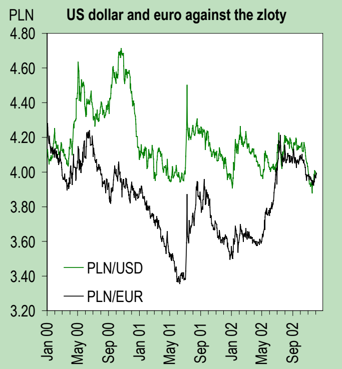
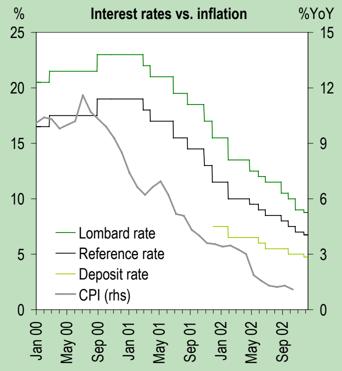
Bank Zachodni WBK

MACROscope

Polish Economy and Financial Markets

December 2002





In this issue:

Maciej Reluga
Chief Economist
(+48 22) 586 8363

Piotr Bielski
(+48 22) 586 8333
Piotr Bujak
(+48 22) 586 8341
Aleksander Krzyżaniak
(+48 22) 586 8342

Email: firstname.secondname@bzwbk.pl

Pray another day

■ In this issue of MACROscope we present the expected scenario of economic situation in 2003. Positive outcome of the Copenhagen summit, increasing chances for "YES" vote in accession referendum in June next year, convinced almost everyone that this will be the last year for Poland outside the EU. However, this is not the end of challenges for the Polish government. Poland will receive additional €1bn in cash up front, while this money used to be reserved for future infrastructure projects, which is positive news for the finance minister. While it means easier planning of budgets for the next years, the reform of public finances will be still very difficult. Especially as the finance minister plans to propose unpopular measures just before the accession referendum. The government will therefore still have a few other things to pray for in the future.

■ In our opinion the next year will be the year of the economic growth acceleration. This will result from higher growth rate of investments, while individual consumption should slightly decelerate. We expect inflation to inch up but it should remain in the lower range of the central bank's inflation target of 3% (+/–1%). The fact that CPI will range between 1-1.5% for the whole 1H03 will allow the central bank for further interest rates cuts – in our opinion reference rate will drop to 6% in December 2003. The zloty will remain strong due to higher foreign direct and portfolio investments inflow. However, there will surely remain some risk factors on the Polish financial market. The most important will include: difficult (after delay of necessary changes in 2003 budget) budget planning for 2004 and the appointment of new, "less conservative" members of the MPC.

■ The October statistics published in November did not change the picture of the economic situation. The trends recorded in the previous months were continued for the majority of variables. Industrial production went up again, high retail sales and foreign trade dynamics were maintained. The above again confirms the acceleration of the economic growth. On the other hand, low growth of wages paralleled by only marginal reduction of the unemployment rate translated into another decline of the wage bill. Data on the investments in 3Q02 were also disappointing. This means, that the recovery of the economic situation will be gradual and very moderate. This point of view is confirmed by declining inflation pressure and continued negative money supply dynamics.

■ In November, the MPC again cut all interest rates, this time by 25 bps. Reference rate, which has the most direct influence on the market, was reduced to 6.75% from 7%. The important change was a reduction of rate cut's scale from 50 bps to 25 bps. We are convinced that, after the market interpreted the MPC's decision as a clear and conscious signal for investors, further interest rates cut will not be deeper than 25 bps. It seems to confirm recent MPC member' comments. We expect two rate cuts in this scale in 1Q03 and one cut in 2Q03.

Financial market on 29 November 2002

NBP deposit rate	4.75	WIBOR 3M	6.76	PLN/USD	4.0078
NBP reference rate	6.75	Yield on 52-week T-bills	5.80	PLN/EUR	3.9809
NBP lombard rate	8.75	Yield on 5-year T-bonds	5.93	EUR/USD	0.9933

Special focus

The last year outside the EU

2002 – a year of hope or lost chances?

Year 2002 has passed being marked by the subsequent historically low inflation rates and corresponding interest rate cuts, monthly expectations of the economic recovery signs and the accelerated negotiations with the European Union which will probably have been successfully completed at the time we will be making final adjustments to this report. Completing the negotiations and setting the date of accession to the EU undoubtedly represents the biggest success of the ruling coalition. However, besides successes there were also failures. Long expected reform of the public funds expenses was deferred once again, and the next year's budget has been filled in with one-off income, which, similarly to the better collection of taxes, represented "filling" of many previous budgets (the assessment of the budget was the issue of a monthly edition of one of the previous MACROscopes).

The high budget deficit financed with high supply of bonds was not a problem for investors purchasing Polish T-bonds once more. This is because the real economic sphere was disappointing, which accompanied by the lack of the inflation pressure from the economy demand side and the positive supply shocks, in particular given the decreasing (again!) prices of food resulted in substantial cuts of interest rates by the central bank.

The economy was disappointing but yet not fully. Since the beginning of 2H02, there have been increasingly more signals evidencing the economic growth scenario. Of course, it should be mentioned that this growth is from 0% up to ca 2%, i.e. still it not is the level that could bring about the creation of employment in the economy. Low economic growth results primarily from low capital expenditures and this element is to be the main driver of the growth dynamics next year.

The first signals of recovery can give some hope that it should get better and better with time. This hope is additionally busted by the forthcoming EU membership, which, according to many, should eliminate the better part of the Polish economy problems. Next year is going to be the last one before the EU enlargement. This will be a year of preparations to additional challenges related to the accession. In particular, this relates to the public funds area, which requires taking a number of substantial and brave steps, which was mentioned by us last month. Undoubtedly, a chance for taking the first step in this direction was lost in 2002.

2003 – a slightly better external situation

One of the initial assumptions of the next year macroeconomic situation development scenario is represented by the expected accelerated economic growth in the Western Europe. It should be stated, however, that very marginal signals of economic recovery in the developed countries observed at beginning of 2002 lost their strength. Demand in these countries, delicately speaking, is moderate and the inflation pressure is relatively low. Thus, nobody should be surprised with accompanying subsequent down-adjustments of the GDP growth in these countries. It seems that 2003 will be another period of growth below the trend in both the EU and the USA. However, some marginal development acceleration is expected in the EU and the USA and should be of 1.7% and 2.5%, respectively (up from 0.8% and 2.3% in 2002).

Given the above-mentioned environment, central banks sustained their policy of cutting interest rates, which went down to 1.25% in the USA and down to 2.75% in the Euro zone. Next year this trend is not likely to be continued, while one cannot exclude some marginal increase in interest rates at the end of 2003 (especially in the USA).

It seems that the German economy in particular will find it difficult to leave the stagnation stage (Germany is our main trade partner). This is because there are no instruments that could bring about the recovery. Interest rates, which aim to impact the inflation rate in the entire Eurozone, are simply too high for the German economy. Exchange rate for the trade partners within the Eurozone is fixed. The politicians' temptations to spend a little bit more increasing the budget deficit with the recession in place will not be successful due to ("stupid" as defined by some) limitations of the growth and Stability Pact. If we add the plans to increase taxes and ageing society with the pension system at the efficiency verge, we come to the conclusion that the chances for substantial recovery of this economy are rather poor.

The delayed growth in Germany may of course have some negative impact on the prospects for the Polish exports. However, one should notice some positive features of the Polish foreign trade. The clear-cut growth continues, but what is more important it results mainly from the improvement in the sectors producing highly processed goods. This feature may be positive in the long run as the external demand for these goods should be more stable than the demand for the non-processed goods, in respect of which pricing flexibility may have a more substantial impact. Moreover, one can observe some reorientation in the Polish exports – the exports to Germany went up by only 3% in the first three quarters this year, the growth in the sales to other markets exceeded 20% YoY (to Russia - by 28%, to Sweden - by 26%, to Ukraine - by 22%). Therefore, one may assume that the exports should be relatively good in the subsequent quarters, and next year the exports will grow with the dynamics similar to that witnessed in years 2000-02 (7-9%).

Economic growth acceleration

The adjustments of the global economic growth projections may not evoke excessively optimistic expectations in respect of the Polish economy. On the other hand, the recently published statistics confirm the scenario of a slow economic recovery expected for some time now. Therefore, we sustain our projection of the GDP growth of 3% in 2003. This projection is above the market expectations' average, which, according to Consensus Economics opinion poll (we take part in) is 2.7%. The economic growth expectations' range (from 1.3% to 3.4%) is the best example of the uncertainty level of economic projections in the current conditions. As it seems, even the most optimistic market projections are lower than the government's budget assumptions (3.5%). Well, if the growth dynamics should be close to the lower limits of the above-mentioned range, the Ministry of Finance would be bound to have problems with closing the budget income side. However, in our opinion, there are good grounds to believe in the growth dynamics of ca 3%, which according to our estimates will bring about a gap in our budget income that will only be a little bit bigger than it used to be in the previous years.

Projected growth of GDP and its structure (%YoY)

	BZWBK	FinMin	Exp. range	Exp. average
Economic growth	3.0	3.5	2.7	1.3-3.4
Private consumption	2.3	3.2	2.9	1.0-4.0
Investments	6.0	5.6	3.8	2.0-6.3
Exports	6.4	5.7	7.8	4.2-22.8
Imports	8.1	7.8	7.6	3.1-15.5

Note: Foreign trade data on payments basis
Source: BZ WBK, budget draft 2003, Consensus Economics

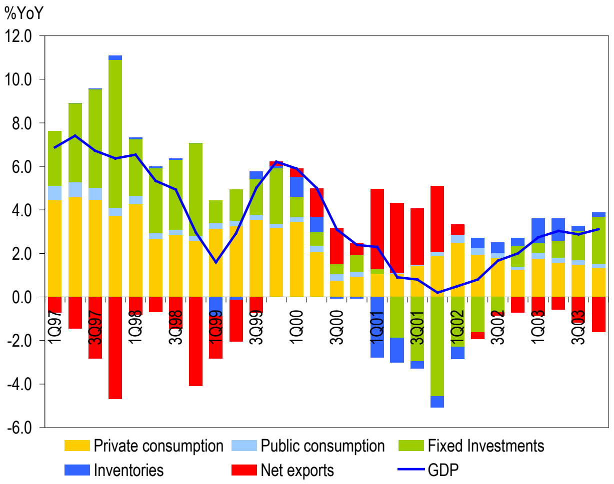
As indicated by the table above, the structure of the internal demand, expected by us, is slightly different from both market expectations and the MF's assumptions. We expect some slow down in the private consumption growth dynamics from 2.8% in 2002 down to 2.3% in 2003. This is because we would find it very difficult to believe that the continuously high unemployment rate with the economic growth close to 3%, which does not generate any substantial additional employment, could allow for maintaining a growth in the consumption at the level close to 3% (or for exceeding the level as the Government assumes). It is even more so, given that next year the inflation will not go down anymore, and one should not forget that the higher real wage bill this year resulted from a positive inflation surprise. It is additionally supported by the fact that the private consumption was (at least partially) financed with the household savings, and this factor has its limits as well. Finally, one should not forget about the higher effective tax rates in 2003.

On the other hand, however, we expect some growth in the investments in fixed assets next year. Of course, this recovery will be partially offset by negative contribution of the net exports to GDP, as the share of investment goods in the Polish imports is quite high (and recently increased).

External stability to maintain...

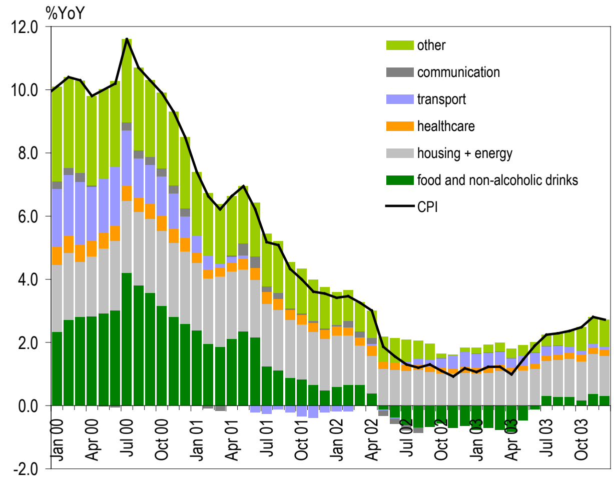
As has been mentioned above, we do not expect a substantial decrease in the export turnover. However, given the import-intensive absorbency of the consumption and investments, the higher growth dynamics of the internal demand will require the import growth acceleration (from 4% up to 8%). Therefore, the impact of the net exports on the economic growth is bound to be negative, and the current account deficit will go up from 3.8% GDP this year up to some 4.4% in 2003. The expected deterioration in this relation is obvious also from the point of view of the relation of savings and investments in the economy. The high budget deficit indicates another year of high negative balance of public savings, while the low interest rates and the deposit interest tax have been decreasing the propensity to saving in the private sector. Therefore, the increase in the domestic investments must be financed with foreign savings, which increase the surplus in the capital account. The surplus with the floating exchange rate regime in place means higher current account deficit. The deterioration in this relation will not be substantial enough to create an element of risk from the point of view of the financial markets. It may be said that the relative external balance will be maintained next year.

Quarterly structure of GDP growth



Source: BZ WBK, CSO

Structure of CPI growth



Source: BZ WBK. CSO

... and internal stability also unchanged

Will the growth in the domestic demand be related to the increased inflation pressure? It may be to some small extent, but we cannot forget about a couple of additional factors. Firstly, the consumption will not grow, and secondly, as usual in Poland, the next year's inflation path will depend to a large extent on food prices. Moreover, we expect PLN to be relatively strong which will decrease the inflation rate due to its impact on the prices of the imported goods. Therefore, we do not expect a substantial increase in the inflation next year and we reckon that CPI will range within the bottom level of the inflation target of the central bank, which is 3% (+/- 1%). We project the inflation of 2.7% in December 2003 against slightly above 1% as at the end of 2002. However, in our opinion the average annual inflation will drop below 2%. This will be because the inflation rate will remain substantially below 2% over at least the first half of 2003.

Food is the most important component of the inflation basket as its share represents ca. 30%. In October this year, the food price inflation was -1.9%, and after the November surprise this decrease will deepen and the deflation will exceed 2%. For comparison, in 2001, which also was a year of "crops failure", food prices inflation was 1.6%. In 2003, in our opinion this component of the inflation basket will range between the rates from both years and will total 1.1%. Such a low level, which will decrease the CPI again will result primarily from this year's good harvest (also high supply of meat) and its impact on the inflation in H1 2003. We expect a 1% deflation in the three summer months (June-August).

As for the other inflation components, we expect some growth in prices in the category "use of flats and power carriers" (from 5.4% up to 6.4%) and in the service categories. We do not envisage any substantial long-term fluctuations on the market of fuel prices – potential increases in the price of crude oil globally should be offset with the strong PLN against USD. However, the relatively stable prices of fuel on monthly basis will result in a higher annual inflation in a "transport" category. The annual inflation rate of alcohol beverages will go up as at the end of next year, as the one-off factor of the excise decrease (in October 2002) will not be repeated.

No problems with the 2003 budget, quite contradictory with the 2004 one

Fiscal policy was one of the main topics in the number of previous issues of our monthly bulletin. We assessed both the so-called "emergency package" of the Ministry of Finance (in August), next year's budget (in October) and we exemplified the challenges the Ministry of Finance will have to face in respect of the subsequent budget – the first one in the EU (November). The budget act approved by the Sejm is also discussed in *Watch: Government and politics*. Therefore, at this point we will limit ourselves to repeating a couple of key elements of the next year's fiscal policy.

We do not have any concerns as far the delivery of the next year's budget is concerned and despite the partial overstating of income (better tax collection, a slightly overstated growth) we do not expect the budget act to be amended over the year. However, in our opinion the shortage in the public funds sector may be higher than the budget assumptions, and the economic deficit seems very unlikely to go down below 5% of the GDP.

This will result mainly from the increased off-central budget expenses.

Planning the budget for the subsequent year may have a substantially higher impact on the financial markets than the scenario of realising the 2003 budget. The EU accession requires a change to the expenses' structure, and the declaration to meet the Maastricht Treaty criteria in 2005 means decreasing the budget deficit down to 3% of the GDP. Although at the beginning of December, Ryszard Michalski – Vice-Minister of Finance, stated that Poland would join the Eurozone a little bit later (this is discussed in *Watch: Central Bank*). However, the deficit must be decreased not only because we want to replace PLN with Euro. Although Poland will not have to comply with the Growth and Stability Pact (deficit below 3% of the GDP) soon after joining the EU, however exceeding this limit may be related to the risk of suspending the inflows from some EU funds. Therefore, it is necessary to reform the structure of the pubic finances (to make some room for investment expenses), and this should be started already in the next year.

The first step taken in this direction will be extremely important for financial markets. Moreover, it will be important from the perspective of the Finance Minister reliability, as he committed himself to present the first proposals aimed at decreasing the "fixed" profile of budget expenses early in 2003. However, one can doubt if any brave political decisions could be made just before the EU accession referendum. In this case, any attempts to decrease social expenses could be interpreted as the accession cost, which would adversely impact the referendum result. Rejecting the EU accession would undoubtedly be a failure of not only the ruling coalition but also of the Polish economy. Given the risk, one can expect that the more serious 2004 budget trail runs will start, as usual, in the mid of year. Nevertheless, it may be one of the reasons, which may substantially limit the PLN appreciation pressure in 2H03.

Rates keep on falling down, zloty remains strong

Historically low level of inflation and the low business activity resulted in subsequent interest rate cuts this year. Despite that we expect the inflation to grow next year (up to 2.7% in December), it is very likely that the MPC will continue its policy of cutting interest rates. The low inflation rate in 1H03 will lead to subsequent 25bp cuts. We should not expect the MPC to decide on the higher scale of the cuts after it applied the 25bp cut strategy in November this year. The decreased scale of interest rate cuts reduced the market expectations for further loosening of the monetary policy. Similarly to April 2002, when the MPC applied the 50bp scale of cuts and did not make any deeper cuts later on, also now one should not expect cuts higher than 25pb. Some market players expected the NBP reference rate to fall down to 5% by the end of next year and now it seems they have to adjust their expectations. Our projected level of the reference rate in December next year is still 6%. Interest rate cuts will cumulate in H1 – two cuts of 25bp in Q1 and one cut in Q2.

The subsequent reductions are bound to be impacted by the low level of inflation and continuously moderate scale of the economic recovery. However, it seems that the MPC now should be more focused on the possibility of inflation growth in the future. In 2004-2005, as this is when we will see the effects of the next year's cuts, a more clear-cut economic recovery is expected which may bring about the higher inflation pressure. If we add to this the harmonisation of some indirect taxes and the process (although it is bound to be very slow) of adjusting prices in Poland and the EU, we may come to the conclusion that the MPC should be conservative if it aims at meeting the Maastricht criteria. In particular, from the central bank's perspective it is always better to overstate the interest rate levels than to understate them.

