24 Oct	On the income side, only PLN70m were found so we have difference in the amount of PLN2.833bn (MPs would like to increase spending by almost PLN3bn). We will not support these changes. Sub-commissions concentrated on increasing expenditures instead of shifting some seeking savings. However, the most important thing (...) is that finance minister announced another package of bills aiming at changing the structure of the budget in order to decrease share of fixed expenditures.
Mieczysław Czerniawski; chief of Public Finance Committee; PAP, 16 Oct PAP, 14 Oct	I expect that the government will present alternative proposition of compensating the decrease of incomes. It should not count on Public Finances Committee because even if we find PLN1bn it will be predicted for other priorities. If the NBP will behave in such a way as it treated budget draft for the next year I would immediately begin work on the NBP charter amendment and reducing salaries in the NBP. Already after preliminary analysis of the budget draft I can say that Public Finances Committee will be able to save PLN700-800m.
Stanisław Stec; deputy chief of Public Finance Committee; PAP, 16 Oct	We will continue work on bills [NBP charter amendment] immediately after finishing work on the budget.

EU negotiations watch

- **YES in Ireland and the Netherlands**
- **Positive news from EU summit in Brussels**
- **Negotiations on financial support in November**

Problems in Ireland and Netherlands are over

The outcome of the Irish referendum on the Nice Treaty were very positive –63% of YES voters. The discussion on enlargement (and possible delay), however, was on sooner than expected. And it was not only because of the planned EU summit in Brussels. The Dutch government collapsed, which raised concerns whether the Netherlands will be able to make a decision about the enlargement at the EU summit in Brussels. The Dutch foreign ministry's spokesman assured that the Netherlands would be able to make a decision irrespective of whether the government in The Hague existed or not. And indeed, Dutch parliament decided that the government in The Hague could give a green light for the EU enlargement during the Brussels summit. In practice, this decision meant that the only problem that has to be resolved before the end of negotiations is to agree the financial conditions of the enlargement.

Financial conditions of enlargement accepted

After resolving the above-mentioned problems, one could not expect other than positive outcome of negotiations in Brussels. The EU member states, Germany and France in particular managed to agree on financial conditions of the enlargement. The agreement was possible because Berlin and Paris decided that from 2007 the budget for agriculture would grow by only 1% in nominal terms. However, candidate countries will get €2.5bn less of structural funds than the European Commission previously proposed. All 10 new members will get €23bn, Poland alone €12.4bn (€1.4bn less). As a result of the agreement on limiting the growth in the agricultural budget, Germany agreed to pay direct subsidies for farmers in candidate countries, starting from 25% of the amount paid for farmers in the exiting member states. Moreover, anonymous EU officials said that the amount might be increased during negotiations to even 30-35% at the expense of projects for rural development. The total amount of funds for Poland in 2004-2006 will amount to €18.8bn. Net of Polish contribution to the EU budget (€7.5bn), Poland will get €11.3 in this period. Because some EU members (e.g. the Netherlands) were afraid of candidate countries' ability to fulfil their obligations arising from the negotiation process, the EU decided to introduce protection clauses allowing it to introduce some restrictions within three years after the date of accession.

Undoubtedly, the agreement at the Brussels summit confirms the most positive scenario of the enlargement. It is likely that the decision about accession of ten countries in 2004 will be made during the next EU summit in Copenhagen to be held on 12-13 December. By that time, financial conditions of enlargement will be negotiated. Poland is also awaiting the closing of negotiations under the competition policy chapter (the government approved the metallurgical industry-restructuring programme) and the negotiations with regard to lower VAT in the construction sector.

...but is it possible to loosen the conditions

In early November, Grzegorz Kołodko, the minister of finance participated in ECOFIN meeting in Brussels speaking in the name of finance ministers of candidate countries. According to the information available on the Ministry of Finance's website, Kołodko said that recent economic crisis of the world economy had an adverse impact on the credibility of macroeconomic policy in all countries. This applies also to the European Monetary Union, in which the policy is regulated by strict conditions of the Maastricht Treaty and the Growth and Stability Pact.

The change in the financial conditions (especially concerning Polish contribution to the EU budget) of joining the EU proposed by the Commission was sought. A more liberal approach should be supported by lower level of public debt in candidate countries, higher share of investment spend in their budgets, and the necessity to maintain high and stable growth in the medium-run. As we said a number of times in the past, planning budgets for 2004-05 will be extremely difficult for the finance minister, as some expenditures would have to be cut to make a room for the fixed spending connected with the EU accession. We will soon find out whether this statement was only an element of negotiations between candidate countries and the EU (although Denmark said this strategy is not likely to work). At the beginning of the next year Kołodko is to present the programme of public finance stabilisation. We hope that the plan will include something more than a proposal to change the rules of the game, as quite interestingly, Kołodko supported also some relaxation of the Stability and Growth Pact restrictions concerning budget deficit limit.

