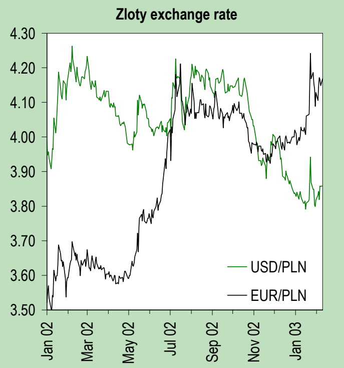
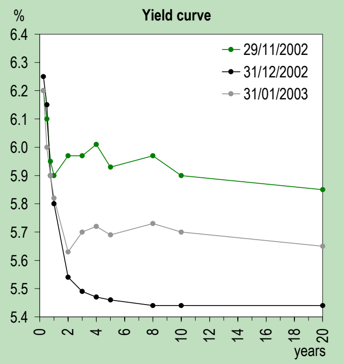
Bank Zachodni WBK

MACROscope

Polish Economy and Financial Markets

February 2003





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

Roller coaster

■ **Once again we are writing a bit more about the zloty exchange rate.** After the turmoil on FX market experienced in January it became evident that zloty might be more responsive to short-term shocks, unfavourable news and one-off events that one might have thought before. Such situation seems to be fortunate for the Polish government, which believes that significant zloty weakening is one of the key pre-requisites for revitalising country's economy, and which openly declared undertaking steps aimed at lowering PLN value. Moreover, in the upcoming quarters we will face a combination of several risk factors with a potentially negative impact on the sentiment on the Polish FX market. At first glance it seems that this year we might truly see a roller-coaster-like exchange rate fluctuations. However, more in-depth analysis presented in this report reveals that the long-term path of zloty exchange rate should not differ much from what we have forecasted in past months. Average zloty exchange rates against the basket of two major currencies should steadily appreciate in the subsequent quarters of this year.

■ **Beginning of the year is usually a period of increased supply of Treasury securities on the auctions.** In addition, 2003 will be the second year in sequence when the Treasuries' issue will be enormous. Therefore, this month, we make an attempt to asses how many, when and what kind of securities will be issued by the Ministry of Finance. In our opinion the issue may be limited in the hardest months down to PLN9-10bn, against the maximum borrowing requirements of up to PLN14bn. Such a high supply will occur as long as for the first four months of the year and then again in August and December. In other months the Treasuries' supply should total PLN6-7bn.

■ **Macroeconomic data** for December 2002 confirmed the trends observed for a couple of months. Industrial output and retail sales continue to grow and foreign trade turnover stays at a high level. Preliminary CSO's data on GDP growth in 2002 show that the economy is slowly gaining the momentum. In 2001 the economic growth dynamics was increasingly lower on a quarterly basis, while in 2002 one could witness a gradual increase in the economic growth dynamics. Despite a gradual economic recovery, which in its better part results from the continued relatively high consumption demand, inflation pressure is very marginal and CPI reached another historically low level in December. The above-mentioned continued, and even accelerating consumption growth is surprising given the situation on the labour market. Unfortunately, in line with our expectation the unemployment rate increased to 18.1% in December. It should be noted, however, that this rate is much better than the one projected a year ago, as during 2002 the pace of unemployment growth substantially decreased. In the last month of 2002, the decrease in the M3 broad money aggregate and personal bank deposits continued; credit growth remained poor.

Financial market on 31 January 2003

NBP deposit rate	4.50	WIBOR 3M	6.47	PLN/USD	3.8173
NBP reference rate	6.50	Yield on 52-week T-bills	5.82	PLN/EUR	4.1286
NBP lombard rate	8.50	Yield on 5-year T-bonds	5.69	EUR/USD	1.0815

Special focus

Ups and downs on FX market

Once again we are writing about the zloty exchange rate. After the turmoil on the FX market experienced in January (see *Market monitor* section) it became evident that the zloty exchange rate might be more prone to short-term shocks, unfavourable news and one-off events that one might have thought before. Obviously, such situation is supported by building atmosphere of global uncertainty on international financial markets, a perspective of war in Iraq and still big doubts regarding Polish government's abilities to undertake comprehensive reform of public finance that would allow Poland for fast EMU membership. Situation of amplified market's fragility seems to be favourable for the Polish government, which believes that significant zloty weakening is one of the key pre-requisites for revitalising country's economy, and which openly declared undertaking steps aimed at lowering zloty exchange rate. The comments made by government's officials are clearly aiming at fuelling market uncertainty and convincing investors that zloty should depreciate. Additionally, the Ministry of Finance announced that in 1Q03 it would start buying foreign currencies on the FX market for the repayment of interest on Polish foreign debt. It is supposed to contribute to zloty weakening even more. At the same time in the upcoming quarters we will face a combination of several risk factors. They would be one-off events, however having potentially long-term consequences for the assessment of Polish economy perspectives and for the sentiment on Polish financial market.

In such situation it seems useful to answer the question, whether the above mentioned factors together with potential government's activity, would be really significant enough to influence our forecasted long-term tendency for zloty appreciation on the road to euro (that we have described in past issues of MACROscope).

After the closure of negotiations with the EU and the settlement of financial conditions for the accession it is also useful to think about the possible impact of financial transfers between EU and Poland on the Polish FX market. We are referring to this issue at the end of this analysis.

Ministry of Finance goes shopping

As we have already mentioned, both the government and finance ministry seem to be strongly interested in making zloty depreciate, or at least curbing down its appreciation. Comments made by heads of economic ministries and PM Leszek Miller himself intensified recently, suggesting that lowering zloty exchange rate is the key precondition for accelerating GDP growth. Both ministers Jerzy Hausner and Grzegorz Kołodko suggested that the government might focus on the exchange rate, aiming at its weakening. Unfortunately the government's competence in this area is strictly limited, because it is in possession of hardly any tools that would allow for direct control over exchange rate. Therefore, having little possibilities of influencing the zloty directly, politicians often tried to exploit the maintaining market nervousness by talking down the currency and fuelling uncertainty regarding zloty prospects. However, recently the government's arsenal was equipped with a new weapon (which by the way has been suggested by the MPC in 1H02 during its talks on the FX policy with minister Marek Belka). The Ministry of Finance announced that it is going to purchase foreign currencies on the market for the repayment of interest on foreign debt (so far they were buying the currencies from the NBP, which did not impact exchange rates). Deputy finance minister Ryszard Michalski ensured that they would be ready for making such operations very soon, already in 1Q03. However, the market was not informed about amounts, currencies, and dates of planned transactions and – according to the latest FinMin's declarations – will not receive such information. This lack of information is of course on of the elements aimed at boosting market uncertainty and therefore enforcing the effects of future intervention measures.

While verbal interventions, even those made by prominent officials, have not impressed the Polish FX market for a long time, the emergence of new instrument in finance minister's hands appealed to the investors at once. Already the announcement of FinMin's possible activity on the FX market cooled down sentiment of market participants, and unconfirmed rumours that the ministry started to purchase currency via one of big international banks were among the main reasons of big panic and investors' flee. This led to rapid zloty depreciation by more than 5% in mid-January.

If the market reacted so violently only to the suspicions about FinMin's FX purchases (despite the ministry was not ready for the transactions), one could suppose that substantial tension will remain after the ministry will announce the readiness for buying currencies. And it will be especially high around the likely dates of purchases. We believe that in fact the growth of fears and uncertainty among investors awaiting ministry's operations will be the main vehicle for potential zloty depreciation. Meanwhile, the realisation of transactions, which are unlikely to be very big (see below), should lead to a market stabilisation and a return of the exchange rate to its long-term trend. In this case the dealers' saying "buy on rumours, sell on news" should be very adequate – the exact moments of FinMin's transactions should create perfect opportunities for selling dollars and euros at the attractive rate. The next interest payments related to Poland's foreign debt servicing are scheduled for March, however it seems very likely that FinMin could start purchases of foreign currencies even earlier. Therefore in the upcoming weeks we could see another wave of zloty turbulence. One could wonder however, to what degree those short-term developments would influence long-term trends on the FX market. Whether the FinMin's "interventions" would prove effective enough to curb down or even reverse the long-term trend of zloty appreciation, determined by fundamental factors? To answer such questions, one should determine first, how big would be the amounts at FinMin's disposal and how many foreign currencies it will try to buy.

It has to be mentioned that the Ministry of Finance clearly said that it would buy foreign currencies on the Polish market only for the repayment of interest of foreign debt while principal payments will be rolled over on the offshore markets. It is a factor limiting the potential amounts that the ministry could buy on the FX market. Planned interest payments for foreign debt servicing in the next couple of years are presented in the table below.

The figures in the table are only an approximation. They are based on the information as in November 2002, and obviously do not include the interest on foreign bonds that will be issued in future for rolling over maturing foreign debt, nor the reduction of interest because of possible premature repurchase of external debt (FinMin already announced that it was going to buy back all the outstanding PDI Brady bonds amounting to ca. US$1.1bn).

Planned interest payments for Poland's foreign debt servicing

	2003*	2004	2005	2006
INTEREST PAYMENTS (US$m)	**1 320.6**	**1 445.3**	**1 577.0**	**1 724.6**
INTEREST PAYMENTS (PLNm)	**5 282.5**	**5 765.0**	**6 339.4**	**7 072.6**
Interest on foreign loans and credits	2 323.0	-	-	-
Interest on foreign bonds and Brady bonds	2 279.0	-	-	-
Payments due to guarantees granted for foreign loans	625.4	-	-	-
Other guarantees and assurances	55.0	-	-	-

* Value in PLN according to 2003 Budget Act

Source: Ministry of Finance (as for 20 Nov 2002)

It is worth noticing also that regardless of government's and finance minister's will, the scope of FinMin's "interventions" will be strictly constrained not only by the value of interest due but also by the current situation of public finances. Realisation of budget in 2003is likely to be anyway, due to overly optimistic macroeconomic assumptions, and 2004 will be a real challenge because of Poland's contributions to the EU budget. Meanwhile, a purchase of foreign currencies for debt servicing on the market hurts the budget twofold: first, the expenses on foreign debt services will be higher if FinMin really manages to weaken the zloty; second, it lowers the NBP's profit (to be transferred to budget next year), as so called revaluation reserve is not released when the currencies are bought on the market rather than in central bank. Perhaps the latter effect was the reason why the Ministry of Finance started to strive for releasing a part of the NBP's revaluation reserve – see more details in *Government and politics* section.

It all suggests that the FinMin's weaponry, so feared by the financial market, is not that heavy, and therefore not that dangerous. The perspective of showing additional demand for foreign currencies at around US$1.3-1.5bn <u>annually</u> does not seem to be a factor, which should trigger rebuilding medium- and long-term forecasts of exchange rates. Daily turnover on the Polish FX market is estimated at US$1-2bn and the annual net balance of balance of payment's financial account amounts to US$7bn. Therefore the annual demand for hard currencies that Ministry of Finance could show on the market does not seem to be a significant top-up for the long-term exchange rate trends. Nevertheless, one has to realise that (as we have written above) in the periods close to FinMin's possible transactions investors' nerves and zloty volatility could be as high as they used to be in the middle of January.

Although the Ministry of Finance does not want to reveal its strategy regarding the amounts and dates of planned purchases, one could formulate a couple of hypothesis regarding the likely scenario of "interventions". It seems highly unlikely that they would decide to buy the entire amount scheduled for all year in one or two huge shots. In such a situation, despite the short-term shock for the market would be undoubtedly very strong, then after a deep breath investors would surely realise that all the missiles for the year have been wasted and finance minister would be left with nothing but helplessly watching steady zloty appreciation again. It seems probable that the whole operation would be divided into four-five transactions, amounting to US$200-300m each. The dates would be approximately indicated by the schedule of interest payments on Polish foreign debt[1], but most of all they should be dependent on current exchange rate developments. Minister Grzegorz Kołodko said recently that foreign currencies needed for the debt servicing would be bought "as cheap as possible". It obviously stems from the hard budget constraint, that we referred to earlier – the current exchange rate would have direct impact on this year's costs of foreign debt servicing. It suggests choosing such moments for the "interventions" when the exchange rate would approach a local maximum against dollar or euro.

The last issue related to FinMin's "interventions" is a question about currencies, which it will want to buy on the market. The ministry did not share with us the detailed information about currency structure of planned interest payments. However, if we assume that it is similar to the currency structure of Polish foreign debt (see table below), then euro should have dominant position in those payments. Nevertheless, considering that we expect market's reaction more to announcement than to realisation of MinFin's transactions, the structure of currencies they would buy should not have a major impact on the zloty exchange rate fluctuations.

Currency structure of Poland's foreign debt

Currency	Share in foreign debt
EUR	46%
US$	34%
Other currencies*	21%

* i.e.: Worldbank's pool, CHF, GBP,CAD,NOK,SEK,JPY
Note: data as for November 2002
Source: BZ WBK estimates based on Finance Ministry's data

Second half 2003: great accumulation

Apart from the potential actions taken by the Ministry of Finance, this year will see a couple of events which can have significant impact on the moods recorded on the Polish financial market. Almost all of them should be recorded in second half of the year and, potentially, each of these factors can result in increased apprehension on the part of the investors and temporary weakening of the Polish zloty.

The first in the line of the key events will be the accession referendum where the Poles will decide whether our country should join the EU based on the terms and conditions negotiated by the government. The most likely referendum date is 8 June. We have mentioned it on a number of occasions that the support for the European integration among those who declare the will to participate in the referendum stays at a safe high level (above two thirds) which seems to ensure a positive outcome of the vote. The biggest question mark is still over the turnout, which may be below the required 50%. Fears of such a situation, where the Polish accession to the EU could be complicated or delayed, may drive the volatility of the PLN rate up around the middle of the year. This might happen, especially if it turns out that the estimated turnout declines as a result of a negative campaign conducted by the EU-opponents and/or the ineffective information policy of the government.

Another factor, which will determine the mood on the Polish financial market, is the actions taken by the government and the Minister of Finance in respect of the fiscal policy. Grzegorz Kołodko said that the public finance reform, required to ensure the budget stability following the accession, was to be presented in 3Q03, at the latest. Usually, the first core parameters of the budget act are presented in July or August. These figures, along with the action pack defining the utilisation of the EU funds and preventing the explosion of budget deficit in 2004, will be subject to rigid assessment by the market which will determine, to a large extent, the PLN rate and the yield on Polish treasuries in 2H03. Even though we do realise that it is difficult to expect a thorough reform of the public expenses, covering e.g. overhaul of the welfare system, financial restructuring of the budget-related agencies and funds, etc, we are convinced that the solutions presented by Mr Kołodko will help the market "swallow" the draft 2004 budget without panic. The budget deficit is unlikely to fall, however, with a bit of luck, it should not increase substantially either. With effective marketing done by Kołodko and riding the wave of optimism brought by the positive outcome of the accession referendum, the overall sentiment on the Polish financial market should not deteriorate substantially.

An important event for the financial market will be the change in the composition of the MPC. The term of office of the existing MPC expires at the beginning of 2004. Therefore, at the end of this year, Sejm, Senat and the President of the Republic of Poland should appoint three (unless the NBP Act changes by that time) candidates for new members of the MPC each. Speculations as regards who is the most likely candidate are bound to be stirred

[1] Next interest payments on bonds are scheduled for March and April, next ones for July and October. FinMin does not publish the agenda regarding interest payments on loans and credits.

in 2H03. For the market, it will be important whether the persons pencilled in to take over the management of monetary issues will be susceptible to the suggestions and demands of the government and the parliament (as most of the pessimist fear), or whether this group will comprise enough professionals who are capable of managing the state monetary policy in a responsible manner directly prior to the Poland's entering the Eurozone. Being aware of the marginal predictability (and often also rationality) of the political decisions, such as, undoubtedly, the appointment of the MPC members, especially in the periods of high pressure and great social expectations, in our opinion the worst-case scenario for the creation of the new MPC is rather unlikely. A separate analysis in one of the next MACROscopes will be devoted to our expectations concerning the future composition of the MPC. Let us just say now that in the most likely scenario, the new composition of the MPC will not 'scare' the financial market to the extent that it would cause panic among the investors. This will be due to the fact that, e.g. the freedom of the Polish central bank and the autonomy of the monetary policy it pursues will be gradually limited as prospects of Poland's entering the Eurozone become more realistic.

Even though the interest rate policy of the central bank may gradually lose significance for the financial market, the new MPC will be left with one very important tool, namely the exchange rate. Upon accession to the EU, we will get closer to the moment of the entrance to the ERM-2. This is inseparably related to the need to set a fixed EUR/PLN parity as the midpoint of the admissible FX volatility range (agreeing the volatility range is a separate issue, but let us now assume that, in line with the declarations of the joint NBP-FinMin team, it is to be at +/- 15%). Before the parity is agreed, it will be necessary for the Ministry of Finance to reach a consensus on this issue with the NBP, and then to reach a preliminary agreement on this issue with the European Commission. These agreements should enter the key stage at the end of this year. It seems likely that at various stages of work and consultations, more or less official information about the projected or proposed parity levels will leak out to the market, which of course may trigger increased FX volatility. Special attention will be paid to the statements made by the representatives of the Ministry of Finance and the candidate MPC members, as they will be the ones to decide about the Polish stance on the issue of parity in the negotiations.

It can be anticipated that the stance of the Polish government on the issue of PLN/EUR parity will be more or less similar to that presented recently by Grzegorz Kołodko – he was quoted as saying that the optimum EUR/PLN level would be 4.35. Similar views may be also presented by some of the candidate MPC members (actually, these views may be one of the key factors determining their appointment by the parliament). However, what will matter for the long-term market trends are not only the statements made by the representatives of Polish economic circles, but also by the EU. It seems unlikely that the EU would accept the central parity which was indeed (e.g. 15-20%) far from the average market rate from the period preceding the entrance to ERM-2. If, on the other hand, the central rate is set several percentage points above the market rate prevailing in a given period, the latter does not have to change significantly. As a result, positive deviation of the zloty market value against the central parity will be recorded following the entrance to ERM-2, similarly to what happened across the bulk of the period when the zloty was still fluctuating in the controlled range around central rate (1995-2000).

Potential risk factors for the FX market in 2003 and their potential long-term implications

Event / factor	Projected date	Impact
Accession referendum: NO	8 June	*
Accession referendum: turnout <50%	As above	**
2004 draft budget	July-August	****
List of candidates for the MPC	Q3	**
Recommended PLN/EUR parity	Q3/Q4	***

Note: The number of asterisks reflects the subjective, anticipated long-term implications of a given factor for the weakening of PLN (the product of the likelihood of a given event, which could weaken the PLN and the potential impact on the FX rate trend).
Source: BZ WBK

Each of the risk factors listed above can, potentially, result in growth of uncertainty on the Polish FX market and temporarily weaken the zloty. Under special circumstances, their implications could accumulate triggering more conspicuous and more permanent changes in the exchange rate in 2H03. However, in the core and most likely scenario, we expect that the long-term FX change tendency will not substantially change against what we assumed in the previous months. The average PLN rate against the basket of the two core currencies should gradually strengthen in the subsequent quarters of this year. This process will be also continued in the subsequent years. Detailed information on the projected EUR/PLN and USD/PLN rates are presented in the tables at the end of the report.

Impact of transfers from the European Union

The bottom line of two preceding chapters was that despite relatively high risk of short-term turbulence on the FX market, resulting in temporary zloty depreciation, our forecasted long-term trend for zloty appreciation on the road to euro should not be influenced much in 2003. In one of the previous MACROscopes we have argued that among the factors that might strengthen the zloty in subsequent years there will be the inflow of transfers from the European Union. Considering that the levels of future financial flows are more or less recognised after the conclusion of accession negotiations, it is worth answering the question how big would be the potential impact of EU funds on the situation on the Polish FX market.