Framework on the basis of which the central bank is going to operate in the medium-term perspective has not been precisely defined. Of course, the MPC is going to aim at stabilising the inflation rate at the existing low level. This level is likely to be precisely defined next year when the subsequent medium-term monetary policy strategy will be announced by the MPC. The MPC choice is difficult in a sense that it still does not know the prospects of joining the EMU, which in turn depends on the government's plans of the fiscal adjustment. A question arises if a 3% inflation rate is to be the upper or medium limit of the next inflation target. As the joint representation of the government and the central bank on the readiness to meet the Maastricht criteria is still valid, it seems to us that the next inflation target will be set at 2% (+/- 1%), which would most probably ensure meeting the inflation criteria. What is more, it seems that the subsequent medium-term target will not necessarily be defined as a point target (the end of next year), but rather like an ongoing target – stabilisation of prices at a low level. This target set by the current members of the MPC will be pursued by their followers. Nevertheless, the next year's decisions on interest rate changes will be made based on the long transmission mechanism.

What will be the impact of exchange rate on the MPC's decisions? It seems that the appreciation pressure related to expectations in respect of monetary policy will slightly decrease due to the November decrease in the scale of the interest rate cuts. However, despite the above-mentioned facts, as was numerously emphasised in the past, PLN will probably remain relatively strong due to a lower country risk resulting from the prospects of the EU accession. We disagree with the opinion that it would be necessary to dramatically cut interest rates in order to weaken the PLN appreciation pressure (obviously, in the case of a cut of e.g. 200pb. capital could flow out of Poland, but that would rather be the result of the crippled faith in the fixed decrease in inflation) and in our opinion such actions would be similarly ineffective as in Hungary and Slovakia. Therefore, we believe that strong PLN will have an impact on the interest rate cut decisions only via the channel of decreasing import prices and decreasing the expected inflation.

Expected interest rate cuts and signing the accession treaty will have an impact on the inflow of the portfolio capital early in 2003, which will strengthen PLN. If it is supported by the stronger evidence of the economic growth, a hope for the real convergence may also increase and in this way “invite” larger volumes of the long-term capital in the form of foreign investments. Privatisation, although it is likely to be delicately accelerated, is not bound to have an impact on PLN exchange rate, as the government is very likely to effect the transactions outside the FX market. The short-term capital may feel unsafe before the EU accession referendum in Poland, especially if preceded by an aggressive negative campaign or a split in the ruling coalition. However, we expect a positive result of the referendum (if there is low participation in the referendum, then the parliament will approve the EU accession), the potential deterioration in the FX market will be short-term in nature. After that, PLN should remain relatively strong, which will be supported by signing the accession treaties in the member states.

However, investments on the Polish market, as usual, will not be one sided and there will appear some risk factors. As is now, one can identify two which are the most substantial – the 2004 budget draft and the appointment of new members of the MPC. The impact of budget planning may have twofold implications on the financial markets and one can be afraid that either of them would be negative. If the Finance Minister's concepts are blocked at the cabinet – government level, which would mean a lower chance for decreasing the deficit, investors may be disappointed with the prospect of the deferred meeting the Maastricht criteria. On the other hand, if the Finance Minister has enough power to persuade the Prime Minister to brave actions (at the expense of the increased risk of the EU accession referendum failure) it may bring about some changes in the ruling coalition which could also have an adverse impact on the financial market. Of course in the former case this impact would be substantially more evident, as it could be related to a potential dismissal of the MF (who would be replaced by. e.g. the current Minister of Labour).

The other element, not yet considered by financial markets, is the replacement of the nine members of the MPC. Officially, the replacement will take place early in 2004, however, the long list of names is bound to be known early in 2H03. The three candidates appointed by President Kwaśniewski would be moderate in their opinions. i.e. they will not generate the risk of a clear-cut change in the monetary policy, similarly to e.g. the two subsequent President's economic advisers (Marek Belka and Witold Orłowski, both Professors of Economy). However, the other six candidates (three from the Sejm and three from the Senate) of the ruling coalition may be, as the vice-minister Michalski said it, less conservative. This may mean that the financial markets may start to value the potential change to the monetary policy. This change would not be related to interest rates, which would be at a relatively low level and their potential cut by another 100pb would not have any substantial implications (but for the better mood of the politicians). The change would be related to the exchange rate policy – the bigger chance for the agreement between the government and the central Bank in respect of the Euro exchange parity (weaker PLN), potential change in the FX regime to a more pro-active one, potential implementation of the currency band etc. Should the names associated with these ideas appear next year, it would undoubtedly adversely impact the financial markets.

The same factors, which will impact the FX market, will determine the situation on the debt securities market. Yield curve is bound to remain relatively flat at the level depending on the subsequent interest rate cuts (see above). The above-mentioned risk factors could result in the yield growth. Nevertheless, it seems that each clear-cut yield growth will be perceived as an opportunity to buy Polish bonds. Given that we do not expect the Ministry of Finance to have problems with placing a large number of T-bonds on the market.

For the tables with the projections of the macroeconomic variables see the last pages of this report.

Economic update

- **Positive tendencies observed in the economy in previous months were continued in October**
- **On the other hand, data on investments in 3Q02 were disappointing**
- **Lack of inflationary pressure in the economy**

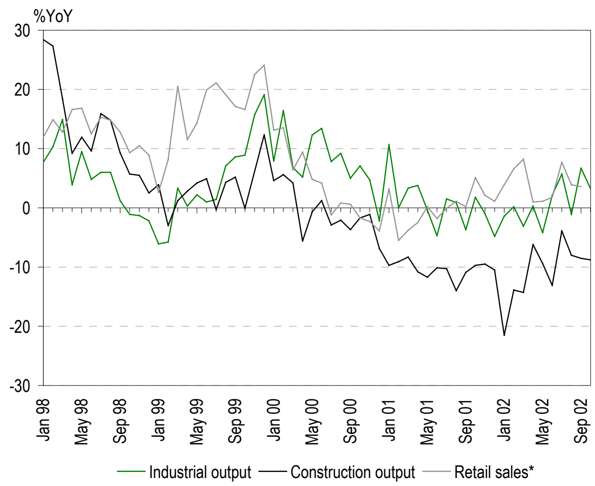
Slowly ahead

The October statistics published in November did not change the picture of the economic situation. For the majority of macroeconomic indicators, the trends recorded in the previous months were continued. Industrial production went up again, high retail sales and foreign trade dynamics were maintained. The above again confirms the moderate acceleration of the economic growth. October also witnessed new positive phenomena. First of all, for the first time since 1997, the unemployment rate in October was down comparing with previous month. However, it is still hard to call it a substantial improvement on the labour market. Low wages' dynamics in the enterprises sector paralleled by only marginal increase of the employment translated into another decline in the wage bill. Data on the investments in 3Q02 disappointed as well. This means, that the improvement of the economic situation will be gradual and very moderate. This point of view is confirmed by declining inflation pressure and continued negative money supply dynamics. The analysis of the economic situation indicates seasonal deterioration of the standing of businesses; however a noticeable improvement in this regard is recorded against a corresponding period of last year. All in all, it seems that in October the scenario of gradual and not too dramatic economic upturn was confirmed.

Robust growth of industrial output...

Industrial production increased in October by 4.4%MoM and 3.2%YoY. The CSO informed that after seasonal adjustment the growth amounted to 3.1%YoY. The result was slightly weaker than we expected, though the difference was not very substantial and does not change the general conclusion about overall economic situation. Growth of production in October was roughly the same as the average increase recorded in 3Q02. The positive feature was that once again output growth recorded in "manufacturing" was stronger than the headline figure (amounted to 8.3%MoM and 4.0%YoY), while the overall output growth was dragged down by the poor performance of mining and energy sectors. In our opinion such data confirm that the recovery trend observed in Polish industry in 3Q02 is also continuing in the fourth quarter, though – as we repeated many times in the past – the pace of improvement is not very impressive. Most likely the November's industrial output figure will look much less optimistic, as we forecast that it might fall more than 1%YoY, nevertheless the collapse would be entirely the result of the lower number of working days. In turn, December's figure should be very strong, and all in all the average production growth in 4Q02 should be slightly above the level of 3.3% recorded in 3Q02. We do not change our forecast of GDP growth of 2% in 4Q02.

Real growth, %YoY



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

...and retail sales

Retail sales grew in October by 6.3%MoM and 5.1%YoY in nominal terms, in line with our expectations. This was slightly higher than 4.7%YoY recorded in September and the same as in August. However, given lower inflation in October, the annual growth of retail sales in real terms (to be released by the CSO later) should be even stronger than in previous months. Similarly to previous months the fastest growth was recorded in non-specialised shops selling mostly groceries and tobacco (25.3%YoY) and in cosmetics and pharmaceuticals (21.5%YoY). Significant increase took place in motor vehicles (13.5%YoY), which confirmed preliminary data from the company monitoring car market in Poland. Still, healthy retail sales figure indicates that despite falling wage bill in the enterprise sector private consumption remains relatively strong in 4Q02.

Foreign trade turnover also keeps growing fast

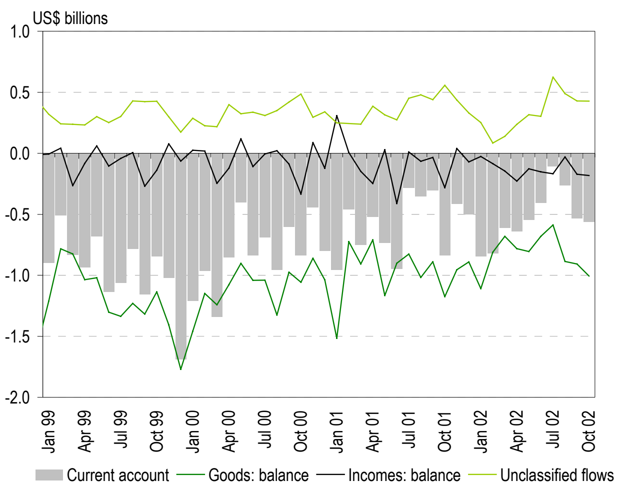
Current account deficit in October reached US$562m, trade deficit US$1.006bn and unclassified surplus US$427m. As we expected, the data confirmed that positive trends in foreign trade were continued. Exports amounted to US$3.157bn (higher level was recorded only once – in July this year) and imports reached US$4.163bn (the highest level since December 1999) both rising by 13.6%YoY and 5.3%YoY, respectively. However, one should remember that balance of payments figures expressed in US dollar are positively affected by EUR/USD exchange rate movements (see table below). In the euro terms exports grew by only 4.9%YoY and imports growth rate was negative pointing to -2.8%YoY. Nevertheless, balance of payments figures expressed in all currencies (also in PLN) indicate that both external and domestic demand remain robust. Lower than in previous month growth rates of exports and imports are related to very high base effect in October 2001. Close to record-high level of exports (in the euro terms record level despite lower annual growth rate that in US dollars) shows that restructuring process allowed Polish enterprises to remain competitive on the foreign markets while higher imports suggest growing domestic demand (possibly related to recovering investments).

Export and import growth in October, %YoY

	in USD	in EUR	in PLN	2/3EUR / 1/3USD*
Exports	13.6	4.9	13.2	7.7
Imports	5.3	-2.8	4.9	-0.2

*Note: * the relation approximately reflects currency structure of Poland's foreign trade*
Source: NBP, own calculations

Elements of the balance of payments



Source: NBP

October's balance of payments figures confirmed also another positive trend: unclassified flows surplus maintained at high level observed in previous month while its annual fall of 23.3%YoY stems from extremely high base in October last year. This figure, reflecting mostly flows of unregistered cross-border trade, is also expected to remain relatively strong in subsequent months. We estimate that cumulative 12-month C/A deficit reached 3.4% of GDP in October, down from 3.6% a month ago.

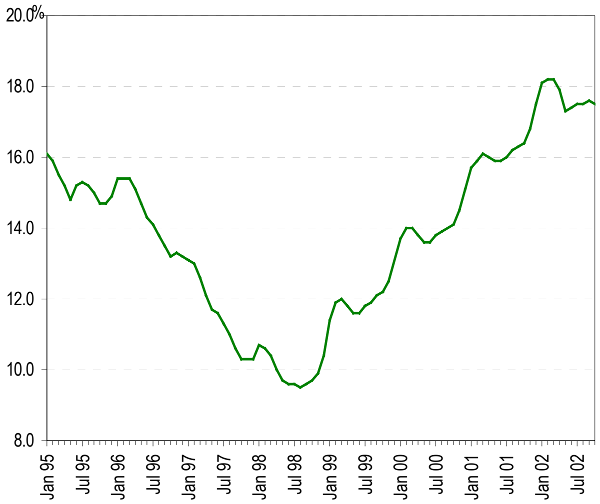
According to the CSO's (customs-based) foreign trade statistics exports in US$ terms were growing 12.8%YoY in 3Q02, while in January-September the increase amounted to 9.9%YoY. Imports grew 12.1%YoY in 3Q02 and 5.8%YoY in the first nine months of the year. The figures generally confirmed the picture delivered earlier by the NBP's figures based on payments – the deceleration of both imports and exports recorded in August proved temporary and was followed by the pick up of trade turnover in September. So, the foreign trade performance in 3Q02 was considerably better than in the first half of 2002. What is interesting, customs-based figures show also that in 3Q02 the growth rate of export and import clearly converged, and in September import was expanding faster than export (for the first time since mid-2000). Again, such developments is consistent with the scenario of economic expansion in 2H02, and may reflect the acceleration of domestic demand (i.e. most likely the gradual recovery of investments, as it is difficult to assume any significant acceleration of private consumption amid declining wage bill).

Wage bill in corporate sector keeps falling

In October average employment in corporate sector inched up by 0.1%MoM, which was the first increase recorded since February 2001. Still, the number of jobs was much lower than last year, although the decline was milder than in previous months and amounted to 3.4%YoY (compared to -4%YoY on average in 3Q02). However, at the same time average wage in corporations dropped by 1.7%MoM, dragging the annual growth of wages down to 0.5%YoY from 3.9%YoY recorded in September. As a result the nominal wage bill in the enterprises sector in October was 3% lower than in corresponding month of 2001 and in real terms the fall amounted to 4%YoY.

These statistics give mixed signals. On the one hand, the increase of employment, even if not impressing, gives a hope that they are more willing to hire new staff after two years of constant reduction. But on the other hand, dramatic fall of salaries clearly suggests that one should not expect any significant pass through from wages to inflation in the medium term and that households' purchasing power remains subdued, which gives rather gloomy prospects for private consumption growth in 4Q02.

The unemployment rate, %



Source: CSO

The CSO's data on registered unemployment seems to confirm the assumption about possible improvement of the situation on the labour market. The unemployment rate dropped to 17.5% in October from 17.6% recorded in September. The number of unemployed increased by 5.8%YoY and reached 3.108m. This was in line with hints given earlier by finance minister Grzegorz Kołodko and labour minister Jerzy Hausner. However, the level of unemployment rate is still over 1pp higher than in the corresponding period of the previous year. Moreover, as labour minister pointed out, next three months will bring sharp seasonal worsening of the situation on the labour market. We expect that at the end of the year the unemployment rate will be above 18%. Meanwhile, labour minister announced that the unemployment rate in November would rise only slightly and at the end of this year it would probably be lower than 18%. Well, if those revelations prove right, we could see long awaited recovery on the labour market in the near term. It would increase chances that the recovery initiated in 3Q02 would continue without major disruptions in subsequent quarters. Meanwhile, we still do not know where are those thousands of new graduates that were supposed to enter the labour market this year. Maybe, some of them found a job thanks to the government's program *"The first job"* but it is also likely that better than expected unemployment figure results from changes in procedures concerning registration of unemployed. Incentives to register as unemployed are smaller as a result of recent changes in the social security regulations, according to which people unemployed do not have necessarily register in the labour offices in order to receive access to the public healthcare.

...and preliminary data on investments in 3Q02 look disappointing

The CSO published preliminary data on investments after the three quarters of 2002. In the first nine months of this year overall investments as well as fixed investments fell by around 15.5%YoY against some 15%YoY drop in 1H02. If these figures were comparable with data from the System of National Accounts (SNA- used for calculations of GDP growth) it would mean that in 3Q02 we may see similar fixed investments fall as in 2Q02 (-8.4%YoY) and such a result would be undoubtedly disappointing. Nevertheless, the CSO's data on investments are aggregated only on a basis of reports from enterprises with over 50 employees. We expect that investment activity of smaller enterprises was higher and fixed investments reduction in the national accounts in 3Q02 should not be as high as in previous quarters.

In 1Q-3Q02 period the number of newly started investments substantially increased (by 69.1%YoY against 82.2%YoY in 1H02). However, the estimated nominal value of new investments decelerated after the third quarter of this year. After nine months of this year it was 8.6% higher than in the corresponding period of the previous year, but the annual figure amounted to as much as 23.7%, which suggest that new investments fell by some 20% in the 3Q02 alone.

The structure of investments was a positive feature. The deepest fall was recorded in buildings and structures, which are economically less effective than investments in machines, installations and tools, which experienced lower drop. Moreover, after the third quarter a decrease of investments deepened only in investments in means of transport.

... despite better financial results of enterprises

The CSO's data on financial results of companies after the first three quarters of 2002 showed continuing improvement of profitability in Polish non-financial corporations and the major indices of financial stance improved slightly - both in relation to corresponding period of last year and to those observed in the first half of this year. Although overall companies' revenues in the first three quarters of 2002 were below the corresponding level in 2001, the revenues in 3Q02 alone returned into black, confirming what we have already observed in other statistical data – revitalisation of business activity in 2H02. The cost reduction heavily contributed to the improvement of financial situation, which should improve the competitiveness of the Polish companies facilitating further expansion of their activity in the future. Interestingly enough, the best performance was recorded among exporting companies (and the higher the share of exports in total production, the better was the financial result). Well, one of the factors contributing to such a performance was the zloty weakening against euro by almost 10% on average in 3Q02.

In general, the results are quite positive and confirm that situation in corporate sector has already started to improve in 3Q02. FinMin's data about CIT inflows in October (see below) suggest that this process is also continuing in the subsequent quarter. We can hope that finally such positive developments would translate into entrepreneurs' decisions regarding employment, and October's data seem to deliver first evidence that this might be happening (see above).

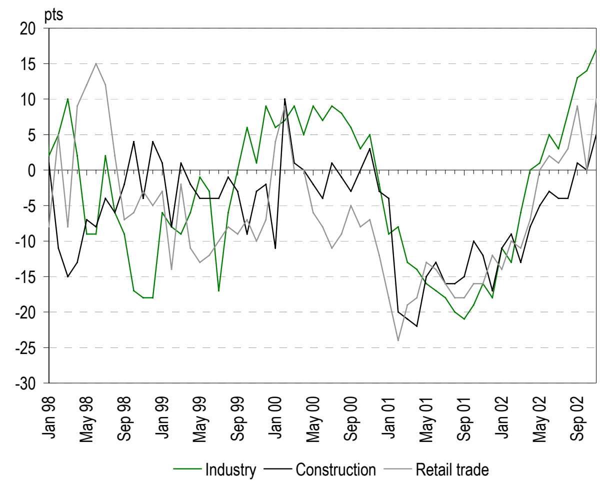
How the GDP growth will be affected by a change in inventories?

