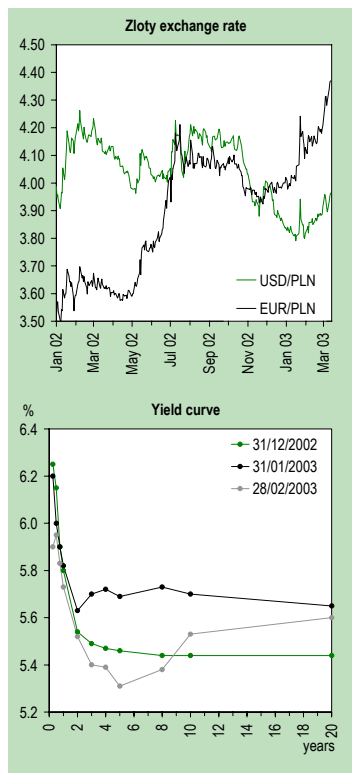




MACROscope

Polish Economy and Financial Markets

March 2003



Middle distance runners

■ Economists tackle with analysis of macroeconomic indicators in the short, medium and long run. In February medium-term monetary policy strategy was presented, as well as the finance minister's programme being a general concept of analogous strategy for fiscal policy. In the short-run the situation on financial markets was dominated by high uncertainty connected with political situation in Poland and abroad. As John Maynard Keynes said "in the long run, we are all dead".

■ The programme for restoration of Poland's public finances aims at fast economic growth, "fair redistribution" of the national income, beneficial integration with the EU and finally Poland's entry to the Eurozone by meeting the Maastricht criteria in 2006. The programme includes positive elements pointing towards a rationalisation of public spending, but not many details were given in this respect. More detailed information concerned revenues side of the budget, but it includes two important flaws – a possible increase of the effective tax rate for richer taxpayers, which may limit long-run growth potential and a proposal of freeing revaluation provisions, which may be connected with money printing.

■ The new medium term strategy of monetary policy, similarly as majority of recent decisions, seems to be a compromise between two different Council's factions with two different views. One could say that the new strategy has been designed as a universal scheme, to minimise the risk of rejecting it also by new MPC members, even considering their economic views might be less "conservative". Leszek Balcerowicz said during press conference that he could not imagine that new MPC would discard the medium-term strategy. And it also seems to be confirmed by the number of quotes from the document. Of course some of new members could interpret the strategy as the document which ties their hands. If such a view prevails in the new MPC, the strategy can be changed, or at least some parts of it can be modified, especially those concerning exchange rate policy.

■ January proved to be a month of record breaking, at least as regards economic figures. Inflation rate fell again, registered unemployment rate hiked to 18.7%, average employment in corporate sector plummeted sharply by more than 100,000. These are figures that do not bode well for economy's condition. Nevertheless, January also saw a set of less spectacular, yet more positive data: industrial output, retail sales, export and import turnover and state budget performance – this information confirmed that the gradual improvement in real economy is really taking place.

■ Record levels were also observed on the foreign exchange market in February. Macroeconomic fundamentals indicate this situation should not be long-term and the zloty should make up for the losses during this year, and especially after positive outcome of EU referendum in June. However, one has to remember another Keynes' sentence saying that "the market can stay irrational longer than you can remain solvent".

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Financial market on 28 February 2003

NBP deposit rate	4.25	WIBOR 3M	6.27	PLN/USD	3.9135
NBP reference rate	6.25	Yield on 52-week T-bills	5.73	PLN/EUR	4.2083
NBP lombard rate	8.25	Yield on 5-year T-bonds	5.31	EUR/USD	1.0753

Special focus

Rescue package II

At the end of February – beginning March finance minister Grzegorz Kołodko presented the programme for restoration of public finances being a medium-term strategy for fiscal policy. It aims at fast growth, beneficial EU membership and fast euro adoption by meeting Maastricht criteria in 2006. The programme includes positive measures aimed at rationalisation of budget spending, but not many details in this respect were given. More detailed plan concerns revenues side of the budget, unfortunately including two very serious flaws – a possible increase of effective tax burden for richer group of taxpayers, which may constrain a long-term potential of the economic growth and an idea freeing central bank's revaluation provisions, which might be connected with money printing. The only (unfortunately not economic) justification for the fact that the programme does not include deeper cuts in budget spending is the political situation. However, this situation is even more complicated after the ruling coalition collapsed. Well, as Hilary Clinton said *"the challenge is to practice politics as the art of making what appears to be impossible, possible"*.

Three scenarios, but only one realistic

On the last day of February finance minister Grzegorz Kołodko presented first details (although not many details) of his programme for Restoration of Poland's Public Finances. At the moment of preparing this report, ministers and deputies are discussing the proposal, while the cabinet will officially talk about the plan on 19 March. The main goals of this programme are: fast economic growth, "fair redistribution" of the national income, beneficial integration with the EU and finally Poland's entry to the Eurozone. Kołodko presented three scenarios for the development of the macroeconomic situation.

1. A scenario of "financial irresponsibility" – proposed public finances' reform not adopted, leading to increase of budget deficit to PLN57bn or 6.5% of GDP in 2004, which would remain at a similar level in two subsequent years, and fast increase of public debt from 51.2% of GDP in 2003 to almost 60% in 2006. In this scenario, fixed spending would remain at high level and total budgetary expenditure growth would be at 11.6% in 2004 and 5-7% in 2005-06. Such scenario would mean a significant delay of Poland's membership in the Eurozone.

2. Second scenario called "scenario of social disturbances" assumes considerable cuts in budgetary spending (of above PLN65bn in 2004-06), but it could not be accepted from the political point of view. It is not very important whether Kołodko-economist would support such a scenario, as undoubtedly Kołodko-finance minister has no chance for its implementation because of political limitations.
3. Third scenario proposed by Kołodko and called "scenario of stabilisation and development" is a compromise between the above two pictures. According to Kołodko this does not lead to sharp reductions in budgetary spending, allows to co-finance resources from the EU, does not require increase of tax burden, and does not cause uncontrollable increase of public debt.