Market monitor

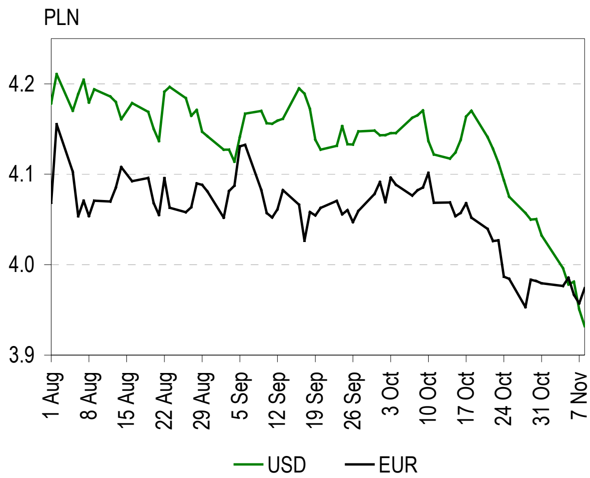
- **Revival on FX market and return of the strong zloty**
- **Flattening yield curve**
- **New 10-year benchmark issue**

The zloty strongest since beginning of July

A stagnation that had lasted since August on the domestic FX market maintained also in early October. A low turnover was recorded and the zloty rates against the dollar and the euro remained quite stable. Nevertheless, around 10 October the market became more active, mainly as a result of a few events related to Poland's accession to the European Union. Firstly, higher exchange rate fluctuations were observed, but then the zloty strengthened substantially against both the dollar and the euro. At the end of the month the zloty was traded against currency basket at the strongest level since beginning of July, which was in line with our expectations presented a month ago.

In the central bank the dollar was fixed between PLN 4.0324 (31 October) and PLN 4.1706 (9 October), and on average at PLN 4.1212 (versus 4.1499 in September). The euro was fixed between PLN 3.9530 (28 October) and PLN 4.1016 (10 October), and on average at PLN 4.0443 (PLN 4.0695 in September).

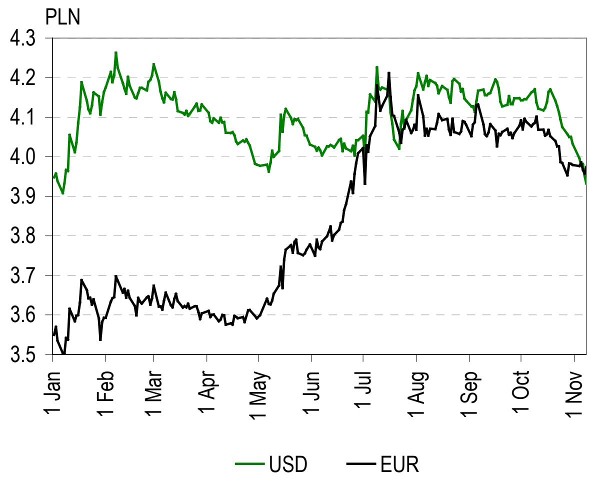
Zloty FX rate in recent months



Source: NBP

The revival on the market began from positive reaction to the European Commission's report released on 9 October concerning readiness of candidate countries for joining the Union. However next day brought deterioration in sentiment caused by an uncertainty before the Nice Treaty referendum in Ireland and after dismissal of the Dutch government that resulted among others from dispute concerning the EU enlargement. Both events were threats to accessing the EU on earlier assumed date.

Zloty FX rate in 2002

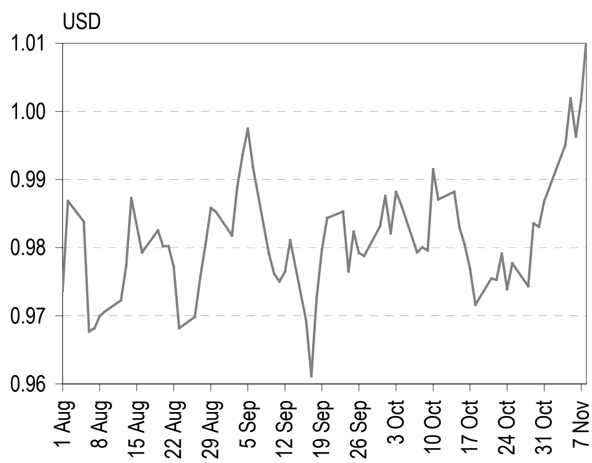


Source: NBP, BZ WBK

Irish YES in above mentioned referendum and agreement between Germany and France concerning financial conditions of the enlargement, caused that investors assessed Poland's membership in the EU as almost certain. As a result, large demand for the zloty from foreign investors playing for interest rate convergence appeared. During the week 21-25 October the zloty strengthened by as much as 2.5% against the dollar-euro basket, and the zloty FX rate fell below 4.0 for the euro and below 4.1 for the dollar. Rate cut that surprised the market also supported the zloty strengthening. At the same time, on global market the EURUSD rate increased, which resulted in zloty strengthening more against the American currency than the European one.

Since the beginning of November still the zloty has been strengthening and during the first week it gained 1.4% against currency basket. On global market the dollar has been weakening against other main currencies and the EURUSD rate increased and exceeded the parity level.