Data on inventories in enterprises in 3Q02 published by the CSO in November are quite optimistic from the point of view of the economic growth prospects (positive change in inventories increases the GDP growth). While level of inventories in 3Q02 decreased by 3,4%YoY (after falls of 4,0%YoY in 2Q02 and 4,3%YoY in 1Q02) the change in inventories during 3Q02 increased by over 80%YoY. These figures suggest that probably lower than expected dynamics of fixed investments (see above) may be at least partially offset by higher growth of change in inventories. However, it is not sure, as the CSO's data are derived only on a basis of big enterprises (with over 50 employees). Moreover, data on inventories in enterprises are not consistent with estimations in the SNA (used to calculate GDP growth), as the CSO's data do not cover other sectors of the economy, e.g. agriculture or public sector. Also, what is very important, inventories' change has residual character (it is a result of estimations of other elements contributing to GDP growth) in the SNA, which means that it is very difficult to estimate it. Nevertheless, it does not change positive conclusions from the CSO's data. Structure of inventories is also a positive feature, as inventories of finished products and production in progress decreased and inventories of goods remained almost unchanged. On the other hand, after several month of decline, inventories of materials inched up. This suggests that enterprises do not face significant barrier of insufficient demand and plan to increase production.

Business survey results improved...

Business survey results released by the CSO confirmed that the economic climate keeps gradually improving in 4Q02 in relation to corresponding period of last year, however the activity in corporate sector is still not strong enough to claim that the hard times for companies are over. Three main indices computed for industry, construction and retail trade, were not only notably higher than in corresponding period of last year, but their annual growth significantly accelerated as compared to previous months (see chart below). Nevertheless, in all three cases the absolute level of the climate index remained negative, reflecting the fact that the number of entrepreneurs with pessimistic assessments of business climate still outweighs the number of optimists. Several negative features are still present, especially in terms of expected employment reduction. Situation seems to be brighter in retail trade, which was confirmed by another robust increase of sales in October.

Business climate, YoY



Source: CSO, BZ WBK

The NBP's quarterly survey of economic climate suggests that economic situation should improve in 4Q02, though the progress will not be substantial. Among the most important positive features of the survey one should note the following: companies report higher capacity utilisation; they also plan to expand production level (in all sectors of the economy), and – what is particularly important – to increase investments (mostly in new machinery and equipment). On the other side, entrepreneurs expect slight deterioration of demand in 4Q02 (though the expectations are less pessimistic than in previous quarter); they also reported weakening of the inflow of new orders.

The indicator of consumers' optimism (WOK) increased moderately in November in relation to previous month and reached the highest level since two years. The propensity to consume increased by 2pp and the assessment of economic situation stabilised at the very high level – also the highest since two years. The annual changes of all three indices increased for the fourth consecutive month, although the improvement was less considerable than in previous months. Similarly to the last month's results, the most significant change was observed for the assessment of overall economic climate (4.3%YoY), while consumers' optimism increased by 3.8%YoY and the propensity to consume by 2.3%YoY.

...but weak monetary data do not necessarily confirm recovery in the economy

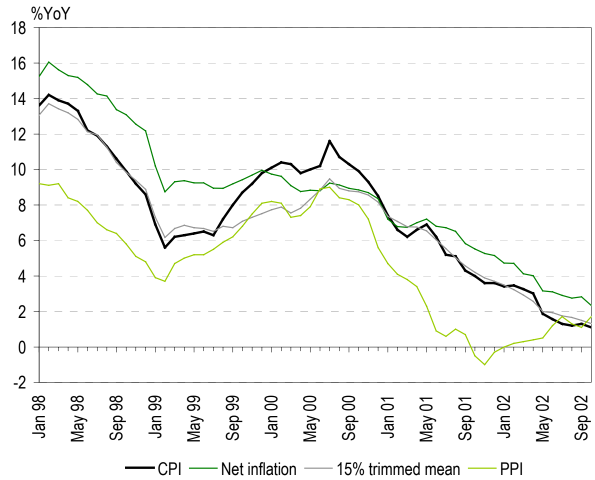
Broad money M3 increased only 0.1%MoM in October, which implied annual decline by –2.5%YoY (compared to –1.5%YoY in September and –0.2% in August). According to 'old definition', broad money growth (M2) reached 1.5%YoY, down from 2.6%YoY in September. Still, the deposits continued to evaporate out of the banking system, mostly because of the collapse of their biggest component – households' deposits. The latter fell –1%MoM and –5.6%YoY. At the same time the banking credit was virtually stagnant, reflecting hardly any signs of revival in the economy. The growth of total credit decelerated to 4.4%YoY from 4.9%YoY last month while the corporate credit grew only 0.5%YoY (-0.8%MoM). In case of households the growth was also shy, reaching 0.2%MoM and 8.3%YoY. Adjusting the series for price growth gives fairly similar results – there is fast downward trend of broad money and households' deposits, while corporate credit remains completely idle for nearly a year and households' credit gradually weakens.

Data on money and its components do not correspond well with the observed recovery in the real sector of the economy. Given that real activity accelerated already in 3Q02 (value added growth was most likely twice as fast as in 2Q02) and our conviction that this improvement would continue also in 4Q02, one could expect to see some signs of revitalisation also on the credit market. Central bank's statistics do not provide the evidence of this. This could mean that the expectations for further acceleration of economic growth should not be excessive. But also it means that the slight improvement of economic situation observed so far is not likely to exert pressure on the price growth.

Lack of inflationary pressure in the economy

Latest data from the CSO and the NBP confirmed that still there are no signs of inflationary pressure in the economy. To the contrary, inflation is very likely to fall even more in the near term and to stay low in the subsequent months and quarters.

Measures of inflation, %YoY



Source: CSO, NBP

CPI growth declined to 1.1% in October from 1.3% in September. Again, supply factors were responsible for prices increase on a monthly basis. Food prices grew by 1.0%MoM and transport prices by 0.9%MoM. The latter stemmed from 2.0% growth of fuel prices. This time also clothing and shoes prices pushed CPI upwards growing by 0.5%MoM. On the other hand, consistently with expectations, prices of alcoholic beverages and tobacco, which dropped by 3.2%MoM resulting from excise tax reduction on alcoholic beverages since the beginning of the month, were the main factor that dragged CPI down in October.

Annual growth of producers' prices accelerated considerably in October to 1.7%YoY from 1.1% recorded in September. However, this result was expected and was caused to large extent by the so-called 'low-base effect', i.e. the fact that PPI plummeted sharply at the end of 2001, following deep reduction of oil prices, and now even stable or only marginally falling prices push annual PPI growth upwards. This effect would also hold for two consecutive months, and we expect producers' price growth to accelerate further in November and December. Despite acceleration of annual growth rate, the PPI figures seem to reflect the general weakness of inflationary pressure in the economy (monthly increase are very limited). Perhaps the improvement of real activity signalled by industrial output figures is still too weak to have significant effect on prices.

It is also difficult to expect acceleration of inflation, as data on food prices and alcoholic beverages and tobacco prices in November were very positive. As we expected, prices of food and non-alcoholic beverages dropped by 0.2%MoM in the second half of November, following surprising 0.4%MoM decline in the first half of the month. This resulted in average 0.3%MoM decline for the whole November. Also, prices of alcoholic drinks and tobacco fell by 0.8%MoM, after –1.5%MoM change recorded in the first half, which suggests continuation of downward trend of alcohol prices caused by October's reduction of excise tax. Considering the above information we estimate that CPI declined slightly in November by 0.1%MoM, which brought the annual inflation rate down to 0.9%YoY from 1.1% in October.

Also the NBP's measures of core inflation surprised with the scale of its fall recorded in October. Net inflation (CPI excluding oil and food prices) dropped to 2.3%YoY from 2.8%YoY recorded in September and 15%-trimmed mean fell to 1.3%YoY from 1.5%YoY. Other three indices were below 1%YoY. Inflation excluding controlled prices reached record low level of 0.51%YoY. The fall of core inflation was deeper than the decrease of headline inflation and provided strong evidence that there is no inflationary pressure in the economy. Although it has to be stressed that the most important measure (15% trimmed mean) is still above headline figure, suggesting that CPI inflation may rise in the following months. Of course an expected increase is not likely to be significant threatening the next-year inflation target of 2-4%.

No threat for this year's budget

According to the finance ministry's data on the budget realisation after ten months of this year budget deficit after October widened to PLN34.05bn representing 85.1% of the amount planned for the whole year (against 74.4% after three-quarters). This was higher than our expectations at 78% and market consensus of 82%. However, robust budget revenues suggest improvement in the economy while the deficit is a result of faster than expected rise in expenditures. Total revenues reached 81% of the plan increasing by 1.6% in Jan-Oct period against 0.9% after September. This was a result of high growth of revenues from indirect taxes, which reached 9% in Jan-Oct period (9.4% after nine months of the year). Revenues from CIT were even better, as they grew by 11.4% after ten months of the year (compared to only 4.2% planned for the whole year) and by 24.7%YoY in October alone. Both CIT and indirect taxes revenues' performance seems to confirm gradually improving economic situation.

Total expenditures after October reached 81.9% of the plan growing by 8.1% in Jan-Oct period (above the whole year plan at 7.1%). The most remarkable growth rates (higher than after previous months) in Jan-Oct period was observed in subsidies to the Labour Fund and to the Social Security Fund, which grew by 80.6% and 36.1%, respectively. While it should not pose threat for this year's budget realisation it confirms our concerns that these funds may be a problem for fiscal policy performance also next year.

Central bank watch

- **25bp rate cut in November**
- **Following cuts will not be deeper**
- **MPC expects the improvement of economic situation**
- **How long will the zloty float?**

All rates down by 25bp in November

The MPC decided in November to cut all official interest rates one more time, this time by 25bps. The reference rate having the most direct influence on the market was reduced to 6.75% from 7%. Lombard rate indicating marginal cost of money fell to 8.75%, discount rate to 7.5% and deposit rate being bottom band for market interest rates stands at 4.75% since today. The MPC also maintained neutral bias in monetary policy.

It seems that the NBP president Leszek Balcerowicz wanted to be consistent with his earlier statements. NBP president reiterated again that "the current level of interest rates is very close to appropriate for the economic situation" and that 25bp cut does not stand in odds with the same statement expressed the previous month. Last decision brings us just closer to the end of the cycle. Also, last month Balcerowicz said, "falling CPI inflation because of lower excise tax on alcohol should not influence monetary policy", and indeed current level of inflation was not listed as an argument for the rate cut. Of course, there was no problem to find other arguments showing no inflationary pressure – core inflation measures, lower inflationary expectations, lower money supply dynamics, low wage growth, low growth in the Western Europe, especially in Germany.

The MPC said that the real economic activity data for 3Q02 and for October (production, retail sales, financial situation of enterprises, high growth in the market services sector) confirm earlier assumption about gradual improvement of the economic situation. Although, as usual, the MPC said that there are some signs suggesting cautious approach – lower growth in the construction sector, low investments in 3Q02, business climate indices, and delayed recovery in Germany. The MPC expects that the domestic demand will accelerate in the following quarters.

The MPC said that there is no threat for 2003 inflation target at the moment, but increasing inflationary pressure is possible in 2003 and 2004. The risk factors include fuel prices, possible zloty weakening at the end of 2003, expansive fiscal policy. The MPC suggested many times in the statement that present decision affects inflation in 2004, which is quite clear having in mind time lags between monetary policy decisions and the reaction of the economy. This shows also, however, that low (or very low) inflation at the beginning of 2003 would not necessarily mean much deeper rate cuts, as the MPC is already thinking about the next medium-term inflation target and the economic perspective longer than 2003. Even despite the fact that nine new members of the Council will join Leszek Balcerowicz in 2004.

Another important change was the reduction of the scale of the rate cut from 50bps to 25bps. Such a move was similar to April's decision, when the MPC decided to cut by 50bp after a series of 100-150bps reductions, which then announced the permanent shift to smaller moves in the subsequent months. We have argued before November's meeting that reducing the scale of rate cuts is likely to limit market's expectations for further monetary expansion, therefore limiting the appreciation pressure on the zloty. And indeed, similarly as in April, the investors' expectations were trimmed down. Here, it is worth to ask whether the reduction of the interest rate cut scale was a conscious decision of the MPC or was it, once again, the result of a compromise between the advocates of more aggressive easing and their hawkish opponents. We tend to believe that at least some of the MPC "doves" voted for deeper rate cut in November (the true answer will be known in January). Nevertheless, we believe that after the market interpreted the MPC decision as deliberate move and clear sign for the investors, the subsequent rate cuts will not be deeper than 25bps each. Latest MPC members' comments seem to support this view.

Despite the fact that in November the inflation rate probably fell to another record-low level (below 1%), we do not expect interest rates to be cut in December. This is because the last MPC meeting this year is scheduled for 17-18 December, which is 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. Recent comments made by Janusz Krzyżewski. Dariusz Rosati and Leszek Balcerowicz seem to confirm this view. We see another reduction of interest rate by 25bps at the beginning of the next year.

Inflation report for 3Q02

According to the NBP's *Inflation report for 3Q02* released at the beginning of December, the central bank estimates that GDP growth in 3Q02 accelerated to 1.9%YoY from

0.8% in 2Q02, amid faster growth of domestic demand (1.7%YoY) and improvement of net exports. Private consumption growth remained strong (growing 3%YoY), while the fall of fixed investments was smaller than in previous quarters (–3.4%YoY compared to -8.4% in 2Q02). NBP anticipates further improvement of economic conditions in the subsequent quarters, however the recovery would be rather slow. According to its forecast Poland will not benefit from global economic upturn earlier than in 2H03, and therefore the next year's GDP growth will amount to 2-3%.

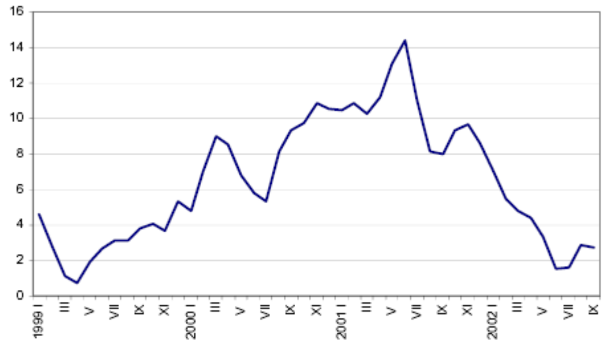
The central bank noticed only minor improvement on the labour market in 3Q02 in relation to 1H02. The employment in corporate sector continued to shrink, although at slower pace than in two preceding quarters. Nominal wages in corporate sector were growing much slower than in corresponding period of 2001, however real wages growth was similar due to much lower inflation. Also, the non-registered incomes were probably continuing strong growth amid an expansion of non-registered economy. NBP estimated that in 3Q02 the growth of households' registered disposable income was slightly lower than in 1H02 and its purchasing power increased by 0.4%YoY.

NBP remains concerned about fiscal policy. It predicts that until the end of 2002 economic deficit of public finance could reach as much as 5.5-5.8% of GDP against planned 4.8%. The report reiterates that the shape of fiscal policy in 2003 projected in the government's budget draft does not constitute any tightening of fiscal conditions and would not be beneficial for long-term growth prospects.

As regards inflation perspectives. NBP said this year's inflation target would be undershot. According to the bank, the weakening of inflationary pressure in 2Q02 was a consequence of both supply and demand side factors (on the one hand delaying economic recovery in Poland and abroad and low growth of households' disposable income; on the other hand record-deep collapse of food prices). NBP thinks that downward trend of food prices might also be continued in 4Q02.

The central bank reiterated that the level of inflation target for 2003 (3% ±1pp) implies a shift from disinflation policy into a stage of inflation stabilisation at the low level. The NBP also published its monetary condition index (MCI), which inched up a little in 3Q02 following the period of constant decline since December 2001.

MCI (base = Dec 1994)



Source: Inflation report, NBP

The *Inflation report* delivered also the detailed voting pattern of MPC members over the monetary policy decisions in 3Q02 (for details see the table below). It revealed that in July, when there was no rate cut, four MPC members (the usual 'doves') opted for 50-bps rate cut, and in August two of them proposed deeper 75-bps reduction.

How long will the zloty float (freely)?

At the beginning of December the deputy finance minister Ryszard Michalski, interviewed by PAP, made several interesting remarks about the zloty exchange rate and its perspectives ahead EMU entry. He, of course, repeated the usual government's mantra that the zloty is overvalued, having detrimental effect on Poland's economic growth and especially on the Polish exporters' performance.

Results of MPC voting over interest rates in 2002

	Jan	Jan	Jan	Mar	Apr	Apr	May	May	Jun	Jun	Jul	Aug	Aug	Sep	Oct	Nov
Change(bp)	-200	-100	-150	-100	-100	-50	-75	-50	-100	-50	-50	-75	-50	-50	-50	-25
Decision	NO	NO	YES	NO	NO	YES	NO	YES	NO	YES	NO	NO	YES	YES	YES	YES
Balcerowicz	-	-	+	-	-	+	-	+	-	+	-	-	+	+	n/a	n/a
Dąbrowski	-	-	-	-	-	-	-	-	-	-	-	-	+	-	n/a	n/a
Grabowski	-	+	-	-	-	+	-	+	-	+	-	-	+	-	n/a	n/a
Józefiak	-	+	-	-	-	+	-	+	-	+	-	-	+	+	n/a	n/a
Krzyżewski	-	-	+	-	+	+	-	+	-	+	+	-	+	+	n/a	n/a
Łączkowski	-	+	-	-	-	+	-	+	-	+	-	-	+	+	n/a	n/a
Pruski	-	-	-	-	-	-	-	+	-	-	-	-	+	-	n/a	n/a
Rosati	+	-	+	+	absent		+	+	+	+	+		absent		n/a	n/a
Wójtowicz	+	-	+	+	+	-	+	+	+	+	+	+	+	+	n/a	n/a
Ziółkowska	+	-	+	+	+	-	+	-	+	+	+	+	+	+	n/a	n/a

Source: NBP, Government monitor

According to Michalski the Ministry of Finance plans to begin purchases of foreign currencies for interest payments on Polish foreign debt directly on the FX market. Such a solution was proposed several months earlier by the MPC as a way limiting the appreciation pressure on the zloty. It seems that the FinMin wants to return to the idea and the first operations of that sort might take place in the spring. The spending on foreign debt servicing amounts to PLN4.7bn next year, which means that the government would buy some US$1.2bn on the market. Additionally, Michalski announced that at the beginning of 2003 FinMin would launch new issues of foreign currencies denominated: in the US, Japan, and UK. In April the ministry plans to buy back another part of Polish Brady bonds.