Balance of flows between EU and Poland in 2003-2006

	2003	2004	2005	2006
NET TRANSFERS FROM EU (€m, 1999 prices)	**844**	**1 409**	**2 640**	**3 001**
Total payments from EU	844	2 985	5 069	5 496
Total own resources	0	-1 576	-2 429	-2 495
NET TRANSFERS FROM EU (€m, current prices)	**914**	**1 556**	**2 973**	**3 447**
Total payments from EU	914	3 296	5 708	6 313
Total own resources	0	-1 740	-2 735	-2 866
NET TRANSFERS FROM EU ($m, current prices)	**957**	**1 556**	**2 973**	**3 447**
Total payments from EU	957	3 296	5 708	6 313
Total own resources	0	-1 740	-2 735	-2 866
EUR/USD exchange rate	*1.05*	*1.00*	*1.00*	*1.00*

Source: BZ WBK estimates

In January issue of MACROscope we have presented approximate values of financial flows between EU and Poland until 2006, estimated in accordance with the outcome of accession negotiations completed in December. Starting in 2004, the transfers will be made in both directions (to and from Poland). Of course it does not necessarily mean that at the time of paying its contribution to the EU's budget the Polish government will have to buy the relevant amount of euros, and after the support funds from EU will be acquired, they will be automatically switched into Polish zlotys. It is very likely that Poland will try to work out a solution allowing for compensation of payments in both directions, in a way that only the surplus of transfers from EU over the Poland's contribution would be switched into zlotys. Such a solution has been already mentioned by representatives of both finance ministry and the central bank. NBP president Leszek Balcerowicz said already in December 2002 that a part of the EU funds might go back to Poland in zlotys from the special account, on which Poland's contribution to the EU budget would be paid (also in zlotys). He recalled the examples of Denmark and Sweden, which used to employ such a mechanism in the past. Similar opinion was expressed in the middle of January by deputy finance minister Jarosław Stypa, who hinted that the FX market should pay attention only to the balance of flows between EU and Poland in the upcoming years. He said "there will be a special account for settlements with EU, most likely in the NBP, on which the surplus of EU funds over Poland's contribution would be transferred".

The table below presents estimated balance of flows between EU and Poland until 2006. It shows that while in 2004 the net balance of transfers will barely offset the sum of currencies that FinMin wants to buy on the market for foreign debt servicing, then in two subsequent years it would grow more than twice. According to deputy finance minister Jarosław Stypa Poland will receive much bigger structural funds after 2006 (however no estimated values are available yet). What is interesting, deputy minister said it is an argument for early euro adoption in Poland, allowing for removing foreign exchange risk – clearly Finance Ministry is afraid of significant impact of EU transfers on zloty exchange rate.

The impact of incoming EU funds on the Polish FX market would depend not only on the amount, but also on the procedures of the exchange from euros into zlotys. As far as it goes, we did not manage to get any reliable and detailed information about the possible methods of exchange from one currency to another in future. However, from what we already know, it seems likely that a substantial part of the "surplus" EU funds may not go through the Polish FX market. The money transferred from EU will go to the central account of so-called National Fund held in the NBP. From there the money will be sent out to particular ministries and further to units executing EU projects. Therefore it seems that if Ministry of Finance, being in charge of National Fund's account, would like to minimise the impact of EU funds on zloty appreciation, the switch from euros into zlotys would be made entirely by the NBP. Of course it would lead to automatic increase of monetary base, i.e. creation of central bank's reserve money, however the direct impact on the exchange rate would be eliminated. Nevertheless, if FinMin's official explicitly was afraid of FX risk related to inflow of EU funds, then perhaps the ministry already realised that it would be impossible to convert all of the net EU transfers in the NBP without a risk of destabilisation of monetary situation. Unfortunately, lack of any official comments on this issue makes it very hard to determine how big could be the potential scale of currency exchange related to EU funds on Polish FX market.

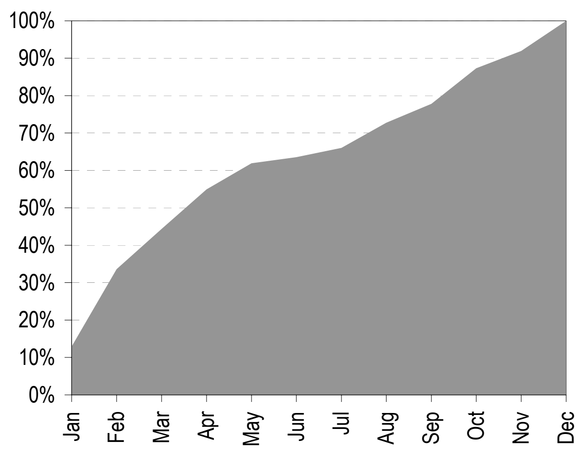
Purchasing Treasury securities

Beginning of each year is usually a period of an increased supply of Treasury securities on the primary market. In addition, 2003 will be the second year in sequence when the Treasury securities issue is likely to be enormous and will be close to PLN100bn. Therefore, this month, similarly to last year, we make an attempt to asses how many, when and what kind of securities will be issued by the Ministry of Finance. The tender sales of the securities result from the borrowing requirements of the State Treasury. It is necessary to obtain funds from a financial market to finance the budget deficit (although in this respect the income from the issue of Treasury bills and bonds is not the sole source to cover the deficit) and to repurchase maturing securities issued in previous years.

Financing of the budget deficit

In line with the 2003 Budget Act adopted by the parliament and signed off by the President, this year's deficit is to total PLN38.7bn, of which 33.6bn is to be covered with domestic sources. The planned privatisation proceeds total PLN9.1bn, of which PLN7.4bn is to finance the deficit. However, PLN3.3bn was allocated to compensation payments for the budget sectors' employees. Having factored in other income and expenses, which are not included in the budget income and expenses either, we arrive at PLN29.3bn which, in line with the act, is to be financed with the issue of domestic Treasuries over the entire year.

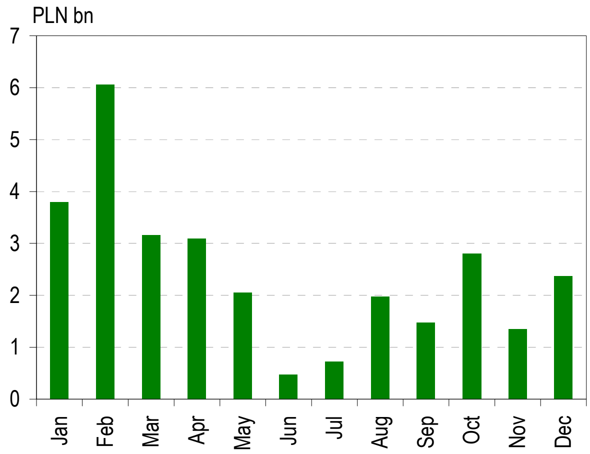
Average deficit in 2000-2002



Note: YtD, % of the annual deficit
Source: *Ministry of Finance, BZ WBK*

In order to estimate borrowing requirements of the State Treasury resulting from the deficit volume in individual months of this year we considered trends, which appeared in 2000-2002. The analysis of data on the budget performance allows for notifying quite evident regularity in the performance against the budget plan in the subsequent months. The highest deficit is always recorded in February (on average it is 20.7% of the annual deficit) and after Q1 it is close to 50%, so that after four months (1/3 of a year) it clearly exceeds 50% of the plan. High deficit in the beginning of a year is typical and results from cumulating of some expenses in this period (e.g. payment of subsidies for local governments). The lowest deficit (on average it is 1.6% of the annual figure) is always recorded in June, when the NBP lodges the last year profits to the budget.

Deficit financed with the Treasuries' issue in 2003



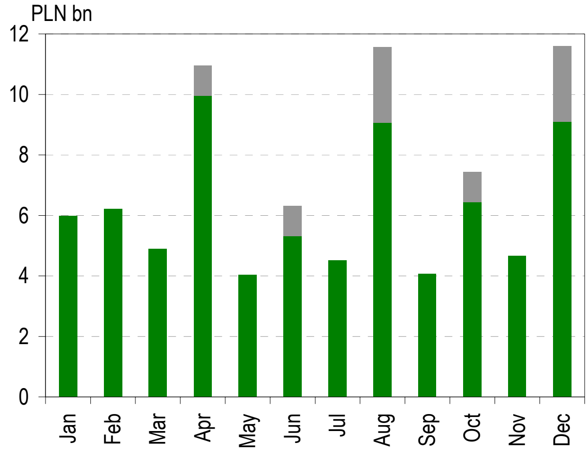
Source: Ministry of Finance, BZ WBK

Comparing the obtained profile of the budget realisation to the amount, which is to be financed with the issue of Treasury securities this year, we have come up with the chart presented above. We have assumed some simplification here which will be abandoned in the subsequent sections of this analysis, when we translate the borrowing requirements into the securities issue in subsequent months. We assume that the issue profile should comply with the profile of the budget deficit realisation during the year, while in reality the Ministry has some room for manoeuvres using reserves and other sources of funds.

Repurchase of maturing securities

We have estimated that as at the end of January 2003 the State Treasury must repurchase maturing domestic securities totalling ca. PLN78bn and these liabilities will grow further by PLN4bn after the issue of short T-bills in the following months (primarily 13- and 26-week bills), which will mature still before the year end. The better part of this debt is represented by the issue of T-bills – 57.3%, i.e. PLN47bn (having factored in the issue of during-year bills issue). The substantial part is also represented by the wholesale T-bonds (OK, OS, TZ series) totalling PLN28bn, i.e. 34.1% of this year's liabilities. A substantially smaller amount is required for the purchase of saving bonds (DOS and COI series) – PLN4.2bn, i.e. 5.1%. Moreover, PLN 2.8bn (3.4%) will be spent by the Ministry on the repurchase of the so-called non-market Treasury securities (USD bonds, restructuring bonds, etc.).

Treasury securities maturity in 2003



Note: Bonds repurchase forecast has been marked grey.
Source: Ministry of Finance, BZ WBK

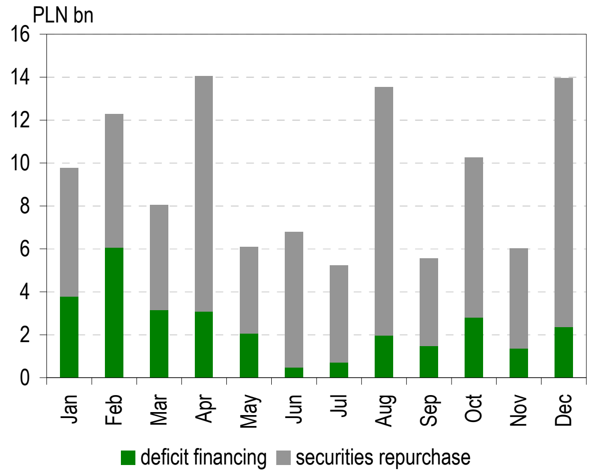
The chart above presents our estimation of the total value of Treasury securities maturing in individual months of 2003. As it seems, Treasury securities maturity profile is quite diversified as the amounts range from PLN4bn to PLN12bn. Each month liabilities due to the repurchase of T-bills total PLN3-4bn, although at times they may be as high as PLN5bn (in January and October). Liabilities due to saving bonds represent relatively marginal but at the same regular payments. Liabilities due to wholesale bonds are substantial and irregular, which brings about substantial cumulating of payments in April, August and December. The wholesale bonds will also be repurchased in even months, which also translates into higher columns in the chart.

In order to reduce the cumulating payments, which for the first time occurred in 2002, since November 2001 T-bonds switching tenders have been organised. In the course of them long maturity bonds, which are sold on the primary market in a given period of time, are offered in exchange for securities which will be repurchased in the forthcoming months. Based on the results of the tenders so far we estimated and marked on the chart the highest bonds amounts (with the assumption of the most favourable market situation and high determination of the Ministry), which may be repurchased before the maturity term of individual securities. They total PLN8bn. In our assumptions we factored in the fact that OS0203 bonds (maturing in February) switching has been completed, and the switching of bonds maturing in April (OK0403 and CK0403) has been in progress and over the remaining two months the Ministry will repurchase less securities than in the case of August or December series. It should be emphasised, however, that tenders do not in fact limit T-bonds issue, and they only transfer some supply from the Wednesday's auction closely monitored by the entire financial market to the earlier tenders on Tuesdays which are monitored with slightly less attention.

Funds to be obtained from financial market

By summing up the amounts required for financing the budget deficit and the repurchase of Treasury securities we arrive at over PLN111bn the Ministry of Finance must obtain in order to close the balance of income and expenses this year. The chart below presents how this amount spreads over the following months (the chart was generated as a result of summing up two previous charts).

Borrowing requirements of the State Treasury in 2003

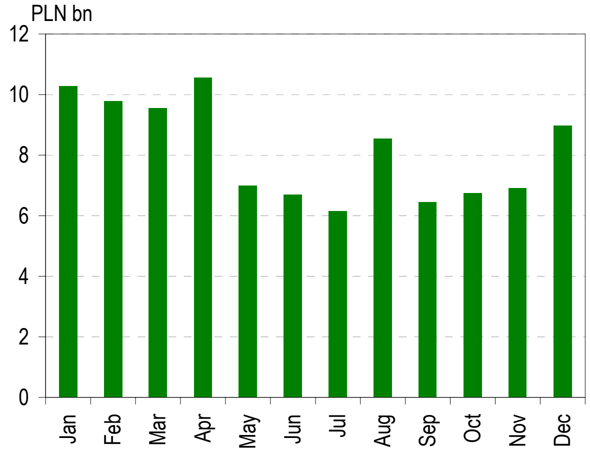


Source: Ministry of Finance, BZ WBK

February, April, August and December will be the most difficult months for the Ministry as the substantial cumulating of payments occur then. In the case of the last three months it results from cumulating payments due to the repurchase of securities, while in February the high amount results from high budget deficit. As has been stated above, liabilities due to the maturing bonds will be most likely reduced in the course of the switching tenders to which some of the supply will be transferred. Moreover, data from previous years indicate that the Ministry does not issue on a monthly basis as many securities as indicated by the borrowing requirement estimates, but in some way it flattens the supply. In these months when the requirements are smaller, the issue exceeds the requirements. In this way a liquidity reserve is generated in the form of funds deposited in the NBP accounts, which are used in the hardest months so that the securities supply is not excessive then. This reserve may also be generated from other sources, e.g. a substantial amount from the privatisation transaction.

According to the information on the budget realisation, as at the end of last year, PLN 7.3bn was deposited in the State's accounts. This money can be used for regulating budget liquidity at the beginning of this year. The privatisation proceeds will not support budget liquidity as it is seems that the better part of them will show up only in H2 or even in Q4.

T-bills and T-bonds supply forecast



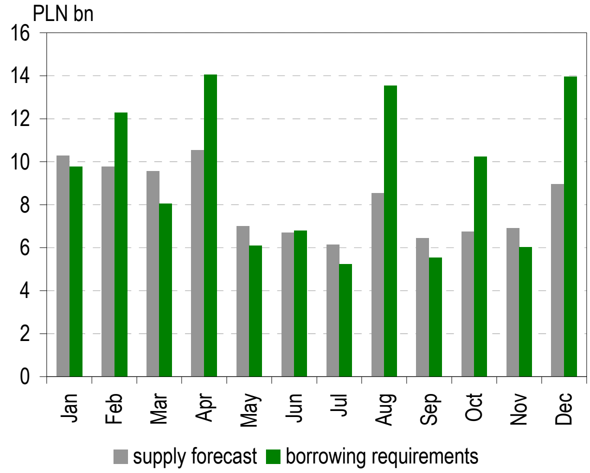
Source: BZ WBK

Supply of Treasury bonds and bills

What will be the supply level of bills and whole sale T-bonds on the primary market in the entire 2003 and individual months? In the case of the wholesale T-bonds we focused exclusively on the primary market tenders, excluding this part of issue which will take place in the course of the switching tenders. Starting from our estimations of the State Treasury borrowing requirements we reduced them by the projected repurchase of bonds in the course of the switching auctions, i.e. by PLN8bn as well as by an amount, which according to our assumptions, may be obtained from the retail bonds issue. We have assumed quite an optimistic scenario, that each month the sales will total PLN500mln, which totals PLN6bn p.a. This way we calculated the total annual supply of bills and bonds of PLN97bn. In turn, based on the data from previous years, we assessed the volumes of supply, which may be transferred from months when borrowing requirements are high to those months when they are smaller. Finally, we came up with the monthly volumes of the Treasury securities supply on the primary market, which are presented on the chart. The values of the bills and bonds issues in the entire year will be at a similar level, while their mutual relation in subsequent months will depend on the current market situation.

The following chart includes comparison of our forecast to the estimated borrowing requirements. In our opinion the issue may be limited in the hardest months down to PLN9-10bn, against the needed maximum of up to PLN14bn. Such a high supply will occur as long as for the first four months of the year, which are bound to represent hard times on the treasury securities market, and then again in August and December. In other months the Treasury securities supply should total PLN6-7bn.

Treasuries' supply forecast vs borrowing requirements



Source: Ministry of Finance, BZ WBK

In addition, a potential growth in the Treasury securities supply is also an important issue, in case the last year scenario materialised again and the better part of privatisation proceeds were not generated. Notwithstanding the fact that the new Treasury Minister has announced an accelerated process of the State-owned companies sales, however, depending on the potential deficit volume, the growth in the issue of securities could amount to even PLN5bn and would accumulate in H2, which means that in that period a monthly supply could go up by ca. PLN1bn.

Economic update

- **December saw continuation of previous trends**
- **GDP growth is slowly accelerating**
- **....while inflation has not hit the bottom yet**
- **2002 has been the worst on the labour market since the beginning of transition**

Economic data for December 2002 confirmed the trends observed for a couple of months. Industrial output and retail sales continued to grow and foreign trade turnover stayed at high level. In the entire 2002 the GDP growth was 1.3%, i.e. slightly more than last year. However, in 2001 the economic growth dynamics was increasingly lower on a quarterly basis, while in 2002 one could witness a gradual increase in the economic growth dynamics. Although the CSO has not announced the economic growth estimates for the 4Q02 itself, according to our calculations the growth met our expectations and totalled ca. 2%YoY. It means that, in line with our projections, the GDP growth dynamics is very moderate. Further gradual improvement of the economic growth dynamics should bring about the average annual growth of ca. 3% in 2003.

Despite a gradual economic recovery, which in its better part results from the continued relatively high consumption demand, inflation pressure is very marginal and CPI reached another historically low level in December. The above-mentioned continued, and even accelerating consumption growth is surprising given the situation on the labour market. Unfortunately, contrary to the July statements of Grzegorz Kołodko the unemployment rate not only did not start to fall from November onwards, but it recorded another growth in December, again in line with our expectations, and totalled 18.1%. It should be noted, however, that this rate is much better than the one projected a year ago, as during 2002 the unemployment growth rate tempo substantially decreased. In the last month of 2002, the decrease in the M3 broad money aggregate and personal bank deposits continued; credit growth remained poor.

In 4Q02 industrial output was still growing

In December 2002 economic activity in industry turned out to be lower than expected – industrial output fell by 2.5%MoM and grew by 5.1%YoY growth, while market consensus pointed to 7.7%YoY on average. The annual growth rate was higher than in November (3.1%YoY), however one should bear in mind that it was boosted mainly by the higher number of working days than in December 2001. Seasonally adjusted growth rate of industrial output slowed down to 3.2%YoY from 6.5%YoY in November. The figures disappointed the market, suggesting that the economic recovery may be weaker than expected. However, one should remember that data on industrial production growth in annual terms are volatile and also in the past they differed much from one month to another. It is usually caused by one-off factors. For example, in November 2002 we observed significant growth (close to 30%YoY) of output in "manufacture of other transport equipment" while in December 2002 it recorded 51%YoY fall substantially affecting the overall figure. This was possibly related to sale of a few ships (this also happened in the past and affected also foreign trade data), which in 2001 were probably sold in December and not in November as in 2002. Because of such shifts in statistical base resulting in high volatility of annual growth figures on a monthly basis it is worth to look at average values over longer time span than a month (see table below). It shows that industrial production was growing quite robustly and even accelerated (seasonally adjusted series) at the end of 2002. This confirms that economic recovery is continuing although its pace is not very impressive. However, one should remember that nobody but finance minister expected sharp recovery.

Real economic activity indicators, %YoY

	1Q02	2Q02	3Q02	4Q02
Industrial production (unadjusted)	-1.4	-0.6	3.8	3.8
Ind. prod. (seasonally adjusted)	-0.7	-0.4	2.5	4.3
Ind. prod. (net of working days) *	0.1	-0.6	2.1	5.7
Construction output	-16.6	-9.6	-6.8	-9.3
Investments	-13.2	-8.4	-6.3	-4.0*
Retails sales in nominal terms	7.1	2.5	6.1	5.0
Retails sales in real terms	6.2	1.3	5.1	4.3**
Private consumption	3.5	2.9	3.1	3.6*
GDP growth	0.5	0.8	1.6	2.0*

Note: * BZ WBK estimations; ** average for October-November
Source: CSO, BZ WBK

Another argument suggesting that the economy will gain momentum very slowly is data on December's construction output. According to the CSO it grew by 37.1%MoM but in annual terms its fall deepened to 10.4%YoY from 8.6%YoY recorded in November. These figures suggest that investment activity in the economy remains limited and we will not see sharp rebound in investments in 4Q02. We do not change our view and still forecast that GDP growth will not exceed 3% in 2003.