EURUSD FX rate

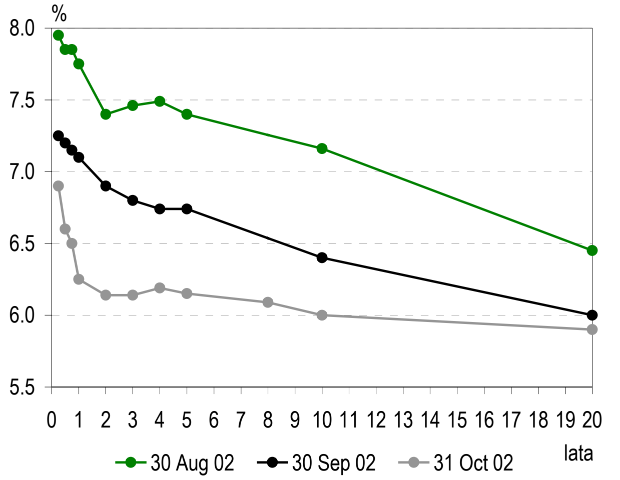


Source: NBP

T-bond market even stronger

Also T-bond market was mainly influenced by the sequence of events related to the EU accession process. Consecutive weeks showed lower and lower levels of yields, and market corrections lasted only for a day or two. Moreover, the interest rate cut unexpected for market's participants was a supportive factor for the market, since it caused expectations for another such a move already in November. Weaker data on food prices decreased these expectations only slightly. The largest fall in yields took place in 1-5 year sector, which resulted in clear flattening of the yield curve in this segment. Average yields in October almost exactly matched our forecasts presented in previous MACROscope.

Yield curve

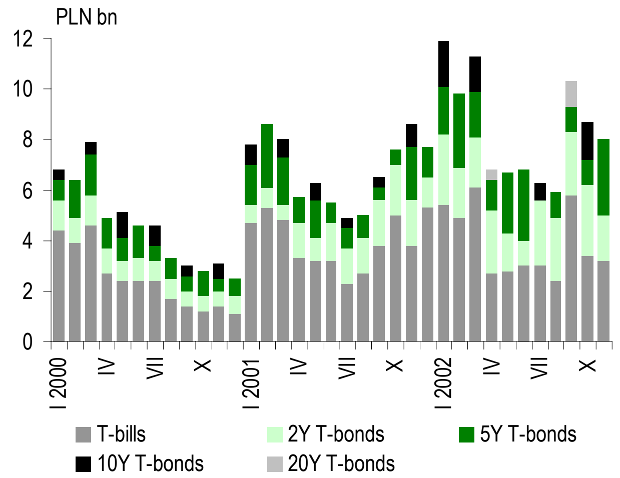


Source: BZ WBK

On Wednesday, 10 October the first auction of new 10-year benchmark DS1013 took place. Investors were very willing to purchase this paper and a demand was over three and a half times larger than supply. Average yield was clearly below expectations and it was much lower than on previous auctions. However, one should remember that last auction took place in July when official interest rates were higher by 100bps and previous benchmark had actual maturity shorter by three years.

At T-bond auction on 6 November the Finance Ministry offered two-year bonds (OK0804) worth of PLN1.8bn. Demand for them was threefold of supply, so it was quite high compared to auctions of these papers in recent months. In such a situation the Finance Ministry sold all the papers easily and average yield was at secondary market level, which means a substantial fall from previous month, stronger than a scale of recent NBP's reference rate cut.

Supply of treasuries



Source: Finance Ministry, BZ WBK

Treasury bill auctions (PLN m)

	OFFER (SALE)		
Date of auction	13-week	52-week	Total
07.10.2002	100 (100)	800 (800)	900 (900)
14.10.2002	100 (100)	800 (800)	900 (900)
21.10.2002	-	800 (800)	800 (800)
28.10.2002	-	800 (800)	800 (800)
Total in October	**200 (200)**	**3 200 (3 200)**	**3 400 (3 400)**
04.11.2002	-	800	800
07.11.2002	-	800	800
18.11.2002	-	800	800
25.11.2002	-	800	800
Total in November	**-**	**3200**	**3200**

Source: Finance Ministry

Treasury bond auctions in 2002 (PLN m)

Month	First auction							Second auction			
	date	T-bonds	offer	sale	T-bonds	offer	sale	date	T-bonds	offer	sale
January	09.01	OK1203	2 800	2 800	PS1106	1 900	1 900	16.01	DS1110	1 800	1 800
February	06.02	OK1203	2 000	2 000	PS1106	2 900	2 900	13.02	DZ0811	500	495.5
March	06.03	OK1203	2 000	2 000	PS1106	1 800	1 800	20.03	DS1110	1 400	1 400
April	03.04	OK0404	2 500	1 756.5	PS1106	1 200	1 200	10.04	WS0922	400	400
May	08.05	OK0404	1 500	1 500	PS0507	2 400	2 400	-	-	-	-
June	05.06	OK0404	1 000	1 000	PS0507	2 800	2 800	-	-	-	-
July	03.07	OK0404	2 600	1 922.1	-	-	-	17.07	DS1110	700	700
August	07.08	OK0804	2 500	2 500	PS0507	1 000	1 000	-	-	-	-
September	04.09	OK0804	2 500	2 500	PS0507	1 000	1 000	11.09	WS0922	1 000	1 000
October	02.10	OK0804	2 800	2 800	PS0507	1 000	1 000	09.10	DS1013	1 500	1 500
November	06.11	OK0804	1 800	-	-	-	-	20.11	PS0608	3 000	-
December	04.12	OK1204	-	-	-	-	-	-	-	-	-