Michalski said that FinMin and the government believe that it could be a good idea to replace current FX regime with the managed float system before joining the ERM-2 system, as it would create a useful tool for affecting economic activity and avoiding excessive exchange rate volatility. Unfortunately, said Michalski, such a move is unfeasible at the moment, because it requires the central bank's agreement, while at present the NBP does not want to change the FX regime. The minister suggested that "the next MPC" (i.e. after the replacement of nine current members by the new ones) might be definitely less conservative, which might be a hint that the government hopes to change the FX regime at the beginning of the new MPC's term (at the beginning of 2004).

Michalski said that after the date of the EU enlargement has been delayed until May 2004, the beginning of 2007 is the earliest possible date of Poland's EMU entry. It means – said minister – that all of the Maastricht convergence criteria, except the one regarding exchange rate, must be fulfilled in 2006, which allows for some additional "breath" in the reform of public finance. However, he said there is still high probability that Poland would be able to lower budget deficit below 3% of GDP already in 2005. It seems that the government is already thinking about softer approach to the budget for 2004 and most likely this would not be a significant step of the necessary reform of public spending.

Short after Michalski's interview the NBP issued official press release on its website. It said that the central bank welcomed the ministry's declaration about buying foreign currencies on the market, however it reminded that the strategy of direct inflation targeting adopted by the MPC rules out the possibility of targeting exchange rate at the same time. Still, said the statement, "NBP does not rule out the possibility of matching direct inflation targeting with introduction of a wide band for exchange rate fluctuations around market-determined parity". The latter sentence was very surprising, as it contradicted the view presented up to date by all MPC members and NBP governor Leszek Balcerowicz. We believe, however, that it does not mean that central bank's official stance has changed, but rather is a consequence of a misunderstanding or a confusion within the NBP. This surprising statement was followed immediately by several MPC members' comments in the newswires. Both Grzegorz Wójtowicz and Bogusław Grabowski said that still in the MPC's opinion the introduction of band for currency fluctuations is very unlikely and should be ruled out. The press release was probably issued by the deputy NBP president Andrzej Bratkowski, while Leszek Balcerowicz was on a trip abroad. One day later Bratkowski explained in *Rzeczpospolita daily* that the above mentioned sentence simply meant that the NBP does not anticipate 30% zloty exchange rate fluctuations under normal economic circumstances. Therefore, we argue that abandoning the free float of the zloty is still very unlikely until the end of this term of the MPC. However, at the beginning of 2004 the government might want to force through the shift into managed float that would be aimed at some weakening of the zloty before the ERM2 entry.

Comments of the MPC members and central bank representatives

The first half of November saw very few appearances of the central bank representatives in the media. In their few statements, the MPC representatives (we recorded the statements of Wiesława Ziółkowska and Grzegorz Wójtowicz only) emphasised their believes that given the marginal dynamics of inflation processes not only this year's inflation target but also the next year's one are safe. After the release of data on the historically low inflation in October, Janusz Krzyżewski – a representative of doves in the MPC, mentioned even a threat of deflation in the Polish economy. As the month went on, the other members of the MPC also made some public statements envisaging that the inflation processes should stay under control in the near future.

Besides the inflation prospects, in the previous month the NBP officials focused on the exchange rate issues. All the MPC members making statements on this issue excluded the possibility of effecting the FX interventions. Some confusion was causedw by the observations of Dariusz Rosati in his interview for Reuters. He said that the central bank would not focus on the reduction of inflation any more, but rather on its stabilisation, which is to bring about a shift in focus in the monetary policy. The substantial appreciation of the zloty, the NBP was ready to accept while reducing the inflation, currently is redundant and causes the excessive cost for the economy. Rosati observed that the zloty appreciation reflects a speculative inflow of portfolio capital resulting from high expectations of interest rate cuts. Rosati suggested that the MPC could be willing to limit the zloty appreciation pressure, but excluded the possibility of FX interventions at the same time (at least in the short/medium term) and/or change in the exchange rate regime. Instead, he mentioned the possibility of decreasing interest rates by the central bank, as the cuts would limit the speculative demand for the zloty related to market expectations for interest rate cuts.

Rosati's statement busted the expectations for the interest rate cuts but it was soon neutralised by the statements made by two other members of the MPC – Bogusław Grabowski and Cezary Józefiak. According to Grabowski, the zloty appreciation on the Polish financial market is excessive, as investors are overoptimistic in their assessment of risk related to Poland's accession to the EU. He said that these overoptimistic expectations will certainly be considered at the next meeting of the MPC, but he added that the MPC should not follow the market [cutting interest rates]. Moreover, Grabowski stated that the MPC does not ignore exchange rates, but it does not think of any target the zloty exchange while making the decisions on the inflation target. Cezary Józefiak said that he was not sure if the interest rate cut would support the zloty depreciation, as the currencies appreciation observed in the better part of countries within our region results from deeper and more fundamental reasons. On the contrary, Józefiak reckons that even an interest cut of 50bp would bust the market expectations for deep loosening of monetary policy and (most probably) it would support further zloty appreciation. In turn Marek Dąbrowski said that the recent zloty appreciation is related to the process of the UE integration and agreed with Grabowski, that markets do overshoot. Rosati said, a few days after his initial statement suggesting that a cut in interest rates could be a way of weakening the zloty, that it would be illusive to think that the zloty could be weakened for good. He added that the zloty appreciation scale is not alarming for the economy and expressed his opinion that the zloty will continue to appreciate and will remain strong by the end of its life.

Just before the MPC meeting, Bogusław Grabowski gave a comprehensive interview for PAP agency. He said that the next medium-term target of the monetary policy would depend primarily on the government's declaration related to the date of Poland's readiness to meet the Maastricht Treaty criterion on the budget deficit. In his opinion reduction of the budget deficit down to below 3% will be the most difficult criterion to be met by Poland and the government should declare if it is capable of effecting the necessary reforms of the public finances. Grabowski commented also the GDP growth and inflation prospects. He expects the GDP growth to accelerate in 2H03 (he expects the growth to range from 2% to 3% in the entire 2003), but its scale will depend on the situation in the global economy. Grabowski said that the accelerated GDP growth would result from the investment demand recovery. However, he believes that the investments will be lower than projected, while the consumption will exceed the expected levels. He added that should this situation be continued in the longer run, it may represent a threat to the macroeconomic stabilisation.

After the MPC meeting, Leszek Balcerowicz – president of the NBP, emphasised again that "the current level of interest rates is very close to the level adequate for the existing economic situation", and that the cut of 25bp is not contradictory to the same statement made previous month. Asked about the inflation forecast of the Ministry of Finance of 0.8%YoY in December 2002 he said that it is not impossible that CPI could go down below 1%YoY as at the year end. However, he emphasised that the decisions on the monetary policy are not made based on the data for a given month, but are rather developed based on the future projections. Balcerowicz added that the lower than expected October's CPI resulted mainly from the deflation in the food market and the decrease in the fuel prices, and these factors may not be projected and do may be only temporary.

WHO, WHEN, WHERE	COMMENT
Leszek Balcerowicz, NBP president; PAP, 27 Nov	Decreased scale of cuts is a signal [that the interest rates are approaching level perceived by the MPC as appropriate]. During this cycle of interest rates reduction the Council has consequently shifted from bigger scale of rates cuts to smaller ones and there was no case of reverse situation. This is not an accidental strategy. Data concerning October in relation to the corresponding month of the previous year suggest continuation of the gradual recovery. [...] Relatively high growth rate of retail sales is maintaining. The exchange rate volatility is a natural phenomenon to some extent in our FX regime [i.e. free floating]. The interest rates level and its changes are not the only factor, which affect it [the exchange rate]. Along with fall of interest rates the meaning of this factor is diminishing. Short-term exchange rate movements during a month cannot be an argument for decision on interest rates or at least this is not a sufficient argument. Stronger arguments are needed.
PAP, 22 Nov	[Joining the Eurozone] will be a really difficult task from the budget consolidation's point of view. It is also important for macroeconomic stabilisation. Early meeting of Maastricht criteria is supportive for economic growth. The key factor is the fiscal policy's discipline. Early membership in the Eurozone would also help in stabilising inflation at a low level, would stabilise FX market and would create good conditions for the Polish export development and FDI inflow. A strategy of joining the Eurozone does not require economic costs but political courage.
Jerzy Stopyra, Deputy NBP governor; PAP, 22 Nov PAP, 21 Nov	I think that one should expect reduction of obligatory reserve requirements the next year. The date and scale of reduction will depend on the situation on the liquidity in the banking sector. This [zloty strengthening] is fundamentally justified. We see no speculation. We are monitoring it all the time, and the monetary policy is being adjusted to this. Zloty exchange rate is determined by self-sufficient market mechanism. If the market perceived data on our economy very positively: good GDP growth figure in 3Q02, very good situation in balance of payments, low inflation, moderate budget deficit, than it priced in these positive data. The market is self-sufficient. If too strong zloty weakens foreign trade trend than the zloty will weaken for this reason.
Marek Dąbrowski, MPC member; NBP's press conference, 27 Nov	Speculations in the region are connected with the process of the European integration. Market reactions do often overshoot. It is related to the fact that the global economic situation increases interest rates disparity and there are not many investment opportunities to invest with low risk.
Bogusław Grabowski, MPC member; PAP, Reuters, 27 Nov	This is not true that the exchange rate is ignored [by the MPC] but this is natural that in direct inflation targeting strategy the MPC has not any targeted level of exchange rate. Monetary policy will not make any decisions on interest rates level, which would be aimed at depreciation or appreciation of the exchange rate, i.e. the MPC will not pursue any intermediate target in monetary policy.

PAP, 26 Nov	The convergence process is too deep. The market underestimates risk connected with fiscal policy. Investors may realise that the convergence process of nominal interest rates is too deep and too fast. As a result [in 2003] we may see slight increase of long-term interest rates coupled with depreciation of the zloty. The MPC is working on the medium-term strategy of monetary policy after 2003. We have to set another [medium-term inflation] target and it will be based mainly on the date of EMU accession. This date is to be set by the government. The government has to declare when it will be ready with fiscal criterion [budget deficit below 3%]. For better co-ordination of fiscal and monetary policy the government should decide whether is possible to carry out public finances' reform. [...] It seems to me that many politicians do not realise what declaration of reducing budget deficit below 3% in 2005 means. If public finances reform will not be carried out in 1-2 years we will experience very lax fiscal policy and overly loose monetary policy. Foreign investors will withdraw from the Polish market, as they will stop to believe that Poland is on the right path to the EMU. The problem is that one cannot count on fast and significant economic recovery because we still have stagnation in the world economy. GDP growth will approach 1.5-2% in 3Q02 and it will maintain on more or less this level in 1H03. The economic growth will accelerate in 2H03, which will mean the whole year growth at 2-3% in 2003. [...] This is wide range but it well reflects uncertainty connected with the global economy situation. GDP growth in the nearest months will accelerate and it will be driven by recovering investment demand. However, investment process will be slower than we expected while consumption will be stronger than predictions. (...) Consumption and net exports strengthened economic growth in 3Q02 but if GDP growth will be based on consumption and it will not be followed by higher investments then it will not be good for macroeconomic stabilisation in long-term. [Economic recovery in 2003] will be connected with domestic demand rebound and recovery in the global economy. It will be followed by increase of fuel and raw materials prices, which always precedes economic recovery. We may also experience stronger growth of food prices. (...) Along with inflation increase inflation expectations may rise and this may lead to higher wage pressure but on the other hand it will be constrained by bad situation on the labour market.
Puls Biznesu, 18 Nov	Decreasing of the overliquidity in the banking sector should be easier in the future. In 2004-05 the banking sector may come through from overliquidity to lack of liquidity. [...] The intervention rate will be a maximum interest rate on the money market instead of being a minimum one. The autonomy of monetary policy will be gradually constrained. [...] Arbitrage made by financial markets co-decides about the level of interest rates. The pace of nominal convergence of short-term interest rates depends at the moment mainly on credibility of fiscal policy. [...] The most important is that just after the end of work on 2003 budget finance minister should begin preparing deep reform of public finances. The biggest threats will arise at the end of 2003 and in 2004. Now, we will decide, to what extent these threats will arise in the future. If the MPC will cut rates deeply. it does not mean overshooting of the inflation target. but may be dangerous for meeting Maastricht criteria in 2005.
Cezary Józefiak, MPC member; Reuters, 22 Nov	I doubt if decreasing interest rates disparity would help in weakening the Central European currencies. I am not convinced that the difference in interest rates is the main reason for that, although it is one of the reasons. Some factors standing behind strengthening of the zloty are unavoidable. Investment funds seek investment opportunities and bearing in mind troubles in Argentina and Brazil they have no other place to invest. I would be against FX interventions as long as we have free float exchange rate regime.
Janusz Krzyżewski, MPC member PAP, 15 Nov	We are approaching the moment, when we have to be very cautious not to cause the deflation and surely it will be very important element of our deliberations. We have to consider whether there would be continuing stagnation and whether we are entering the deflation danger zone. Nevertheless nominal growth of inflation reflects the improvement of economic climate. I rule out the possibility that inflation exceeds 1.4% at the end of this year. [...] And in December 2003 inflation should not be higher than 2.5%. Our goal is to adjust the rates in well-known direction and we proved this. One has to remember that our operations cannot cause irresponsible exchange rate correction and cannot cause complete destruction of propensity to save. We model our steps a lot. For sure most of the colleagues looks at the exchange rate with calm. I rule out the possibility of interventions, because it is the essence of free exchange rate. But I would also prefer the zloty not to fluctuate in such manner.
Dariusz Rosati, MPC member; TVP1, 29 Nov PR3, 25 Nov	The economy is gradually bottoming out but the pace of recovery is very slow. There will not be significant improvement in the nearest months. It is good that the economy is gaining the momentum because it means that the unemployment rate will not rise. The main weakness of the budget [for 2003] is that it does not include any form of public finances' reform, i.e. any efforts aiming at decreasing of rigid expenditures and increasing bigger resources on investments. Income side of the budget raises much concerns, casts much doubts on, above all, the assumed pace of the economic growth. This is ambitious assumption and not everyone agrees with it. (...) The Polish economy has a chance to grow by 3-3.5. Maybe this is the upper end of possible growth in 2003 but it is surely not impossible. What is much more negative is the fact higher growth of wages is assumed, which is not coupled with increase of labour productivity. The main of source of the zloty strength is a clear perspective of Poland's accession to the EU. After the Irish referendum and solution of the problem in the Netherlands, after Brussels summit agreement on financial conditions of the enlargement, it seems not that there is nothing, which could stop the process. The pace of the zloty strengthening is not alarmist. In my opinion the zloty is slightly too strong taking into account fundamental factors. (...) In general, in 2-3 years the zloty will remain strong currency and we have to prepare for this. It is illusion that one could permanently weaken the zloty, unless the government declare that it does not want to enter the EU. Then we would have weakening. But if strategic prospects will not change. the zloty will remain strong until the end of its existence.
Reuters, 21 Nov	Over the last several months inflation is at a satisfactory level, where we don't want to lower it, but stabilise it. This means that we can change the accents in monetary policy. The MPC had been willing to apply a certain dose of zloty appreciation to limit inflation – through lowering the price of imports - but that in the present price environment the Council did not have to pay that cost. Strengthening of the zloty exchange rate to lower inflation is no longer needed, and it is harmful. The zloty is strengthening and this is not a result of direct capital inflow in Polish instruments but this is clearly speculative inflow stemming from expectations for rates cut. Strengthening of the zloty leading to further drop of inflation is no longer needed, and it is harmful. We have a few possibilities. Cutting interest rates we will decrease that part of demand for the zloty, which results from expectations for rates cut. We still have such a possibility. [...] Another possibility is intervention on the FX market. Theoretically, there is such possibility. We have never said that we will never intervene but we have reiterated that FX interventions are costly and not effective. The other possibility is to change the exchange rate regime. [...] These are dramatic choices. We will have face them if the capital inflow to Poland will be so much that we will not avoid strengthening of the zloty to such a level, from which it will have to sharply fall. At the moment we are not in such a situation.

PAP, 20 Nov	When taking up monetary policy decision, still we take into account macroeconomic factors, including mainly the level of future inflation. Present zloty FX rate is not a principal argument determining interest rate cut. Zloty FX rate is not a threat at the moment, in a sense that I do not expect any collapse. I cannot see any threat from inflation side; there is no inflationary pressure. Inflation should amount to about 1.5% at the end of this year and 2-2.5% at the end of 2003. Strengthening of the zloty is a phenomenon that could not have been avoided, since it resulted from accumulated structural and cyclical factors. Structural factors, i.e. intensity of positive information related to Poland's accession to the EU were heightened by good foreign exchange figures and expectations of interest rate cut. For the next year I see some uncertainties that could cause a weakening of the zloty, among which uncertainty concerning the result of accession referendum after recent local elections and uncertainty related to exchange of MPC members on turn of the years 2003-04. If zloty strengthens for structural reasons, i.e. related to Poland's accession to the EU, than intervention on the market would be ineffective, expensive and impermanent. Intervention against the market would be ineffective.
Rzeczpospolita, 20 Nov	The zloty is somehow stronger than it should be taking into account fundamental factors such as: export performance, foreign direct investment inflow or fiscal situation. Polish currency is additionally strengthened by positive development in the EU accession process and market expectations for interest rates cuts. It was supported by latest economic figures including data indicating further drop of inflation. In 2003 the zloty should weaken, which will be related to accession referendum in May or appointment of the new MPC. [...] The MPC has to take it into account in its decisions. Such rapid fall (of the zloty exchange rate) would cause inflationary pressure. On the other hand the MPC takes into account that presently high exchange rate causes inflation decrease through a fall of import prices.
PAP, 20 Nov	October's industrial production data confirm a slow economic pick-up but the pace is still not bewildering. Growth rate is still very weak. GDP will rise by 1.5-2% in 3Q02 and in 4Q02; I count on 2.5% growth. I estimate that if results of the last two quarters match the expectations than [in 2003] we could expect GDP growth of 3.5%. Situation in real sphere, on FX market and labour market make it almost certain that there are no inflationary threats in next several quarters.
Grzegorz Wójtowicz, MPC member; Reuters, 25 Nov	Since March we have significant fluctuations of this indicator [retail sales] amid seasonal factors. In this case [October's figures] sales of school products and some products specific for this period of the year. Therefore I am not surprised with high growth – this is a normal reaction of the economy. I think that GDP growth at 1.3% is the most probable this year, but we cannot exclude a possibility of 1.4%. [...] I think that growth in 4Q02 will be similar to 3Q02. There are no negative signals. Starting from now [October] inflation indicators will stabilise or increase moderately.
PiG (Law and Economy daily), 22 Nov	Information about increased profit of the NBP presented in this way may suggest existence of some hidden accounts or creative accounting. There are no such practices and the matter [increased profit of the NBP] has been known for weeks. Not revealing it for the public previously enough caused unnecessary emotions.
PAP, 15 Nov	In October inflation fell to a lower level than I had expected, that means 1.1% from 1.3% and this allows for correcting inflation forecasts for the end of the year to barely 1.3-1.5%. Unexpected inflation collapse this year is caused by deep fall of prices of food and fuels and strong zloty. Of course one cannot hope that those factors would last forever. There is no inflationary pressure at the moment, and the possible rebound of inflation next year should not be sharp. Therefore inflation rate at the end of 2003 should reach at most 2-2.5%. In 2003 GDP is likely to grow by ca. 3%, although exceeding 3% would be extremely difficult. It is hard to expect that external demand or investments would be the driving force behind GDP growth.
Wiesława Ziółkowska, MPC member; Reuters, 28 Nov	Nothing indicates that there will be important factors for strong weakening of the zloty. Not only interest rates and expectations for their further cuts influence the zloty, but also convergence play, economic situation in the Eurozone and in the United States, as well as fears concerning conflict with Iraq.
PAP, 25 Nov	There are no demand factors that could threaten inflation. At the end of the year inflation will be lower than it was forecasted just a few weeks ago. Inflation will be below lower end of the [inflationary] target.
PAP, 7 Nov	The central bank will act in line with its strategy i.e. it will not intervene on the FX market unless the inflation target is in danger. There is no such threat now. I expect that CPI at the end of this year will be below inflation target and will reach around 1.5% and in 2003 inflation should be within the inflation target range. Strengthening of the zloty does not stem from the latest rate cut, but from portfolio investment inflow. Investments in the western Europe and in the USA are less attractive now. An interest rates disparity is still high.
Tomasz Pasikowski. NBP Board member; PAP, 21 Nov	We have modified a 2002 financial plan to increase the profit. The profits will be higher thanks to cost lowering, higher revenues from reserve management and doing away with a part of foreign exchange rate risk reserves.