GDP growth forecasts – optimism *ex officio* again

Kołodko's programme assumes that GDP growth will accelerate from 3.5% in 2003 to 4.9% in 2004, 5.4% in 2005 and 6.0% in 2006 (interestingly, these forecasts do not depend on the adopted scenario). The unemployment rate is forecasted to fall gradually to 14% in 2006. This scenario assumes that budget expenditure nominal growth rate will be lower than revenue growth rate (and both will be lower than GDP dynamics). This would allow for gradual reduction of budget deficit-to-GDP ratio and stabilisation of public debt at the level of 50-55% of GDP (below 45% of GDP according to EU standards). Such levels of budget deficit and public debt would allow to meet the Maastricht criteria in 2006. While this suggests that due to procedural issues Poland's membership in the Eurozone may be delayed by one year (data for 2006 will be available only in 2007 making Eurozone entry possible in 2008, or mid-2007), finance minister still maintained the official view about euro adoption in 2007.

Public finances in 2003-2006 under "scenario of stabilisation and development"

	2003	2004	2005	2006
Revenues in PLN bn	155.7	160.2	169.2	178.8
Expenditures in PLN bn	194.4	200.2	208.7	214.7
Budget deficit in PLN bn	38.7	40.0	39.5	35.9
Budget deficit in % of GDP	4.8	4.6	4.2	3.5
Budget deficit in % of GDP*	4.1	3.8	3.4	2.9
Public debt in % of GDP	51.2	52.6	53.0	52.7
Public debt in % of GDP*	43.6	44.7	44.9	44.6

* According to the EU standards (ESA-95 methodology)
Source: Ministry of Finance,



Spending side – not many details

Finance minister Grzegorz Kołodko plans the following actions aimed at rationalisation of the expenditure side of the budget:

- liquidation of indexation of pensions, social benefits and other expenditures,
- liquidation of most of wasteful state funds,
- liquidation of two state agencies (one linked to agriculture sector) and tighter control over the remaining ones,
- tighter control over state health-care institutions and possibly allowing them to provide partly or fully paid services – Kołodko’s economic advisor Elżbieta Chojna-Duch talked about this solution a few weeks ago,
- reduction of subsidies to social security office for farmers (KRUS) - although no details were given in this respect, finance minister said that farmers should pay a contribution for social security system, as they would be the most beneficial group after the EU accession,
- improvement of the overall financial discipline (strengthening of supervision over public funds, audit of public finances, etc.).

A general picture of the above-mentioned measures seems to be very desirable and if implemented it could improve the public finances. However, finance minister did not present many details of reform’s spending-side and it is difficult to assess whether the planned budget spending cuts are deep enough.

Revenues side – detailed, but not very positive

On the other hand, Kołodko’s plans connected with revenues’ side are quite complete and include:

- simplification of the tax system (presently 59 taxes written down in 35 acts and 20 decrees) – not an amendment to current tax laws, but completely new system would be proposed,
- reductions of PIT rates, but mostly for the poorest - three new variants of PIT rates (see table below),
- maintaining current tax brackets at the current (low!) level until 2007,
- increase in the number of persons and groups obliged to pay taxes (no details were given but it is likely to concern farmers, who presently do not pay income tax),

- liquidation of almost all tax allowances and tax exemptions – PLN12.2bn additional revenues for the budget in 2004-07,
- unification of taxation of all kinds of capital income (expiry of the exemption from the capital income tax at the end of this year) – new tax rate to be between current dividend tax rate (15%) and current tax rate on income from interests on deposits (20%),
- reduction of CIT rate to 24%, and what is more local authorities would be allowed to reduce it even deeper as they will be granted all revenues from personal and corporate income taxes,
- no increase of base VAT rate.

Three variants of tax rates changes

1.	2005	17%, 19%, 30%, 40%
	2006	15%, 19%, 30%, 40%
	2007	13%, 19%, 30%, 40%
2.	2004	0%, 17%, 19%, 30%, 40%
	2007	0%, 15%, 19%, 30%, 40%
3.	2005	18%, 29%, 39%
	2007	17%, 28%, 38%
	Currently	19%, 30%, 40%

Source: Finance Ministry

Changes on the revenue side of the budget are not as unambiguously beneficial for the economy as a general concept of modifications on the expenditure side. While finance minister said that tax changes are neutral for the budget, they are not neutral for different groups of taxpayers. Of course the general idea of simplification of the tax system and reduction of CIT rate should be perceived as positive, but changes in PIT mean in practice that tax burden will be effectively raised for richer taxpayers. This is not consistent with finance minister’s will to create environment for capital formation and to increase domestic savings which is necessary to achieve projected fast pace of economic growth based on exports and investments. But the proposed change of tax system suggests that consumption demand is more preferable source of growth, at least in the short-run. Namely, only in one out of three versions, the two highest tax rates decrease.

Difficult agreement - money to be printed?

Moreover, very controversial element of the programme is the fact that it assumes that around one third of central bank’s revaluation provisions (they amount to nearly PLN27bn) would be used to co-finance EU



projects. We mentioned this idea already last month. Just to remind, 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.

Majority of MPC members consequently oppose this proposal, as it could have serious negative consequences for the money market being an excessive money supply impulse, which could create a risk of inflation increase. MPC member Janusz Krzyżewski, who formerly was a chief of the legal department at the NBP, said that such action would be against the law as it was not the part of the MPC's monetary policy guidelines, which under the constitution are binding for the central bank.

In fact it is not clear at the moment at which stage is the FinMin's idea of using some of NBP's revaluation provision. The ministry still reiterate that talks with the central bank are taking place, while the public communication department of the NBP deny any "negotiations". Deputy finance minister Ryszard Michalski said that consultations are very technical and take place between the two institutions. And indeed, on 11 March NBP representative did not deny talks between the NBP and MinFin, but he did not confirm any decisions taken by the central bank. What is interesting, the NBP Governor said only that "this issue will be resolved in line with the standards of civilised accounting". Finance minister Grzegorz Kołodko also said that consultations and talks are underway – "we are discussing with the Governor of the independent central bank Mr Balcerowicz (...) deputy ministers with deputy presidents, experts with experts". So possibly, unofficial discussion takes place without the MPC presence, as current members will not decide about monetary policy next year anyway.

Of course it is very difficult to imagine that the central bank's Governor (does not matter whether with current or next MPC) agrees on transferring money to the budget with significant amount of money. However, different scenario is quite imaginable and it was also suggested by the representatives of the Ministry of Finance. We believe that any steps that would result in sharp increase of central bank's reserve money - in practice, on the liabilities side of the NBP balance lower

revaluation provisions would be compensated by higher cash in circulation meaning printing money - would be very unlikely. The aim is rather to decrease revaluation provisions (liabilities side) at the cost of lower foreign exchange reserves on the assets side of the central bank's balance. In such a situation foreign currencies could be used by the government for foreign debt repayment or payments for the EU budget (via a special fund in the NBP – we wrote about this issue last month). To achieve this goal, the Ministry of Finance would have to convince the central bank that the current level of FX reserves is excessive. In our opinion, this persuasion will be much more possible when new Monetary Policy Council will be appointed at the beginning of the next year. The MPC member Bogusław Grabowski vigorously opposed the idea, saying that so-called revaluation reserve is only an item within NBP balance sheet, and not "a bag with bucks", out of which one could repay foreign debt. The problem is that he will decide about opening this bag.