Source: Finance Ministry

International review

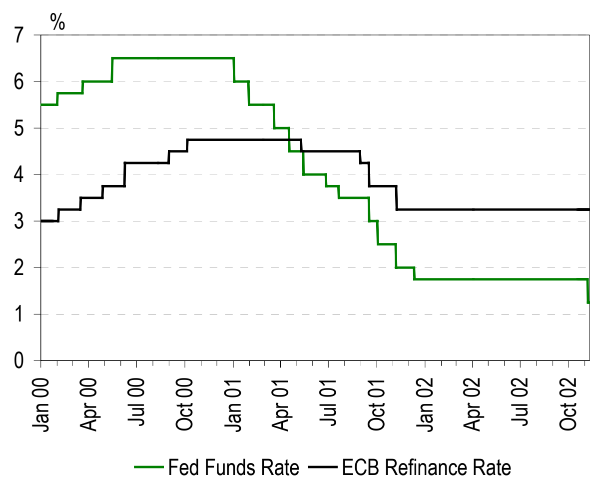
- **Interest rate cut in the United States; rates unchanged in the Eurozone**
- **High inflation in the Eurozone**
- **Growth acceleration in the USA in 3Q02**
- **Still worse business climate, activity and sentiment indicators**

Rates down in the US, unchanged in the Eurozone

At the meeting on 6 November Federal Open Market Committee cut interest rates by 50 bp to 1.25%. Fed's move was stronger than expected by majority of analysts who forecasted 25 bp cut. In the report Fed stated that lowering interest rates is aimed at helping the American economy to overcome a slowdown, that is suggested by recent data from labour market and industry. At the same time the report said that threats of further weakening of economic growth and increase in inflation are balanced, and firm interest rate cut should help the economy to pass this period of uncertainty. In this way they gave a clear signal, that Fed is not going to cut rates any more in near future.

One day later the Council of the European Central Bank decided to leave Eurozone's interest rates unchanged, though markets expected that after Fed's decision, the ECB would follow it. Refinance rate (main interest rate) has remained at 3.25% since November last year. Despite worsening prospects of economic growth, the ECB is worried about inflation, which maintains above 2% in the Eurozone. At the same time ECB President Wim Duisenberg assured that the Council would watch all threats to economic growth in the Eurozone carefully.

Interest rates in the USA and Eurozone



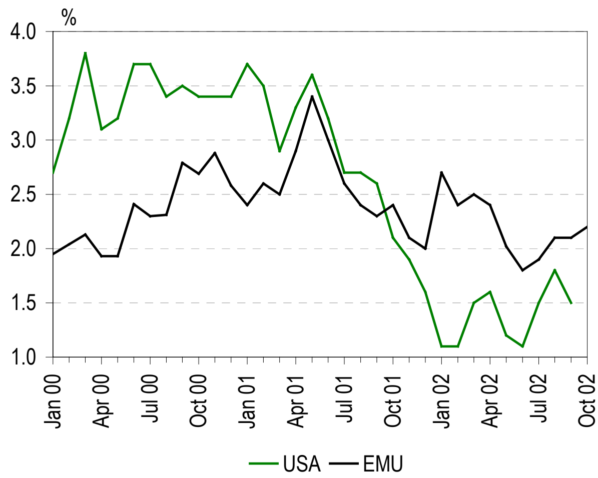
Source: Reuters

CPI above 2% in the Eurozone, below in the USA

According to final data, inflation in the Eurozone amounted to 0.3%MoM in September, which translated into annual inflation rate of 2.1%, while preliminary estimations pointed to increase in consumer prices of 2.2%YoY. Analysts expected inflation at 0.3%MoM and 2.2%YoY. Revised data mean that inflation in annual terms remained at August's level. According to preliminary estimations, annual inflation rate in the Eurozone increased to 2.2% in October, which exactly matched analysts' forecast. For a third consecutive month inflation remained above 2.0%, i.e. target ceiling imposed by the ECB, as an indicator of medium-term price stability.

In the United States consumer prices rose by 0.2%MoM in September, which exactly matched analysts forecasts and allowed the annual inflation rate to fall to 1.5% from 1.8% in August. The strongest price hike was recorded for energy and cars.

Annual inflation



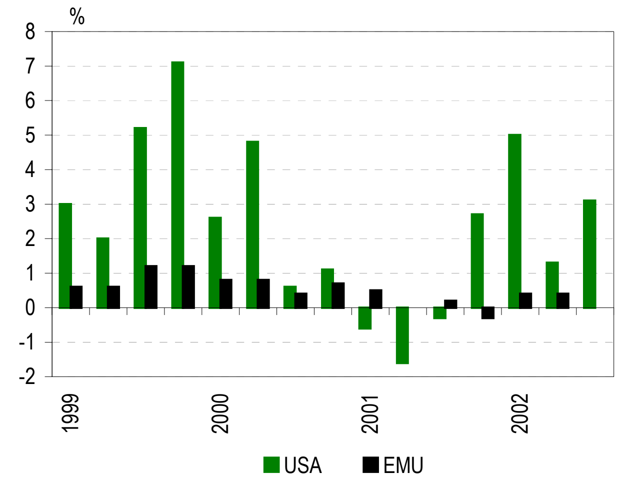
Source: Reuters

No clear signs of global recovery

Earlier estimations of Eurozone's economic growth in 2Q02 were confirmed in the last, third release. According to these data, Eurozone's GDP increased by 0.4%QoQ and 0.7%YoY, which matched analysts' expectations. Also the European Commission's growth forecasts for 3Q and 4Q this year remained unchanged. The Commission forecasts GDP growth of 0.2-0.5%QoQ in each of the quarters.