INFORMATION AFTER THE MONETARY POLICY COUNCIL MEETING ON 26-27 NOVEMBER 2002

The Monetary Policy Council held its meeting on November 26-27. 2002. The Council was submitted the materials prepared by the Management Board and departments of the NBP as well as information and analytical materials prepared by the Ministry of Finance, banks and research institutes. The Council discussed the external conditions of the Polish economy and tendencies in the real sector of the economy, in the area of wages and social
Benefits, in public finance sector, in the area of money supply, lending and interest rates, and the formation of inflation expectations, prices and the inflation outlook.

Decision of the Monetary Policy Council

In October 2002, in the economy dominant were still the developments that supported the strengthening of a low level of inflation:

- all core inflation measures lowered,
- inflation expectations of both, individuals and bank analysts, have stabilised at the same low level as a month before.
- the annualised dynamics of total money supply lowered visibly, the dynamics of cash stabilised, and the annualised dynamics of lending remains at a low level,
- a moderate wage growth – in conditions of a high level of unemployment – does not threaten in a form of the increased inflation pressure,
- the growth forecasts of the world economy. Including, in particular the German economy, indicate that the economic boom can be expected only in the 2nd half of 2003, and it will be much slower than forecasted a month ago.

The factors that decide on the economic growth – and indirectly on inflation tendencies – in 2003 and 2004 rather confirm the earlier data on a gradual improvement of the economic activity.

- In the 3rd quarter this year
- the added value in industry increased,
- the drop of the volume of construction and assembling production decreased,
- the data on the improvement of the financial situation of enterprises got confirmed,
- a high sales dynamics in sections included into market services was maintained,

A higher pace of the GDP growth in the 3rd quarter is a positive signal, especially at the background of the worsening economic situation in Germany.

- In October:
- the sold industrial output was bigger than in the same month last year by 3.2%,
- the retail sales dynamics increased. in nominal terms it was higher by 5.1% than in the same month last year.

However, there is still uncertainty about the permanence of the boom:

- The drop of construction output got bigger (from 6.1% to 8.8%),
- Latest results of the economic situation research made by GUS indicate worsening of the climate in processing industry, construction, and retail sales.
- Despite the improvement of the financial situation of enterprises, the investments expressed in fixed prices after three quarters were – like in the 1st six months this year - lower by 15.5% than in the same period of 2001 (this drop, however, was related to enterprises that hire more than 50 employees. so in this situation it does not decide on the scale of the investment drop taken into consideration in national accounts),
- The latest forecasts shift in time again the moment of the economic boom in Germany what results in shifting the period of the accelerated growth of Polish exports into the second half of 2003.

Summing up, it should be said that the growth pace of domestic demand within the quarters to come would gradually increase. The process of integration with the EU, especially in 2004 and in the following years, will contribute to the acceleration of the investment growth.

There are still factors that can make it difficult to stabilize inflation on a low level:

- Despite the fact that oil prices on world markets lowered in October, the uncertainty connected with the conflict concerning Iraq makes it necessary to expect their rise again,
- In October, the third month in a row already, the deposits of households placed at banks dropped, in part as a result of the lower interest rates and the introduction of the tax on interest income,
- Despite a very low dynamics of monetary aggregates, it is difficult to assess precisely what will be their delayed reaction to the already made decisions on the interest rate cuts that as related to 2001 are at a radically lower level,
- There is a threat of a bigger than planned in the draft act on the state budget for the year 2003 economic deficit of the public finance sector, mainly as a result of a bigger shortage of this sector units beyond the state budget.
- The rise of sale prices in industry in 2002 is the evidence of these prices high sensitivity to a change of the exchange rate of the zloty. Together with the improvement of the economic growth dynamics, there should be expected the increased current account deficit of the balance of payments what would depreciate the zloty. In this situation, it cannot be excluded that in the 2nd half of 2003 and in 2004 two factors that increase the inflation pressure will be cumulated: the increase of domestic demand and the drop of the exchange rate of the zloty.

That is why, although now there are no serious visible threats to the accomplishment of the inflation target in 2003, the increase of inflation pressure by the end of 2003 and in 2004 cannot be excluded.

The Monetary Policy Council acknowledged that, from the point of view of future inflation, factors reducing the inflation pressure have got a bigger impact than factors threatening the inflation stabilisation and decided to:

- **cut the lombard rate from 9.0% to 8.75% annualised;**
- **cut the rediscount rate from 7.75% to 7.50% annualised;**
- **cut the minimum yield on 28-day open market operations to the amount 6.75% annualised;**
- **cut the deposit rate (for term deposits placed by banks at the NBP) to the amount 4.75% annualised.**

The Council maintains its neutral position in monetary policy.

The Monetary Policy Council has approved the financial plan of the NBP for the year 2003 and has continued its discussion on a medium-term strategy of monetary policy for the period 2004-2006. The Council has also accepted the Report on Inflation in the 3rd Quarter 2002.

The next meeting of the Monetary Policy Council will be held on December 17-18, 2002.

I. Evaluation of the economic situation

In the 3rd quarter this year, the added value in industry increased, the drop of the construction and assembling production volume decreased, and a high sales dynamics in sections included into market services was maintained. The increase of domestic demand resulted from a further decrease of the accumulation drop and still high dynamics of individual consumption as compared to the increase of gross income at disposal of households. Despite a low dynamics of income growth, the dynamics of retail sales volume increased. At the same time, deposits dropped and lending to households grew faster. Both these phenomena at the same time are the evidence of a further drop of savings rate. The data prepared by GUS on foreign trade turnover in the 2nd quarter 2002 show that the dynamics of exports accelerated considerably. The volume of Poland's exports in the 2nd quarter 2002 grew at the pace 7.4% despite a slow economic growth in Germany (0.1% of GDP in the 2nd quarter 2002) and in the euro zone (0.7% of GDP in the 2nd quarter 2002). On the basis of the information on payments for exports it is assessed that a big growth pace of exports volume has also been maintained in the 3rd quarter what indicates the increase of the demand driven elasticity of the Polish export. It can be assumed that the strengthening of the Polish export reaction to a growth of demand from abroad is of a permanent nature and is a result of the restructuring in exporting enterprises made within the period 2000-2001.

A clear strengthening of political risk world-wide in the 3rd quarter this year resulted in a considerable worsening of consumer confidence indices in major economies. The most visible it was in the USA where the Conference Board's index measuring confidence of American consumers dropped in October as compared to September this year by over 14 points, therefore at a similar scale as after the events of September 11, 2001when this drop amounted to 17 points. The index of German consumers' confidence also declined from the level –5 in September this year to –11 in October.
However, there were no big drops of indices reflecting Improvement of economic situation in the 3rd quarter this year confidence of entrepreneurs. It was, inter alia, affected by such factors as good results in the area of labour efficiency and growth in the U.S. economy in the 3rd quarter, and the stabilisation of the situation at stock exchanges. A positive signal for international financial markets was a bigger than expected interest rate cut by FED and the announcement of the President Bush administration about more fiscal steps in order to boost the American economy.
A favorable signal for the economic situation climate in the region of accession economies was also the official approval of the date of the European Union enlargement for the next 10 countries.

Still, a factor connected with a high level of uncertainty is the formation of oil prices on the world markets.
Until the half of October, oil prices have been maintained at a high level of about USD 28. Since the second half of October, however, the prices for that raw material dropped what resulted from the relaxation of a direct threat of the war in the Persian Gulf. Within the price of oil, the so-called war premium has been reduced. The average oil price in October this year amounted to USD 27.6 per barrel, so it was lower by USD 0.8 than in the previous month.
The price drop was also affected by the information on a further increase of oil production by OPEC member countries, despite the earlier decision on maintaining the existing limits at the unchanged level. However, the oil prices drop did not last long, in November the price rose from the level of USD 22.8 per barrel on November 14 to USD 24.85 per barrel on November 25 this year.

II. Situation in public finance sector

The accomplishment of the state budget after ten months this year means that there is no threat of exceeding the statutory level of budget deficit. The advanced accomplishment of the annual plan of the state budget revenues indicates that it is possible to reach the level of budget revenues that is close to the one planned in the act on the state budget for the year 2002. The financial effects of systemic changes that became effective in the 4th quarter this year, i.e. the decrease by 30% of the excise tax on alcohol products and the quarterly settlements of VAT by small and medium-size enterprises do not result – according to the information from the Ministry of Finance – in an essential decrease of the state budget revenues. It is mainly the result of a very little interest of enterprises in the new system of settlements. The dynamics of the state budget expenses in October this year was high what was, inter alia, related to high costs of the debt service, the increased subsidy for FUS, and transferring the funds for the teachers' salary rises (the accomplishment of the 3rd stage of the education reform). After ten months the state budget expenses were higher by 8.1% than in the same period last year, but the index reflecting their accomplishment as compared to the plan was not much different than the ones reached in the previous years. The outlook for achieving the planned amounts of revenues in 2002 will probably not make it necessary to reduce the budget expenses. Within the recent months, the financial situation of FUS and FP was still unfavourable. These funds will note a big excess of expenses over the revenues that is financed by bank loans. Only the financial situation of the Agricultural Market Agency looks a bit more favourable than it resulted from the forecasted accomplishment inserted into the act on the state budget for the year 2003. According to the NBP forecasts, the economic deficit of the whole public finance sector in 2002 will be at the level of about 5.8% of GDP, i.e. by 1 percentage point bigger than planned in the draft act on the state budget.

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

In October 2002, the M3 money supply increased by PLN 0.35 billion. This increase would have been bigger if there were not a strong appreciation of the zloty. After eliminating exchange rate differences, the growth of M3 would have amounted to PLN 1.7 billion. The annualised dynamics of money supply has been getting lower since May this year and it is the third month in a row when it is negative. In October it amounted to -2.5%. However, the annualised dynamics of cash in circulation stabilised: it amounted to 14.8% as compared to 14.6% in September and over 18% in previous months. October 2002 was the third consecutive month when a material drop of deposits placed by households was noted – it amounted to over PLN 2 billion (after eliminating exchange rate differences. this drop would be lower by PLN 0.6 billion). The annualised dynamics of deposits of households is accompanied by a strong downward trend, in October it amounted to –5.6%. In October, as compared to September this year, the drop of loans to both, businesses and households, was noted. Annualised dynamics of these categories in October this year amounted to 0.5% and 8.3%, respectively, while in September this year these amounts were 1.2% and 8.4%.

As compared to September this year, in October – after a positive result of the referendum in Ireland – the zloty visibly appreciated against both the dollar by 0.7% and the euro by 0.3%. In November, the appreciation tendency of the zloty was stronger. Within the period November 1-25, the exchange rate of the zloty appreciated by 4.6% and 2.9%, respectively.

IV. Prices, inflation expectations

In October this year, the 12-month inflation lowered to the level 1.1% as compared to 1.3% in September this year. The lower annualised growth pace of prices in October this year results from the drop of prices for alcoholic beverages what was related to the decrease of the excise tax on alcohol products and a drop of prices for tobacco products as well. In October, the foodstuffs together with non-alcoholic beverages, alcohol and tobacco products got more expensive by 0.3%, while in September by 0.6% and by 0.6% a year ago. The prices for foodstuffs and condiments dropped within a year by 2%.
The annualised index of the sold industrial output prices in October amounted to 1.7%. It was affected by the price rise: in the section production and supply of electric energy, gas and water by 6.9%, in mining and quarrying by 1.0%, and in industrial processing by 0.8%. Therefore, there is still the phenomenon of the biggest increases of output prices in sections with limited market mechanisms. Inflation on a low level supports the enhancement of low inflation expectations. In November this year, inflation expectations of both, individuals and bank analysts, stabilised. The 12-month inflation rate expected by bank analysts at the end of this year amounted to 1.5% as a month before, but the expected annualised inflation rate (October 2003) amounted to 2.5%. The mid-year inflation rate forecasted for 2004 amounted to 2.7%. The inflation rate expected by individuals within the year to come amounted to 0.9%, as in October this year.

Government and politics

- **Sejm passed the budget for 2003**
- **Tax abolition against the Constitution**
- **The proceeds from restructuring lower than planned**
- **...but budget revenue secured by the NBP profit**
- **Budget for 2004 remains a significant problem**

Higher NBP profit saved budget revenues in 2003

In November the Constitutional Tribunal unanimously rejected the tax abolition bill accepted by the parliament, that constituted one of the major elements of the Grzegorz Kołodko's "rescue package" for the economy. This means that next year's budget revenues would be lower by PLN600m. What is more, it is clear now that budget receipts from the government's restructuring package will be also much lower (probably by PLN700m) than planned due to low interest in the programme among the entrepreneurs.

Nevertheless it turned out that finance minister Grzegorz Kołodko had no problems at all with filling up the gap in the budget's revenues amounting to PLN1.3bn. The finance ministry submitted the amendment to the budget bill, according to which most of the revenue shortage would be covered by higher transfer from the NBP profit that would amount to PLN4.681bn instead of PLN3.567bn (net increase of PLN1.113bn). The residual gap would be closed by three other sources: higher revenues from excise tax (mostly on alcohol, PLN83m), higher custom inflows (PLN60m), and lower costs of debt servicing (PLN43.4m).

The biggest position on the above list – the increase of NBP profit was officially confirmed by the central bank. According to the NBP, the revision of the bank's forecasted profit for 2002 is based on the following arguments: higher income from the management of foreign exchange reserves, higher revenues from exchange rate operations, declining costs of open market operations, reduction of bank's operational costs. Ironically, the government's problems with the budget have been solved this time by the NBP, the same institution that was blamed for all economic problems and hampering government's economic policy; and at the same that strongly criticised the budget draft in October.

Budget passed by Sejm, healthcare contribution increased

At the end of November the Lower House accepted the budget for the next year. As one could expect, the deputies smoothly accepted all amendments shifting some revenues and expenditures, which did not change the general assessment of the budget draft that we presented in the October's MACROscope. However, the deputies decided also to increase the share of PIT financing healthcare funds from 7.75% to 8% (interestingly enough, this was the proposal of the opposition party Law and Justice). What is more, according to the proposed amendment, only a part of this contribution (7.75%) could be deducted from the tax, which is another factor increasing the effective tax burden next year.

The Upper House made several amendments to the budget bill, shifting some minor expenditures and marginally increasing both spending and revenues. Voting over Senate's amendments is planned during last Sejm's session this year on 17-20 December. If President Kwaśniewski signs the bill before the year-end, it would be the first time in the history of Poland's modern democracy that the work on budget bill will be completed before the end of year.

In general it seems that the changes made to the budget during last stage of work in the parliament should not create additional risk for realisation of the next year's budget revenues. Anyway, as we have written before, even in case the revenues turn out to be lower than planned by PLN1-2bn, the government should not have significant problems with keeping the deficit under control. It would be possible to cut current expenditures then (or postpone them until 2004) as was the case many times in previous years.

The finance minister will face much more severe problems when constructing the budget for 2004, because of sizeable "rigid" costs related to the EU accession (we have written more about this in the previous issue of MACROscope). Because of that, the Polish government decided to change the negotiation stance and asked to reduce the Poland's contribution to the Union's budget by 80% in 2004, 60% in 2005 and by 40% in 2006. The government proposed also an alternative solution – assuming that if Poland has to pay full premium, it should receive an adequate compensation payment from the EU.

Comments of the government members and politicians

The exchange rate issues, similarly as in the case of the central bank officials, dominated in comments of the government's members and politicians. However, their opinion was completely different than those of central bankers. The zloty exchange rate is seen as overvalued not only by finance minister Grzegorz Kołodko but also by economy minister Jacek Piechota, infrastructure minister Marek Pol and Prime Minister Leszek Miller. Asked about zloty exchange rate Miller said the zloty is still overvalued (hampering economic growth) and real interest rates are also too high for the economy. Nevertheless, he added that the NBP and the Monetary Policy Council are well informed about the government's opinion and the cabinet is not going to try to enforce any monetary policy decisions. Such a view was reiterated later by deputy PM Grzegorz Kołodko.

At the beginning of November, the Cabinet Council (i.e. the non-decisive body consisting of the council of ministers headed by Poland's President) was held. It debated over the strategy of Poland's development after the EU entry. President Kwaśniewski and PM Miller gave several comments during the press conference after the meeting. Kwaśniewski said that adopting euro in Poland short after the EU accession is one of the top priorities of the government's development strategy and that our country is very close to meeting necessary Maastricht criteria. It was confirmed by PM Miller who added also that the government closely co-operates with the NBP and those joint efforts are "very promising" and should enable us to meet convergence criteria on time.