Therefore, one can imagine a situation, in which lowering revaluation provisions would not mean money printing and would not have inflationary consequences. In this scenario freeing money would be exchanged for the foreign currency in the central bank and lowering FX reserves would be used for foreign debt repayment. Let us remind that the agreement concerning early debt repayment was already observed between the two institutions NBP. However, when Brazilian debt was repaid, it was a credit given by the central bank and this item should be interpreted as "a subsidy". What is more, a subsidy given by the institution without an excess of assets. And it has to be remembered that it is possible the NBP would need higher FX reserves in the ERM-2 system, and Polish central bank's assets are not very high, as international standards are taken in to account.

In one of his interviews, finance minister said that from macroeconomic point of view the effect is the same if money is spent on foreign debt repayment or on co-financing the EU projects (or contribution to the EU budget). But this is not necessarily the case. Repayment of capital of foreign debt (some US\$2.5bn in 2004) may be done by the issuance of new debt on international market. This is an element financing the deficit, which is not a part of budgetary spending. Therefore if the NBP decides to lower foreign currencies reserves, this leads only to lower public debt. The situation looks different when spending money on the expenditures connected with the EU integration is considered. If budgetary spending in foreign currency connected with EU accession would be covered by FX reserves, there is a



question "what about budget deficit?". If the deficit is lowered by this amount, the final effect might be similar to the scenario of foreign debt repayment. However, if this "saved money" is spent on other budgetary purposes, total demand effect of fiscal policy on the economy could be higher than in a scenario of no financing of contribution to the EU from the reserves.

Of course, strong opposition of the existing MPC members creates a risk of another conflict between the central bank and the government being an additional risk factor on financial markets. This might also suggest that PLN9bn of additional budgetary revenues are not likely to be used in budget for 2004. Not necessarily. Finance minister could prepare budget for 2004 in September this year, expecting an agreement with the new MPC and paying no attention to a possible criticism of the existing Council. New MPC members will be appointed at the beginning of next year and they will be more keen on good co-operation with the government.

How to find a political support?

Despite we do not know all the details of the MF's proposal it could be recognised as a step toward a right direction, although it cannot be perceived as a far-reaching programme. Such a view was shared even by the government's representatives. Jacek Piechota, deputy minister of the economy and social policy advised that draft version of the public finances reform "raises many doubts" as it does not guarantee planned acceleration of economic growth and "does not show" determination which would be desired by the Polish entrepreneurs and foreign investors. In Piechota's opinion, proposals to lower taxes are not far-reaching enough to achieve assumed goals and he hoped Kołodko's programme would be upgraded. Minister Hausner said it is too early to assess the plans before the cabinet discussion, however, let us recall that a few days earlier he said that the government's programme introduced last year "fell into pieces completely" and did not bring about expected results and the situation now requires further efforts in order to boost the economy. There are two possible interpretations of this "intra-government" opposition. First, such comments made by the economy minister and his deputy are aimed at creating appropriate "background" for upcoming debate over the public finance reform in the government and parliament. The suggestions that Kołodko's propositions are surely not deep enough and further reaching measures are necessary to boost the economy would make it easier to convince other government members and MPs to pass the acts that are unpopular or might

displease their electorate. Secondly, however, there is a possibility of another conflict within the government concerning required changes. Hopefully, the first scenario materialises this time.

As mentioned above, the programme includes two serious flaws - an increase of effective tax burden for the richer group of taxpayers and a possible printing of money via freeing central bank's revaluation provisions. The only (unfortunately not economic) justification for the fact that the programme does not include deeper cuts in budget spending is the political situation. And even if Kołodko tried to create a programme, which could be applicable in a current political situation, some of the proposed changes could still meet strong disapproval of some groups (of course, ideas such as printing money are usually very welcomed among politicians) - for example, previous ministers of finance failed to eliminate indexation schemes. Possibly, Kołodko did not want to leave any room for manoeuvre for politicians. Budget deficit according to the EU standards in 2006 is predicted to reach 2.9%, i.e. only 0.1pp below the Maastricht criterion level. This means that politicians cannot change any basic assumptions of the programme as it could increase the level of the deficit and delay Poland's membership in the Eurozone. Also, very optimistic macroeconomic assumptions (fast pace of the GDP growth - up to 6% in 2006) mean that the programme does not allow for any softer actions on the spending side (well, additional revenues may be always easily found). Such a construction of the programme may be a kind of an ultimatum of the minister of finance. "All or nothing" - the programme has to be accepted as a whole.

...especially after the coalition collapsed

The problem is that the situation on the Polish political scene became even more complicated after the ruling coalition collapsed. Being in minority, ruling SLD-UP coalition will have to find support for any single act related to Grzegorz Kołodko's programme (SLD-UP has 212 out of 460 votes in the Lower House and majority in the Upper House). Paradoxically, however, some changes may be easier to adopt without PSL. PSL farmers' party used to oppose changes in social security system for farmers (KRUS), asked for more and more money from the budget on food market intervention, proposed high PIT rate of 50% etc. On the other hand, one could expect that positive changes in public finances might be accepted by the Civic Platform (PO), which, for example, would increase chances for adoption of the third version out of the above-mentioned PIT changes.



The second problem, besides the public finances' reform, is the outcome of the EU referendum in June. The PSL was expected to take decision concerning its support for the EU integration on 22 February. The decision was postponed and now depends on three acts – general act on the agriculture sector, guaranteed direct grants for farmers from the Polish budget and the bio-fuels act. Grzegorz Kołodko announced that only PLN1.5bn (not PLN2.2bn, as PSL's Jarosław Kalinowski would like) will be paid from the budget on grants and such a decision could lead the PSL (being in competition against the radical Samoobrona) to be sceptical about integration. In such a situation, the risk of a failure in referendum would be higher. We, however, think that support of other political parties, as well as the fact that farmers will be the social group having the most benefits after the integration, will play its role. The recent opinion poll showing high support for EU integration is included in the *EU Negotiations watch* section.