According to advanced information, American GDP growth amounted to 3.1%QoQ in 3Q02 this year. The data was weaker than expectations at the level of 3.6%. Acceleration in growth rate from 1.3% recorded in 2Q02 should be perceived positively and it resulted from increase in growth of consumer spending.

GDP growth QoQ



Source: Reuters

Exactly in line with analysts expectations, in August industrial production in the Eurozone rose by 0.6%MoM and it recorded a fall of 0.8%YoY. August's fall in production in annual terms was twelfth in a row. Also data on producer prices were close to expectations. In September prices increased by 0.3%MoM and 0.1%YoY (first growth in annual terms since 12 months). Forecasts pointed to 0.3% and 0.0% respectively. In August Eurozone's retail sales recorded better results than analysts forecasted. It increased by 0.8%MoM and 1.5%YoY, compared to 0.5% and 0.8% expected.

In the United States production recorded a second consecutive and unexpected fall of 0.1%MoM in September, while analysts foresaw an increase of 0.1%. Retail sales fell by as much as 1.2%MoM in September. The fall was larger than analysts expected (0.9%) and the strongest since November 2001, when the sales fell by 2.6%. Such a bad figure was mainly affected by sales of cars (-4.8%), as with sales excluding this sector increased by 0.1%. Producer prices rose only by 0.1%MoM in September, i.e. exactly in line with forecasts. This figure translated into deepening of annual deflation in PPI to 1.9% from 1.6% in August, which means completely no inflationary pressure in economy.

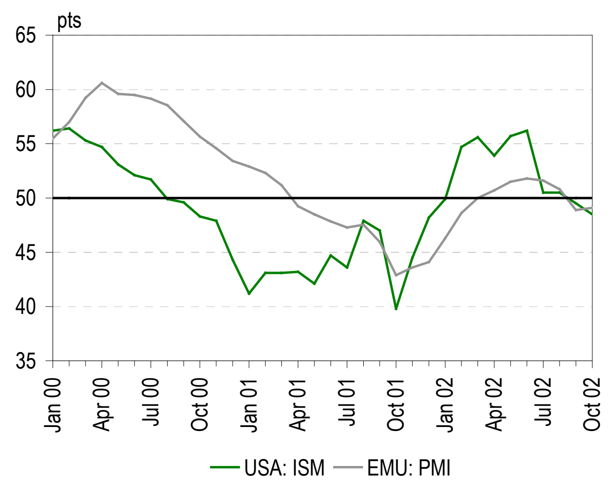
Eurozone's unemployment rate remained at 8.3% in September for fourth consecutive month. The highest unemployment was recorded in Spain (11.2%) and the lowest (2.5%) in Luxembourg.

US unemployment rate increased to 5.7% in October from 5.6% in September. Moreover, for a second consecutive month number of jobs in American economy fell by 5,000 after a fall of 13,000 in September.

Eurozone's M3 money supply growth recorded an unexpected acceleration in September, amounting to 7.4% YoY against 7.0% in August, while a slowdown to 6.7% was expected. High growth rate of money supply resulted from withdrawing money from stock market and investing it in the instruments included in the M3 measure.

In October, for a second month in a row, economic activity in Eurozone's industry maintained at low level. Reuters PMI index increased to 49.1 pts from 48.9 pts in September, while a fall to 48.3 pts was expected. However, the fact that it kept below 50 pt limit means, that Eurozone's industry remains in recession. Analogous index for the United States – ISM also pointed to lack of development in industry, falling to 48.5 pts from 49.5 pts in September, while a fall only to 48.9 pts was foreseen.

Activity Indicators



Source: Reuters

Major business climate indicator for the German economy, index of entrepreneurs' sentiment IFO, recorded a fifth consecutive fall in October to 87.7 pts from 88.2 pts in September. The figure was slightly better than expectations at the level of 87.6 pts. For the consecutive month a worrying signal was observed, when a subindex of assessment of current situation increased but that of expectations for future economic stance fell. This increases uncertainty concerning future economic activity and may be perceived as an argument for interest rate cut in the Eurozone.