...similarly to retail sales

Retail sales in December grew in nominal terms by 18.7%MoM and 4.1%YoY. Although lower than our forecast of above 5% growth, this result was relatively good. The fastest growth was recorded in motor vehicles (26.4%YoY against 12.9%YoY in November), which confirmed previous information given by a company monitoring new cars market in Poland. Relatively high growth rate was also observed in cosmetics and pharmaceuticals (19.4%YoY) and fuels (11.1%YoY). On the other hand, growth rates in five other categories of retail sales experienced deterioration.

December's result means that in the last quarter of 2002 retail sales increased in nominal terms on average by 5.0%YoY after 6.1%YoY in 3Q02. This suggests that the growth rate of private consumption is likely to be lower in 4Q02 compared to the previous quarter but preliminary CSO's data on GDP growth for the whole 2002 indicates that it was on the contrary. However, as we wrote many times in the past, perspectives of the economic growth in 2003 will depend more on investment activity than on consumption.

...as well as foreign trade turnover

The CSO's customs-based foreign trade statistics for January-October 2002 period confirmed positive trends observed in previous months. The data showed that Polish exports and imports were expanding at growing pace at the end of last year. In January-November export expressed in US dollars was 11.4% higher than in corresponding period of 2001, while the analogous growth after ten months amounted to 8.9%. Import grew 8.2%YoY in January-November against 6.4% in first ten months. Of course foreign trade statistics in US dollar terms were boosted by the sharp euro appreciation against US dollar, which took place in 2H02. In the table below you can also find relevant figures in Polish zlotys and in euro, computed by the statistical office. However, even those figures clearly indicate that growth of Polish exports and imports must have rapidly accelerated in November as the cumulative ratios for the fist eleven months of 2002 are markedly higher than those for the first ten months. This is confirmation of previous central bank's data for that period.

Foreign trade statistics according to the CSO

	Jan-Nov 2002			Jan-Oct 2002		
	PLN	USD	EUR	PLN	USD	EUR
Export (%YoY)	11.0	11.4	6.8	8.8	8.9	5.3
Import (%YoY)	7.7	8.2	3.7	6.3	6.4	2.8
Trade balance (bn)	-52.5	-12.8	-13.7	-47.6	-11.6	-12.5

Source: CSO

The NBP's statistics on a payment basis show that fast acceleration of the foreign trade turnover was continued also in December. According to the NBP Poland's trade deficit reached merely US$943m, contracting from the November's level of ca. US$1bn (versus the seasonal hike that typically takes place in December). This was the consequence of sharp exports' upsurge by 10%MoM and more than 30%YoY which outpaced also strong import growth (4.2%MoM and over 24%YoY). As we have written before, exceptionally high annual growth rates for export and import partly resulted from two factors: low exports levels in December 2001 and rapid euro appreciation against US dollar boosting the statistics expressed in dollar terms. To proxy the impact of the exchange rate fluctuations we have estimated annual growth rates of trade turnover in euros, in zlotys, and in the synthetic currency unit consisting of euro and dollars in the 2:1 ratio (approximate currency structure of payments in the Polish foreign trade in last two years) – please see the table below. Although the growth rates in other currencies are obviously lower, the results clearly confirm two major developments: export performance remains incredibly robust despite continuing stagnation in Poland's major trading partners' economies; import started to accelerate in 4Q02, which might reflect shy revitalisation of domestic demand, however still it seems to be only a moderate improvement.

Unexpectedly strong export performance in December might seem to stand at odds with the pattern of industrial production, which was much stronger in November than in December. However, one should remember than the timing of payments (reflected in NBP's data) does not have to match exactly the timing of actual transactions and production in industry.

Exports and imports according to the NBP, %YoY

		USD	EUR	PLN	2/3EUR / 1/3USD*
Dec 02	Exports	30.4	14.2	27.0	19.2
	Imports	24.1	8.7	20.8	13.4
2002	Exports	9.3	3.3	8.7	5.1
	Imports	3.4	-2.1	2.9	-0.4

Note: * the relation approximately reflecting currency structure of Poland's foreign trade
Source: NBP, BZ WBK calculations

Also the balance of unclassified flows was a positive surprise this time, growing to US$466m from US$298m in November. This figure reflects mostly the currency exchange related to cross-border trade and Polish citizens' income from the work abroad.

Deficit of the whole current account shrank to US$519m in December from US$744m in a month before. The gap for the entire 2002 reached US$6.7bn, i.e. ca. 3.5% of GDP against 4% of GDP (US$7.1bn) in 2001 and forecasted 4.2% of GDP in 2003. The deficit in December was notably smaller than we forecasted, mostly because of two factors: smaller trade deficit and higher surplus of unclassified flows.

Deficit on the current account was offset by surplus on financial and capital account. In December the net inflow of foreign portfolio investments remained strong exceeding US$300m. What was interesting, the net inflow of foreign investments in equities was not only positive (for the first time since the mid-2002), but well exceeded US$100m, which happened for the first time since November 2001. In 2002 as a whole there was dramatic outflow of foreign investments in equities, amounting to US$565m, while the net inflow of investments in debt securities surged 86%YoY, reaching almost US$3.5bn. Also, there was clear and sizeable slowdown of foreign direct investments' inflow, which reached nearly US$4bn against US$6.8bn in 2001. In 2002 current account deficit was covered by net FDI in 55%.

GDP growth reached 1.3% in 2002

The conclusion that the economy is gradually and moderately gaining momentum drawn form above-mentioned statistics finds confirmation in preliminary CSO's data on GDP growth in 2002. According to the calculations, Polish real GDP grew 1.3% in 2002, which was exactly as much as we have expected. In 2002 private consumption increased by 3.3% and fixed investments fell –7.2%, which resulted in total 0.8% growth of domestic demand. It means some improvement in relation to 2001, when the corresponding growth rates reached 2%, –8.8% and –1.7%. But clearly the improvement was not very impressive, which confirmed that the economic revival was only moderate last year.

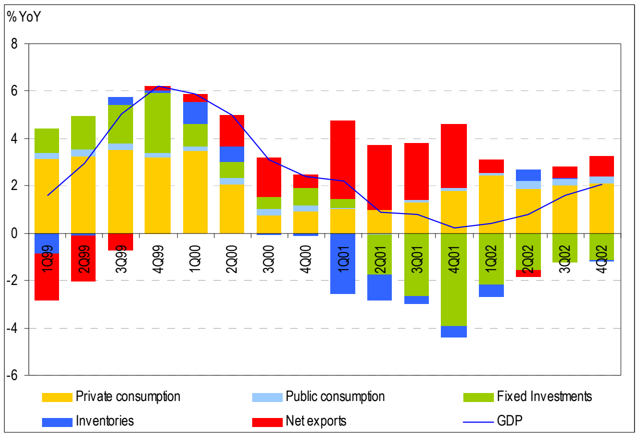
Real growth of GDP and its components, %YoY

	1Q02	2Q02	3Q02	4Q02*	2001	2002
GDP	0.4	0.8	1.6	2.0	1.0	1.3
Domestic demand	-0.2	1.0	1.1	1.2	-1.7	0.8
Total consumption	2.8	2.6	2.8	3.2	1.7	2.9
Private consumption	3.5	2.9	3.1	3.6	2.0	3.3
Public consumption*	0.4	1.6	1.8	1.9	0.3	1.4
Gross accumulation	-18.3	-5.9	-6.0	-4.1	-12.6	-7.3
Fixed Investments	-13.2	-8.4	-6.3	-4.0	-8.8	-7.2
Inventories*	30.8	130.0	1.4	-10.0	-92.0	-41.0
Net exports*	-13.0	6.5	-17.0	-24.0	-41.6	-11.3

Source: CSO, BZ WBK; * BZ WBK estimates

CSO have not calculated GDP figures for 4Q02 alone yet, however one could approximate those figures given the statistics released for whole year and for the first three quarters – please see the table below for full results. According to our estimations GDP growth in 4Q02 was consistent with our forecast and amounted to 2%YoY. This was confirmed by CSO's president Tadeusz Toczyński, who said that "GDP growth in 4Q02 could be estimated at ca. 2%". Nevertheless, such growth rate has been achieved under somehow different than we expected structure of demand. It seems that private consumption accelerated further in 4Q02, up to 3.6%YoY – the fastest growth rate since the beginning of 2000. Meanwhile, fixed investments kept on falling, and although the rate of fall moderated to –4% (from –6.3% in 3Q02), the improvement was slower than we have anticipated. Again, net exports positively contributed to economic growth, adding ca. 0.8 percentage point to GDP growth rate in 4Q02.

Contribution of various components to GDP growth



Source: CSO, BZ WBK estimates

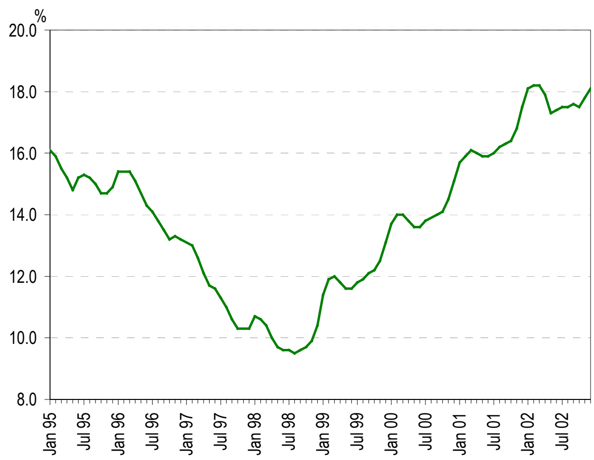
Such results broadly confirm our expected scenario for the development of economic situation in 2003. However, the fact that fixed investments seem to recover from the depression slower than expected, while GDP growth was boosted mainly by private consumption and net exports in 4Q02, suggest that the risks for our scenario are rather on the downside, than on the upside. In other words, continuation of negative trends on the labour market and persisting stagnation in German economy could jeopardise Polish economic growth in subsequent quarters by depressing its two major components. And if private investments will not revitalise vigorously and return into black since the beginning of 2003, it would be extremely hard to attain significant growth acceleration. However, we still believe that sizeable monetary easing delivered so far and still loose fiscal policy, would deliver sufficient stimulus for private entrepreneurs to boost their investment activity, and therefore we stick to our economic forecasts.

GDP growth should accelerate gradually in the subsequent quarters of 2003, however the increases would be surely smaller than recorded last year. In total, GDP growth in 2003 could approach 3%, however, as have mentioned above, it should rather be treated as a maximum this year.

2002 was not good for the labour market

Not large acceleration of the economic growth in the previous year did not make possible improvement on the labour market. The CSO said that the unemployment rate at the end of 2002 reached 18.1%. This was in line with our forecast and recent hints given by economy and social affairs minister Jerzy Hausner. The number of unemployed amounted to 3.22m – up over 100,000 from a year earlier. We may expect that 2003 is not likely to be much worse for the labour market or it may be even slightly better. However, we do not believe that one should expect the unemployment rate to drop to 16-17% at the end of 2003 as minister Hausner predicts. Particularly in January and February we will experience further seasonal growth of the unemployment rate, which will reach new record high level of 18.4%.

Registered unemployment rate



Source: CSO

...although wages and employment in December were slightly better than expected

Wages in corporate sector increased 8.1%MoM and 2.4%YoY in December, slightly above forecasts. High growth of wages in relation to November was a typical seasonal phenomenon. However, the fact that the salaries did not decelerate, but rather accelerated in last two months of 2002 (from 1.8%YoY in November and 0.5%YoY in October 2002) somehow does not correspond well to the contraction of households' deposits observed earlier in monetary statistics (see below). Most likely the shift from bank deposits into other saving facilities observed in November was also continued in the last month of last year. In real terms corporate wages grew 1.5%YoY against 0.9%YoY in November and –0.6% in October. As a result, the growth of real wages in 4Q02 amounted to 0.6%YoY and was notably lower than in 3Q02 (2.3%YoY).

Also the employment figures were better than expected. Average employment in corporations fell by 0.5%MoM and –2.3%YoY. Clearly the job destruction process in Polish companies loses the impetus, despite the fact that the entrepreneurs keep talking about further layoffs in most of the business polls. The average fall of employment in 4Q02 reached 3%YoY, while it was around 4%YoY in 3Q02 and in the first half of last year was close to 5%.

Consequently the growth of nominal wage bill in the enterprises sector improved in December to 0%YoY from –1.4%YoY in previous month. The figure recovered from the red for the first time since February 2002. Also the real wage bill growth was better, although it still remained negative at –0.8%YoY (compared to –2.3% in November). On average, the fall of real wage bill in corporate sector was deeper in 4Q02 than in the preceding quarter (–2.4%YoY in 4Q02 against –1.8% in 3Q02). Nevertheless, it did not hamper private consumption growth that much, as we estimate that the retail sales in 4Q02 grew almost as fast as in previous quarter.

Growing consumers' optimism

Despite high unemployment and poor dynamics of households' income, there is some improvement in consumers' sentiment, which is confirmed by results of consumer's optimism survey performed by Ipsos-Demoskop institute in January. All three indicators computed by Ipsos recorded growth in comparison with the December, which reflected seasonal improvement. However, they also grew in relation to the corresponding period of the previous year, which confirm positive tendencies observed since several months. The overall optimism index rose by 5.4%YoY, households' propensity to consume increased by 3.6% and the assessment of economic climate grew by 8.3%. According to the survey January saw also improvement in the assessment of political and social climate. This suggests that growth of consumers' optimism at the beginning of 2003 may be connected with positive outcome of the Copenhagen summit, at which Poland successfully finished accession negotiations with the EU. Perspective of the European integration seems to explain slightly higher fear of unemployment and increasing hopes for improvement of households' financial stance. Unfortunately, the results of the survey were not free from some flaws. Only 7% of households plan to buy durable goods, which is one third of the level observed five years ago. Consumers are also less disposed to borrow and to use savings for consumption.

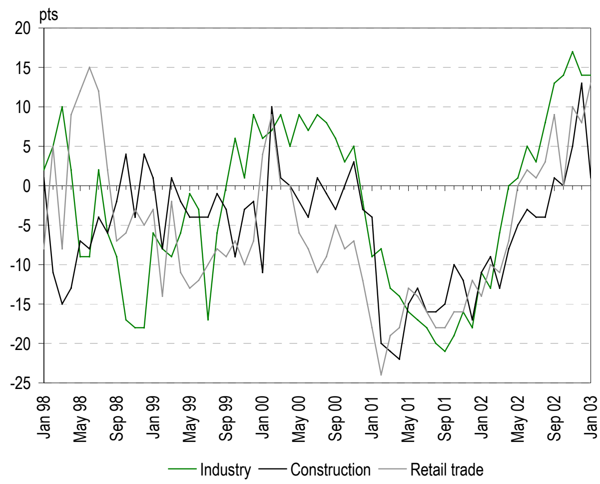
Mixed signals from business climate surveys

The CSO released the results of business climate survey in January. Business climate indicator for industry recorded growth by 8pts compared to December and for the first time since February 2001 its value was not negative amounting to zero. Moreover, as in previous months it was much better than in the corresponding period of last year. It stemmed mainly from substantially better expectations for future demand and production. Companies recorded also fall of excessive inventories. On the other hand assessment of current level of demand and production was still negative. Entrepreneurs were also afraid of further worsening of their financial stance and are going to continue cuts in employment, however at lower pace than in previous months.

While in construction and retail trade business climate indices experienced seasonal deterioration they are still growing in annual terms. Nevertheless, in construction the improvement in comparison with analogous period of the previous year is low. This is related to deep fall of new orders and worsening of construction companies' financial stance. Problems with financial situation are also constraints for better performance of retail trade. All in all, signals from CSO's business climate survey are not unambiguous. Indicators for industry and retail trade keeps accelerating, which bodes well for economic activity in these sectors, although stagnation in construction is a bad sign for investment activity in the nearest time.

Mixed results were also brought by central bank's business climate survey. The overall conclusion of the NBP's report on business climate in 1Q03 is that the economy is in a state of stagnation but is more likely to recover than to deteriorate. The main reason for relatively difficult situation of enterprises is still low demand. Over 60% of enterprises evaluate their economic situation as good one but it is predicted to worsen in subsequent quarters. However, some increase in new orders is expected in future, particularly among exporters, as well as a rise of production. The NBP forecasts annual growth of industrial output in first three months of this year at 7%, 3% and 8.5% respectively (this gives an average growth of above 6%, while we forecast 3.5%). Also investments are forecasted to slightly increase in 1Q03. Most of them are going to be financed with own resources, even despite the fact that level of interest rates is perceived as an obstacle for development by falling number of enterprises (in this quarter it was reported by only 5.1% of them against 7% in the previous quarter and 13% in 1Q02). This stems from two reasons. First, financial situation of enterprises improved in 2002. Second, enterprises reported that access to bank credit becomes harder. The meaning of this factor has been systematically rising since the beginning of last year (in 1Q03 it was indicated by 9% against 3.7% in 1Q02). Most likely, it is related to growing share of irregular credits in commercial bank's assets, which leads to greater caution in financing of enterprises' activity.

CSO's business climate indicators, YoY



Source: CSO

The exchange rate and its fluctuations are perceived as an obstacle for development by 14.3% of enterprises, which is less than an average in the last two years. The enterprises' forecast of the zloty exchange rate for the end of 1Q03 is stronger than their expectations for the end 2002 prepared three months ago, which means that firms do not believe in finance minister's assurances about inevitable zloty weakening. The EUR/PLN rate at the end of March is seen at 4.02 PLN and the USD/PLN rate at 4.03 PLN. According to polled enterprises the level of the exchange rate, which guarantees profitability of exports stands at 3.93 PLN against the dollar and at 3.77 PLN against the euro.

This suggest that current level of the zloty exchange rate should lead to further acceleration of exports (most of payments are in euro) and additional profits of exporters, which may be reinvested in the future. It is confirmed by entrepreneurs' declarations in the survey.

Money supply is still contracting

Monetary statistics clearly do not indicate the possibility that domestic demand and the economic growth might significantly accelerate. In December 2002 broad money increased 0.8%MoM, following –0.9%MoM in November. However in annual terms M3 collapsed – 2.3%YoY, which was the second deepest fall in history (after –2.5%YoY in October 2002). In general, the data confirmed that the trends observed in recent months still persist. As the MPC pointed out in its communiqué after January's meeting, money supply was substantially affected by exchange rate fluctuations (appreciation of the zloty against the dollar and weakening against the euro). Excluding this effect monthly growth of M3 was higher and reached 1.2% or PLN3.8bn. Also, PLN0.6bn of the monthly growth stemmed from accounting operations: in December commercial banks entered in the books resources received from issuance of their bonds in November.

Growth of money supply on a monthly basis resulted mainly from increase of corporate deposits by 8.6%MoM, which is typical for December. This seasonal effect did not concerned households' deposits, which dropped by 0.9%MoM or PLN1.8bn. Although the bulk of this amount stems from changes in the zloty exchange rate, usually households increased their deposits in the last month of a year due to seasonally increased incomes.

In annual terms households' deposits declined by –0.9%YoY, which was the sixth drop in a row. However, fall of household's deposits does not necessarily mean proportional fall of propensity to save as one can observe dynamic development of alternative forms of saving. According to the NBP transfer of households' financial resources from bank deposits to investment funds approximately amounted to PLN2bn in December.

With regard to money creation side corporate loans remained practically idle, growing 1.6%YoY (after 1.2% in November) and there was also no big improvement as regards households' loans (8.5%YoY growth after 7.8% in previous month). In both cases the moderate increase of annual growth reflected mostly very weak performance in December 2001 (the "base effect"). We believe that monetary figures for December do not change the overall picture of current economic situation.

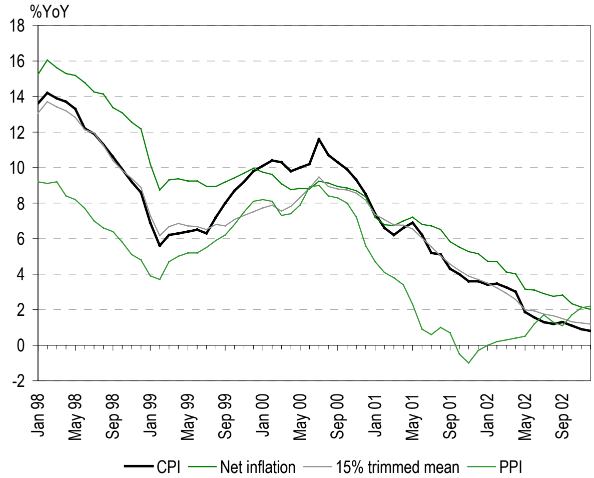
Inflation still falling – success or failure?