Nevertheless, risk factors on the foreign currency exchange market, which were discussed in February's issue of *MACROscope*, including the reform of public finances, the EU referendum and the new MPC members appointment, may be more significant in current political situation, leading to weaker zloty and higher yields on average in following quarters, as compared with the previous forecasts.

Earlier elections – a possible scenario after the EU referendum

Earlier elections are possible in three cases – decision of 2/3 of MPs, PM dismissal without a possibility of creating another government and no budget act until the end of January. In practice, only the third possibility could be a way to earlier elections. However, even if the parliament fails to approve the budget act for the next year, the president does not have to call new elections. After the coalition collapsed, Marek Borowski - Lower House speaker and Józef Oleksy - another SLD official mentioned a possibility of earlier elections. While it seems that only radical parties (Samoobrona and the League of Polish Families) would like the idea of earlier elections, as they have relatively high social support at the moment, this should not be necessarily the case in spring 2004. After "yes" vote in referendum (and appointment of the new anti-unemployment MPC members), SLD may have much higher support than today, counting on at least the same number of MPs after elections. Positive sentiment after integration and hopes for unemployment reduction connected with this fact may be the only factors, on which the SLD could build its public support. Actually, these would be the same aspects as SLD could use one year later (in 2005), and therefore it may be useful not to wait and hold elections already in 2004.



A universal scheme

In February, in addition to interest rate cuts, the MPC accepted and published new medium-term strategy of monetary policy. Adoption of this document was widely anticipated, as several MPC members hinted about it in their public comments during the last couple of months. Similarly to majority of decisions of the current MPC, the strategy seems to be a compromise between two different Council's fractions with two different views. One could say that the new strategy has been designed as a universal scheme, to minimise the risk of rejecting it also by new MPC members, even considering their economic views might be less "conservative". It seemed to be confirmed by Leszek Balcerowicz, who, during the press conference, said that he could not imagine that new MPC would discard this medium-term strategy. Moreover, it also seems to be confirmed by the number of quotes from the document. Of course some of the new members could interpret the strategy as the document which ties their hands. If such a view prevails in the new MPC, the strategy can be changed, or at least some parts of it can be modified, especially those concerning the exchange rate policy.

The strategy for successors

The new medium-term strategy does not have a precise timeframe, and has been established for the period "beyond 2003". It stems from the fact that the time limit for the life of this strategy would be defined by the moment of Poland's entry to the Eurozone, which cannot be reliably defined now. Nevertheless, the MPC strongly emphasised that it believed Poland should accept euro as a common currency as soon as possible, while the earliest feasible date being 2007.

The MPC members used to explain many times in the past why they had decided to work out the new medium-term strategy for the time period when their term of office would be over, and they have also included their main reason in the prepared document. First of all, conducting monetary policy based on direct inflationary targeting strategy (which the MPC decided to continue) requires a medium-term inflation rate target. The second argument was that due to lags in monetary transmission mechanism, the effects of the MPC decisions made in 2003 would fully reveal in 2004-2005. Therefore, as the MPC highlighted, transparency of monetary policy required defining and announcing the next medium-term inflation rate target right now. What is more, inflation is already at a low level, which creates some new environment for the

monetary policy, changing also the main target from decreasing inflation to stabilisation at a low level.

Inflation target in line with expectations

The main points of new medium-term strategy confirmed earlier suggestions specified by the MPC members in public interviews. Inflation target has been set at 2.5% +/- 1 percentage point (exactly as Wiesława Ziółkowska said). The MPC decided that after 2003 it would still target CPI index, which is widely understood in Poland, however the requirement of meeting the Maastricht convergence criteria would make it necessary to track also the 12-month moving average of HICP (Harmonised Index of Consumer Prices), used in the Eurozone. What is more, the MPC should still take into account the developments of core inflation measures computed in the NBP.

The MPC allowed a possibility of setting additional short-term inflation target, consistent with meeting the Maastricht criterion, when the date of euro adoption will be set. What is interesting, the MPC said that this target would be set "if the reference value for inflation is lower than 2.5%". This means that if (for some unexpected reasons) this value is higher and the Maastricht criterion would accept higher inflation at around 3-4%, the MPC would not change its inflation target. We do not know whether such asymmetric policy would be accepted by the new Council.

The Council also decided to abandon short-term annual targets for the sake of continuous monitoring of medium-term goal (the solution hinted by Dariusz Rosati). The new target has been assessed by the MPC as "consistent with the fast economic growth" in Poland and at the same time as "close enough to the expected reference level for inflation convergence criterion". This last assertion seems to reflect very well the overall construction of new medium-term strategy of the monetary policy - the document looks like trying reconciling dovish and hawkish arguments at the same time. On the one hand the framework outlined by present MPC should not be too tight even for much more "output-smoothing" central bankers that might be appointed for the next MPC term. On the other hand, it still allows for steering the Polish economy into the Eurozone within the soonest possible timeframe if this is the policymakers' choice.

Instruments of the Monetary Policy Council remain unchanged, although the NBP will aim at standardising monetary policy instruments of open market operations with those binding in the Eurosystem - we covered this



issue in MACROscope of September 2002 – which is also connected with planned decrease of obligatory reserve requirements.

Usual compromise

In general, the MPC decided that achieving low inflation level under low inflationary expectations in Poland required the change of monetary policy framework and modification of its main objectives. As mentioned above, the new strategy assumes shifting main focus of the monetary policy from disinflation to stabilising inflation at a low level. This – according to the MPC – would allow for less restrictive monetary policy than in the period of reducing inflation. It would be also possible to conduct the monetary policy with the lower interest rate disparity between Poland and the Eurozone (as Poland's country risk will be lower after the EU accession). These statements seem to be proposed by this MPC-fraction, which usually supports more expansionary monetary policy, which may increase expectations for further cuts. Nevertheless, later in the text there is something for the other side. The statement said that despite the new medium-term target was set above the current inflation level it does not imply the necessity to undertake expansive monetary policy, because deep inflation fall in 2002 was mainly a consequence of transitory supply-side factors. These two (dovish and hawkish) points of view show that the text of the document is also a kind of compromise between current MPC members. If one remembers that “doves” used to have higher impact on monetary decisions in recent months (or even quarters), one may suppose that financial markets would still maintain relatively high expectations regarding the scope of interest rate cuts this year.