As usually, finance minister took the most prominent position in our monthly government's watch. Kołodko spoke, among others, on chances for Poland to meet Maastricht criteria and enter the EMU. Finance minister remains very optimistic about prospective economic developments, forecasting GDP growth at 2% in 3Q02 and above 2% in 4Q02. He said that without sharp GDP growth acceleration it might be impossible for Poland to meet Maastricht fiscal criterion. It may suggest that no real reform on the spending side should be expected. However, he stressed that Poland is going to meet all Maastricht criteria in 2005. Kołodko added that it would not mean that Poland would automatically join the Eurozone in 2006. Finance minister said that Poland would be free to choose whether it wants to enter the EMU in 2006 or later and it will depend on the level of the zloty exchange rate against the euro. Meanwhile, Kołodko sees zloty to be overvalued, mostly due to inadequate monetary policy. He is not afraid of the level of public debt (this is one of Maastricht criteria – public debt cannot exceed 60% in relation to GDP) and told that according to the Polish methodology it will not be higher than 55% of GDP in 2006. In his opinion, public debt to GDP ratio calculated in accordance with the European standards will reach only 51%. Minister Kołodko commented also the MPC decision to cut all interest rates by 25bps. In his opinion the decision disappointed the market, but the cut was a move in a right direction. However, Kołodko said that reductions of nominal interest rates have been insufficient, as real interest rates are still very high. At the same time Kołodko stressed that inflation is at the very low level and is expected to decline further.

Of course, a lot of politicians' statements in November concerned accession talks with the EU. Both European affairs minister Danuta Huebner and chief negotiator with the EU Jan Truszczyński announced though negotiations until the end, i.e. until the Copenhagen summit. As Poles' support for the EU accession seems not to be unconditional one may expect that conditions of Poland's membership will be crucial for the outcome of the accession referendum, which is probably to be held in June 2003. Presidential advisor Witold Orłowski said he is concerned about the outcome of the referendum, as the government will face very aggressive campaign of eurosceptics and the strength of negative campaign is bigger, so a positive one should be more much more intensive.

Labour minister Jerzy Hausner said that the unemployment rate in November would rise again after fall in October to 17.5%. However, in labour minister's opinion from spring 2003 onwards the unemployment rate should begin to gradually but permanently fall.

WHO. WHEN. WHERE	COMMENT
Aleksander Kwaśniewski, President; PAP, 27 Nov	It is important that we are at the turning point. We are talking about the things, which seemed to be very inflexible until now. The negotiations are continuing and I hope there will be more interesting ideas in the future. The Danish proposals show the understanding of our situation and some flexibility. It is very important for candidate countries they will not be a net contributor to the EU budget. The EU's elasticity is restricted by the budget for 2000-06 accepted in Berlin. At the beginning of the next year we have to propose significant changes in our budget. They should concern taxes, but not higher taxes in my opinion. As international examples show, higher taxes are not positive for economic growth, but our budget also has its constraints.
PAP, 6 Nov	Everything indicates that Poland will be able to meet the Eurozone entry criteria. (...) We want to very seriously engage in the country's bid to join the euro zone, we are treating membership in the (single currency) system as an important element of Poland's development strategy.
Leszek Miller, Prime Minister; PAP, 26 Nov	Inflation at the low level and unfavourable effects of zloty strengthening are the factors that the Monetary Policy Council should take into account deciding on interest rates. I hope that in the situation of very low and stable inflation the MPC will begin to behave less doctrinally than they do, and they will lower interest rates. We have many various signals, but a path taken by the NBP and the MPC, of such a drip, I mean very slow lowering interest rates, is not the best one. In my opinion, certainly there are conditions in Poland these days for a bold step to cut interest rates much deeper, because there is no threat of inflation. Today, inflation in Poland is lower than in many EU's countries and interest rates one of the highest in Europe and in the world.
Reuters, 26 Nov	We must say it straightforwardly that the information we received today [on EU financial package] means a clear improvement. However, obviously it does not solve all the problems.
PAP, 6 Nov	The government co-operates in this issue [exchange rate strategy before entering the Eurozone] with the NBP and the co-operation bodes well for the future. Everything indicates that Poland will be able to meet Maastricht criteria. The government's opinion is well known to the central bank, we think the zloty is overvalued and the exchange rate makes life difficult for exporters. We also think that real interest rates are still too high, which impedes economic growth. It seems to me from the signals that I am getting from EU member states that it is possible to increase the initial sum of direct payments from 25 percent to a higher number.
PAP, 4 Nov	In our opinion local governments should be created without interference of the central government, but today I cannot say, who will be a coalition partner of SLD-UP.
Grzegorz Kołodko, finance minister; PR1, 28 Nov PAP, 28 Nov	The market is disappointed. […] Deeper rate cut was expected. Inflation is very, very low and is still falling. […] Despite this minimal cut, the rates are very high in real terms. But for sure this was a move in the right direction. Even if we meet Maastricht criteria it will not mean automatic entering the Eurozone. The criterion is to be met in order to have a choice. We plan very ambitiously to meet them in 2005. If it is beneficial for us to join the Eurozone in 2006 then we will join it, if not, we will not do that, but it will not happen earlier for sure. […] FX rate will be a substantial factor. It depends at what rate we would enter the Eurozone. Even in pessimistic scenario the debt calculated by the Polish methodology should not exceed 55% in 2006, and by the EU's methodology 51%.
PR1, 21 Nov	I think that the idea [of tax abolition] was reasonable. If there were mistakes [in the act] than we must correct them and get back to the idea of legal regulations. Because we must fight with the grey economy.
PAP, 21 Nov	Budgetary revenues and expenditures will not be changed in 2003. [...] Expenditures will be most likely higher [in real terms] than assumed because inflation will be lower and may decline even further. This means that real growth of expenditures in the next year may reach 2.5% instead of 2.2% assumed in the budget.

	Difficult budget for 2002 is successfully realised. It was even possible to introduce the third stage of wage increases for teachers. Budgetary revenues for 10 months reached 81% of the plan and expenditures 81.9%. [...] Thus this year's budget will be successfully realised. It is only me who decides when and on what conditions I deal with politics, when I go in or go out [of the government]. If the opposition propose such funny motions [confidence vote on finance minister] it indicates only one thing. They are irritated by the fact that that the economic policy is more and more effective and we have more and more signs of improvement of the situation in the economy and in public finances.
PAP, 17 Nov	There will be a problem with meeting convergence criteria if we increase the deficit. Otherwise there are two ways - to rise revenues through rationalising taxes or to curtail expenditure. But it is not possible to reduce spending, with such a high level of rigid expenditure. The biggest problem for Poland will be to fulfil the budget deficit criterion. There will be no problems with meeting the public debt criterion, or the inflation and FX fluctuation band criterions. Undoubtedly we will also meet interest rate criterion. The only chance for meeting deficit criterion is sharp acceleration of economic growth and tax revenues otherwise this can't be done. Fulfilment of the criteria does not mean that we will enter the Eurozone as fast as possible. The decisions on this matter will be made in appropriate time, which is not now. Whether joining EMU would be beneficial or not, it will depend on the exchange rate upon EMU entry. We have to aim at meeting all Maastricht criteria in 2005, but it will turn out later whether it will be possible. Restructuring of public finance is important in the short term, but also has long-term implications. Public debt at the end of 2002 will reach 44.6% of GDP according to the ESA methodology. According to the Polish standards it would be ca. 5 points higher, reaching 49.5-50% of GDP. We approach regulatory border of 50%, but it's still safe level of public debt, assuming there will be no unpredictable events in the future and we will keep public finance in check. The budget expenditures must be rationalised in a way that fewer spending will be enforced by law and regulations, often not corresponding to present economic situation. Restructuring the finances is also connected with the EU accession. I would be happy about inflation collapse if it was not accompanied with the cost being the deceleration of economic growth. If there are no external shocks (which is always uncertain) next year's inflation could be lower than written down [in the budget]. Average inflation could be lower than 2.3%. At this stage we have to stabilise inflation at such low level. If inflation would fluctuate at 1-2.5%, it won't harm the economy. But further reduction of inflation could be dangerous.
PAP, 14 Nov	Finding such amount [for full premium to EU budget], which will make up for ca. 1.5% of Poland's GDP, could prove impossible if GDP growth remains at the level observed in 2001 and 2002. If there are instruments for zloty weakening, no doubt we will use them. It is all about the co-ordination between fiscal and monetary policies and the best instrument here is interest rate reduction, which could be supported by budget deficit reduction. We will help in zloty weakening to promote growth without inflation and macroeconomic restructuring, to improve Polish companies' competitiveness. Zloty appreciation is not the long-term trend; the exchange rate is artificially overvalued and hampers the competitiveness of the Polish economy. We will see what will be the zloty exchange rate until the end of its days, but for sure it will be weaker. Some of the proposals [of public finance reform] will be ready already next month. The broader discussion should take place at the beginning of next year. It is much greater undertaking and it is about large package for stabilisation and development under greater absorption of structural funds. It requires saving up some money, which will be possible only if we are not engaged in some rigid expenditures. It would require some legal changes, which will be considered in parliament in 1H03, to create new conditions for budget for 2004.
Polish Radio, 14 Nov	The recovery continues in 4Q02. We still believe that GDP will grow in 4Q02 by more than 2%. It grew by 2% in 3Q02. [In October] the unemployment fell for the first time in many months, it is very important news.
PAP, 8 Nov	Money is too costly and this makes the economic situation more difficult. The exchange rate is overvalued. In our conditions it would be better if it was weaker.
Polish Radio 1, 7 Nov	There are a few countries [in the EU] where the budget tops three percent...but a majority where it is much lower. We would like to look at the total...and allow the possibility to transfer or average out the deficits. This is a creative proposal. I wouldn't dare to go as far as Prodi. The Growth and Stability Pact is not stupid, but debate is needed. We are at the beginning stage of this project [pension system reform in Poland] and we have to look at it from the point of view of long-term interests of the Polish economy. The system is generally well designed. There are such ideas [liquidation of open pension funds]. However, the reform assumes that we will gradually shift from pay-as-you-go system to fully funding system and much depends on how the Polish economy will grow and what will be rate of returns on the capital market. One should not do any rapid steps and change fundamental ideas of the reform under the pressure of poor fiscal situation. I think that it [gradually phasing in of full Polish contribution to the EU budget] will not be allowed due to pressures in the EU budget. We will be rather able to negotiate that the EU will increase compensations in order to assure that Poland will get more from the EU than it will pay. The matter is that we have to pay the whole contribution to the EU budget while we will get direct payments for our agriculture only after some time. We will also have to contribute to different projects. Our country will get more funds than it will have to pay. However, for the budget it will be a problem because not all money will flow to the budget, but directly to the economy. That is why we are preparing for deep reform of public finances. We want to increase our funds absorption capacity and make expenditures more flexible.
PAP, 5 Nov	Budgetary framework for all new members will dramatically change due to the accession, both in terms of the level of expenditures and its structure. On the spending side, from the day of the accession. Poland will have to pay contribution to the EU budget on a monthly basis in the amount equalling 6-7% of budget revenues. This is a very serious issue given that a high proportion of current government expenditure in the candidate countries, to the order of 60 to 80 percent, is at present completely inflexible. Additional inflexibility stemming from obligatory contribution to the EU budget and conditions of payment from the EU will leave any room for discretionary fiscal policy.
Jacek Krzyślak, chief of dept. in MinFin; PAP, 28 Nov	According to our estimations, inflation will fall to 1% in December or even deeper. Average annual inflation in 2003 may be lower than 2.2% assumed in 2003 budget. This [downward revision annual inflation forecast in 2003 from 2.3% to 2.2%] is a technical revision resulting from a lower than previously forecasted annual consumer price index in past months.
Reuters, 6 Nov	Our scenario assumes that food prices will be stable until the half of next year. Afterwards, we will experience effects of next year's crops, which are difficult to assess at the moment. Inflation may exceed 2% in June 2003. In May and June we may see an increase of prices just because of seasonal factors.
PAP, 5 Nov	The most important is that we agreed that above all we have to achieve strong fundamentals of sustainable growth. If it will turn out that this could be achieved by devaluation of the zloty before entering ERM2, then one cannot rule out such a possibility.

	One has to define what are the conditions of the sustainable growth. After experiences of 2000 and 2001 it seems that we cannot function well without devaluation. Now it seems that exporters are handling with the strong zloty. However, it cannot last forever and from the point of view of the economy a weakening of the zloty would be beneficial. On the other hand, the present appreciation is a natural process. We may treat expenditures related to our membership in the EU as inflexible, but they will be dedicated, excluding contribution to the budget, for development projects. Thus they cannot be treated the same as present rigid expenditures. We have undertaken some actions, supervised by deputy prime minister Kołodko, which aims at restructuring of public finances sector. The main goal is to make more flexible both revenue and expenditure side.
Ryszard Michalski, deputy finance min. PAP, 13 Nov	Moody's decision levelling the rating for [Poland's] domestic and offshore debt is a proof that external observers positively assess our efforts in the area of economic policy and negotiations with the EU. We are marching in the right direction, we are appreciated and the perspectives are promising.
Irena Ożóg, deputy finance minister PAP, 17 Nov PAP, 7 Nov PAP, Reuters. 5 Nov	I fear that it will not be possible to obtain PLN1.3bn from restructuring as planned in the budget. It will be even PLN600m less as not many large companies joined the programme. The Ministry of Finance data shows that there is no correlation between a level of CIT rate and both investments and unemployment. There are different measures that could be used [in order to weaken the zloty] but the most important are interest rates. Finance Ministry is not preparing legislation to weaken the zloty. There are no ministerial plans to weaken the zloty.
Halina Wasilewska-Trenkner, deputy finance min.; PAP, 7 Nov PAP, 6 Nov	We estimate that ZUS [Social Security Fund] debt to open pension funds will reach PLN6-7bn at the end of this year, out of which some 20% (i.e. PLN1.2-1.4bn) will be interest. This year it [to pay back ZUS debt to open pension funds in cash] surely will not be possible. Probably it will not be possible also the next year. This is not assumed in the budget draft. In order to pay back the debt we have to know to whom and how much.
Witold Orłowski. President's economic advisor; PAP, 21 Nov	Of course. I am concerned about the outcome of the referendum. We will face very aggressive campaign of eurosceptics. They have right to that but the strength of negative campaign is bigger so a positive one should be more much more intensive. I am afraid that in minds of many people these two things [entering the EU and public finances reform] will be connected. This is another point indicating that implementation of the reform will be difficult and at the same time it may negatively affect support for the EU. [...] The fact that dramatic changes in public finances will have to be done in 2003 is not an effect of negotiations with the EU but stems from a delay in reforms. I think that politicians do not realise that present stabilisation of the Polish economy, easiness with which we attract foreign capital and high credibility of Poland stem at least in a half from the fact that the market assumes Poland's membership in the EU. If the market begins to think that we will not join the EU we may experience significant turmoil in the economy. Rapid outflow of foreign capital, not only portfolio capital, may take place, which is likely to lead to currency crisis.
PAP, 20 Nov	Budget for 2004 is a big question mark. (...) Cutting spending is not easy but I do not think that the minister will decided to increase the deficit.
Danuta Huebner. Minister for European affairs; PAP. 26 Nov Reuters. 4 Nov	Negotiations will be tough to the very end, but the compromise must be reached at certain moment and we want it to be as close to our expectations as possible. We are glad that the EU started approaching it. The presented offer means that Poland will have a positive balance in the first year of membership at the level of €1.5bn and during three first years €6.5bn in total. The economy will grow nearly two percent this year, or at least above two percent in the third and fourth quarter.
Jan Truszczyński, chief negotiator with the EU; PAP, 26 Nov PAP, 22 Nov	The newest negotiation offer is a large step in the right direction. […] Certainly it is not completely satisfactory from the point of view of Poland's needs. It would seem very difficult for me to close the negotiations exactly at the level of this offer without any improvement in any key issue. The government wants that Poland could pay 20% of a contribution to the EU budget in the first year of membership in the EU. 40% in the second year and 60% in the third year. [...] If the EU will not agree on that and we will have to pay 100% of a contribution to the EU budget then we will demand compensations from the EU in the amount of proposed reduction in contribution. The need for stable situation of public finances in first years of membership is the second reason, for which we think the financial offer of the EU is not sufficient.
PAP, 4 Nov	Our arguments that in terms of revenues and competitiveness our farm sector cannot suffer from the accession are well understood. There is very high probability that the EU will accept our proposal to maintain reduced VAT rate for apartments.
Jerzy Hausner, labour minister; PAP, 27 XI PAP, 14 Nov PAP, Reuters, 7 Nov	This [interest rate cut] is a positive and expected signal, there are no reasons for any comments. We are facing three most difficult months. It will be possible to reverse the upward trend only in spring. From that time unemployment in Poland can be expected to fall slowly. […] Unemployment will rise slightly in November. There is high probability that at the end of this year the unemployment rate would not exceed 18%. We have agreed to a proposal to pay back the entire bonds in bonds, but I have delayed the scheme because I want to see how the process of contributions' identification is going on. I wanted to resolve the pension fund debt issue this year, but today I see there is no chance for this.
Krzysztof Pater, deputy labour minister; PAP, 27 XI	Starting from 2004 indexation of old-age pensions and disability pensions will be based on inflation indicator increased by 20% of real wage growth in previous year. This is the systemic solution that will oblige in 2004 and next years. The change in rules of the indexation is mainly aimed at budget stabilisation. Current mechanism enables very large fluctuations in valorisation rate. Changing the mechanism will cause a stabilisation of spending.
Jacek Piechota, economy minister; Reuters, 21 Nov	The government has a unanimous opinion on the matter of interest rate cut. The strong zloty is reducing the profitability of our exporters and we are counting on co-operation with the central bank in that respect.
Marek Pol, deputy PM infrastructure minister; PAP, 8 Nov	The exchange rate influences the economy in two ways. Firstly, if the domestic currency is too strong the country's products loose competitiveness on the global market. Secondly, negative influence stems from the volatility of the exchange rate. We hope the dollar exchange rate will reach again values assumed in the budget, i.e. above 4PLN.
Marek Dyduch, SLD's general secretary PAP, 11 Nov	[The outcome of local elections] it is surely the warning for SLD, that if we don't solve the urgent problems in Poland, like unemployment, if we don't ensure the appropriate economic growth, then we can easily imagine what happens next.
Marek Olewiński, deputy chief of public finance commission; PAP, 20 Nov	This year's budget indicates that [next year] PLN600m can be gained from better tax collection.

EU negotiations watch

- **EU enlargement date set to 1st May 2004**
- **Denmark proposed improved financial offer...**
- **...but Poland wanted to achieve more**
- **ECB does not welcome new EMU members soon**

EU enlargement scheduled for 1st May 2004

In the middle of November the foreign ministers of the EU member states agreed that the EU enlargement would take place on 1st May 2004. Such decision has been explained by the fact that parliaments of the member states might not be able to ratify the accession treaties on time, if the enlargement was scheduled for January. In our opinion, this is not a bad news for Poland. Slight delay in the EU accession might be even beneficial for the Polish budget in 2004, as in the first year of membership we will pay only part of the full premium to EU's budget (ca. PLN3-4bn less) while the transfers from the EU to Poland will remain unchanged. Settlement of the date for the enlargement has met with positive reaction of the financial markets.