"Inflation at 0.8% is a failure" – said MPC member Janusz Krzyżewski after the CSO informed that CPI in December grew only 0.1%MoM and 0.8%YoY. Indeed, the result was slightly below expectations and well below MPC's inflation target for 2002 of 2-4%. Well, frankly speaking we have already got used to the fact that MPC misses its short-term objectives, and at least after 2002 their record got even – two consecutive years of overshooting the target were followed by two years of undershooting. And just after the MPC has revised its inflation target for 2002 down in June from 4-6% range we had very bad feelings about this. Also, the financial market should not be astonished, as CPI inflation below 1% in December 2002 has been pricing-in for a long time. However, what might affect investors' behaviour is the assessment whether recent inflation figures might change the MPC's perception of current economic situation and hasten (and/or deepen) the prospective monetary easing.

MPC members always stress that they make decisions about interest rates basing on predicted rather than past inflation. However, the truth is that forecasted inflation path might shift downwards along with falling current inflation. Such low growth of consumer prices in December was mainly the consequence of falling prices of tobacco (-0.4%MoM) and fuels (-0.8%MoM), very low (as for December) growth of food prices (0.3%MoM), and fairy stable prices of other goods and services. It seems that it will take some time until the situation on food market reverses. Also fuel prices should not grow excessively (assuming no worst-case scenario regarding Iraq war), as high oil prices are offset by weak dollar against the zloty. The revitalisation of domestic demand seems to be too gradual and not strong enough to deliver significant price pressure. Therefore we believe that inflation will fall further in the subsequent months, before it starts to gradually pick up.

The average growth of food prices in January was in line with our expectations and amounted to 0.6%MoM. Also, prices of alcoholic beverages continued to fall in January (-0.2%MoM), which imply that CPI in January will drop to another record low level of 0.6%YoY. However, if performance of other elements of CPI basket will be more favourable than in our quite conservative assumptions, inflation in January may be even lower and reach only 0.5%YoY. At the end of the year inflation should not exceed 2.5%YoY and average annual inflation should be below 1.5% (against 1.9% in 2002).

Inflation measures



Source: CSO, NBP

Core inflation also down

Following the decline of headline CPI index all five measures of core inflation fell in December. The declines were even slightly deeper than in case of CPI and ranged from 0.06 to 0.16 percentage point against 0.05 fall of CPI. Three out of five measures were below 1%YoY, and the lowest one – inflation excluding controlled prices – reached as low as 0.16%YoY. The highest was the "net inflation" index, excluding prices of food and fuels, which reached 2.02%YoY. Our estimation of "net inflation" for January indicates its another fall to 1.8%YoY.

In general, the data confirmed that no inflationary pressure could be expected in Polish economy in the medium term. Although the pace of core inflation fall seems to be slowing down, all indices keep declining, which is the strong argument for another interest rates reductions. It is worth noticing that at January's MPC meeting NBP governor Leszek Balcerowicz stressed that core inflation performance would be the most important argument for decisions on interest rates (see section *Central bank watch*).

PPI acceleration poses no threat for inflation

The CSO said that producer prices in December accelerated to 2.2%YoY from a revised 1.7%YoY in November. On a monthly basis PPI grew by 0.1%. Of course we did not expect such a major revision of November's data (it turned out there was no increase of 12M PPI in November), but monthly figure matched our expectations. Annual figure was slightly lower than our forecast of 2.3%YoY. As in previous months acceleration of PPI growth in annual terms resulted from very low base in the corresponding period of last year. Therefore, acceleration of annual PPI does not create inflation risk. Only moderate growth of producer prices on monthly basis stemmed from relatively low fuel prices on the domestic market and strong zloty constraining prices growth through decreasing impact on import prices.

Budget realisation in 2002 in line with expectations

The Ministry of Finance officially said that the budget deficit in 2002 reached PLN39.4bn or 98.5% of the plan. Revenues were at PLN143.54bn or 98.9% of the plan. Similarly to previous years the main source of budgetary revenues were inflows from indirect tax, which grew by 9.3% in nominal terms in 2002 compared with the previous year and constituted 62.8% of the overall revenues in 2002 (against 59.7% in 2001). Realisation of these revenues was lower than assumed and reached 98.7% of the plan. According to the Ministry of Finance, this stemmed from later than initially planned introduction of excise tax on electricity (it came into effect in July) and reduction of excise tax on alcohol (since the beginning of October). To a lesser extent it resulted from lower than expected revenues from VAT. The second item of revenues, which contributed to lower than planned overall budgetary revenues were inflows from PIT. They reached only 90.9% of the planned amount growing by only 2.9% in nominal terms during the whole year in relation to 2001. This is a consequence of lower than assumed inflation and lower than forecasted employment in the economy (smaller tax base). On the other hand, 2002 budget recorded higher than assumed incomes from CIT. In the whole year it grew by 13.4% in nominal terms and reached 108.3% of the plan. Such favourable performance of inflows from corporate tax was connected with better financial stance of companies during 2002. Also, revenues from state budgetary entities exceeded assumptions and reached 109.5% of the plan. This item includes customs duties, which were higher than forecasted in 2002 most likely due to higher than assumed growth rate of imports.

Expenditure side of the budget amounted to PLN182.95bn or 98.8% of the plan. According to the Ministry of Finance all spending items except debt-servicing costs were realised in 100%. Nevertheless, lower than planned servicing costs of domestic (by

3.9%) and foreign (by 4.1%) debt helped in budget realisation allowing even to lower budget deficit below the limit written down in the budget act.

The most significant differences compared to the plan was observed in the structure of the budget deficit financing. The government managed to collect only one third of assumed revenues from privatisation (PLN2.18bn instead of planned PLN6.6bn). Thus, deficit had to be financed through increased issuance of government's papers. The amount of treasury bills and treasury bonds sold in 2002 amounted to 136.6% and 106.6% of the plan, respectively.

In general, realisation of the budget was in line with expectations. Shortage of revenues reached PLN1.56bn (the middle of forecasted by us range of PLN1-2bn) but it was offset by lower costs of public debt servicing. As expected, conservative macroeconomic assumptions allowed for save budget execution.

Budget realisation in 2002

	Plan	Realisation PLNm	%
REVENUES	**145 101.6**	**143 538.0**	**98.9**
Direct taxes	91 324.5	90 119.1	98.7
CIT	13 833.8	14 988.2	108.3
PIT	26 540.4	24 130.3	90.9
Revenues of state budgetary entities	9 801.9	10 732.6	109.5
Including: customs duties	3 479.0	3 812.0	109.6
Other revenues	3 601.0	3 567.8	99.1
including: central bank profit	1 961.8	2 582.2	131.6
EXPENDITURES	**185 101.6**	**182 950.0**	**98.8**
Domestic debt servicing	21 150.0	20 323.9	96.1
Foreign debt servicing	3 882.0	3 724.4	95.9
Subsidy for Labour Fund	3 634.6	3 634.6	100.0
Subsidy for old-age and disability pensions fund	15 391.7	15 391.2	100.0
Subsidy for Social Security Fund	26 987.9	26 987.9	100.0
Overall subsidies for local governments	29 701.6	29 701.6	100.0
DEFICIT	**40 000.0**	**39 412.0**	**98.5**
DEFICIT FINANCING	**40 000.0**	**39 412.0**	**98.5**
Treasury bills	5 850.4	7 993.6	136.6
Treasury bonds	26 613.8	28 365.0	106.6
Privatisation	6 600	2 178.4	33.0

Source: Ministry of Finance

Central bank watch

- **Interest rates lower by 25 bp**
- **...and president's decisive vote was crucial again**
- **Another medium-term strategy in February**

Interest rates lower by 25bps

There were no surprises, the MPC cut main interest rates by 25bps and kept neutral bias in its monetary policy. The rationale behind their decision was also widely understood: favourable inflationary environment together with slower than expected pace of economic recovery, and lack of signals that might endanger the process of inflation stabilisation at relatively low level. In the document explaining the decision, presented during the press conference after the meeting, MPC pointed out the following major arguments supporting monetary easing:

a) strengthening of signals that domestic demand growth remains low:

- wage growth in corporate sector remains low,
- continuing fall of construction output suggests that investment demand remains very low,
- persists low dynamics of monetary statistics – M3 and credit; growth of cash in circulation stabilised,

b) [recent economic data] confirm lack of recovery symptoms in the German economy: business and consumers' sentiment remains low; economic forecasts are also being lowered,

c) current inflation and core inflation are lower once again.

Actually the first page of MPC's statement has been overwhelmed by the word "low" in all its variations, suggesting that recent economic data were somehow disappointing for the MPC and might have worsened their assessment of current and forecasted economic situation. However, during the press conference Leszek Balcerowicz said that the Council did not change its economic outlook and sticks to the scenario of gradual economic revival.

Among the factors being the potential source of inflationary pressure in the economy, and therefore limiting the scope for deeper interest rate cuts, MPC mentioned (as usual):

- the scale of interest rate cuts already made was significant and have not revealed its full effect yet; the rate cuts delivered so far "will influence domestic demand in 2H03 and in 2004",
- probability that economic deficit of public finance will be higher than planned in 2003 and uncertainty regarding fiscal policy in 2004;
- high oil prices.

During the press conference NBP president Leszek Balcerowicz have focused on the first of the above mentioned risk factors, underscoring that it is the most important constraint for further interest rate reductions. And we believe that indeed the uncertainty regarding if, when and how strong the impact of past interest rate cut would reveal, would be one of the strongest argument preventing MPC from deeper than 25bps cuts in the near future. The situation of public finances also remains an impediment for monetary easing, however it did not prevent MPC from cutting the rates so far, and also this time president Balcerowicz suggested that it is only one of the elements considered. Delaying reforms planned by minister Kołodko until 2H03 should not effect in analogous delaying of interest rate cuts.

Leszek Balcerowicz said after the meeting that the most important for the subsequent monetary policy decisions would be the changes in core inflation. It suggests that the measures computed by NBP should be traced very closely, and as long as their downward trend continues, the monetary easing cycle is not over.

All in all, we believe that still moderate economic recovery, continuing fall of CPI and core inflation, and the lack of medium-term inflationary pressure would make MPC lower interest rates again already in February. Third cut this year is possible until the end of 1H03, and in 2H03 interest rates should remain stable as core inflation is likely to stop falling, and economic growth should accelerate more vigorously. Uncertainty regarding the impact of up-to-date reductions would cause that none of interest rate cuts this year should exceed 25bps.

NBP president decided about rate cut again

Voting results at the MPC meeting in November were published in the Government's Monitor last month. Notwithstanding the scale of rates reduction, the result of November's voting was exactly the same as in October (see table below). Hawkish faction within the MPC was once again unanimous and wanted to keep rates unchanged (see the table below). In such situation, similarly to October's meeting, decisive voice belonged to NBP governor Leszek Balcerowicz.

Actually, there was no case in 2001 and 2002 that any decision of the MPC was not consistent with NBP governor point of view (he was the only MPC member with the votes exactly in line with all MPC decisions in this period). We believe that this will be the case also in the near future. Taking into account that hawks are not likely to support further rate cuts, it seems that monetary easing will be continued as long as Balcerowicz will vote for the rate cuts. Results of the MPC's voting in November shows that the MPC decision to lower the scale of interest rates reduction to 25bp on order to limit expectation for further monetary easing was not unanimous. This should constrain expected cumulative scale of interest rates reduction in 2003 even more, as half of the MPC members did not wanted any easing at all.

New medium-term strategy in February

Until the end of this month, the Monetary Policy Council will probably prepare the next monetary policy strategy. Although this document will be practically prepared for the new Council, one of the current members Dariusz Rosati is not afraid of a policy conducted by his successors. He said they would make decision in a better situation, with the economy growing by 4%, with falling unemployment, low inflation and much lower interest rates. Well, Rosati's optimism on the new MPC's policy is not surprising, as the new MPC member's profile is likely to be close to Rosati's view on monetary policy and exchange rate. With regard to the latter Rosati thinks that the zloty is "clearly too strong" considering economic fundamentals.

MPC voting results 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	-	-	+	-	-	+	-	+	-	+	-	-	+	+	+	+
Dąbrowski	-	-	-	-	-	-	-	-	-	-	-	-	+	-	-	-
Grabowski	-	+	-	-	-	+	-	+	-	+	-	-	+	-	-	-
Józefiak	-	+	-	-	-	+	-	+	-	+	-	-	+	+	-	-
Krzyżewski	-	-	+	-	+	+	-	+	-	+	+	-	+	+	+	+
Łączkowski	-	+	-	-	-	+	-	+	-	+	-	-	+	+	-	-
Pruski	-	-	-	-	-	-	-	+	-	-	-	-	+	-	-	-
Rosati	+	-	+	+	absent		+	+	+	+	+		absent		+	+
Wójtowicz	+	-	+	+	+	-	+	+	+	+	+	+	+	+	+	+
Ziółkowska	+	-	+	+	+	-	+	-	+	+	+	+	+	+	+	+

Source: NBP, Government's Monitor

Comments of the MPC members and central bank representatives

As usual, some comments of the NBP representatives were focused on discussing monthly macroeconomic data releases. After the release of the output data the so-called dove fraction seemed to be disappointed. Wiesława Ziółkowska stated almost clearly that there were more arguments for than against interest cuts at the January MPC meeting. Janusz Krzyżewski, in turn, was disappointed with the inflation data, which in his opinion confirmed potential deflation. After this type of comments, the hawk fraction retaliated (only in mass-media because as everybody knows the interest rate cuts was positively outvoted in January). Bogusław Grabowski, who gave three extensive interviews over three days, said that the expansive fiscal policy leaves little room for interest rate cuts – " at this stage only small adjustments will be made". Cezary Józefiak and Jerzy Pruski as well observed that the MPC, which was criticised by the MinFin for maintaining exceedingly high interest rates, should continue conservative policy in order to stabilise inflation rate at a low level. As usual, one of the arguments was the expansive fiscal policy. However, it seems that the NBP representatives agree that despite a delay in the public funds reform the chance to meet the Maastricht Treaty criterion in respect of the public deficit (below 3% of the GDP) is high and Poland will be able to join the Eurozone in 2007.

Many of the January comments related to the situation on the FX market. The first deputy of the NBP President expressed an opinion compliant with the better part of interpretations, that the sharp weakening of PLN was correlated with the strong fluctuations of the Hungarian forint to USD and EURO. The Hungarian problems once again confirmed the NBP's opinion on FX policy – FX interventions would be damaging, and the liquid exchange rate is the best system in the current situation.

In the previous report the most intriguing comment was a quote of Grzegorz Wójtowicz who "did not encourage to drink alcohol" after the decrease in excise duty. In January the top of the podium will be awarded to Cezary Józefiak who, commenting the government's economic growth projection, said that "who aims low will not achieve much". Well, it happened in the past that the MPC aimed low with the year-end inflation, which then turned out to be high (due to adverse climate conditions). In fact, over the last two years the MPC continued to aim low and the year-end inflation was even lower.

WHO, WHEN, WHERE	COMMENT
Leszek Balcerowicz, NBP president PR1, 30 Jan PAP, 29 Jan	Low inflation is success of our economy and we have to take care of it. That is why our interest rates policy will be aimed at maintaining low level of inflation. [...] During last two years the level of interest rates has been substantially lowered and we have to care of low inflation. We maintain our forecast of gradual economic recovery, but there is substantial uncertainty. [...]. Perspectives of the economic growth depend on whether there will be structural reforms and how deep they will be. [...] I hope that proposals of necessary public finances reform will be presented soon but so far they are not known. It is worth to have such FX regime, which we have now, i.e. free floating regime because we can avoid situation that took place in Hungary. [...] From the market's point of view it would be good if such actions (FinMin's purchases of foreign exchange on the FX market) were predictable.
ISB, 15 I	Poland will most probably enter the euro zone in 2007. And although 2006 cannot be excluded just yet, it does seem to be a very optimistic scenario. [Fast euro adoption] is certainly better from the perspective of long -term economic growth.
Józef Stopyra NBP vice-president PAP, 24 Jan	The MP's accusations [against NBP] are misleading. As regards the draft [amendment to the NBP bill submitted by Samoobrona party], it is incompatible with Polish constitution and European law. Budget for 2004 will be the most difficult in last 14 years. If there were no reform of the public finance, then budget deficit could be higher than in 2003. [Fixed parity against euro within ERM2] at PLN4.35 is possible. Possible is also another level, ultimately it will depend on fundamental factors. Developments on [Polish] market are strongly correlated with the movements of Hungarian forint against dollar and euro. After the wave of speculations against forint [...] there was strong Hungarian central bank's FX intervention defending the band of currency fluctuations. Investors probably recorded significant losses and some of them closed their position in Poland to neutralise the negative impact. Nevertheless, we do not observe the outflow from the bond market.
Andrzej Bratkowski deputy president NBP PAP, 17 Jan	CPI is likely to fall again in January from December's level of 0.8%YoY, however at the end of 2003 it should reach 2%YoY. Inflation is now lower because of temporary factors, which do not depend on monetary policy. The introduction of euro in 2006 is a question of good will of the EU. I hope that EU would shorten the required period within ERM-2. It might be difficult due to procedural reasons. There is a big chance that Poland will become Eurozone member in 2007. The probability of adopting euro in 2006 is much lower, although cannot be excluded completely. The main concern related to Poland's readiness for euro adoption is the condition of public finances sector. Budget deficit must be reduced, and the reform of public finance is necessary for this.
Bogusław Grabowski MPC member PAP, 23 Jan	The closer to end of monetary easing, the more we have to realise that we are approaching the end of this process, because for three consecutive quarters domestic demand and economic growth accelerate. The scale of interest rate cuts must be smaller and smaller, and the intervals between cuts have to be larger. Considering that we have to meet Maastricht inflation criterion it would be good if after 0.8% inflation at the end of 2002 there will be no strong inflation acceleration up to the upper limit of inflation target. Such case would be a disaster. Permanent disinflation and solidifying low inflation in Polish economy requires that real interest rates remain at high level, despite low growth of domestic demand. We point out that at present factors positive for inflation cumulated and there is high probability that their impact would weaken [...] Inflation would be in the target for 2003, i.e. around 3% +/- 1pp. Inflationary pressure would slightly increase amid recovering domestic demand and economic activity, but not in the nearest months but at the end of 2003 and in 2004. Very much will depend on the situation in agriculture. Bad crops may boost inflation very quickly. Positive supply factors, i.e. fall of food prices by nearly 3% will not be ever-lasting. We want to create stable disinflationary environment, i.e. lower inflationary expectations permanently. Make households and entrepreneurs get used to low inflation. The period of disinflation is over, now is the period of inflation stabilisation, which is as difficult task as lowering inflation. Central parity [of zloty against euro] should not vary much from the market level of exchange rate observed shortly before ERM2 entry. We cannot allow that ERM2 entry will significantly constraint exchange rate fluctuations. It would immediately fuel speculative behaviour of the FX market. Central parity will have to rely on the relatively short history of market exchange rate fluctuations. The length of this period would depend on the stability of exchange rate. If fluctuations within several months will not be high, then we can imagine using short reference period for setting the parity. Central parity could be much different from current exchange rate if there will be clear and explicit evidence that it deviates from the equilibrium level, i.e. if it will be driven by sizeable privatisation flows, transfers from EU and speculative actions. We believe that the best solution for Polish economy is joining EMU as fast as possible and that the period within ERM2 should be the shortest possible. We certainly will not change opinion on these issues. One could be afraid that while participating ERM2 system, we could experience intensified appreciation pressure because of speculative flows. It is a field for re-thinking for ECB and European Commission.