What is also interesting, the strategy assumes that in case of breaching inflation target due to unpredictable shocks, the monetary policy would pursue to bring inflation back to its target level in the medium term, which should be made in a way that would minimise fluctuations of production. Such elements like output smoothing have never entered the MPC's reaction function before (at least explicitly), which also suggests the new strategy has been a priori fitted to the more dovish preferences of new central bankers. The MPC could assume that introduction of this factor is possible due to the fact that inflation is already low, which allows for lowering the costs of monetary policy conducting for the real sphere of the economy. However, this theory is not necessarily valid, if we take into account that results of inflationary expectations in Poland are quite

ambiguous (this issue is covered in more details in *Economic Update* section below). Nevertheless Bogusław Grabowski (who used to belong to the hawkish faction) said that if inflation increase after the EU accession is more significant than expected (the NBP expects one-off shock of 0.4pp) creating a risk for the target, the MPC would be ready to react. Well, this reaction will be up to the new council.

Foreign exchange policy

While the document signals that some aspects of the monetary policy would change in future, there is one area, in which the MPC members' opinion is unchanged and unanimous – foreign exchange policy. The new medium-term strategy says that future monetary policy should be conducted under free floating exchange rate, FX regime should not be changed until ERM-2 entry and the brackets for possible fluctuations of zloty in ERM-2 system should be set to the maximum possible width (+/- 15%). Unfortunately, exchange rate policy might be in fact the area where the discrepancy between present and future MPC members' opinions might be most visible. While in general the new MPC will be constrained by the requirements of meeting the Maastricht criteria (therefore changes of FX regime before ERM-2 entry seem unlikely), in details it might have quite different approach e.g. the new MPC might prefer narrower brackets of fluctuations within ERM-2 (even not necessarily symmetric one) and also be much less reluctant to FX interventions. What is interesting, while in the document of the monetary policy guidelines for each year, the MPC is pointing to a possibility of intervention on the foreign exchange market, this time there is no single word about it.

The new strategy stated that devaluation of central parity rate against euro during the period of presence within ERM-2 would breach the exchange rate convergence criteria. Is it a hint for the new MPC to set the parity on relatively weak level against the euro?

Economic update

- Record-high unemployment and exceptionally low employment in January
- Inflation also at the lowest level in history
- However the recovery in trade and industry goes on
- ...supported by good performance of foreign trade and high budget revenues

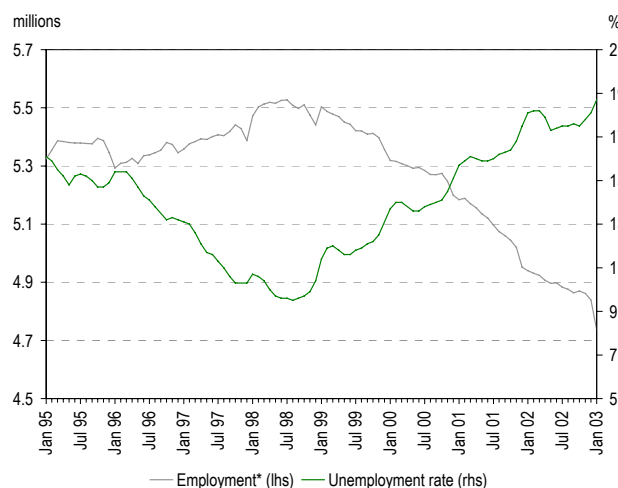
January proved to be a month of record breaking, at least as regards economic figures. Registered unemployment rate hiked to 18.7% – the highest level since the beginning of economic transition. At the same time average employment in corporate sector plummeted sharply by more than 100,000 to the record-low level of 4.7m. All-time minimum was also reached by the inflation rate, falling to 0.4%YoY. The list of record-breaking figures includes also Poland's official FX reserves, which in January exceeded US\$30bn for the first time ever. Most of the indices quoted above are unfortunately the record achievements that do not bode well for economy's condition. Nevertheless, in January we saw also a set of less spectacular, yet more positive data: industrial output, retail sales, export and import turnover and state budget performance – all those information confirmed the gradual improvement in real economy is really taking place.

The overall picture drawn by those economic figures is not distant from what we presented in previous MACROscope editions: economic growth continues the path of steady, yet not very fast recovery. At the same time this process, and especially the rebound of domestic demand, is still weak enough that it cannot reverse the negative trends on the labour market and lower the record-high unemployment. Nor it is able to exert any significant pressure on price growth.

Record-breaking unemployment rate...

According to the CSO the registered unemployment rate surged to new record high level of 18.7% at the end of January rising by 0.6pp compared to the corresponding period of last year. The number of unemployed increased by 2.1%YoY and reached 3.32m, i.e. 104,000 more than in December. Those figures seem to be consistent with data on employment in the enterprise sector, which were fairly disappointing.

Unemployment rate and average employment in corporate sector



* Data adjusted for CSO's change in methodology in 2000.

Source: CSO, BZ WBK

Average employment in corporate sector fell by 103,000 in January (2.1%MoM), constituting another record – the lowest number of jobs in Polish economy since early 90's, which amounted to merely 4.7m. It brought the annual rate of employment fall down to – 4.1%YoY from –2.3%YoY in December. The figure was much weaker than we expected (-2%YoY), and below average level in 4Q02 (-3%YoY). More detailed CSO's data showed that deep reduction of labour force took place in most of major economy's sectors, with the biggest impact visible in building and construction. The number of jobs fell by 30,000 (-1,5%MoM) in manufacturing, by 21,000 in trade and repairs (-2,5%), 7,000 in transport and communication (-1,4%). In construction sector average employment plummeted by 41,000 i.e. more than 10%MoM. Probably to a large extent it was caused by severe weather conditions, which made construction works impossible. Nevertheless, even excluding the change of employment in construction, the pace of job destruction in the remaining sectors is hard to explain. In the preceding years there were several equally sharp adjustments in January, however, they were all caused by the change of CSO's statistical methodology.

At the same time corporate wage growth improved somehow to 2.7%YoY against 2.4%YoY in December, and was only marginally below forecasted 3%YoY growth. This time, however, no methodology changes have been announced. At the press conference after last MPC meeting Leszek Balcerowicz said that deep employment fall in January might be just a one-off disturbance of the trend. Nevertheless, it is hard to expect that the number of jobs recovered by more than 100,000 during the next month.



Clearly, the situation on the labour market at the beginning of 2003 is not only difficult but still keeps deteriorating. However, one should notice that the pace of such unfavourable trends is decelerating – the annual pace (excluding seasonal effects) of unemployment growth is gradually diminishing. We expect that in February the registered unemployment rate will slightly rise to 18.9% due to strong seasonal effect but from March onwards it should begin to fall.