The date of the enlargement was confirmed during the EU summit in Copenhagen on 12-13 December. The accession treaties are likely to be signed in Athens on 16 April 2003. Then, they would be approved by the parliaments of all the 15 EU member states, and meanwhile in Poland there will be referendum on the EU accession (most likely in June).

Denmark improved the offer for candidates

At the very end of November Denmark, which currently presides the European Union, presented the modified financial offer for candidate countries. According to the Danish proposal the candidate countries would have to pay €2.5bn less to EU's budget in the first year of membership, they would receive over €1bn more in cash and could spend more own funds to improve the competitiveness of agriculture. Denmark proposed that new members, receiving 25% of direct payments from EU, would be able to amend this up to 40% of full subsidies. They also suggested the increase in milk production quotas and additional €1bn for borders protection and improvement of food safety.

Denmark's offer was intended to satisfy peasant lobbyists in candidate counties, especially having in mind the possible impact on the results of the accession referenda in those countries. Danes believed also that their offer would be the ultimate one and it would facilitate to conclude the negotiations on financial conditions earlier (i.e. before the Copenhagen summit). However, the result proved to be different from the above mentioned, at least in case of Poland. One could suspect that in fact the "Danish compromise" just increased the starting point for the concluding demands of Poland presented in Copenhagen.

...but Poland wanted to achieve more

The governments in most of candidate countries welcomed the Danish proposal as a significant step in a right direction. And almost all of them, except for Poland and Malta, achieved the final agreement on the enlargement conditions in the final stage of negotiations before Copenhagen summit. Polish government, although it has noticed the improvement of the proposed conditions, unanimously agreed that the offer is still unsatisfactory. Poland submitted the list of additional postulates, including higher reimbursements for the budget in 2004-06, higher direct subsidies and the possibility to improve them from the domestic budget, increasing production quotas in agriculture, maintaining lower VAT in construction and machinery for agriculture.

The Polish government decided that it would press for accepting all postulates that were not resolved yet until the last minutes during the Copenhagen summit. Co-ruling coalition party PSL adopted a very rigid position, warning that it could leave the government and the coalition in case Polish proposals concerning agriculture are not accepted.

The happy end of negotiations

On Friday, the 13th of December Poland and other 9 candidate countries finished negotiations with the European Union. The EU agreed to pay a bit more comparing to the "Danish proposal". The Polish negotiators received almost everything they wanted:

- Poland will receive additional €1bn in cash up front, while this money were reserved for future infrastructure projects – positive news for Finance Minister, as it means easier (although still difficult) planning of budgets for the next years.
- Higher direct payments for farmers (55%, 60% and 65% in 2004-06 - a part of money will flow from structural funds and/or from the Polish budget)
- Agreement for higher milk production in Poland
- Lower VAT in the construction sector
- Additional €108m for Eastern borders' protection

The final outcome of the negotiations was undoubtedly the success of the ruling coalition, and this should positively affect the financial markets. Not only because of the fact that the negotiations finished (it was mostly priced-in), but the conditions of joining the EU increase the chances for the YES vote in the accession referendum, which will be scheduled for June next year. Also, better financial conditions for Polish farmers decrease the possibility of coalition collapse. Although, it has to be stressed that the PSL chief and Minister of Agriculture Jarosław Kalinowski said that it was just “the good result, and not a success”.

More information about the final stage of negotiations and its results will be included in January’s MACROscope.

Falling support for the accession?

According to recent public opinion survey by CBOS institute, in December 67% of those who declared to take part in the accession referendum was going to vote YES (down from 73% in November), 22% was against Poland’s membership in the EU (up from 18% last month) and 11% has not made up their minds so far (compared to 9% a month ago). Maybe the Polish society was disappointed with financial conditions of the enlargement offered by the EU, and therefore it would be very interesting to analyse the polls’ results published after the Copenhagen summit. While the support for the enlargement remains high, its falling level before the negative campaign of eurosceptics began for good may be another argument for Polish officials to actively promote the EU accession before the referendum.

Europe does not welcome new Eurozone members

In recent weeks there appeared a number of comments from the European Union officials, suggesting clearly that present EMU members are not very enthusiastic about extending the Eurozone soon by including some of those countries that would enter the EU in 2004.

In early December Reuters unofficially published the economic report prepared by the European Commission. In this document The Commission warns ten candidate countries that they should not pursue fast Eurozone entry, because it might be harmful for their economies. According to the Commission, “an adoption (of the euro) when micro- and macroeconomic conditions are not yet fully adapted to the requirements of a monetary union poses important risks to managing the transition process to euro-area membership, to macroeconomic developments afterwards, and to catching up and the convergence process in general”. Moreover, fast fulfilment of Maastricht convergence criteria by the candidate countries “could be inconsistent with the need for further catching up towards the income levels of the EU member states in the run up to euro participation, as it could imply a very restrictive macroeconomic policy stance”, which in turn would make the catching up process very long.

Recently several top officials from the European Central Bank (including Wim Duisenberg, Jean-Claude Trichet, Pedro Solbes and Eugenio Domingo Solans) commented in a very similar mood. They suggested that the ECB was not interested in the new EU members’ fast entry into the common currency area. What was interesting, NBP governor Leszek Balcerowicz was quite optimistic about the ECB’s stance, saying that “ECB’s view evolves towards better understanding of our arguments supporting fast euro adoption”. Also the chief of the Hungarian Central Bank said at the beginning of December that he felt that ECB did not discourage them to adopt euro as fast as possible.

Market monitor

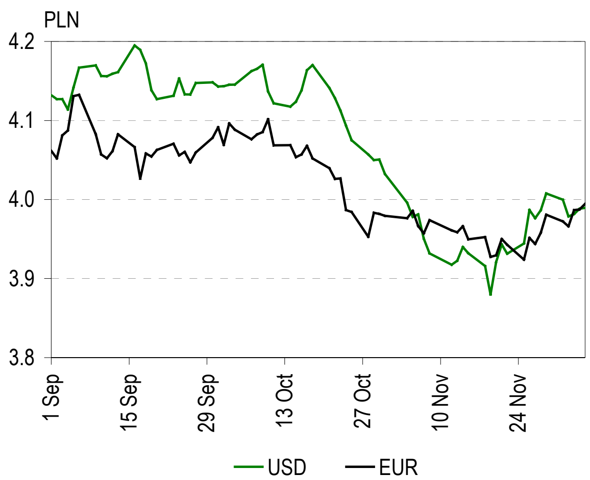
- **Polish zloty growing strong… until the correction**
- **First drop of bonds' prices since Belka's resignation**
- **Issue of new 2-year and 5-year bonds series**

Zloty's historical strongest against dollar

In November, the domestic FX market was very active. High turnover was recorded paralleled by substantial fluctuations in PLN (when PLN was strengthening. adjustments were made and investors were really determined to realise profits). Therefore, even though in the entire month PLN was much stronger than in October, at the end of November it was only slightly stronger than at the end of October.

According to the NBP fixings in November USD was rated between PLN 3.8798 (19 Nov) and PLN 4.0078 (29 Nov) and the average rate was PLN 3.9496 (against PLN 4.1212 in October). EUR rate ranged from PLN 3.9239 (25 Nov) to 3.9856 (5 Nov) and the average rate was at PLN 4.9555 (PLN 4.0443 in October). Average exchange rate against both euro and the dollar (3.95PLN) were consistent with our forecasts presented in November's MACROscope

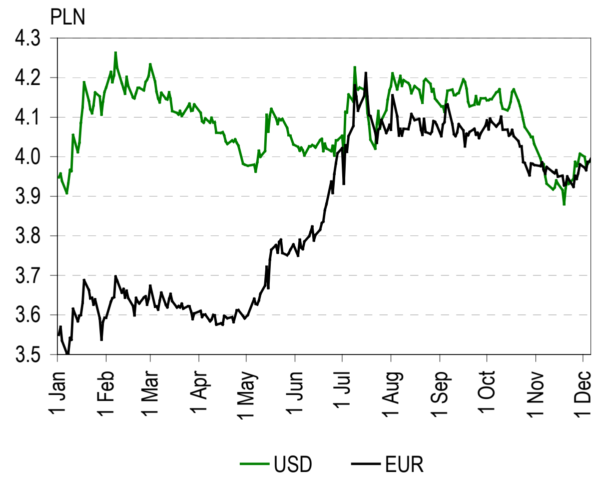
Zloty FX rate recent months



Source: NBP

At the beginning of November, the demand for PLN stayed strong – following the referendum in Ireland and the decision of the EU members concerning terms and conditions of the enlargement. In the first decade, PLN bolstered mainly against USD, which weakened against other key currencies and the EUR/USD rate went above the parity. The second decade saw substantial FX rate fluctuations. As stated above, the ups had been followed by strong adjustments. However, all in all, marginal strengthening was recorded. On 19 November the USD/PLN rate hit the record low since zloty liberalisation in April 2000 with EUR/USD rate in above USD 1.01.

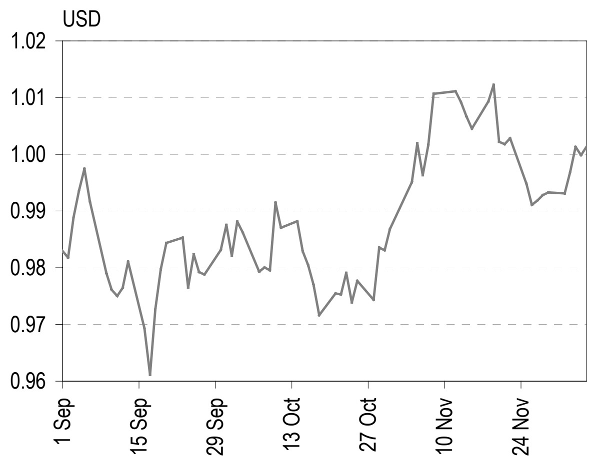
Zloty FX rate in 2002



Source: NBP

The third decade of November saw PLN supply on the part of investors, as most of them were realising profits. Weakening of PLN was paralleled by deteriorating situation on the fixed income market following the decision of the MPC (see below). Additionally, PLN depreciation was driven by the plummeting EUR/USD, rate below the parity level. Because of this relatively strong adjustment recorded at the end of the month, at the end of November PLN was only marginally stronger comparing with the previous month.

EUR/USD FX rate

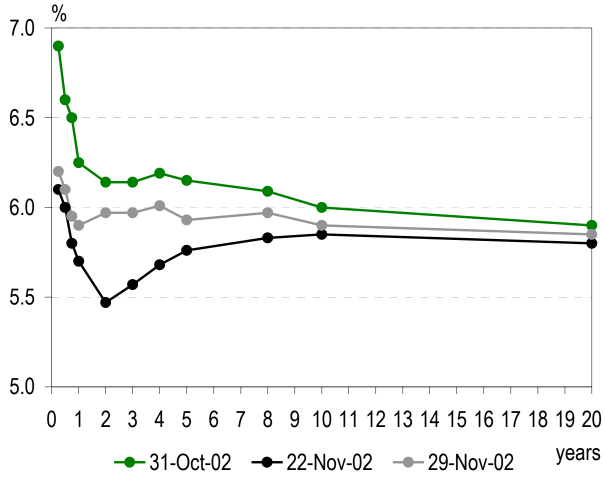


Source: NBP. BZ WBK

Correction on T-bond market after MPC's decision

The yields' downward trend commenced in July had been continued until the MPC meeting. The market was much stronger for shorter tenors and as a result, the yield curve was positive in the 2-10-year segment. As a consequence, two-year yield was below our forecast presented in the last MACROscope, while expectations for other tenors were correct. The market responded to the decision of the MPC with a noticeable yields' increase (the move was also more significant on the shorter end of the curve), as the MPC made smaller cuts than expected and announced smaller cuts in the future, which reduced the scale of the expected monetary easing. It was the first conspicuous weakening on the market since the beginning of July, i.e. resignation of Marek Belka, the Minister of Finance.

Yield curve



Source: BZ WBK

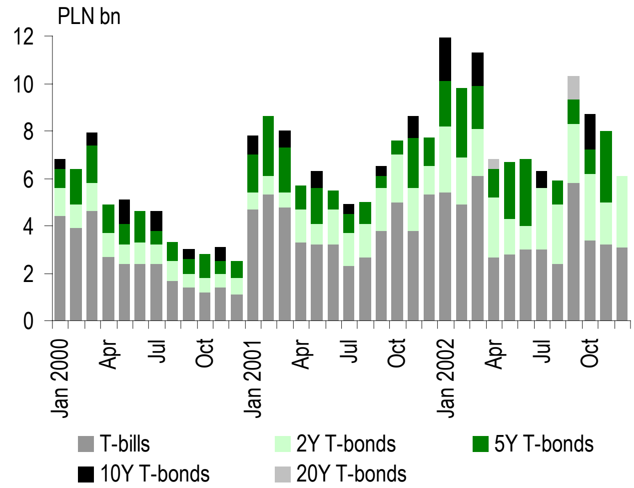
Treasury bill auctions (PLN m)

	OFFER (SALES)		
Date of auction	13-week	52-week	Total
04.11.2002	-	800 (800)	800 (800)
07.11.2002	-	800 (800)	800 (800)
18.11.2002	-	800 (800)	800 (800)
25.11.2002	-	800 (800)	800 (800)
November total	-	3200 (3200)	3200 (3200)
02.12.2002	-	1000	1000
09.12.2002	100	700	800
16.12.2002	100	1200	1300
December total	200	2900	3100

Source: Finance Ministry

In the course of the last two auctions of Treasury bonds, the Ministry of Finance sold new benchmark securities. On 20 November, 5-year bonds were offered (PS0608), and on 4 December 2-year ones (OK1204). In both cases, the supply was relatively high (PLN3bn each), however, it was adequately matched with the demand of the investors. After the auction, large issue brought quite high turnover on the secondary market. Average yield was at the level of the secondary market which, in both cases, translated into a slump as compared with the previous auction's results and the scale of the NBP rate cuts in that period.

Supply of treasuries



Source: Finance Ministry. BZ WBK

At the end of November, the Ministry of Finance published the bonds issue calendar for the next year. The auction dates calculated in line with the principles specified by the Ministry are presented in the table below.

Treasury bond auctions in 2003

	2Y	5Y	10Y	20Y
Jan	8	22	15	-
Feb	5	19	-	12
Mar	5	19	12	-
Apr	2	16	-	-
May	7	21	-	-
Jun	4	18	-	-
Jul	2	-	9	-
Aug	6	-	-	-
Sep	3	17	-	10
Oct	1	15	8	-
Nov	5	19	-	-
Dec	3	-	-	-

Source: Finance Ministry. BZ WBK

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	1 800	-	-	-	20.11	PS0608	3 000	3 000
December	04.12	OK1204	3 000	3 000	-	-	-	-	-	-	-

Source: Finance Ministry

International review

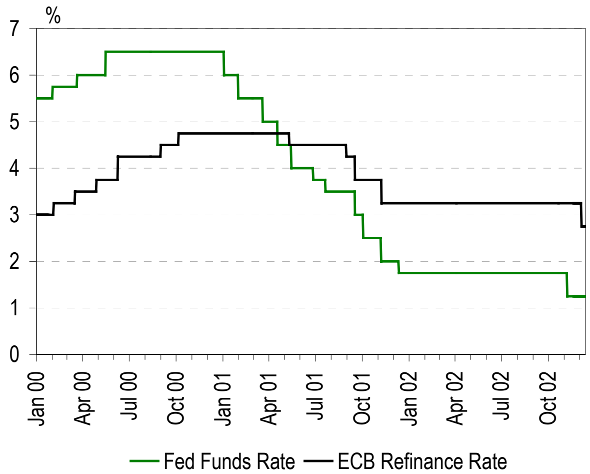
- **Interest rate cut in the Eurozone; rates unchanged in the United States this time**
- **Falling inflation in the Eurozone**
- **Recession in the Eurozone in 1Q03?**
- **In the USA even faster growth in third quarter**

European rates down following the American

At the meeting on 5 December the Council of the European Central Bank decided to lower interest rates in the Eurozone by 50 bps. The decision matched expectations of financial markets. Starting from 6 December, main interest rate – refinance rate – amounts to 2.75%, which is the lowest level from October 1999. During the press conference the ECB president Wim Duisenberg stated that arguments for interest rate had strengthened since previous meeting, because inflationary pressure had weakened partially as a result of sluggish economic growth. Duisenberg suggested that the ECB would not cut interest rates further in the near future.

Five days later the Federal Open Market Committee left interest rates in the United States unchanged. Also, this decision matched market expectations. Federal funds rate remained at 1.25%, the lowest level for 40 years. Fed decided to wait and see how the economy would cope with transitory difficulties after interest rate cut last month. Similarly to last month, Fed's statement said that threats of further weakening of economic growth and increase in inflation are balanced.

Interest rates in the USA and Eurozone



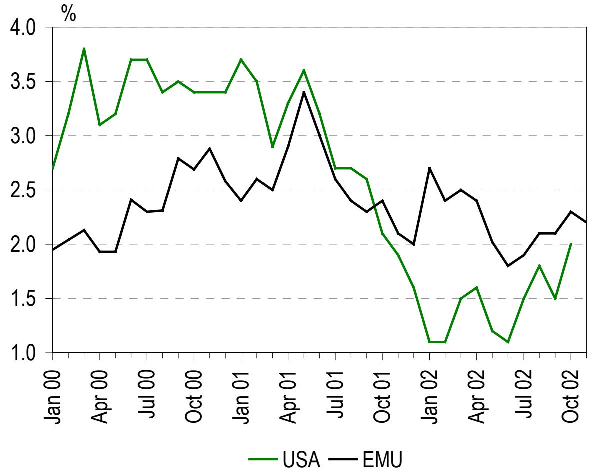
Source: Reuters

Unexpected fall in inflation in November

According to final data, inflation in the Eurozone amounted to 0.3%MoM in October, which translated into rise in annual inflation rate to 2.3% from 2.1% in September, while preliminary estimations pointed to acceleration to 2.2%YoY. Analysts expected inflation at 0.2%MoM and 2.2%YoY. It means the highest annual inflation rate since April this year. According to the preliminary estimations, in November annual inflation rate in the Eurozone decreased unexpectedly to 2.2%, while expectations pointed to maintaining it at the previous level. Though inflation remains above 2%, i.e. target ceiling imposed by the ECB, as an indicator of price stability for a fourth consecutive month its unexpected fall and forecasts of fall in 1Q03 were the arguments for interest rate cut for the ECB.

In the United States consumer prices rose by 0.3%MoM in October, which exactly matched analysts forecasts and resulted in increase in annual inflation to 2.0% from 1.5% in September. The strongest price hike was recorded for energy.