What's hot this month

Monday	Tuesday	Wednesday	Thursday	Friday
4 November POL: T-bill auction (PLN 800m) *EMU: Producer prices (Sep)* *USA: Factory orders (Sep)*	**5** *EMU: Unemployment (Sep)*	**6** POL: T-bond auction OK0804 POL: Food prices (2H Oct) *GER: Industrial orders (Sep)* *USA: Fed meeting*	**7** POL: T-bill auction (PLN 800m) *GER: Unemployment (Oct)* *EMU: ECB meeting* *EMU: GDP (2Q)*	**8** *GER: Industrial output (Sep)*
11	**12**	**13** *FRA: Inflation preliminary (Oct)*	**14** POL: Money supply (Oct) *ITA: Industrial output (Sep)* *ITA: GDP (3Q)* *USA: Retail sales (Oct)*	**15** POL: Inflation (Oct) *FRA: Industrial output (Sep)* *ITA: Inflation final (Oct)* *USA: Industrial output (Oct)* *USA: Producer prices (Oct)*
18 POL: Wages & employment (Oct) POL: T-bill auction (PLN 800m) *EMU: Inflation final (Oct)*	**19** *EMU: Industrial output (Sep)* *EMU: Foreign trade (Sep)* *USA: Inflation (Oct)* *USA: Foreign trade (Sep)*	**20** POL: Industrial output (Oct) POL: Producer prices (Oct) POL: T-bond auction PS0608	**21** POL: Business climate (Nov) *GER: GDP (3Q)*	**22** *FRA: Inflation final (Oct)* *FRA: GDP (3Q)*
25 POL: Core inflation (Oct) POL: T-bill auction (PLN 800m)	**26** POL: MPC meeting) *USA: GDP (3Q)*	**27** POL: MPC meeting (decision) POL: Food prices (1H Nov)	**28** *ITA: Inflation preliminary (Nov)* *EMU: GDP (3Q)* *EMU: Money supply (Oct)*	**29** POL: Balance of payment (Oct) *EMU: Inflation preliminary (Nov)* *EMU: Economic sentiment (Nov)* *EMU: Business climate (Nov)*
2 December POL: T-bill auction *EMU: PMI (Nov)* *EMU: Retail sales (Sep)* *USA: ISM (Nov)*	**3** *EMU: Producer prices (Oct)* *EMU: Unemployment (Oct)*	**4** POL: T-bond auction OK1204 *GER: Unemployment (Nov)*	**5** *GER: Industrial orders (Oct)* *EMU: ECB meeting*	**6** POL: Food prices (2H Nov) *USA: Unemployment (Nov)*

Source: CSO, NBP, Finance Ministry, Reuters

Data release calendar for 2002

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
MPC meeting	29-30	26-27	26-27	24-25	28-29	25-26	18-19	27-28	24-25	22-23	26-27	17-18[a]
CPI	15	15[b]	15[c]	15	15	17	15	19	16	15	15	16
Core inflation	21	-	21	18	20	21	22	26	23	22	25	23
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	28	30	29	28	31	30	30	31	29	27
Money supply	14	14	14	12	14	14	12	14	13	14	14	13
NBP balance sheet	7	7	7	5	7	7	5	7	6	7	7	6
Business climate indices	7[d] , 21[e]	20	20	18	21	19	18	22	19	18	21	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 preliminary schedule,
[b] preliminary data, [c] final data (January, February), [d] December 2001, [e] January 2002, [f] February 2002

Source: CSO, NBP

Economic data and forecasts

Monthly economic indicators

		Sep 01	Oct 01	Nov 01	Dec 01	Jan 02	Feb 02	Mar 02	Apr 02	May 02	Jun 02	Jul 02	Aug 02	Sep 02	Oct 02	Nov 02
GDP	%YoY	0.8	x	x	0.2	x	x	0.5	x	x	0.8	x	x	1.7	x	x
Industrial production	%YoY	-3.7	1.8	-1.0	-4.8	-1.4	0.2	-3.1	0.3	-4.2	2.1	5.7	-1.1	6.7	3.9	-0.7
Retail sales ***	%YoY	1.3	5.8	2.4	2.4	4.7	6.7	9.9	3.1	1.8	2.5	8.6	5.1	4.7	-	-
Unemployment rate	%	16.3	16.4	16.8	17.5	18.1	18.2	18.2	17.9	17.3	17.4	17.5	17.5	17.6	17.7	18.0
Gross wages ** ***	%YoY	6.2	7.8	6.6	5.3	5.7	5.5	4.8	2.3	4.2	3.9	4.1	2.8	3.8	3.2	3.5
Export (acc. to NBP)	USDm	2 287	2 778	2 555	2 540	2 308	2 141	2 467	2 739	2 610	2 678	3 175	2 669	2 877	3 035	2 883
Import (acc. to NBP)	USDm	3 176	3 953	3 509	3 430	3 418	2 952	3 148	3 521	3 416	3 360	3 763	3 556	3 775	3 964	3 884
Trade balance (acc.to NBP)	USDm	-889	-1 175	-954	-890	-1 110	-811	-681	-782	-806	-682	-588	-887	-898	-929	-1 001
Current account balance	USDm	-304	-838	-417	-500	-847	-820	-612	-643	-549	-408	-108	-265	-538	-579	-621
Budget deficit (cumulative)	PLNbn	-21.8	-24.6	-27.7	-32.6	-6.9	-13.7	-16.4	-20.0	-23.0	-25.0	-25.7	-27.3	-29.8	-31.2	-35.2
CPI	%YoY	4.3	4.0	3.6	3.6	3.4	3.5	3.3	3.0	1.9	1.6	1.3	1.2	1.3	1.1	1.2
PPI	%YoY	0.7	-0.5	-1.0	-0.3	0.0	0.2	0.3	0.4	0.5	1.2	1.7	1.3	1.0	1.6	2.4
Broad money (M3)	%YoY	12.6	11.4	7.5	9.2	7.8	6.9	3.2	2.4	3.2	2.5	1.3	-0.2	-1.5	-1.8	1.2
Deposits	%YoY	13.6	12.0	7.3	8.9	6.9	5.7	1.7	0.6	1.3	0.5	-0.8	-2.5	-3.5	-2.5	-2.0
Credits	%YoY	11.5	9.7	8.9	9.3	9.0	8.8	7.1	6.6	7.9	9.4	7.5	5.9	4.9	6.0	8.0
USD/PLN	PLN	4.22	4.13	4.09	4.01	4.06	4.19	4.14	4.06	4.05	4.03	4.12	4.18	4.15	4.12	3.95
EUR/PLN	PLN	3.85	3.74	3.64	3.58	3.59	3.64	3.63	3.59	3.71	3.85	4.09	4.08	4.07	4.04	3.95
Reference rate *	%	14.50	13.00	11.50	11.50	10.00	10.00	10.00	9.50	9.00	8.50	8.50	8.00	7.50	7.00	7.00
WIBOR 3M	%	14.73	14.01	13.91	12.29	11.90	10.83	10.32	10.20	9.89	9.30	8.89	8.55	8.07	7.45	7.10
Lombard rate *	%	18.50	17.00	15.50	15.50	13.50	13.50	13.50	12.50	12.00	11.50	11.50	10.50	10.00	9.00	9.00
Yield on 52-week T-bills	%	14.01	12.64	11.80	10.66	9.62	9.68	9.62	9.56	9.22	8.54	8.35	7.86	7.25	6.77	5.90
Yield on 2-year T-bonds	%	13.57	11.36	11.00	10.70	9.11	9.37	9.32	9.22	9.03	8.27	8.12	7.60	7.16	6.62	5.90
Yield on 5-year T-bonds	%	12.92	11.32	10.13	9.91	8.91	9.26	9.11	9.02	8.90	8.17	8.11	7.62	7.07	6.57	5.95
Yield on 10-year T-bonds	%	11.57	10.31	9.19	8.92	8.25	8.34	8.25	8.19	8.02	7.55	7.63	7.29	6.79	6.22	5.95