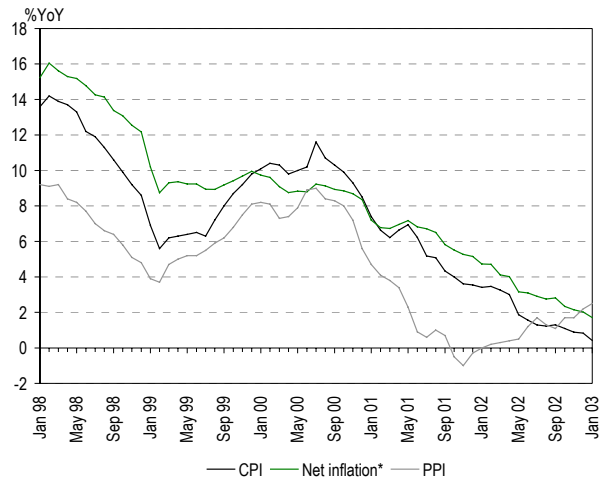
Gradual improvement of the labour market outlook is confirmed by recent data from the Labour Force Survey, which are consistent with definitions of the International Labour Organisation. According to the data the unemployment rate fell to 19.7% in 4Q02 from 19.8% in 3Q02 contrary to seasonal effect observed in previous years. Thus, similarly to data on the registered unemployment rate based on statistics from labour offices, annual growth rate of the unemployment considerably decreased in the last quarter of last year.

...record-low inflation rate...

Inflation rate in January also reached the level that has never been recorded in Poland since the beginning of economic transition. Consumer prices rose by 0.4%MoM. In annual terms inflation decelerated to 0.4%YoY from 0.8%YoY in December. The figures were better than consensus forecast standing at 0.6%YoY (the same as our forecast). Deeper than predicted decline of inflation resulted from surprisingly low growth of food prices (0.4%MoM and – 3.6%YoY). This was inconsistent with preliminary CSO's information released ten days earlier, which indicated 0.55%MoM growth of food prices in January. Performance of other CPI components was broadly in line expectations, except for transportation prices (including fuel prices), which increased more than expected (1.3%MoM), and housing prices (0.6%MoM) that recorded relatively low growth taking into account seasonal factors.

Looking at January's inflation data one has to remember that those figures are preliminary. It stems from the fact that CSO changes the weights in CPI basket every year (according to the structure of households' consumption in the preceding year). Inflation rate for January computed with new weights will be announced together with February's inflation rate. Because of changes in weight system, the CSO has not released more detailed price indices, and therefore NBP did not release core inflation measures for January. However, according to our own estimates 'net inflation' (CPI excluding food and fuel prices) fell from 2% in December to 1.6%YoY in January.

Measures of inflation



* January 2003 – BZ WBK estimate
Source: CSO, NBP, BZ WBK

We envisage that in next two months CPI growth will stabilise at 0.4%YoY. It would be supported by still very low food prices, which fell by 0.2%MoM in February. Most likely food prices will fall in annual terms until summer, dragging down the overall growth of consumer prices. Inflation is likely to remain below 1% until June and in April it could be as low as 0.1%YoY. In the remainder of this year CPI should gradually increase up to slightly above 2%YoY in December.

Unlike the consumer prices, the growth of PPI keeps accelerating. In January producer prices increased by 0.4%MoM and 2.5%YoY (against 2.2%YoY in December). Producer prices were pushed upwards by considerable increase of fuel prices (5.6%MoM). However, most of PPI growth in annual terms is still a result of very low base of previous year. Therefore, if fuel prices' growth is not continued in next months, we should not see additional inflationary pressure from producer prices. When statistical base effect will fade in the second half of the year annual growth of producer prices will decline.

...and falling inflation expectations...

According to the NBP calculations based on Ipsos-Demoskop survey, households' inflation expectations (expressed as expected average annual inflation in the nearest 12 months) fell in February to record low level of 0.6% from 0.7% in January. The NBP revealed also the structure of households' answers from the survey in January (structure of answers is always published with one-month lag). It worsened again confirming that recent fall of inflation expectations is to a large extent a result of the fact that households' perception of inflation processes is backward looking.

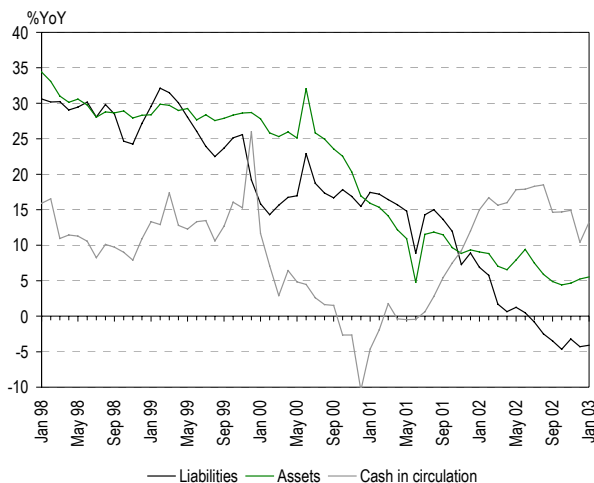


One should also remember that the central bank opinion poll does not include the exact question about the expected inflation rate and it is calculated using some quantitative methods. The central bank asks only about a possible inflation fall, increase or stabilisation. This means that households' perception about current inflation rate may be completely different from that assumed in the NBP research. And indeed, the results of PBS opinion poll held at the end of the last year showed that current inflation rate perceived by households amounts to around 4%, and not to below 1%.

...monetary misery continues...

In January there were no substantial changes in monetary trends. Broad money M3 fell -1.4%YoY, following -2.3%YoY drop in December 2002. As expected, the fall was driven by households' deposits, which collapsed -5.5%YoY. Households' deposits fell also on a monthly basis (-0.3%MoM), which is a highly untypical phenomenon for January and has never happened in Poland's history of economic transition. Households' deposits have been steadily declining for six consecutive months, which also has never happened before and clearly signals a radical change in individuals' preferences regarding ways of money management. In January, similarly as in two preceding months, there was a sharp increase of 'other M3 components', which among others includes money saved in (tax-free) banks' saving bonds. Over Oct'02-Jan'03 period households' deposits contracted by some PLN5.8bn, while the increase in 'other M3 components' amounted to PLN2.2bn, nearly 40% of the former. Of course banks' bonds are not the only facilities that the money goes to. The others include investment funds, bonds and private consumption, which was ballooning in 4Q02 despite further deterioration on the labour market.