	Medium-term strategy [of monetary policy] should be released until the end of February and it should contain no surprises. It will look beyond 2003. We do not want to close it with any specific time framework. Present medium-term strategy was constrained by the end of MPC term, the next one will be constrained by Eurozone entry. But neither present nor the next MPC will decide about the year of EMU entry. The government will decide, by determining its fiscal policy. The [next medium-term] inflation target will be the same as in stabilised economies with low inflation. [...] There will be no change of monetary policy strategy, nor the change of exchange rate regime. We still want to conduct monetary policy within direct inflation targeting framework under free floating exchange rate. Monetary criteria are in practice fulfilled and monetary policy has already prepared the ground for accession [to EMU]. Now the most important is to meet fiscal goals.
TVN24, 22 Jan	It would be good if the Ministry of Finance bought the money for foreign debt servicing on the market rather than in NBP. But it should be done in clear and transparent way. The Ministry should announce how much it wants to buy in a given year [...] then market participants would know the purpose and size of the operation. Exchange rate fluctuations that are not caused by macroeconomic, fundamental reasons, but rather by uncertain actions of economic policymakers are harmful for economic developments.
RadioZet, 22 Jan	The period of significant interest rate reductions is over. All decisions regarding interest rates will be much more cautious now. If [...] world economy starts to accelerate, especially since the mid-year, if our economy starts to accelerate also, then [...] we can count only for minor interest rate adjustments.
Reuters, 21 Jan	There is a chance to meet Maastricht criteria. I'm not talking about 2005, because it would be extremely hard, possibly in 2006, but I believe it would be achieved without deep reform of public finances. The reform would be shallow and superficial. I think that lowering the deficit would not be persistent and under the first economic slowdown in the next economic cycle the lack of public finance reform would show up. I think in 2004-05 economic growth could reach up to 4%, but without deep structural changes in Polish economy, including public finances, it would be possible to increase the potential growth, i.e. to permanently boost growth rate well above 4%. Significant factor accelerating GDP growth would be EU integration, fall of inflation and inflationary expectations. The growth will be also supported by the cumulative effect of interest rates reductions in last one and half of a year. In future the GDP growth may also accelerate as a result of recovery in the global economy since the second half of 2003. Without any factors, which would allow for constraining restrictiveness of monetary policy, such as fiscal policy or structural factors of inflation, there is not much room for interest rates reduction. In subsequent months level of monetary policy restrictiveness will also depend on the pace on economic recovery, both in Poland and abroad. Fiscal factor causes that one cannot count on substantial decrease of monetary policy restrictiveness in months to come. Until the end of 2003 or 2004 we will be slowly reaching the level of real interest rate, which will be the level of natural interest rate. According to the NBP's calculations the level of natural, real interest rate in Poland is 4.5-6.0%. Actually, we have such level at 6.0% presently, but we have it during the economic stagnation while talking about the 4.5-6.0% range the upper limit would be more proper for the stage of economic recovery. The MPC announced in April 2002 that it decreases scale of further interest rates cuts. For the second time the NBP president announced it at the press conference in October. I want to stress that between April and October there was no case that bigger reduction followed the smaller one. It is a good hint for the future. During the nearest weeks, most likely until the end of February, the MPC will announce medium-term strategy of monetary policy after 2003, which will not be constrain by any particular time horizon. According to the strategy Poland should continue direct inflation strategy coupled with fully free float exchange rate regime. Poland should also join the EMU as soon as possible and the zloty presence in ERM-2 should as short as possible. Particular dates will be set by the government as they will be fully determined by fiscal policy. Monetary criteria [inflation, interest rates] has been already met and we wait for fiscal criteria fulfilment.
Reuters, 16 Jan	Inflation is benign. But we need to pay attention to demand factors, especially on the food market, which depressed the CPI figure. We have to wait for the PPI, which has been picking up for a few months, and for industrial output data. Inflation should stay within its 2-4 percent target range in 2003. A lot will depend on world markets...but under current forecasts, we should meet the inflation target, or not above 3.0% at the end of 2003. However, to reach such a level, monetary policy would have to be cautious. The free float is the best system for Poland. The regime should not be changed before Poland joins ERM-2 - which it should do at the last possible minute. Otherwise we could have Hungary's conflict: choosing between forex and inflation targets. Unhelpful fiscal policy only further aggravates this situation. I hope the two-year period in ERM-2 would be shortened to curb the threat of speculative inflows sparked by an artificial ceiling. The ERM-2 system is widely criticised, especially in the context of the accession countries. Do the Baltic states, for example, need another trial period after several years running a sound currency board?. Maybe this will make the European Central Bank and the European Commission think it over and scrap or shorten ERM-2. The timing of joining the euro zone will be set by the government through its reform of the public finance sector. But it would be a huge mistake to join the ERM-2 without being sure that in a maximum of two years fiscal policy meets the Maastricht criteria.
Cezary Józefiak, MPC member; PAP, 30 Jan	This year possible GDP growth is 2.5-3%. We experience mild economic recovery, which I hope will be more vigorous in the second half of the year. [...] The external situation is very uncertain, particularly in German economy. Investment demand, which has been falling for two years, is falling slower and there is a hope that this year will see rise in investment.
Reuters, 30 Jan	It is good that we have such growth (of GDP in 2002) but it is important what factors caused it – net exports and consumption. As these factors were fluctuating during last months it is hard to say what is the trend. I think that if we had 3% of GDP growth in 2003 it would be good. The government assumed 3.5% growth but I think that the plan is too optimistic. I think that in the long-term we will observe appreciation trend of the zloty due to perspective of membership in the EU and later in the EMU, but it should be rather slowly process. [...] However, one cannot exclude some deviations from the trend because our market is not very big and important events abroad may have impact on the zloty exchange rate.
Reuters, 23 Jan	The most important goal of monetary policy is price stabilisation. Now we have stabilisation of inflation, and although it has been reduced substantially, it is not the level that would persist. If we want to create sustainable low inflation expectations we have to be consistent with our actions [...]. I do not share the view that monetary policy is to influence the economic climate. [...] We will continue the policy line we have accepted. We now expect inflation to be at 2.0-2.5 percent at the end of this year. We have learned from Hungary, where people began to act nervously. They were not the first to take losses from inconsistency and undertaking actions, which are dangerous in our situation. I welcome the short-term signs [of recovery], but I do not draw the conclusions that it is a trend already. I believe that corporate investments are the most important for the economy. Those who aim low, do not reach high. The government wants to reach high. I think that we should be very glad if we reach 3% [of GDP growth in 2003].

PAP, 15 Jan	The MPC will not make its decision basing (only) on December's inflation, because we always look forward while December's CPI is only the information from the past. We take into account some trends – EU accession, difference in prices between Poland and the EU etc. Given there are no major surprises (oil prices shock, sharp food prices increase), the annual rate can hover around two percent this year. December's inflation was driven by cheap food and fuel, but at the same time net inflation, which excludes these two factors is at around 2%. Now we should expect inflation increase, not sharp, but rather moderate. Everyone expects higher investments and economy rebound, and this should have its inflationary consequences.
Janusz Krzyżewski MPC member PAP, 15 Jan Puls Biznesu, 7 Jan.	I was sure that inflation in December was some 0.2pp higher. Inflation at 0.8% is a failure, especially as this was a period of Christmas shopping. My worries about deflation are well justified. This is very bad signal. This comes mainly from the labour market erosion. The decision of the joining the Ministry of Economy and Labour Ministry should improve the government's policy. Lower administration means better situation. Government reshuffle should not influence foreign exchange market.
Jerzy Pruski MPC member PAP, 17 Jan	The optimal solution for the monetary policy is to maintain such a policy, which is consistent with floating exchange rate regime until the ERM-2 entry, and then the most wide currency band within the ERM2. The biggest challenge for the Monetary Policy Council is to stabilise inflation at such a low level that Poland can join the euro-zone as soon as possible -- at around 2-3 percent. There is no room for further short-term costs of disinflation. In the near term, the MPC will release will soon issue the document, outlining the monetary policy framework beyond 2003, which would help in maintaining continuity despite change of MPC members. It would not be binding for new MPC, but this would show what the current MPC perceives as the optimal monetary policy. The key issue for the Polish economy is the reform of public finances sector and meeting of Maastricht fiscal criterion. This strategy should include both changes on the spending side and changes in tax system, but in my opinion the reform should focus on the expenditures side. These should be legislative changes. On the tax side, we need simplicity and possibly also a change (a decrease of course) of tax levels. Restrictive fiscal policy should be measured as a share of public spending into GDP – this ratio should go down.
Dariusz Rosati, MPC member; Gazeta Wyborcza, 31 Jan PAP, 27 Jan	I predicted slightly better results [GDP]. Earlier data on retail sales, foreign trade and consumption suggested that the recovery was stronger. [3.5% GDP growth in this year assumed in the budget] is possible but it is the upper limit of what we can achieve. Investment demand has to eventually increase. Private consumption grows strongly enough. We cannot expect more taking into account bad situation on the labour market. I would not expect further acceleration of exports in the first half of this year – the results of last year are good and they should be maintained. [Making decision on interest rates level] we will evaluate if under present state of the economy any factors accelerating inflation may occur in time horizon of 6-9 months. If it turned out that we have downward tendencies in both inflation and the economic growth we will be reducing interest rates. Inflation in January will maintain at December's level, i.e. it will amount to 0.7-0.8%YoY. What is the most important for us there are no threats for inflation. [...] However, we see that such low level of inflation results from temporary factors. Inflation will most likely increase along with acceleration of the economic growth. These are preliminary estimations. I think that in 4Q02 GDP should grow by 2-2.5% and in the whole 2002 by 1.4-1.6%. In this year I expect 3-3.5%. [...] The recovery is quite slowly. We expected some time ago that it will be more vigorous but it turned out that both external situation and domestic conditions have not allowed for faster growth. Nevertheless, we definitely observe gradual acceleration of the growth, which is confirmed by data on industrial production, retail sales and stabilisation of unemployment.
Grzegorz Wójtowicz MPC member PAP, 22 Jan PAP, 20 Jan PAP, 15 Jan	Looking at data for the last quarter, it is likely that GDP growth in 2002 reached ca. 1.3% and in this year it will amount to 2.5-3.0%. There is nothing to worry about. I think that the economy is gaining momentum although monthly statistics are volatile. Increase of retail sales is quite good. It is evident that there was impact of Christmas shopping, particularly in those branches, which indicate that consumer confidence is growing. Another data will show whether this is a permanent trend. Still, the brightest point of the economy is exports and I hope investments as well. After substantial fall they should eventually rise. December's data [on industrial output] shows that the economy is gaining momentum but the recovery is quite slow. Probably, more significant recovery will take place in the second half of the year, which will lead to GDP growth in the whole year at 2.5-3.0%. The data are lower than expected, recovery in investment is slow, but export is performing quite well, consumption did not fall. We can expect some fall in the 12-month (inflation) index in January, but we have to prepare for the index to rise in February-March with possible stabilisation in April. Inflation will rise because of food prices' increase and limited wages' growth pressure. Inflation would amount to 2.0-2.5% in December 2002. GDP growth in 1Q03 should be similar to growth in 2H02 – 1.5-2.0%, but we should not exceed 3% in 2003 as a whole.
Wiesława Ziółkowska MPC member PAP, 20 Jan PAP, 7 Jan. Puls Biznesu, PAP, 6-7 Jan.	In my opinion more and more factors speaks for interest rates reduction than against it. [The latest data on industrial output] This is not good news. Production in December is lower than in October and November, which does not bode well for GDP growth in 4Q02. The economic growth is too slow. We expected that GDP growth would be higher than in 3Q02 when it amounted to 1.6% and in 4Q02 it could exceed 2%. It seems to me that it will be difficult to pull the economy out of the stagnation. I think that the recovery in Poland depends to a large extent on the German economy performance, which is growing very slowly at the moment. One should not count on substantial rebound in 1Q03. It is difficult to say when the economic recovery will take place in Poland. Annual inflation in December 2002 should amount to 0.8-0.9% and at the end of 2003 it should be at around 2%. Still, there are no clear signs of domestic demand recovery, which means that economic revival is moderate - in 4Q02 GDP rose by 2%. I would expect still very stable food prices in 1H03, which means low inflation. However, even more visible economic recovery in 2H03, which I expect, should not translate into higher inflationary pressure, as the unemployment rate will remain high and disposable income should be low. There is a room for interest rates reduction of 100-150bp in 2003. Government decision about the reconstruction of the cabinet should not influence the FX market. Joint ministry of economy and labour should improve the decision making process. I do not know yet how deep will be the changes, but Jerzy Hausner is very competent. Maybe this is positive that such a person will govern the things.

INFORMATION AFTER THE MONETARY POLICY COUNCIL MEETING ON 28-29 JANUARY2003

On 28-29 January the Monetary Policy Council held a meeting. The Council read materials prepared by NBP Management Board and its Departments and also information and analyses furnished by the Ministry of Finance, banks and research institutes. The Council then discussed the external environment of the Polish economy as well as real trends, trends in payments and social welfare benefits, matters involving the public financial sector, the money supply, loans and interest rates and the structures of pricing and inflationary expectations, as well as the expected rate of inflation.

Decision of the Monetary Policy Council

New economic data which emerged since the previous meeting of the Monetary Policy Council:

- Indicates strengthening signs of a continuing low growth rate in domestic demand:
  - a low salary growth rate in the industrial sector
  - a further declining growth rate in construction industry proves the investment related demand to be very low,
  - the annual growth rate of monetary aggregates - M3 and loans - remains low, the cash growth rate has levelled off,
- Confirms that the German economy shows no signs of an upturn: optimism both by entrepreneurs and consumers' remained low for another month, economic growth forecasts have been downgraded.
- Shows that the current inflation and base inflation rate indicators have been reduced again.

Factors potentially stimulating inflationary pressure include:

- the level to date of interest rate cuts which, allowing for the customary time lag, will gradually stimulate growth in domestic demand in the second half of 2003 and in 2004,
- a probable overrun in the level of economic deficit in the public finance sector as envisaged in the draft 2003 Budget Act and uncertainty underlying fiscal policy for 2004,
- high oil prices fuelled by the impending military confrontation in Iraq.

The Monetary Policy Council resolved:

- **to reduce the lombard rate from 8.75% to 8.50% p.a.,**
- **to reduce the re-discount rate from 7.50% to 7.25% p.a.,**
- **that the National Bank of Poland will conduct open market operations for 14-day maturities with a profitability rate of at least 6.50% p.a.,**
- **that the interest rate on term deposits taken by NBP from banks will be held at 4.50% p.a.,**

The Council confirms its neutral approach in respect of monetary policy.

***

In December 2002 inflation for the preceding twelve-month period stood at 0.8%, and fell below the short-term inflation target for 2002. This lower-than-expected inflation rate during the last several months of the year is primarily due to factors outside the domain of monetary policy. The major factors include:

- declining prices of foodstuffs and non-alcoholic drinks,
- a lower-than-expected rise in regulated prices, including a drop in alcohol and tobacco prices,
- a lower-than-expected global economic position.

2002 witnessed a continuing high supply in the foodstuffs and agricultural produce market stemming, amongst other causes, from good cereal, fruit and vegetable crops. These depressed the prices of foodstuffs and non-alcoholic drinks by 2.7%.

Relying on the available predictions for the 2002 national budget and pronouncements from bodies responsible for price regulation, a higher increase in excise duties and a curtailment of at least a portion of the lower VAT rates to date. This was attributable to a need to adjust indirect tax rates to those prevailing in the European Union. Consequently, an expectation of at least a 5% increase in regulated prices in 2002 would have been justified, whereas in reality it only reached 2.7%. This lower increase in prices in this group of goods and services was largely due to falling alcohol prices (3.1%) in the wake of the recently-reduced excise duty on spirits.

If it had been assumed that foodstuff, alcoholic and non-alcoholic drinks prices would grow at around the 2001 rate, the goods and services growth indicator in 2002 would have approached ca. 2.5%. In December 2002 the base inflation rate computed after exclusion of food and fuel prices was only 2%. The considerable decline in the global economic situation contributed to the lessening of inflationary pressures via lower-than-expected growth in domestic demand and more favourable prices for numerous raw materials and imported goods.

The next meeting of the Monetary Policy Council is scheduled for 25-26 February 2003.

***

I. Assessment of the economic situation

In November and December 2002 indicators anticipating the status of the US economy were markedly better than in the euro zone. American entrepreneurs' optimism was discernibly higher (the NAPM index rose in December to 54.7 in comparison with 49.2 in November); the orders portfolio in the processing industry expanded rapidly. In December American consumer-confidence weakened somewhat in comparison to November after information about employment figures was published. However, the high growth in US retail sales (4.6% compared to 2.7% in November) indicates that growth in individual consumption remains the chief growth factor in the American economy.

By contrast, in the euro zone, the last two months of 2002 demonstrated a clear downturn, as shown by the majority of economic indicators. The industrial/economic activity index (PMI) dipped from 49.5 in November to 48.4 in December. German industry failed to report improvement; the IFO Institute indicator, best reflecting the mood of German companies rose only slightly - from 87.3 in December to 87.4 in January. Despite the Christmas shopping season, most West European economies (most notably those of Germany and Italy) suffered a sharp decline in consumer optimism (the index shows German consumer

confidence declining from –11 in October to –17 in November and to –20 in December 2002). Evidence of the deteriorating confidence amongst German consumers is borne out by a fall in retail sales by almost 6%in November 2002, whereas in October the decline stood at a negligible 0.1%.
Global oil prices continue to be a big question mark. A general strike in Venezuela and the already commonly-shared perception of the inevitability of a war with Iraq once again sent oil prices up in December 2002. On 20 December the price of oil reached USD 30 a barrel and levelled off. Thus, the average price of oil, month on month, was the highest in December 2002. Compared to December 2001 it rose by nearly USD 10 a barrel i.e. by nearly 50%.

Venezuela's continued general strike, which has paralysed the country since early December, has reduced the global oil supply by over 2 million barrels a day. This is compounded by the market's anguished concern about the likelihood of continued supply of oil from the Persian Gulf. A war with Iraq may cause global oil production to shrink by another 2.5m. barrels a day (the current Iraqi quota under the oil-for-food programme). Should these two crises coincide, oil prices are bound to increase.

The Polish economy is showing signs of slow and gradual economic revival. During the third quarter of 2002 it grew by 1.6% and gross added value rebounded to 1.8%. On the demand side, growth was mainly stimulated by individual consumption and exports.

In December 2002, the annual industrial output rose by 5.1%. Seasonally adjusted industrial production grew by 4.1% year on year. Production growth in the most significant industrial category – the Improved expectations in the USA Sharp deterioration of consumer-confidence in the euro zone Oil prices rise again In third quarter 2002 GDP grew by 1.6% Industrial production growth – further fall in 4 processing industry - reached 6.7% (seasonally adjusted growth – 5.3%). Construction and assembly production shrank in December by 10.4% (the decline in November being -8.6%).

The November figures for the balance-of-payments confirm that a positive trend in foreign trade has been maintained. Exports are growing ever faster. Exports in EUR terms rose for a third month in a row – in this case the rise amounted to 6.1% as compared with the preceding year. Since the beginning of the year receipts from exports has risen by 2%. After a decline in October, imports rose again (by 3.1% in comparison with November 2001). Nevertheless, imports for the year to date were below the figures for the previous year (a fall of 3.4%).

Reliable statistical data also shows a higher level of exports. Between January and October 2002, exports computed in EUR rose by 5.3%. Similarly, imports were higher than in 2001, even if their value rose at a lower rate (2.8%). Increased exports between January and October 2002 were primarily attributable to higher sales to Russia, Norway and Sweden. In terms of the main country groups, the most significant growth in sales was reported in the group of countries belonging to the Commonwealth of Independent States - 12.1% (including a 22% increase in exports to Russia) and Central and Eastern European countries - 9.8%. Sales to European Union countries rose by 4.1%. The lower growth rate of sales to EU countries principally resulted from a fall in exports to Germany (by 0.7%). The poor results of exports to Poland's main trading partner were partly offset by a large increase in exports to France and Sweden.

Analyses of economic performance by the Central Statistical Office in December 2002 indicated a break in the trend of improving respondents' optimism, a trend which emerged at the beginning of 2002. Seasonally adjusted data indicates that the assessment of the situation in the processing industry, in terms of both domestic and foreign demand, sold products, inventory levels and the potential for on-going settlement of financial liabilities in December 2002 was pessimistic and bleaker than in November (although better than in December 2001). This pessimism was supported in respect of employment forecasts and was additionally reported in respect of the financial situation and the overall economic conditions. In the construction industry increasing pessimism was noteworthy in respect of the assessment of demand, production and the economic situation of construction and assembly companies. Research into trade points to the continuation of very pessimistic perceptions of the current and future standing in this sector.

The most recent research into the economic situation (carried out in January) indicates that pessimism is strong amongst respondents. A slight improvement was noted in the assessment of the overall conditions of the processing industry, primarily due to better-than-expected forecasts relating to demand and production; however the assessment of the current situation by companies continues to be negative. On the other hand, the pessimistic construction and assembly production Good November results for foreign trade Changes in the geographic structure of Poland's export Worsening economic situation in the processing and in the construction industries 5 assessment of the current situation of construction and trade intensified (primarily in respect of product sales by the construction industry and trade sales figures, as well as the financial standing of companies). Forecasts for the nearest future are equally bleak.

II. Situation of public sector finances

Government revenue in 2002 was lower than expected. Lower than planned receipts from indirect taxes and personal income tax were partly offset by high corporate tax receipts (CIT) and non-taxable receipts, chiefly stemming from higher NBP earnings and customs duties. Higher tax receipts, approx. 7.3%, indicate that the economic situation in 2002, especially the financial situation of Polish companies, was slightly improved. Despite a shortfall on the revenue side (PLN 1.6Bn.), the budget deficit reached PLN 39.4 Bn. (0.5% below the statutory limit) due to a reduction in expenditure to PLN 182.9 Bn., and partly to lower-than-expected costs of public debt servicing.