Source: CSO, NBP, BZ WBK

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

Quarterly and annual economic indicators

		1998	1999	2000	2001	2002	2003	1Q01	2Q01	3Q01	4Q01	1Q02	2Q02	3Q02	4Q02
GDP	PLNbn	553.6	615.1	685.0	721.6	750.8	791.3	165.4	176.5	179.6	200.0	171.4	182.8	186.2	210.4
GDP	%YoY	4.8	4.1	4.0	1.0	1.3	3.0	2.3	0.9	0.8	0.2	0.5	0.8	1.7	2.0
Total consumption	%YoY	4.2	4.4	2.4	1.8	1.8	2.1	-1.3	-1.8	-1.7	-2.8	0.0	2.7	2.5	1.9
- Private consumption	%YoY	4.8	5.2	2.6	2.1	2.7	2.3	1.2	1.3	1.8	2.9	3.2	2.9	2.7	2.1
Fixed investments	%YoY	14.2	6.8	2.7	-10.2	-1.0	6.5	0.0	0.2	0.2	1.4	2.0	-8.4	-3.5	3.3
Industrial production	%YoY	3.5	3.6	6.8	-0.2	1.5	3.4	4.5	-0.7	-0.8	-2.6	-1.6	-0.4	3.3	4.4
Retail sales (real terms)	%YoY	2.6	4.0	1.0	0.2	-	-	-3.1	-0.2	1.2	3.7	5.8	0.7	5.1	-
Unemployment rate *	%	10.4	13.1	15.1	17.4	18.7	19.0	16.1	15.9	16.3	17.4	18.1	17.4	17.6	18.7
Gross wages (real terms)	%YoY	4.3	3.3	1.3	1.6	1.9	1.3	1.7	-0.3	2.2	3.2	1.9	1.4	2.3	1.9
Export (acc. to NBP)	USDm	30 122	26 347	28 256	30 276	32 553	35 000	7 436	7 508	7 459	7 873	6 916	7 347	8 721	8 889
Import (acc. to NBP)	USDm	43 842	40 727	41 424	41 955	42 875	47 000	10 584	10 286	10 193	10 892	9 518	9 621	11 094	11 966
Trade balance (acc.to NBP)	USDm	-13 720	-14 380	-13 168	-11 679	-10 322	-12 000	-3 148	-2 778	-2 734	-3 019	-2 602	-2 274	-2 373	-3 077
Current account balance	USDm	-6 862	-11 558	-9 946	-7 075	-6 872	-9 000	-2 170	-2 205	-945	-1 755	-2 279	-2 075	-911	-2 082
Current account balance	% GDP	-4.3	-7.4	-6.3	-4.0	-3.7	-4.4	-4.9	-5.2	-4.2	-4.0	-4.1	-4.0	-3.9	-4.0
Budget deficit (cumulative)*	PLNbn	-13.2	-12.5	-15.4	-32.6	-40.0	-38.7	-15.0	-18.8	-21.9	-32.6	-16.4	-25.0	-29.8	-40.0
Budget deficit (cumulative)*	% GDP	-2.4	-2.0	-2.2	-4.5	-5.3	-4.9	-9.1	-2.2	-1.7	-5.3	-9.6	-3.4	-2.6	-4.9
CPI	%YoY	11.8	7.3	10.1	5.5	2.0	2.2	6.7	6.6	4.9	3.7	3.4	2.1	1.3	1.3
CPI*	%YoY	8.6	9.8	8.5	3.6	1.5	2.7	6.2	6.2	4.3	3.7	3.3	1.6	1.3	1.5
PPI	%YoY	7.3	5.7	7.8	1.6	1.1	2.5	4.2	2.2	0.8	-0.6	0.2	0.7	1.3	2.3
Broad money (M3)	%YoY	25.3	24.6	15.2	12.1	2.2	5.0	14.7	11.8	14.1	12.9	5.9	2.7	-0.1	0.2
Deposits	%YoY	28.4	26.4	17.2	13.5	0.3	10.5	17.1	13.6	15.7	13.3	4.8	0.8	-2.3	-2.0
Credits	%YoY	30.0	28.6	24.7	11.3	7.6	15.0	15.4	9.7	11.3	8.1	8.3	8.0	6.1	8.0
USD/PLN	PLN	3.49	3.97	4.35	4.09	4.08	3.86	4.09	3.99	4.22	4.08	4.13	4.05	4.15	4.00
EUR/PLN	PLN	3.92	4.23	4.01	3.67	3.85	3.86	3.78	3.49	3.76	3.65	3.62	3.72	4.08	3.97
Reference rate *	%	15.50	16.50	19.00	11.50	7.00	6.00	18.00	15.50	14.50	11.50	10.00	8.50	7.50	7.00
WIBOR 3M	%	21.34	14.73	18.78	16.08	9.14	6.51	18.53	17.09	15.37	13.45	11.02	9.80	8.50	7.23
Lombard rate *	%	20.00	20.50	23.00	15.50	9.00	7.50	22.00	19.50	18.50	15.50	13.50	11.50	10.00	9.00
Yield on 52-week T-bills	%	18.59	12.95	17.77	14.77	8.18	5.50	17.02	15.70	14.67	11.72	9.64	9.11	7.82	6.17
Yield on 2-year T-bonds	%	18.08	12.41	17.37	13.91	7.96	5.50	15.59	14.91	14.37	10.83	9.27	8.84	7.63	6.12
Yield on 5-year T-bonds	%	15.83	10.87	14.00	12.59	7.88	5.63	13.12	13.38	13.43	10.45	9.09	8.69	7.60	6.14
Yield on 10-year T-bonds	%	x	9.60	11.79	10.74	7.37	5.69	10.46	11.22	11.81	9.48	8.28	7.92	7.24	6.02