Banking system's assets and liabilities



Source: NBP

There was no significant acceleration of credit growth in January. Households' loans were growing at 8.7%YoY against 8.5% in December, however the improvement resulted mainly from low base effect, rather than higher customers' demand. At the same time corporate loans increased only 1.1%YoY (1.6% in Dec'02), showing that the revival of Polish companies' activity is still not very powerful. The only loans that keep growing fast recently are those to local governments, which seem to be highly anti-cyclical. Their rate of growth reached 33.2%YoY in January, and although it nearly halved in course of the last 9-12 months, it still signals that economic deficit this year might be significantly higher than the one assumed by minister Kołodko in this year's budget.

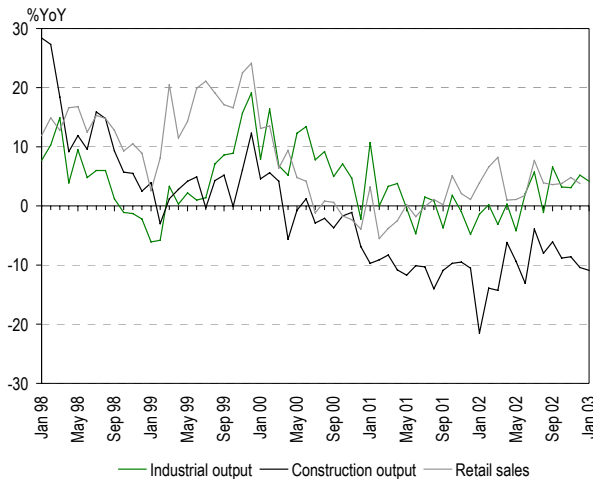
...and construction remains in depression

January data on construction output were pessimistic. Production plummeted by 64.5%MoM and although it was largely a seasonal slump, the annual fall of construction output deepened to 10.9%YoY, therefore remaining deep in red for more than 30 months. Bad weather conditions were among the factors that contributed to weak construction performance, however this does not change the general conclusion that construction's contribution to GDP growth in 1Q03 would remain negative. This also suggests that investment activity may remain weak in the nearest months, which would constrain acceleration of GDP growth in first quarters of this year.

However gradual recovery is visible in industry...

Industrial output in January grew by 4.2%YoY after 5.1%YoY recorded in December and 3.8%YoY average growth in 4Q02. In relation to previous month - 5.9%MoM fall was recorded, being the typical seasonal effect. Seasonally adjusted industrial output inched up by 0.8%MoM and in annual terms increased by 4.4%YoY against 3.2%YoY in the previous month and 4.3%YoY on average in the last quarter of last year. What is positive, growth of production was driven mainly by manufacturing while activity in mining and utilities remained low. Structure of output growth across sectors of the industry shows that it is the highest in branches dominated by exporters and foreign investors. Data on industrial output were broadly in line with our expectations and they confirm that while the economy is on an upward trend the pace of recovery is slow. We expect that industrial output growth figures should be roughly the same in the next months.

Real growth



Source: CSO

...as well as in retail trade

Similarly to industrial production, nominal retail sales fell in January in relation to previous month (by 24%MoM) amid strong seasonal factor. In the annual terms retail sales growth rate accelerated to 6.4% from 4.1% in December and 5.0%YoY on average in 4Q02. The CSO revealed also data on retail sales in real terms for December - it grew by 18.3%MoM and 3.8%YoY against 4.8%YoY in November. The highest growth in nominal terms was recorded in sales of motor vehicles, which confirmed earlier information on new car sales in January. Robust growth was also observed in food, beverages and tobacco (23.4%YoY) as well as in pharmaceuticals and cosmetics (16.1%YoY). On the other hand, there are some signs of weakening in consumption demand. Fall of "other retail sales in non-specialised shops" deepened to 16.6%YoY from 4.2%YoY drop on average in 4Q02. Moreover, following very low growth in the final quarter of 2002, for the first time since two years January saw a decrease of retail sales in furniture, appliances and electronics (by 4.5%YoY). Shrinking demand for durable goods (except motor vehicles) suggests that acceleration of retail sales observed in January may not to be permanent and private consumption growth in this year will not be higher than in 2002. This confirms our view that rebound in investments will be crucial for GDP growth acceleration this year.

Strong exports, lower C/A deficit

According to NBP, Poland's current account deficit widened to US\$712m in January from US\$485 in December almost exactly matching our expectations of US\$720m. 12-month cumulative current account deficit as a ratio to GDP declined to 3.5% from 3.6% in previous month. Also trade gap was very close to our forecast and reached US\$1.15bn (we forecasted US\$1.1bn). Despite seasonal growth of trade gap January was another month

of continuation of positive trends in foreign trade. Both exports and imports expressed in dollars dropped on a monthly basis due to seasonal factor but in annual terms they recorded high growth rates. Although in other currencies (for the first time the central bank published figures not only in dollar terms but also in euros and zlotys) foreign trade dynamics were lower, the results show that exports performance remains strong despite continuing stagnation in Poland's major trade partners, particularly in Germany. On the other hand imports continues acceleration started in 4Q02 which indicates a moderate revitalisation of domestic demand. However, as usual in recent months, some part of it reflects increased demand for components needed for export production.

Exports and imports growth rates for January, %YoY

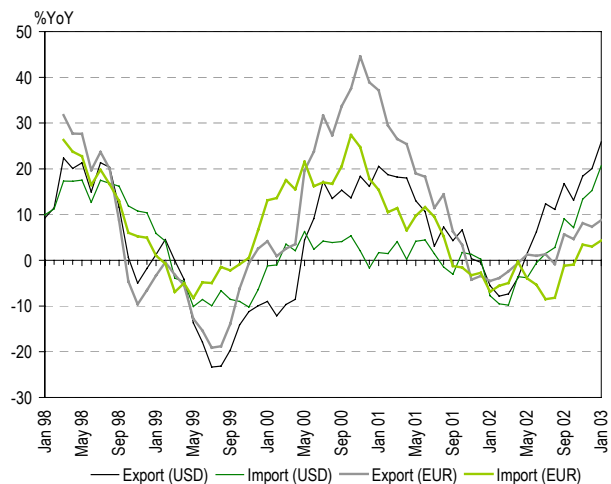
	USD	EUR	PLN	2/3EUR / 1/3USD*
Exports	30.2	8.2	22.8	15.0
Imports	21.5	1.2	14.7	7.4

Note: * the relation approximately reflecting currency structure of Poland's foreign trade

Source: NBP, BZ WBK calculations

Surplus of unclassified flows, which reflects mostly the currency exchange related to cross-border trade flows was also relatively high in January falling only slightly to US\$443m from US\$466m in December. On the other hand, January saw higher than expected deficit in services (-US\$149m against -US\$55m on average in 4Q02 and -US\$88m in January 2002).