The funding of the deficit in 2002 was different than forecast. Privatisation receipts reached PLN 2.3 Bn. instead of the planned PLN 6.6 Bn. The deficit was financed mainly by the issue of Treasury securities on the domestic market, and issues in foreign markets partly covered foreign debt repayment. Consequently, planned net sales of Treasury securities on the domestic market were exceeded in respect of both Treasury bills and bonds.

Information gathered on funds and agencies confirms that their standing did not improve significantly compared to preceding months. A rise of debt in the banking system by, amongst others, the Labour Fund, the Social Security Fund and the Agricultural Market Agency, as well as on the part of local authorities, shows that the remaining public finances sector created, in 2002, a larger deficit than in the previous year. This was larger even than the one declared at the beginning of the year. It is estimated that the economic deficit of the entire public finances sector for 2002 may reach approx. 5.5 – 5.7% of GDP.

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

In December 2002, the M3 money supply rose by PLN2.6 Bn. (0.8%) above that of November 2002. Interest rate differences (appreciation of the zloty against the dollar and weakening against the euro) had a material impact on the aggregate M3 volume. After elimination of interest rate differences, monthly rise in M3 would have amounted to approx. PLN3.8 bn. (1.2%). At the same time, approx. PLN 0.6 bn. of the rise in monthly M3 is attributable to accounting practises: in December banks booked receipts from the issue of bank bonds as other M3 components.

The M3 increase in December 2002 stemmed primarily from PLN 4.4 Bn. (8.6%) higher corporate deposits, a typical phenomenon prior to the Budget deficit in 2002 below statutory levels Economic deficit of the public finances sector in 2002 accounted for 5.5 - 5.7% of GDP Money supply increase in December results from typical year-end rise in corporate deposits Decline in household deposits 6 end-of –year period. Household deposits (private individuals) shrank by PLN 1.8 Bn. (0.9%), of which approx. PLN 0.8 Bn. was attributable to exchange-rate differences. The shrinking household deposit base manifest since the beginning of last year was accompanied by dynamic growth in the volumes ploughed into alternative forms of savings. Estimated flow of household funds to investment funds reached PLN 2 Bn. in December.

On the money-creation side, the year-end saw another typical December phenomenon, i.e. a drop in total amounts due by PLN 1.8 Bn. (- 0.7%), caused primarily by a fall in amounts due from corporations (by PLN 3 Bn., i.e. 2.3%). Amounts due from households rose by PLN 0.3 Bn. (0.3%). The annual rate of growth in amounts due from households rose slightly in December 2002 to 8.5%, and the annual rate of growth of corporate loans reached 1.6 %. In December 2002 the zloty continued to gain ground against the US dollar (0.9%), but depreciated 0.8% against the euro. The euro continued gaining against the dollar and rose by 1.9% during the month.

IV. Prices, inflationary expectations

In December 2002, the twelve-month inflation rate fell again to 0.8%. The trend was helped by the lower prices of food and non-alcoholic drinks, alcohol and tobacco, clothing and footwear. The growth rate of prices relating to domestic consumption and furnishing was also lower than in the previous year. On the other hand, transport costs rose slightly as a result of higher fuel prices. The latter had dropped during the preceding year.

At the end of 2002 the annual inflation indicator "net" (i.e. excluding food, non-alcoholic drinks and fuel prices from the CPI) totalled 2.0%. Other base inflation indicators at the end of 2002 fitted into a bandwidth of 0.16% (base inflation rate after the exclusion of regulated prices) to 1.2% (15% end-adjusted mean). The average annual price increase in commodities and services totalled 1.9% in 2002.

The sold-products prices in December 2002 rose by 0.1% above those in the previous month. Sales value of industrial products over a twelve-month period rose by 2.2%, pushed up by rising prices in all sectors of industry. Prices rose most steeply on the part of producers in those sectors where market-force rules have not yet taken effect. Electricity, gas and water supply-sector production prices rose 6.8% (as compared to 10.8% during the previous year), and in mining and quarrying the same rose 3.4% (as compared to 2.9% during the previous year). In industrial processing, prices rose by 1.4% (as compared to a 2.6% drop during the previous year). The most significant price rises over the twelve-month period as reported in the manufacture of coke and refined petroleum products, were 20.6% higher than during the previous year (when they dropped by 19.7%).

Low inflation strengthens low inflationary expectations. In January 2003 the structure of replies to questions from an Ipsos- Demoskop survey, based on which the analysis is conducted of individuals' inflationary expectations, deteriorated markedly in terms of impact on the quantification of the expected inflation rate. At the same time, January witnessed a further decline in the rate of current inflation, which neutralised the result of undesirable changes in the structure of replies to the questions of the survey. The quantification procedure of inflationary expectations justifies the conclusion that in January 2003 individuals expect a 0.7% rate of price rises this year, which implies that the same declined by 0.1 of a percentage point in comparison with the results of a survey conducted in December last year. Meanwhile, banking analysts expect the inflation rate in the month preceding the same month of next year (i.e. December 2003) to rise by 0.1 percentage point to reach 2.6%, whilst the average annual inflation rate for 2004 is estimated to be 2.7%, or 0.1 percentage point above December's forecast.

Government and politics

- **Changes in the cabinet... again**
- **What about reform of public finances?**
- **Controversial ideas of two ministers**
- **Open pension funds as a part of public finances?**

Changes in the cabinet... again

In January Prime Minister Leszek Miller announced another changes in the cabinet. Healthcare minister Mariusz Łapiński was dismissed and was replaced with Marek Balicki (SLD candidate for presidential post in Warsaw in recent local governments' elections). The change was widely expected, especially after the conflict of healthcare minister with finance minister with regard to healthcare contribution – we wrote about this last month.

In the meantime, the Upper House passed the bill increasing the contribution for the healthcare fund by 0.25 percentage point every year until 2007 (up to 9% of personal income), despite the government tried to persuade senators to leave the rate unchanged. However, there is still a hope that the Constitutional Tribunal rejects the bill (the Supreme Chamber of Doctors is against) or president Kwaśniewski veto it.

Also, there were some change in the Ministry of Finance, as two deputy ministers were dismissed – Irena Ożóg (responsible for taxes) and Tomasz Michalak (custom duties). What is important, Hanna Wasilewska-Trenkner, who is responsible for the budget, stayed in the office and, according to Gazeta Wyborcza information, her position was even strengthened, as she will have a control over local governments' finances.

In January, the first press conference of the new treasury minister Sławomir Cytrycki was held. He announced that he would do his best to achieve privatisation revenues of PLN9.1bn (ca. US$2.3bn) assumed in 2003 budget, however he did not elaborated much on the details. Among others the ministry is going to sell state's stakes in PKO BP, BGŻ (big state-owned banks), PZU (the biggest insurance company in Poland) and PLL LOT (national airline). Higher revenues from privatisation would be positive for fixed income but one have to wait whether new minister's declaration would be followed by actions.

What about reform of public finances?

Still more declarations about planned reform of public finances in Poland. In January, finance minister Grzegorz Kołodko told a few possible dates of presenting the whole package of public finance reforms (details in the table with politicians' quotes below). Firstly, he said that the main elements of reform would be presented in 2Q03 and 3Q03 and after approval by the parliament, legislative changes in public finances will come into effect in 4Q03. This would enable to incorporate all necessary changes in 2004 budget. However, in another interview finance minister that the government would discuss this issue already at the end of 1Q03. So now no matter when the reform would actually show up, he might say it is in line with his declarations. The proposed measures – said Kołodko – are supposed to increase the elasticity of budget spending and secure the funds for financing expenses related to EU accession. The reform would incorporate deep changes in tax system, including growth of local governments' share in tax revenues, simplification of tax rules and lowering tax burden.

More details about FinMin's plans regarding public finance reform have been revealed by minister Kołodko's senior advisor Elżbieta Chojna-Duch. Among others, she mentioned "zero" obligatory increase of old-age and disability pensions, modification of social security system, liquidation of some budgetary funds and agencies, reform or liquidation of some redundant state institutions, cancelling all tax deductions and increase of VAT rates, allowing for bankruptcy of ineffective public health centres, etc. Very brave and far-reaching propositions indeed! If implemented, they might be beneficial for the conditions of Polish public finances. However, these are still only propositions and it remains to be seen how much out of those postulates will remain in the actual reform accepted by the government. Meanwhile, one should not expect that financial markets or MPC would react spontaneously to pure declarations.

MPC member Dariusz Rosati criticised finance minister Grzegorz Kołodko's policy for delaying necessary reform of public finances. In Rosati's opinion Kołodko should have carried out the reform immediately after he took over his post in July 2002, when he had enjoyed big political support, which has substantially decreased in recent months. Rosati said that Kołodko came to the government completely unprepared and presented only two discredited bills, postponing important decisions. MPC member pointed out that now the reform would be much more difficult to implement or even propose, as Poland faces accession referendum in June and unpopular measures could undermine support for the accession.

Another "interesting idea" of the Finance Ministry

Before the Ministry of Finance presents the so-called reform of public finances, it tries to find other sources to help difficult budgetary situation. It is pressuring the central bank to free up at least a part of the PLN27bn (US$7bn) held in the form of the so-called revaluation provisions against the foreign exchange rate risk. The provision is the difference between the average exchange rate at which the central bank bought its hard currency reserves (the bulk of which was done in the early and mid-1990s), and the current zloty exchange rate. The money appears only on the central bank's balance sheet. If it were freed and transferred to the budget as a part of the NBP's profit, more money would have to be printed, boosting money supply and effectively loosening monetary policy. Taking it into account it is very unlikely that such action could be approved by the central bank. The finance ministry's spokesman, who said that the issue is at the stage of proposals and postulates, officially confirmed the ministry's plans. He added that it is too early to discuss details. The NBP representative said only that the central bank did not conduct any talks with the Ministry of Finance on that issue.

...and the Ministry of Economy

It seems that central bank's revaluation provisions are not the only provisions, which the government wants to bring into play. Economy and social policy minister Jerzy Hausner's new idea is to employ commercial banks' provisions on irregular credits. The plan is that banks could lower their reserves created as a consequence of bad loans in their portfolio and this freed money would be used for credit activity of some sectors of the economy, chosen by the government. Hausner did not give any details but this may be another example of controversial and complicated measures, which are not likely to have substantial positive influence on the economic activity.

Swansong of deputy finance minister

Deputy Finance Minister Irena Ożóg said, just before the dismissal, that tax revenues in 2003 might be higher than planned by PLN200m. This effect, which was not included in the budget, would be connected with higher taxes from restructuring companies, as these firms could participate in the restructuring programme only under the condition of no delay in current taxes payments. On the other hand, however, total revenues from the restructuring programme amounted to only PLN423m comparing with the budgetary plan of PLN1.3bn and with the Ministry of Finance's November's announcement about PLN700m.

Irena Ożóg said also that the Ministry of Finance is not likely to extend the period of no capital income tax in Poland. This was not consistent with the line of reasoning of new treasury minister Sławomir Cytrycki, who said that the Polish capital market needs higher capitalisation and higher liquidity. Undoubtedly the introduction of capital income tax is not likely to increase turnover on the stock exchange. Well, a possible introduction of capital income tax was one of the hot issues in the media in recent weeks and we saw a lot of contradictory statements concerning this issue.

Open pension funds as a part of public finances?

According to the ISB agency Poland was allowed by the European Union to treat the open pension funds (OFE) as a part of public finances sector, which was confirmed by deputy minister of economy and social affairs Krzysztof Pater. This would mean significantly lower level of public debt and public finances deficit (by a few percentage points) in Poland, which increases chances for fulfilment of Maastricht criteria regarding public finances in the declared data, i.e. 2005.

As deputy minister Pater said, the final decision concerning the definition of open pension funds will be probably taken in May, which implies that OFE might be incorporated into the public finances' sector already in September (in March of 2004 at the latest). Minister said, however, that though OFE would be statistically incorporated into the public finances' sector, the government would not undertake any moves to change the law on public finances. In particular, there are no plans to list OFE as public institutions.

Comments of the government members and politicians

The better part of the politicians' comments made in January were substantial enough for us to elaborate on them above. Primarily, they related to subsequent changes in the government, the ever-expected public funds reform and the planned activity of the Ministry of Finance on the FX market.

WHO. WHEN. WHERE	COMMENT
Aleksander Kwaśniewski Poland's President PAP, 7 Jan	Mr Cytrycki is present in politics for a long time, forever... He was a competent staff member, a person who engaged his talents in intellectual and managerial projects, more often on back. We are friends for many years and I can say that it is a person with extraordinary managerial skills. He is not the one who loves to be on the newspapers' headlines and in the media.
Leszek Miller, Prime Minister; PAP, 29 Jan	If the MPC acted constructively, attempts to make Polish economy more dynamic would be braver.
PAP, 6 Jan	I hope that the process of further privatisation, which should be accelerated, [...] would be less politicised, because the new [treasury] minister cannot be associated politically. I have decided that it would be positive for the realisation of our programme to release the privatisation from any political tensions. I hope this change would allow this.
Grzegorz Kołodko, finance minister; PR1, 29 Jan	Preparing preliminary assumptions for the next year's budget we also work on the idea of a wide public finances' reform in order to assure necessary flexibility of the budget and safely finance everything [expenditures related to the EU membership]. The whole package [of the reform] will be discussed by the government in last months of this quarter. This is a task for a few years. We want to change important elements of the tax system, the way of local government's financing. Local authorities should be much more autonomous but also their responsibility should be greater. They should be granted with their own revenues, not only share in state budget revenues. [...] However, own tax revenues of local governments should not mean higher overall tax burden. [...] Local governments should be allowed to decrease taxes in order to attract investors. There is common expectation that tax system will be simplified and we will come up to this expectation and I hope that tax rates will also be slightly lower. [...] Tax system should be efficient and fair. Most likely (capital income tax will be introduced) since the beginning of next year but the final decision has not been made so far. [...] It will be presented together with the package of bills reforming public finances. Today, there are neither economic nor social reasons why pensioners should pay taxes and those who earn speculating on the stock market should not.
TVP1, 27 Jan	The ratio of population working in agriculture to that receiving low old-age pensions for farmers is so unfavourable that 90% of KRUS (social security fund for farmers) funds stems from the state budget and only the remaining part from farmers' contributions. [...] The matter is to change these relations so as to maintain level of benefits for farmers in the framework of their revenue and expenditure and decrease burden on taxpayers at the same time. If we manage to save PLN0.5bn in 2004 and create mechanism, which will allow for higher savings in subsequent years, it will be sufficient reform. [Taxing capital income] is only a matter of time. It cannot be in normal economy that pensioners pay taxes and financial elite does not. When? This is a good question. In the nearest years, not necessary in 2004 capital income has to be taxed in a way so that it would be favourable for capital formation.
Warsaw Voice, 23 Jan	The critical mass of such a reform [of the public finance] will be presented for public and political debate in the second and third quarters of 2003; its accepted version will be broadly implemented in the last quarter, in time for the difficult budget of 2004. The reform will involve: 1. decreasing that considerable part of budgetary expenditure which is rigidly pre-determined; 2. improving the performance of quasi-budgetary funds and agencies, including downsizing some of them through consolidation and even liquidation if necessary; 3. shifting expenditure away from certain ineffective or disposable uses, in favour of development aims; 4. restructuring expenditure to make available funds for co-financing projects under structural and cohesion funds provided by the EU; 5. reforming the tax system by reducing or eliminating tax exemptions, and changing tax brackets and scaling. Indeed, Poland has one of the lowest tax burdens, not only in the EU, but among OECD countries. [...]In the longer run, once Poland will have resumed its earlier course of sustained growth at an annual rate of 5 percent or more, we will be in a position to consider further reductions. For Polish entrepreneurs, the main problem is not taxation, but the high cost of finance discouraging investment and the super-strong exchange rate, which is associated with high interest rates and handicaps Polish competitiveness. The strength of the zloty has nothing to do with Polish market fundamentals; it is the consequence of large-scale speculative capital inflows attracted by interest rate differentials caused by the NBP policy of high interest rates. The NBP is claiming to counteract imaginary inflationary pressures allegedly deriving from the fiscal stance, neglecting that actual inflation-currently at under one percent per annum-in the second half of 2002 has been well below its target range of 2-4 percent. Inflationary expectations and core inflation have also been falling, and the strong exchange rate raises serious worries about deflation rather than inflation. Under similar conditions, the Czech National Bank has reduced interest rates below those of the European Central Bank, while the NBP interest rates are still well above the euro-rates. Lower interest rates would correct the zloty overvaluation without the need for central bank intervention in foreign exchange markets. In its wisdom, the supremely independent NBP is seriously lagging behind, in its interest rate policy, Polish inflation trends. All in all, EU transfer should make a contribution of the order of one percent per year to Polish long-term GDP growth. The process of growth acceleration has been visible and steady. [...] Such firm, steady and continuous trends, quantitative and qualitative, lead to reasonable expectations of a GDP growth of the order of 3.5 percent in 2003.
Reuters, 22 Jan	In the short term, the gradual yet limited depreciation of Polish zloty will continue. I think Poland will be coming to the euro in due time, in four or so years from now with the exchange rate much closer to 4.35. If I were an investor on the international financial market, I wouldn't believe so much in the Polish market. I would rather bet on slight depreciation. If nothing were done then the [budget] deficit would rise by 1.3 or 1.4 percentage points of GDP [in 2004]. [However] We will undertake certain measures to contain the deficit. The deficit in 2004 shouldn't be much bigger than it is in 2003.
Polish Radio 1, 8 Jan	We used to reduce taxes when, due to realisation of "Strategy for Poland" programme, there was 6-7% GDP growth [...] then we have started to reduce [taxes]. This issue could return when we will have sufficiently high economic growth.

	[Zloty] exchange rate is definitely overvalued due to speculative movements, which are allowed by disproportionate central bank's interest rates [...]. This exchange rate would depreciate in time [...] which would be supported by government's actions. There will be no better time for buying euros and dollars.
Radio Wrocław, 5 Jan	Those who can buy dollars and euros: households and individuals, entrepreneurs and banks. Because they will be no cheaper than they are now. It is an exceptional opportunity to improve one's financial situation, and the zloty exchange rate depreciation would follow. Today there is no need for such ultra-restrictive monetary policy, cooling down the economy and hampering domestic demand – in fact we need the opposite.
Reuters, 4 Jan	Everybody should buy dollars and euros now - both people as well as banks and businesses - because this is the cheapest they will get. This is a unique opportunity to earn, which will also help weaken the zloty.
Wiesław Ciesielski deputy finance minister PAP, 16 Jan	The restructuring fees will amount to nearly PLN 700 mln, of which PLN 420 mln is constituted by fees on tax arrears, and the budget will additionally receive fees from arrears on customs. I do not expect any problems with budgetary revenues in 2003 because of restructuring fee shortfall.
Jan Czekaj deputy finance minister PAP, 14 Jan	According to our estimation, public debt amounted to 47.5% of GDP at the end of 2002. If we calculate the debt according to the EU methodology, this would be some 3-4 percentage points lower.
Irena Ożóg deputy finance minister PAP, 16 Jan	At the current stage we analyse different variants, but we are inclined to not extend the period of no capital income tax in Poland. However, we envisage some solutions favourable for investors, which would not be a barrier for the capital market. Tax on capital income might be as simple as possible. The condition to participate in the restructuring process is to start pay the taxes on time. This additional effect which was not included in the budget, will bring PLN200m revenues more.
Ryszard Michalski deputy finance minister Reuters, PAP, 24 Jan	We will be buying hard currencies for servicing debt interest costs on market in the first quarter. But we have not done this yet, because we are not ready. We are still preparing the infrastructure and we will be ready soon, sooner than people expect. We fully agree that the market should decide, but we are thinking about a civilised market. It seems that the process of appreciation goes too far. A sort of a regulated market could be a much nicer solution than the volatile, impulsive market we have... Last week's experience was very destructive and shows the market should be regulated and under control. We would like to buy back all the outstanding Brady's bonds. If it's possible, we would like to buy them back before Poland joins European Union next year.
Elżbieta Chojna-Duch, MinFin economic advisor, Gazeta Wyborcza, 29 Jan	Almost 68% of budgetary expenses are fixed and legally determined. What is more, the elasticity of the remaining 32% is also questionable, and a process of fixing some spending is continuing, while fixed expenditure should make not more than 50%. We cannot finance flows from the EU by increasing budget deficit, as we would never enter the EMU. We have to be very careful to not exceed 50% of GDP with the public debt. We can compensate such a shortfall by increasing revenues (there is no much scope here) or by rationalising spending. Negotiations about wages' indexation should be taken in the context of difficult 2004-05 period. Maybe we should introduce no indexation and the finance minister could increase it in the budget? But the government does not think about such a solution. Social spending are very often doubled and money are wasted. Labour minister prepared the project to regulate this social family payments. The supervision of MinFin over budgetary funds should increase. Social Security Fund [also for farmers] should not be liquidated, but should be improved. The contribution paid by farmers should depend on their incomes. We cannot count on significant savings, and therefore finance minister should be like a housewife - very cautious with spending, or even grudging. And looking for additional sources of financing. MinFin is thinking about transferring incomes from taxes to local governments. Deep reforms are necessary also in the healthcare system. We should also abandon all tax deductions and increase VAT rates as soon as possible. There is a special team in the MinFin working on local taxes reform.
Jacek Tomorowicz, director of foreign policy dep. in MinFin, PAP, 30 Jan	We are preparing information policy concerning the purchase foreign currencies for debt servicing on the market. The market cannot expect that we would inform when we are planning to buy and what is our preferred price. We assume that sources for capital repayments will come from bonds' issuance on the international market, while interests would be repaid by foreign currencies bought on the market or in the NBP. We plan to issue bonds on the Japanese and American market. On the US market we can issue additional US$1bn easily, while we plan to do ¥20-30bn of samurai bonds at the beginning of 2003. This would depend on market situation and investors' interest, but we plan to issue US$3bn this year. Recently we doubled our offer (from €750m to €1.5bn) and this gives us liquidity at the beginning of the year. This issue showed that Poland is perceived by foreign investors as the country from the other group, not emerging markets anymore. We are still interested in buy-back of PDI bonds in April. This is constant target of foreign debt management – to replace costly debt by new, cheaper issuance.
Jacek Krzyślak head of research dep. MinFin PAP, 15 Jan	Most likely we will se another record low level of inflation in January. If one expects a rebound of inflation, this may only in 2Q02.
Ludwik Kotecki deputy head of FinMin's research dep. PAP, 22 Jan	We estimate that GDP grew ca. 1.9% in the last quarter of 2002, and in whole 2002 it increased by 1.2%.
Jerzy Hausner minister of economy, labour and social affairs PAP, 26 Jan	There are no complete data yet but unemployment will for sure grow in January. According to my estimates, it will be a 0.2-0.3-percent growth on December figures.
PAP, 23 Jan	I believe we are in situation where the government has no relevant macroeconomic stimulators at hand that could boost economic growth. [...] There is of course some area o macroeconomic policy, i.e. exchange rate policy, which should be the area of co-operation between NBP, MPC and the government, and which allows for some economic stimulation. But in my opinion this field is very narrow, especially for the government.