Źródło: GUS, NBP, BZ WBK

* at the end of period

Bank Zachodni WBK S.A.

TREASURY DIVISION

plac Gen. Władysława Andersa 5, 61-894 Poznań

secretary tel. (+48 61) 856 58 35, fax (+48 61) 856 55 65

This analysis based on information available until 11.11.2002 r. has been prepared by:

ECONOMIC ANALYSIS UNIT

ul. Marszałkowska 142, 00-061 Warszawa, fax (+48 22) 653 46 79

Email: ekonomia@bzwbk.pl Web site (incl. Economic Service page): http://www.bzwbk.pl

Maciej Reluga – Chief Economist

tel. (+48 22) 653 46 63, Email: maciej.reluga@bzwbk.pl

Piotr Bielski	(+48 22) 653 47 33
Piotr Bujak	(+48 22) 586 83 41
Aleksander Krzyżaniak	(+48 22) 586 83 42

TREASURY SERVICES DEPARTMENT

Paul Polaczek tel. (+48 61) 856 55 73, fax (+48 61) 856 55 65

Poznań

pl. Gen. W. Andersa 5, 61-894 Poznań
fax (+48 61) 856 55 65

Piotr Kinastowski

tel. (+48 61) 856 58 22, fax (+48 61) 856 55 65

Juliusz Szymański	(+48 61) 856 58 25
Katarzyna Kamińska	(+48 61) 856 58 25
Robert Król	(+48 61) 856 58 25
Adam Wandzilak	(+48 61) 856 58 25
Waldemar Polowczyk	(+48 61) 856 58 14
Zbigniew Mańke	(+48 61) 856 58 14
Hanna Nowak	(+48 61) 856 58 14
Żaneta Czerniak	(+48 61) 856 58 14
Wojciech Kusik	(+48 61) 856 58 14

Warszawa

ul. Marszałkowska 142, 00-061 Warszawa
fax (+48 22) 653 46 79

Tomasz Dziedzic	(+48 22) 586 83 67
Maciej Jędrzejak	(+48 22) 586 83 70
Piotr Żagan	(+48 22) 586 83 66
Marek Cisek	(+48 22) 586 83 19
Grzegorz Wróbel	(+48 22) 586 83 57

Wrocław

ul. Rynek 9/11, 50-950 Wrocław
fax (+48 71) 370 26 22
Krzysztof Pietrkiewicz
tel. (+48 71) 370 25 87, fax (71) 370 26 22

Maciej Błęcki	(+48 71) 370 26 63
Jerzy Rybczak	(+48 71) 370 24 26
Aleksandra Skiba	(+48 71) 370 24 86
Anna Tarnacka	(+48 71) 370 26 24
Damian Syzdek	(+48 71) 370 25 25
Maciej Makarewicz	(+48 71) 370 24 86
Marcin Mostowy	(+48 71) 370 26 25