Inflation YoY



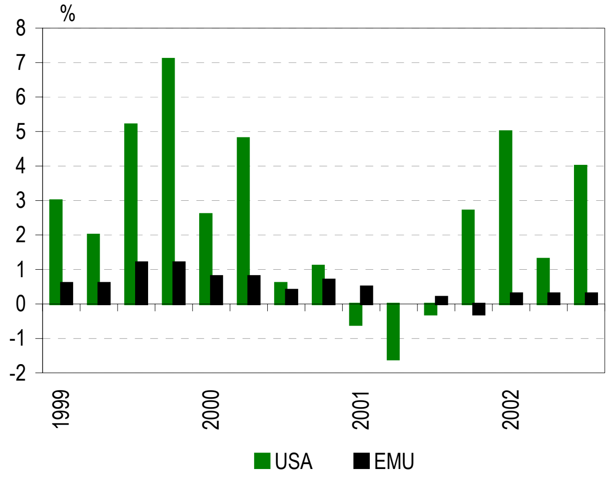
Source: Reuters

Eurozone's recession at the beginning of 2003?

Data on economic growth in the Eurozone in 3Q02 exactly matched markets' expectations and were close to lower end of the European Commission's forecasts range of 0.2-0.5%. GDP rose by 0.3%QoQ, which means a repetition of growth rate recorded in the second quarter (revised from 0.4%). In annual terms Eurozone's GDP increased by 0.8% accelerating from 0.6% in 2Q02. At the same time the Commission reiterated its growth forecast for 4Q02 at 0.2-0.5% and released a forecast for 1Q03 that points to a possibility of GDP fall at the beginning of 2003 (range from -0.2% to 0.2%).

According to preliminary data on economic growth in the United States, in 3Q this year GDP rose by 4.0%QoQ, which was a significantly faster rate than the one released a month ago in advanced information, when the growth amounted to 3.1% only. Analysts expected slightly less significant revision in data - to 3.8%. These data mean that significant acceleration in growth rate took place from 1.3% recorded in 2Q02, which mainly resulted from acceleration in consumption growth, while investment are still declining.

GDP growth QoQ



Source: Reuters

Data on industrial output in the Eurozone were better than forecasts. In September production fell by 0.2%MoM and 0.6%YoY, against expected falls of 0.4% and 0.7%, respectively. September's fall in production in annual terms was already thirteenth in a row. Data on producer prices matched forecasts. In October prices increased by 0.2%MoM, which translated into rapid acceleration in annual growth rate to 0.9% from 0.1% in September. On the contrary, in September retail sales figures were much worse than foreseen. The sales decreased by as much as 2.1%MoM and 0.6%YoY, compared to expectations of -0.3% and 1.6%, respectively. It was the biggest fall in monthly terms since March 2000.

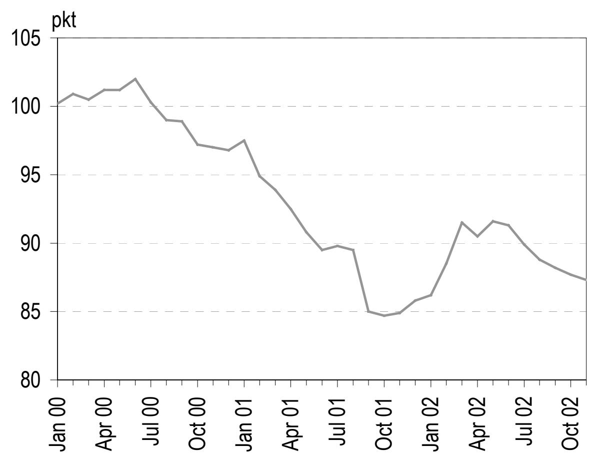
In October, data from the United States on industrial output and producer prices were much worse than expected. Industrial production recorded a third consecutive fall of 0.8%MoM, while a fall of only 0.3% was expected. Prices of sold production rose by as much as 1.1%MoM compared to expectations of 0.2%. It was the largest price increase for more than three years and such a weak figure translated into annual growth of 0.6%, while 1.9% deflation was recorded in September. Also, in October retail sales did not change after a fall of 1.3%MoM (revised down) in September. The figure was better than expectations at the level of -0.2%MoM, but similarly to previous month the sales was week due to falling sales of cars.

In line with analysts' expectations, unemployment rate increased to 8.4% in October from 8.3% in September. The unemployment rate rose for the first month after three months of stabilisation. In November US unemployment rate increased to as much as 6.0% from 5.7% recorded in October, while analysts forecasted much smaller rise to 5.8%. Moreover, number of jobs in American economy decreased by as much as 40,000 after an increase of 6,000 in October.

In November, indices of economic activity in industry of the Eurozone and of the United States improved, but both of them maintained below 50-point limit that separates development from recession. It means that activity was still decreasing, though at slower pace than a month ago. In the Eurozone Reuters PMI index increased to 49.5 pts from 49.1 pts in October. Analogous index for the United States – ISM recorded a result worse than forecasted, increasing to 49.2 pts in November from 48.5 pts in October, while analysts expected 51.3 pts. On the other hand, activity in non-industrial sectors increased at much faster pace than forecasted. In the Eurozone Reuters Services index rose to 50.8 pts from 50.1 pts in October, while analysts expected 50.2 pts. In the USA ISM Non-manufacturing reached 57.4 pts in November against 53.1 pts in October and 53.7 pts expected.

Major business climate indicator for German economy – index of entrepreneurs' sentiment IFO – recorded a sixth consecutive fall in November to 87.3 pts from 87.7 pts in October. However, the figure was considerably better than expectations of 86.8 pts. A representative from IFO institute, that prepares the index, assessed that these data suggest moderate economic revival and remove a threat of recession.

IFO index



Source: Reuters

What's hot this month

Monday	Tuesday	Wednesday	Thursday	Friday
2 December POL: T-bill auction(PLN 1bn) *EMU: PMI (Nov)* *EMU: Retail sales (Sep)* *USA: ISM (Nov)*	**3** *EMU: Producer prices (Oct)* *EMU: Unemployment (Oct)*	**4** POL: T-bond auction OK1204 (PLN 3bn) *GER: Unemployment (Nov)* *EMU: GDP (3Q)* *USA: Factory orders (Oct)*	**5** *GER: Industrial orders (Oct)* *EMU: ECB meeting*	**6** POL: Food prices (2H Nov) *USA: Unemployment (Nov)*
9 POL: T-bill auction(PLN 800m) *GER: Industrial output (Oct)*	**10** *ITA: GDP (3Q)* *USA: Fed meeting*	**11** *FRA: Inflation preliminary (Nov)*	**12** EU summit in Copenhagen *FRA: Industrial output (Oct)* *USA: Retail sales (Nov)*	**13** EU summit in Copenhagen POL: Money supply (Nov) POL: Wages & employment (Nov) *USA: Producer prices (Nov)*
16 POL: Inflation (Nov) POL: T-bill auction(PLN 1.3bn) *ITA: Industrial output (Oct)*	**17** POL: MPC meeting *ITA: Inflation final (Nov)* *USA: Inflation (Nov)*	**18** POL: MPC meeting (decision) POL: Industrial output (Nov) POL: Producer prices (Nov) *EMU: Inflation final (Nov)* *USA: Foreign trade (Oct)*	**19** POL: Business climate (Dec) *EMU: Industrial output (Oct)*	**20** POL: GDP (3Q) POL: Retail sales (Nov) POL: Unemployment (Nov) *FRA: Inflation final (Nov)* *EMU: Foreign trade (Oct)* *USA: GDP (3Q)*
23 POL: Core inflation (Nov)	**24**	**25** **Christmas**	**26** **Christmas**	**27** POL: Balance of payment (Nov)
30 POL: Food prices (1H Dec) *EMU: Money supply (Nov)*	**31**	**1 January** **New Year's Day**	**2** *EMU: PMI (Dec)* *USA: ISM (Dec)*	**3**
6 POL: T-bill auction	**7** POL: Food prices (2H Dec) *EMU: Producer prices (Nov)* *EMU: Unemployment (Vov)* *EMU: Economic sentiment (Dec)* *EMU: Business climate (Dec)*	**8** POL: T-bond auction OK1204 *EMU: Retail sales (Oct)*	**9** *EMU: ECB meeting* *EMU: GDP (3Q)*	**10** *USA: Unemployment (Nov)*

Source: CSO, NBP, Finance Ministry, Reuters

Data release calendar for 2003

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
MPC meeting	28-29[a]	25-26[a]	25-26[a]	29-30[a]	27-28[a]	24-25[a]	29-30[a]	26-27[a]	23-24[a]	28-29[a]	25-26[a]	16-17[a]
CPI	15	17[b]	14[c]	14	14	16	14	14	15	14	14	15
Core inflation	24	-	24[c]	23	23	24	22	25	23	22	24	23
PPI	20	19	19	17	20	17	17	20	17	17	20	17
Industrial output	20	19	19	17	20	17	17	20	17	17	20	17
Gross wages, employment	15	14	14	14	16	13	14	14	12	14	18	12
Trade	about 50 working days after reported period											
Balance of payments	31	28	31	-	-	-	-	-	-	-	-	-
Money supply	14	14	14	-	-	-	-	-	-	-	-	-
NBP balance sheet	7	7	7	-	-	-	-	-	-	-	-	-
Business climate indices	22	21	21	23	22	24	22	22	22	22	21	22
Food prices, 1-15	-	7[d] i 27[e]	27	25	27	27	25	27	26	27	27	29
Food prices, 16-30	7	7	7	7	7	6	7	7	5	7	7	5

[a] according to preliminary schedule,
[b] preliminary data, January, [c] January and February, [d] January, [e] February

Source: CSO, NBP

Economic data and forecasts

Monthly economic indicators

		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	Dec 02
GDP	%YoY	x	x	0.2	x	x	0.5	x	x	0.8	x	x	1.7	x	x	2.0
Industrial production	%YoY	1.8	-1.0	-4.8	-1.4	0.2	-3.1	0.3	-4.2	2.1	5.7	-1.1	6.7	3.2	-1.3	9.2
Retail sales ***	%YoY	5.8	2.4	2.4	4.7	6.7	9.9	3.1	1.8	2.5	8.6	5.1	4.7	5.1	4.7	4.5
Unemployment rate	%	16.4	16.8	17.5	18.1	18.2	18.2	17.9	17.3	17.4	17.5	17.5	17.6	17.5	17.8	18.4
Gross wages ** ***	%YoY	7.8	6.6	5.3	5.7	5.5	4.8	2.3	4.2	3.9	4.1	2.8	3.8	0.5	1.1	1.1
Export (acc. to NBP)	USDm	2 778	2 555	2 540	2 308	2 141	2 467	2 739	2 610	2 678	3 175	2 669	2 850	3 157	2 999	3 089
Import (acc. to NBP)	USDm	3 953	3 509	3 430	3 418	2 952	3 148	3 521	3 416	3 360	3 763	3 556	3 758	4 163	4 080	4 325
Trade balance (acc.to NBP)	USDm	-1 175	-954	-890	-1 110	-811	-681	-782	-806	-682	-588	-887	-908	-1 006	-1 081	-1 235
Current account balance	USDm	-838	-417	-500	-847	-820	-612	-643	-549	-408	-108	-265	-534	-562	-701	-970
Budget deficit (cumulative)	PLNbn	-24.6	-27.7	-32.6	-6.9	-13.7	-16.4	-20.0	-23.0	-25.0	-25.7	-27.3	-29.8	-34.0	-35.2	-40.0
CPI	%YoY	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	0.9	1.2
PPI	%YoY	-0.5	-1.0	-0.3	0.0	0.2	0.3	0.4	0.5	1.2	1.7	1.3	1.1	1.7	2.3	2.9
Broad money (M3)	%YoY	11.4	7.5	9.2	7.8	6.9	3.2	2.4	3.2	2.5	1.3	-0.2	-1.5	-2.5	0.4	0.3
Deposits	%YoY	12.0	7.3	8.9	6.9	5.7	1.7	0.6	1.3	0.5	-0.8	-2.5	-3.5	-4.7	-2.0	-1.5
Credits	%YoY	9.7	8.9	9.3	9.0	8.8	7.1	6.6	7.9	9.4	7.5	5.9	4.9	4.4	8.0	10.0
USD/PLN	PLN	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	3.92
EUR/PLN	PLN	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	3.96	3.92
Reference rate *	%	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	6.75	6.75
WIBOR 3M	%	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	6.81	6.70
Lombard rate *	%	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	8.75	8.75
Yield on 52-week T-bills	%	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	5.88	5.70
Yield on 2-year T-bonds	%	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	5.78	5.75
Yield on 5-year T-bonds	%	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	5.91	5.73
Yield on 10-year T-bonds	%	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	5.89	5.73

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	1Q02	2Q02	3Q02	4Q02	1Q03	2Q03	3Q03	4Q03
GDP	PLNbn	553.6	615.1	685.0	721.6	750.8	791.3	171.4	182.8	186.2	210.4	180.5	192.9	195.9	222.0
GDP	%YoY	4.8	4.1	4.0	1.0	1.3	3.0	0.5	0.8	1.7	2.0	2.7	3.0	2.9	3.1
Total consumption	%YoY	4.2	4.4	2.4	1.8	2.5	2.1	3.2	2.7	2.5	1.9	2.2	2.1	2.1	2.0
- Private consumption	%YoY	4.8	5.2	2.6	2.1	2.8	2.3	3.5	2.9	2.7	2.1	2.4	2.3	2.2	2.2
Fixed investments	%YoY	14.2	6.8	2.7	-10.2	-3.5	6.0	-13.3	-8.4	-3.5	3.3	3.0	4.5	7.0	7.5
Industrial production	%YoY	3.5	3.6	6.8	-0.2	1.3	3.4	-1.6	-0.4	3.3	3.7	3.2	2.8	3.0	4.5
Retail sales (real terms)	%YoY	2.6	4.0	1.0	0.2	3.5	3.1	5.8	0.7	3.9	3.5	4.0	3.0	3.0	2.6
Unemployment rate *	%	10.4	13.1	15.1	17.4	18.4	19.0	18.1	17.4	17.6	18.4	18.8	17.9	17.9	19.0
Gross wages (real terms)	%YoY	4.3	3.3	1.3	1.6	1.4	1.6	1.9	1.4	2.3	-0.2	0.6	1.7	1.8	2.2
Export (acc. to NBP)	USDm	30 122	26 347	28 256	30 276	32 882	35 015	6 916	8 027	8 694	9 245	7 600	8 300	9 130	9 985
Import (acc. to NBP)	USDm	43 842	40 727	41 424	41 955	43 459	47 050	9 518	10 297	11 077	12 567	10 700	10 900	11 850	13 600
Trade balance (acc.to NBP)	USDm	-13 720	-14 380	-13 168	-11 679	-10 577	-12 035	-2 602	-2 270	-2 383	-3 322	-3 100	-2 600	-2 720	-3 615
Current account balance	USDm	-6 862	-11 558	-9 946	-7 075	-7 019	-9 009	-2 279	-2 075	-907	-2 233	-2 635	-1 950	-1 496	-2 928
Current account balance	% GDP	-4.3	-7.4	-6.3	-4.0	-3.8	-4.4	-4.1	-4.0	-3.9	-4.1	-4.1	-4.0	-4.2	-4.4
Budget deficit (cumulative)*	PLNbn	-13.2	-12.5	-15.4	-32.6	-40.0	-38.7	-16.4	-25.0	-29.8	-40.0	-17.1	-24.5	-30.0	-38.7
Budget deficit (cumulative)*	% GDP	-2.4	-2.0	-2.2	-4.5	-5.3	-4.9	-9.6	-13.7	-2.6	-4.9	-9.5	-12.7	-2.8	-3.9
CPI	%YoY	11.8	7.3	10.1	5.5	2.0	1.9	3.4	2.1	1.3	1.1	1.2	1.4	2.3	2.7
CPI*	%YoY	8.6	9.8	8.5	3.6	1.2	2.7	3.3	1.6	1.3	1.2	1.2	1.9	2.4	2.7
PPI	%YoY	7.3	5.7	7.8	1.6	1.1	2.4	0.2	0.7	1.3	2.3	3.1	2.9	1.9	1.7
Broad money (M3)	%YoY	25.3	24.6	15.2	12.1	2.0	4.5	5.9	2.7	-0.1	-0.6	1.5	3.9	5.7	6.9
Deposits	%YoY	28.4	26.4	17.2	13.5	0.1	7.3	4.8	0.8	-2.3	-2.7	1.4	5.2	8.7	13.9
Credits	%YoY	30.0	28.6	24.7	11.3	7.5	12.0	8.3	8.0	6.1	7.5	7.4	9.9	11.9	18.7
USD/PLN	PLN	3.49	3.97	4.35	4.09	4.08	3.85	4.13	4.04	4.15	4.00	3.87	3.85	3.85	3.82
EUR/PLN	PLN	3.92	4.23	4.01	3.67	3.85	3.85	3.62	3.72	4.08	3.97	3.87	3.85	3.85	3.82
Reference rate *	%	15.50	16.50	19.00	11.50	6.75	6.00	10.00	8.50	7.50	6.75	6.25	6.00	6.00	6.00
WIBOR 3M	%	21.34	14.73	18.78	16.08	9.08	6.43	11.02	9.80	8.50	6.99	6.72	6.38	6.30	6.30
Lombard rate *	%	20.00	20.50	23.00	15.50	8.75	7.50	13.50	11.50	10.00	8.75	8.00	7.50	7.50	7.50
Yield on 52-week T-bills	%	18.59	12.95	17.77	14.77	8.17	5.49	9.64	9.11	7.82	6.11	5.70	5.45	5.40	5.40
Yield on 2-year T-bonds	%	18.08	12.41	17.37	13.91	7.95	5.49	9.27	8.84	7.63	6.05	5.70	5.45	5.40	5.40
Yield on 5-year T-bonds	%	15.83	10.87	14.00	12.59	7.86	5.40	9.09	8.69	7.60	6.07	5.60	5.35	5.35	5.30
Yield on 10-year T-bonds	%	x	9.60	11.79	10.74	7.35	5.38	8.28	7.92	7.24	5.94	5.60	5.35	5.30	5.25

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 13.12.2002 r. has been prepared by:

ECONOMIC ANALYSIS UNIT

ul. Marszałkowska 142, 00-061 Warszawa. fax (+48 22) 586 8340

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

Maciej Reluga – Chief Economist

tel. (+48 22) 586 8363, Email: maciej.reluga@bzwbk.pl

Piotr Bielski (+48 22) 586 8333

Piotr Bujak (+48 22) 586 83 41

Aleksander Krzyżaniak (+48 22) 586 83 42

TREASURY SERVICES DEPARTMENT

Poznań

pl. Gen. W. Andersa 5
61-894 Poznań

tel. (+48 61) 856 58 14, (+48 61) 856 58 25

fax (+48 61) 856 55 65

Wrocław

ul. Rynek 9/11
50-950 Wrocław

tel. (+48 71) 370 25 87

fax (+48 71) 370 26 22

Warszawa

ul. Marszałkowska 142
00-061 Warszawa

tel. (+48 22) 586 83 20

fax (+48 22) 586 83 40