	Polish economy is ready for the growth, but still there are strong obstacles impeding the recovery. The problem no. 1 that I'm going to face is how to unleash the potential. The most important problem in addition to investment fall is the growth of unemployment [...] hampering economic growth.
PAP, 20 Jan	The main priority of the new ministry is to lead to permanent and high economic growth, which should reach 5% at the end of 2004. But there is no way we can boost growth by increasing our budget deficit. [...] Among many important factors there is wise use of structural funds, because this money [...] might contribute to modernisation of economy and improvement of its competitiveness. The weight of the problem is lower than we thought. [Necessary funds for co-financing structural funds] It is less than €900m until 2006. Considering that those funds will not be employed at once, but with a delay, they may be delayed until 2007 or 2008. [...] I will try to shift the money from the areas where they are used passively and for consumption for the sake of active use. Unemployment will certainly increase in January because this is the worst time of the cycle. This will be continued also in February, though as of March we should see the beginning of lasting improvement. I am sure that unemployment will begin to fall permanently and that it will be lower in December 2003 than it was in December 2002. But we should not expect a significant decrease and unemployment would still be around 16-17% at the end of the year.
PAP, 8 Jan	The apogee of unemployment growth will take place in January, February. The turning point will be in spring. In March and April the unemployment will fall. In 2003 one can expect that unemployment will be declining in sum, however rather slowly.
PAP, 7 Jan	It is rather unlikely that unemployment falls below 18% [in December]. It will be 18% or 18.1%, but I wouldn't rule out the range 17.9-18.1%. Also in January the situation on the labour market will be difficult, and I would expect the improvement since February. I am convinced that this solution [merge of economy and labour ministries] will be supportive for making reasonable changes in public finances [...]. It cannot be done only from the perspective of the state's chief accountant [...]. Deputy PM [Grzegorz Kołodko] will initiate those changes [regarding public finances] and I am supposed to contribute to them significantly.
Ewa Freyberg deputy min. of economy, labour and social affairs PAP, 20 Jan	Presently the Ministry of Finance works on the ways of linking present budget expenditures with European funds. Utilising EU funds should not necessarily cause rise of budget spending, but rather a shift [within its structure].
PAP, 14 Jan	The National Development Plan approved by the government will allow Poland to use EU funds that will flow in following membership in May 2004. The EU's structural and cohesion funds - both aimed at boosting income and infrastructure levels in the NDP - have been decreased from the €13.8bn preliminarily planned to €11.4bn. Of this amount €7.6bn will be directed for structural fund within 2004-2009 while €3.7bn will be earmarked for cohesion funds to 2010. If Poland use these funds effectively, this would lead to higher GDP growth by 1pp per annum since 2004. Poland will have to find an extra €900m within seven years to co-finance programs supported by the EU. The ministers of finance and economy, labour and social affairs are to prepare by end-February legal proposals that would allow for the extra financing. The changes are expected to be directed towards pro-development structural modifications.
Mariusz Łapiński healthcare minister PAP, 9 Jan	I am compelled by the government's decision. The premium [for healthcare funds] should amount to 7.75%. The healthcare funds would have the loss in 2002 amounting to PLN600m.
Witold Orłowski economic advisor to president PAP, 6 Jan	I am not especially surprised with those changes. I would be very happy if in line with PM's declaration made on Monday it would be possible to accelerate privatisation. But the problem here is aggressive political anti-privatisation lobbying, and the new minister would have to cope with it. As regards merging two ministries, it is certainly useful, because it creates the opportunity for establishing stronger economic ministries.
Mieczysław Czerniawski head of Sejm's public finance committee, SLD Wprost, 12 Jan	The idea of public finance reform means different things for different people. If one expects deep changes in social expenditures, he is wrong. Social revolution means revolution on the streets. I would defend every single zloty for students, pensioners or combatants.

EU negotiations watch

- **Support for accession increased, turnout uncertain**
- **Accession Treaty almost ready to sign**

Support for EU accession inched up in January

According to CBOS polling institute 74% of Poles declaring the will to participate in the EU accession referendum would vote YES and 18% would be against. It means growth of the support for European integration in January, while in December the corresponding ratios reached 67% and 22%. In January 73% of polled persons declared that they might consider participation in the referendum, while 63% of Poles were certain that they will do (against 58% in December). According to CBOS survey 20% of Poles said the final outcome of accession negotiations was better than one could have expected (18% said it was worse and 32% – in line with expectations).

Meanwhile, the survey conducted by another Polish institute – Demoskop – gave slightly different results, especially regarding expected turnout of the referendum. According to Demoskop 78% of Poles showed interest in participation in accession referendum, while only 47% of people were certain that they will go and vote. 69% out of those who would participate declared the support for EU accession, 19% said they would be against and 12% were undecided. Out of 14% of Poles that are not planning to participate in the referendum, 8% said they will definitely stay home, and 6% said “rather not”; 8% were undecided whether to go. According to Demoskop stretching out the referendum to 2 days (the idea promoted by some MPs) would not have significant effect on the turnout, as only 2% of people would decide to vote in the extra day. This question was, however, asked once again in the poll conducted by the PBS agency. It turned out that while this idea attracts more critical than positive comments (59% against 39%), the turn out could increase from 51% to 59% as a result of longer voting period. What is interesting, two-days referendum would be important for both supporters and opponents of the integration.

In January the support for integration increased also in Czech Republic, while it went down in Hungary. In Czech Republic 66% of potential voters wanted to support the accession and 23% were against (respectively 62% and 29% in December), while in Hungary the corresponding ratios reached 71% and 18% (75% and 29% in December). The turnout in the referendum is estimated at 79% in Czech Republic, and 74% in Hungary.

Accession Treaty almost ready to sign

Despite previous doubts of minor coalition partner PSL, the government decided that Poland would accept compromise proposal of the European Union regarding system of direct subsidies’ payments for Polish farmers. As expected the EU interpretation on this issue was approved by the SLD-UP but what is more important it was also accepted by deputy PM and agriculture minister Jarosław Kalinowski. “After the cabinet meeting, I can repeat that the results of our negotiations are good, which give the Polish economy and Polish farming a chance” said PSL leader. Official PSL stance concerning the European integration wil be presented after the party’s congress on 22 February.

The agreement on direct subsidies system was the most serious problem during arduous development of the accession treaty draft, which final version is to be signed at the EU summit in Athens on April 16, 2002. The solution of this problem means that the next serious (actually the most serious one) hurdle to be overcome on Poland’s road to the EU is the accession referendum, which was preliminary scheduled on 8 June.

...as it was accepted by the EU ambassadors

One day after the Polish government decision concerning direct subsidies to farmers, the EU ambassadors accepted the text of the Accession Treaty. In the neat future the text will be translated into all official languages of the enlarged Union, including Polish, then, ii would be sent to the European Commission for the final opinion and to the European Parliament for the final approval.

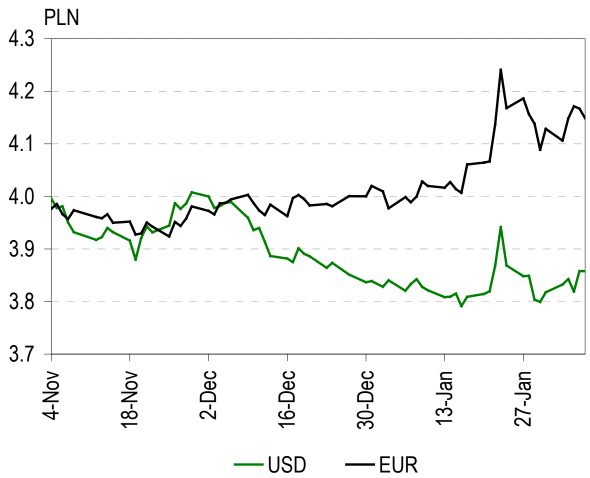
Market monitor

- **Panic on domestic FX market**
- **T-bond market under pressure from primary market**
- **Unsuccessful auctions of T-bonds; successful issue of the eurobonds**

Not all that starts well ends well

Though the first half of the month was sleepy, January was very unquiet on the domestic FX market. At first, turnover was only slightly higher than during Christmas period and FX rates were relatively stable, but then a panic appeared similar to that which happened in July 2002 after dismissal of finance minister. Considerable supply of Polish currency and uncertainty resulted in very active trading, large volatility of rates and significant weakening of the zloty. At the end of the month, when moods calmed down and rates stabilised the zloty was noticeably weaker against currency basket compared with end of December, which almost entirely resulted from weakening against the euro. On the global market the dollar continued weakening, reflecting increasing uncertainty before the war with Iraq.

Zloty FX rate in recent months

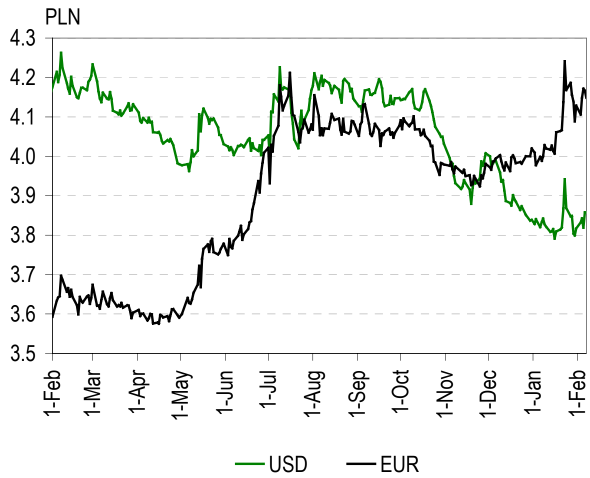


Source: NBP

According to the NBP fixings, in January the dollar was traded between PLN 3.7914 (on 16 Jan) and PLN 3.9418 (23 Jan) and the average rate was PLN 3.8308 (against PLN 3.9136 in December). The euro rate ranged from PLN 3.9773 (on 3 Jan) to 4.2413 (23 Jan) and the average rate amounted to PLN 4.0693 (while at PLN 3.9874 in December). The average USDPLN rate matched our forecast from January's MACROscope and EURPLN was higher than forecasted by 0.06PLN.

During the first half of January the market was very calm. The turnover was low, and rates continued December's trends. The zloty was gradually firming against the dollar and remained stable against the euro.

Zloty FX rate in last year



Source: NBP

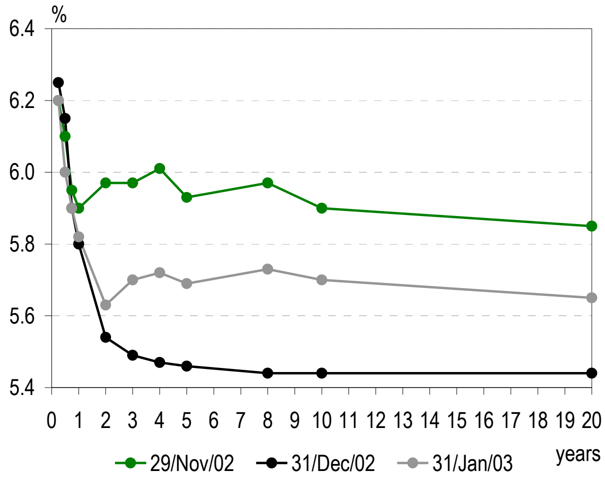
On Thursday, 16 January in the afternoon turmoil started on the Polish FX market, after the National Bank of Hungary cut interest rates second day in sequence and intervened on the market to weaken the forint. It caused nervous reaction of investors who started to sell off the forint and then also the zloty that lost 1.3% against currency basket. Next day was equally nervous when the zloty lost 1% more and uncertainty maintained though it rebounded slightly during the day. Second wave of the sale off took place several days later, on Tuesday, 21 January and it was even more violent. The market was still sensitive. When some rumours appeared, that FinMin is purchasing currencies on the market for foreign debt servicing and that minister Kołodko resigned, investors began to got rid of the zloty again. By Thursday rates were very volatile with the general tendency towards depreciation and negative sentiment to the zloty. In the weakest point it was traded at level lower by 5% than a week earlier.

Next days brought some improvement of mood and the zloty started to appreciate, as investors realised there were no reasons for long-term weakening. The rate against the dollar came back to the level from before a turmoil on the market. The rate against the euro was weaker as meanwhile the European currency strengthened on global market.

Ministry of Finance in trouble?

T-bonds' secondary market was calmer, but a lot was happening on the fixed income market as well, and considerable weakening along the whole curve was recorded. Starting from the beginning of the month the market was under pressure of supply on the auctions announced by the FinMin, which exceeded expectations. When the day of the auction was approaching bonds that were planned to be offered weakened at the secondary market. However, after first successful tenders the yields went down slightly. Turmoil on the FX market, and especially its second wave, flooded into fixed income market and the yield curve moved upwards due to massive closing positions by foreign investors. Finally, the MPC's decision to lower interest rates also translated into weakening, since some foreign investors hoped for deeper cut.

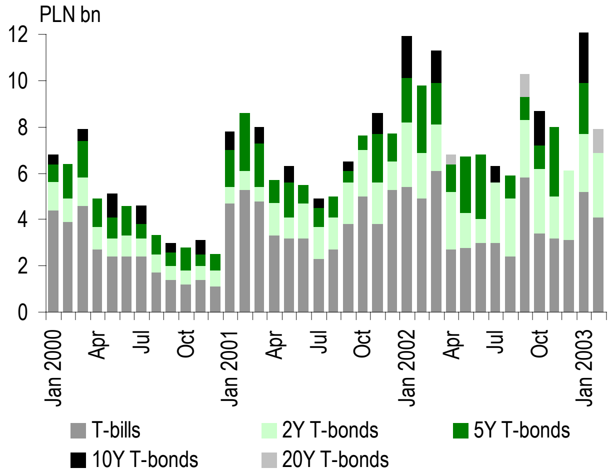
Yield curve



Source: BZ WBK

In recent weeks the Finance Ministry has some trouble with selling T-bonds on primary market. As usual at the beginning of the year, supply is very high. Two first auctions this year were successful, yet. At the second one, on 15 January all offered DS1013 bonds worth of PLN2.0bn were sold and offered prices were good enough so on the next day the ministry held additional tender selling further PLN400m. At the next auctions not all offered bonds were sold. On 22 January PLN2.2bn worth of PS0608 bonds and PLN2.8bn of OK1204 on 5 February were offered. Investors proposed too low prices and though demand exceeded supply majority of it was rejected and the sale amounted to PLN1.9bn and 2.1bn, respectively. In spite of this, average prices were below secondary market level.

Supply of Treasuries



Note: Feb 2003 without 5Y T-bonds
Source: Finance Ministry, BZ WBK

Treasury bill auctions (PLN m)

	OFFER (SALES)			
Date of auction	*13-week*	*26-week*	*52-week*	*Total*
06.01.2003	100 (100)	400 (400)	900 (900)	1400 (1400)
13.01.2003	100 (100)	300 (300)	900 (873.2)	1300 (1273.2)
20.01.2003	-	200 (200)	1000 (1000)	1200 (1200)
27.01.2003	-	300 (300)	1000 (1000)	1300 (1300)
January total	**200 (200)**	**1200 (1200)**	**3800 (3773.2)**	**5200 (5173.2)**
03.02.2003	-	100	800	900
10.02.2003	-	100	800	900
17.02.2003	-	300	900	1200
24.02.2003	-	300	800	1000
February total	**-**	**800**	**3300**	**4100**

Source: Finance Ministry

Poland sold EUR1.25bn worth of the eurobonds

On 27 January Poland completed the issue of 10-year eurobonds. The demand was three times bigger than the initial supply of €750m, and the Ministry of Finance decided to nearly double the offer to €1.25bn. Average yield reached 4.628%, i.e. 61.8bps above benchmark German bonds. The ministry announced that all the proceeds from eurobonds issue would go directly to the government's FX account in the central bank.

Treasury bond auctions in 2003 (PLN m)

Month	*First auction*				*Second auction*				*Third auction*			
	date	*T-bonds*	*offer*	*sale*	*date*	*T-bonds*	*offer*	*sale*	*date*	*T-bonds*	*offer*	*sale*
January	08.01	OK1204	2,500	2,500	15.01	DS1013	2,400	2,400	22.01	PS0608	2,200	1,959.1
February	05.02	OK1204	2,800	2,114.3	12.02	WS0922	1,000	-	19.02	PS0608	-	-
March	05.03	OK1204	-	-	12.03	DS1013	-	-	19.03	PS0608	-	-
April	02.04	OK0405	-	-	16.04	PS0608	-	-	-	-	-	-
May	07.05	OK0405	-	-	21.05	PS0608	-	-	-	-	-	-
June	04.06	OK0405	-	-	18.06	PS0608	-	-	-	-	-	-
July	02.07	OK0405	-	-	9.07	DS1013	-	-	-	-	-	-
August	06.08	OK0805	-	-	-	-	-	-	-	-	-	-
September	03.09	OK0805	-	-	10.09	WS0922	-	-	17.09	5Y	-	-
October	01.10	OK0805	-	-	08.10	DS1013	-	-	15.10	5Y	-	-
November	05.11	OK0805	-	-	19.11	5Y	-	-	-	-	-	-
December	03.12	OK1205	-	-	-	-	-	-	-	-	-	-

Source: Finance Ministry

International review

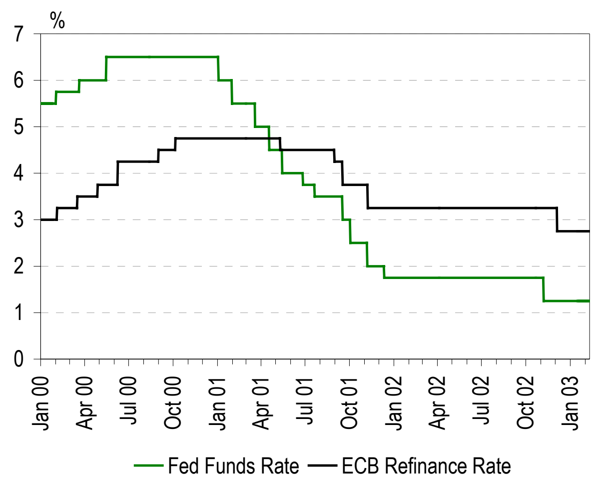
- **Interest rates cut in the Eurozone is coming**
- **European and American inflation a bit above 2%**
- **American GDP growth higher**
- **...while the rate of unemployment lower**
- **...and economic activity indices above European**

Interest rates cut in the Eurozone soon

In line with consensus forecast, the Council of the European Central Bank decided to keep interest rates unchanged at February's meeting. After December's reduction the Refinance Rate (i.e., main interest rate) stands at 2.75%, after it was reduced in December. The Council assessed that present monetary policy is proper for maintaining mid-term price stability, and the level of interest rates should create favourable conditions for economic revival in the Eurozone. However, the ECB president Wim Duisenberg suggested that lowering interest rates in the near future is possible, saying that geopolitical tensions cause increasing threat for economic growth. Rates reduction in the following months may be as significant as 50bps.

The Federal Open Market Committee also kept interest rates unchanged, in line with market expectations. Federal funds rate remained at 1.25%. In the statement Fed said that the economy is threaten to the same degree by price increase and return of economic slowdown, reiterating its opinion presented in November and December.

Interest rates in the USA and Eurozone



Source: Reuters

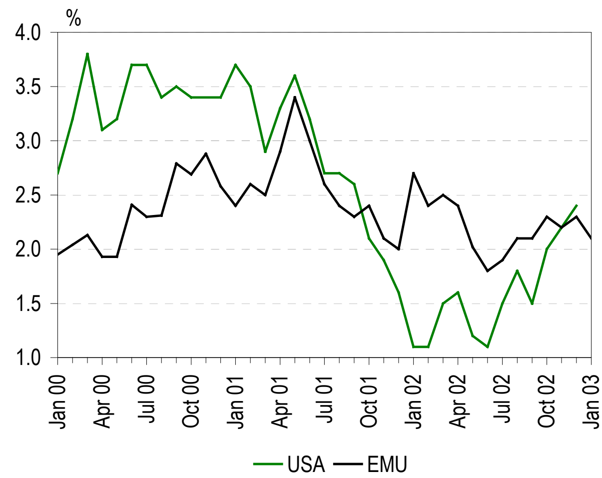
Inflation in Eurozone and US slightly above 2%

According to Eurostat's final release the inflation rate in the Eurozone reached 2.3%YoY and 0.2%MoM in December. It was slightly higher than suggested by preliminary estimates (2.2%YoY) and than recorded in November (also 2.2%YoY). Despite not very impressive economic growth in the EU12 countries, inflation still remains above the ECB's ceiling level of 2%YoY. It was above this target also in January, as according to preliminary estimations annual inflation amounted to 2.1%. This fall was deeper than pointed by forecasts of 2.2% and inflation returned to the level from September 2002. Producer prices in the Eurozone increased by 0.3%MoM in December, which brought the annual index up to 1.5% from 1.1% one month earlier.

US consumer prices inched up by only 0.1%MoM in December, following the same growth rate in November. In the whole 2002 consumer prices increased by 2.4%, which was higher than in two previous years. However, the core inflation excluding food and energy amounted to only 1.9% and was the lowest since 1999. The data suggest that inflationary pressure in the American economy is very limited.

Data from the United States on producer prices were better than expected. In December prices remained unchanged in monthly terms after significant fall of 0.4%MoM a month ago. Expectations pointed to increase in prices of 0.4%. Annual rate of producer inflation accelerated to 1.2% from 0.9% in November.

Inflation YoY



Source: Reuters

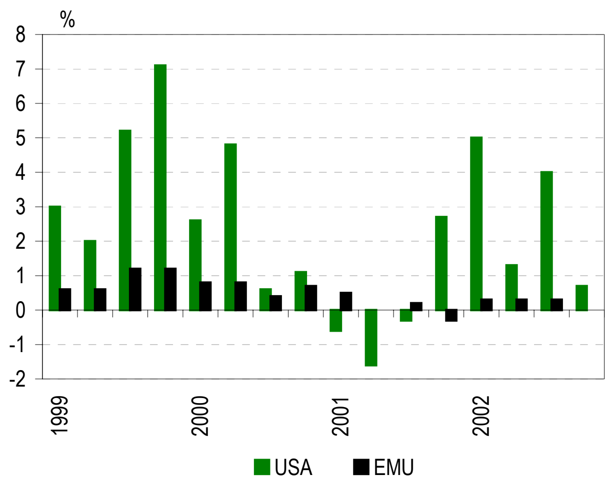
American GDP growth still higher

Earlier estimations of Eurozone's economic growth in 3Q02 were revised up partially in the last, third release. According to these data, Eurozone's GDP increased by 0.3%QoQ and 0.9%YoY in 3Q02 compared to 0.3% and 0.7% released earlier and 0.3% and 0.8% forecasted by analysts. However, the European Commission's growth forecasts for 4Q02 and 1Q03 remained unchanged. The Commission forecasts GDP growth of 0.1-0.4%QoQ in the first of these periods and -0.1-0.3%QoQ in the second one.

The most significant economic problems are observed in the EU's biggest economy. Germany recorded only 0.2% GDP growth rate in 2002, which was the worst performance since 1993. Although the major index of entrepreneurs' sentiment IFO – recorded a first increase in last eight months in January to 87.4 pts from 87.3 pts in December, the figure was slightly worse than expectations and the data on industrial production gave the opposite signal. In December industrial output fell by 2.6%MoM and 0.5%YoY comparing with average forecasts of -1.1% and 1.0%, respectively. What is more, November's result was revised downwards to 2.2% from 2.4% announced earlier.

According to advanced information, US GDP growth amounted to 0.7% QoQ in 4Q02. The data exactly matched analysts' expectations. After clear acceleration in growth rate to 4.0% in 3Q02, this time around significant slowdown took place, mainly as a result of lower consumers' spending, low inventories and a fall in exports. The fourth quarter figure was the worst in 2002. In the whole year, GDP increased by 2.4% compared with only 0.3% in 2001.

GDP growth QoQ



Source: Reuters

...and the rate of unemployment lower

Data on unemployment from the United States proved to be much better than forecasts. In January unemployment rate decreased to 5.7% from 6.0% recorded in December, while analysts forecasted it to remain unchanged. This way the unemployment rate returned to September's level. Moreover, number of jobs in US economy increased by as much as 143,000, which was the biggest increase in the last two years.

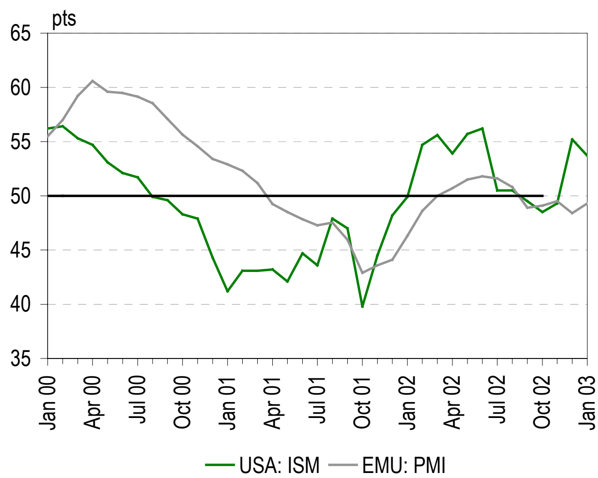
In line with analysts' expectations, which means negative were the results of the Eurozone's unemployment rate amounted to 8.5% in December. Unemployment in Germany increased sharply by 400 thousands people to 4.623 millions bringing the rate of unemployment to 11.1% - the highest level within last five years.

Higher economic activity in the United States

In January, index of economic activity in industry of the Eurozone improved (to 49.3 pts from 48.4 pts), while in the service sector it was worse than forecasted (fall to 50.2 pts from 50.6 pts). Low levels of both indices suggest that economic activity was still relatively low.

The situation in the United States is completely different. In January business activity indices in both industry (ISM fell to 53.7 pts from 55.2 pts) and non-industry (ISM non-manufacturing index increased to 54.6 pts from 54.2 pts) sectors managed to keep above 50 pts limit, which separates development from recession. Also consumer spending increased by 0.9%MoM and incomes rose by 0.4%MoM in December, although consumer sentiment indicators recorded stronger than expected falls.

Economic activity



Source: Reuters

What's hot this month

Monday	Tuesday	Wednesday	Thursday	Friday
3 February POL: T-bill auction (PLN 900m) *EMU: Producer prices (Dec)* *EMU: Unemployment (Dec)* *EMU: PMI (Jan)* *USA: ISM (Jan)*	**4** *ITA: Inflation preliminary (Jan)* *EMU: Inflation prelimianry (Jan)* *EMU: Retail sales (Nov)* *USA: Factory orders (Dec)*	**5** POL: T-bond auction OK1204 (PLN 2.8bn)	**6** *EMU: ECB meeting* *EMU: GDP (3Q)*	**7** POL: Food prices (1H & 2H Jan) *USA: Unemployment (Jan)*
10 POL: T-bill auction (PLN 900m) *GER: Industrial output (Dec)*	**11**	**12** POL: T-bond auction WS0922 *FRA: Industrial output (Dec)*	**13** *USA: Retail sales (Jan)*	**14** POL: Money supply (Jan) POL: Wages & employment (Jan) *ITA: Industrial output (Dec)* *USA: Industrial output (Jan)*
17 POL: Inflation (Jan) POL: T-bill auction (PLN 1.2bn)	**18** *ITA: Inflation final (Jan)* *EMU: Industrial output (Dec)*	**19** POL: Industrial output (Jan) POL: Producer prices (Jan) POL: T-bond auction PS0608 *EMU: Foreign trade (Dec)*	**20** *USA: Producer prices (Jan)* *USA: Foreign trade (Dec)*	**21** POL: Retail sales (Jan) POL: Business climate (Feb) *FRA: GDP (4Q)* *USA: Inflation (Jan)*
24 POL: T-bill auction (PLN 1.1bn)	**25** POL: MPC meeting *GER: IFO (Feb)* *FRA: Inflation (Jan)* *EMU: Retail sales (Dec)*	**26** POL: MPC meeting *GER: GDP (4Q)*	**27** POL: Food prices (1H Feb) *EMU: Money supply (Jan)*	**28** POL: Balance of payment (Jan) *ITA: GDP (4Q)* *EMU: Inflation final (Jan)* *EMU: Inflation prelimianry (Feb)* *EMU: Economic sentiment (Feb)* *EMU: Business climate (Feb)*
3 March POL: T-bill auction *ITA: Inflation prelimianry (Feb)* *EMU: PMI (Jan)* *USA: ISM (Jan)*	**4** *EMU: Producer prices (Jan)* *EMU: Unemployment (Jan)*	**5** POL: T-bond auction OK1204	**6** *EMU: ECB meeting* *EMU: GDP (3Q)*	**7** POL: Food prices (2H Feb) *USA: Unemployment (Feb)*

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	25-26	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
Retail sales	22	21	21	22	22	24	21	22	19	21	24	19
Gross wages, employment	15	14	14	14	16	13	14	14	12	14	18	12
Unemployment	22	21	21	22	22	24	21	22	19	21	24	19
Foreign trade	about 50 working days after reported period											
Balance of payments	31	28	31	30	-	-	-	-	-	-	-	-
Money supply	14	14	14	14	-	-	-	-	-	-	-	-
NBP balance sheet	7	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

		Jan 02	Feb 02	Mar 02	Apr 02	May 02	Jun 02	Jul 02	Aug 02	Sep 02	Oct 02	Nov 02	Dec 02	Jan 03	Feb 03
GDP	%YoY	x	x	0.4	x	x	0.8	x	x	1.6	x	x	2.0	x	x
Industrial production	%YoY	-1.4	0.2	-3.1	0.3	-4.2	2.1	5.7	-1.1	6.7	3.2	3.1	5.1	3.9	3.5
Retail sales ***	%YoY	4.7	6.7	9.9	3.1	1.8	2.5	8.6	5.1	4.7	5.1	5.9	4.1	4.3	6.4
Unemployment rate	%	18.1	18.2	18.2	17.9	17.3	17.4	17.5	17.5	17.6	17.5	17.8	18.1	18.4	18.5
Gross wages ** ***	%YoY	5.7	5.5	4.8	2.3	4.2	3.9	4.1	2.8	3.8	0.5	1.8	2.4	3.0	3.0
Export (acc. to NBP)	USDm	2 308	2 141	2 467	2 739	2 610	2 678	3 175	2 669	2 850	3 134	3 007	3 312	2 870	2 750
Import (acc. to NBP)	USDm	3 418	2 952	3 148	3 521	3 416	3 360	3 763	3 556	3 758	4 161	4 085	4 255	3 800	3 750
Trade balance (acc.to NBP)	USDm	-1 110	-811	-681	-782	-806	-682	-588	-887	-908	-1 027	-1 025	-943	-930	-1 000
Current account balance	USDm	-847	-820	-612	-643	-549	-408	-108	-265	-534	-606	-740	-519	-720	-780
Budget deficit (cumulative)	PLNbn	-6.9	-13.7	-16.4	-20.0	-23.0	-25.0	-25.7	-27.3	-29.8	-34.0	-37.1	-39.4	-6.3	-13.5
CPI	%YoY	3.4	3.5	3.3	3.0	1.9	1.6	1.3	1.2	1.3	1.1	0.9	0.8	0.6	0.6
PPI	%YoY	0.0	0.2	0.3	0.4	0.5	1.2	1.7	1.3	1.1	1.7	1.7	2.2	2.1	2.2
Broad money (M3)	%YoY	7.8	6.9	3.2	2.4	3.2	2.5	1.3	-0.2	-1.5	-2.5	-1.0	-2.3	-2.0	-1.7
Deposits	%YoY	6.9	5.7	1.7	0.6	1.3	0.5	-0.8	-2.5	-3.5	-4.6	-3.2	-4.4	-4.5	-3.9
Credits	%YoY	9.0	8.8	7.1	6.6	7.9	9.4	7.5	5.9	4.9	4.4	4.6	5.3	5.5	5.8
USD/PLN	PLN	4.06	4.19	4.14	4.06	4.05	4.03	4.12	4.18	4.15	4.12	3.95	3.91	3.84	3.80
EUR/PLN	PLN	3.59	3.64	3.63	3.59	3.71	3.85	4.09	4.08	4.07	4.04	3.96	3.99	4.08	4.07
Reference rate *	%	10.00	10.00	10.00	9.50	9.00	8.50	8.50	8.00	7.50	7.00	6.75	6.75	6.50	6.25
WIBOR 3M	%	11.90	10.83	10.32	10.20	9.89	9.30	8.89	8.55	8.07	7.45	6.81	6.82	6.55	6.43
Lombard rate *	%	13.50	13.50	13.50	12.50	12.00	11.50	11.50	10.50	10.00	9.00	8.75	8.75	8.50	8.00
Yield on 52-week T-bills	%	9.62	9.68	9.62	9.56	9.22	8.54	8.35	7.86	7.25	6.77	5.88	5.78	5.74	5.85
Yield on 2-year T-bonds	%	9.11	9.37	9.32	9.22	9.03	8.27	8.12	7.60	7.16	6.62	5.78	5.75	5.55	5.72
Yield on 5-year T-bonds	%	8.91	9.26	9.11	9.02	8.90	8.17	8.11	7.62	7.07	6.57	5.91	5.67	5.57	5.75
Yield on 10-year T-bonds	%	8.25	8.34	8.25	8.19	8.02	7.55	7.63	7.29	6.79	6.22	5.89	5.69	5.62	5.75

Source: CSO. NBP. BZ WBK

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

Quarterly and annual economic indicators

		1999	2000	2001	2002	2003	1Q02	2Q02	3Q02	4Q02	1Q03	2Q03	3Q03	4Q03
GDP	PLNbn	615.1	712.3	749.3	769.4	803.4	177.9	188.8	190.5	212.2	183.5	195.5	199.2	225.2
GDP	%YoY	4.1	4.0	1.0	1.3	3.0	0.4	0.8	1.6	2.0	2.5	2.7	2.8	3.8
Total consumption	%YoY	4.4	2.4	1.8	2.9	2.3	2.8	2.6	2.8	3.2	2.6	2.3	2.2	2.2
- Private consumption	%YoY	5.2	2.6	2.1	3.3	2.5	3.5	2.9	3.1	3.6	2.9	2.6	2.4	2.3
Fixed investments	%YoY	6.8	2.7	-10.2	-7.2	4.9	-13.2	-8.4	-6.3	-4.0	1.0	4.5	6.0	6.0
Industrial production	%YoY	3.6	6.8	-0.2	1.3	4.5	-1.6	-0.4	3.3	3.8	3.5	4.0	4.5	6.2
Retail sales (real terms)	%YoY	4.0	1.0	0.2	3.5	3.2	5.8	0.7	3.9	3.5	4.0	3.0	3.0	2.6
Unemployment rate *	%	13.1	15.1	17.5	18.1	18.5	18.1	17.4	17.6	18.1	18.2	17.7	17.7	18.5
Gross wages (real terms)	%YoY	3.3	1.3	1.6	1.5	2.8	1.9	1.4	2.3	0.6	2.3	3.1	3.1	2.8
Export (acc. to NBP)	USDm	26 347	28 256	30 276	33 090	35 015	6 916	8 027	8 694	9 453	7 600	8 300	9 130	9 985
Import (acc. to NBP)	USDm	40 727	41 424	41 955	43 393	47 050	9 518	10 297	11 077	12 501	10 700	10 900	11 850	13 600
Trade balance (acc.to NBP)	USDm	-14 380	-13 168	-11 679	-10 303	-12 035	-2 602	-2 270	-2 383	-3 048	-3 100	-2 600	-2 720	-3 615
Current account balance	USDm	-11 558	-9 946	-7 075	-6 651	-9 009	-2 279	-2 075	-907	-1 865	-2 635	-1 950	-1 496	-2 928
Current account balance	% GDP	-7.4	-6.3	-4.0	-3.5	-4.2	-3.9	-3.8	-3.8	-3.8	-3.9	-3.7	-3.8	-4.2
Budget deficit (cumulative)*	PLNbn	-12.5	-15.4	-32.6	-39.4	-38.7	-16.4	-25.0	-29.8	-39.4	-17.1	-24.5	-30.0	-38.7
Budget deficit (cumulative)*	% GDP	-2.0	-2.2	-4.3	-5.1	-4.8	-9.2	-13.2	-2.5	-4.6	-5.2	-5.0	-5.0	-4.8
CPI	%YoY	7.3	10.1	5.5	1.9	1.4	3.4	2.1	1.3	0.9	0.6	0.9	1.7	2.2
CPI*	%YoY	9.8	8.5	3.6	0.8	2.4	3.3	1.6	1.3	0.8	0.7	1.3	1.8	2.4
PPI	%YoY	5.7	7.8	1.6	1.0	1.6	0.2	0.7	1.3	1.9	2.2	2.0	1.0	1.4
Broad money (M3)	%YoY	24.6	15.2	12.1	1.6	2.2	5.9	2.7	-0.1	-1.9	-1.1	1.3	3.1	5.5
Deposits	%YoY	26.4	17.2	13.5	-0.2	1.7	4.8	0.8	-2.3	-4.1	-3.1	0.5	3.0	6.4
Credits	%YoY	28.6	24.7	11.3	6.8	8.3	8.3	8.0	6.1	4.8	6.3	7.6	7.8	11.8
USD/PLN	PLN	3.97	4.35	4.09	4.08	3.76	4.13	4.04	4.15	3.99	3.82	3.75	3.73	3.75
EUR/PLN	PLN	4.23	4.01	3.67	3.85	3.94	3.62	3.72	4.08	4.00	4.06	3.97	3.92	3.82
Reference rate *	%	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	%	14.73	18.78	16.08	9.09	6.34	11.02	9.80	8.50	7.03	6.46	6.28	6.30	6.30
Lombard rate *	%	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	%	12.95	17.77	14.77	8.18	5.59	9.64	9.11	7.82	6.14	5.81	5.65	5.50	5.40
Yield on 2-year T-bonds	%	12.41	17.37	13.91	7.94	5.52	9.27	8.84	7.63	6.05	5.66	5.55	5.45	5.40
Yield on 5-year T-bonds	%	10.87	14.00	12.59	7.86	5.56	9.09	8.69	7.60	6.05	5.69	5.60	5.50	5.45
Yield on 10-year T-bonds	%	9.60	11.79	10.74	7.34	5.56	8.28	7.92	7.24	5.93	5.71	5.60	5.50	5.45

Source: 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 10.02.2003 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