Foreign trade turnover (3m moving average)



Source: NBP, BZ WBK

Trends on capital and financial account of the balance of payments were similar as in previous months – gradual worsening of the structure of current account deficit financing was continued. Net inflow of foreign portfolio investments remained strong reaching US\$384m while foreign direct investment remained at relatively low level of US\$334m.



Positive budget performance in January

According to the Ministry of Finance after the first month of this year budget deficit reached PLN4.12bn or 10.6% of the plan for the whole year, which is much better than last year's result when budget deficit reached 17.5% of the planned at the end of January. Better result in 2003 was possible due to relatively low execution of expenditures. At the end of the first month of this year it stood at 8.1% of the plan against 9.4% in the corresponding period of 2002. Performance of budgetary revenues was similar to previous years and amounted to 7.5% of the plan compared to 7.2% after January of the previous year. Budget deficit in January was financed mainly by financial resources transferred from the previous year and issuance of treasury papers. Revenues from privatisation were marginal and amounted to only PLN50m, i.e. only 0.6% of the plan for the whole year.

Sharp increase of budgetary revenues on annual basis was recorded, as they increased by 12.2%, comparing with average growth of 3.2% in 2002. Incomes from indirect taxes rose by 15.9%YoY, while CIT revenues were higher by 45.3%. However, this was mainly the result of very low statistical base of January 2002, as nominal value of CIT revenues was just the same as in January 2001. PIT revenues were higher by 2.6%YoY (average annual growth in 2002 amounted to 1%).

It is difficult to draw conclusions from data for only one month of the year. However, while some shortage of revenues is likely to appear during the year, January's figures suggest that there should not be major problems with the realisation of 2003 budget. It was confirmed by the estimation of budget deficit execution after February – between 20% and 30% – given by head of FinMin's budget department Elżbieta Suchocka-Roguska.



Central bank watch

- **Interest rates reduction in February**
- **...and next cuts are expected, but not necessarily in March**
- **Will the MPC change inflation target for this year?**

Interest rates down again

The Monetary Policy Council cut its main interest rates in February, and it did it exactly in a way that we have envisaged. The most important reference rate was reduced by 25bps to 6.25%, lombard rate was cut by 50bps to 8.0%, while deposit rate remained unchanged at 4.5%. In effect the distance between lombard and deposit rates, representing respectively ceiling and floor for short-term market interest rates, has been narrowed from 400bps to 350bps. It is a natural step following gradual reduction of nominal interest rates' level in Poland (and bringing the set-up of Polish interest rates a bit closer to the one used by the European Central Bank).

Besides deciding on interest level the MPC also published the strategy of monetary policy beyond 2003, which we analyse in *Special focus*.

Weak growth of domestic demand and no signs of recovery in the German economy were the most important factors supporting another rate cut. The MPC's statement said that low domestic demand is signalled by low monetary aggregates, low construction production suggesting low investment demand (although the MPC said that January's fall was driven by cold winter), low growth of wages coupled with the continuing fall of employment. However, NBP president Leszek Balcerowicz said that very deep employment plunge recorded in January (the number of jobs was reduced by over 100,000 – see *Economic update* for more details) should be examined in more details because it may be caused by a one-off factors. On the other hand, similarly as in previous months, the main sources of uncertainty creating potential upward inflationary pressure were: deep scale of interest rate cuts delivered so far, chance of exceeding economic deficit level planned for 2003 and uncertain fiscal perspectives for 2004, risk of oil prices upsurge, steady growth of PPI and observed acceleration of industrial output.

During the press conference Leszek Balcerowicz stressed that inflation fall to 0.4% in January was not a decisive factor behind the decision, as he wanted to put emphasis on forward looking policy of the MPC. Also,

core inflation measures were not argument supporting rate cut, as they were not published in February because of the usual change of weights in CPI basket at the beginning of a year. For the same reason CPI inflation figure for January was the subject to revision.

All in all, we believe that interest rates reduction in February does not mean the end of the easing cycle of monetary policy. In our opinion the MPC may refrain from cutting rates in March due to uncertainty on financial market related to domestic and global politics and resulting in significant weakening of the zloty exchange rate. We think that another rate cuts (most likely two) will be made in the second quarter of this year, and one more cut will probably take place in the second half of the year. Thus, the reference rate would reach 5.5% at the end of 2003, which will be accompanied by CPI inflation at around 2%. Next interest rates cuts are likely to be made by the new MPC in the next year.

Lower inflation target for 2003?

In February, before the MPC published its new strategy, member of the MPC, who wanted to remain anonymous, said that the Council may consider lowering of the inflation target for 2003 (it is presently set at 2-4%). He added that such action would be reasonable not later than in the first half of this year but at the same time he said that so far it has not been included in the agenda of the MPC meeting.

While revisions of inflation targets took place in the past (e.g. in June last year the MPC lowered inflation target for 2002 from 3-5% to 2-4%), one should remember the target for 2003 is the medium-term inflation target, which was set already in 1998 when the MPC decided that inflation at the end of 2003 should not exceed 4% (last year the MPC determined the lower end of the medium-term target and specified that CPI in December of 2003 should stand at 2-4%). In our opinion credibility of the central bank would be hurt more if the medium-term inflation target was changed a few months before the end of 2003, than in a situation that the target was undershot by a few decimals of percentage point.



Comments of the MPC members and central bank representatives

Last month we observed record high activity of central bankers in the media. However, it is not astonishing given the fact that in February the MPC published its monetary policy beyond 2003. Therefore, many central bank officials extensively commented monetary policy perspectives on Poland's road to the Eurozone. Another hot topic in February was the proposal of freeing up the revaluation provisions of the NBP (it became the official element of the finance minister's Programme for Restoration of Poland's Public Finances). The issue was commented by NBP governor, his deputies and most of MPC members. Every one of them was rather against such a solution but it is worth noticing that reaction of the NBP governor was the most reserved. This may suggest that a compromise with finance minister on that issue is possible in the future.

Also, central bankers presented their predictions concerning the pace of the economic growth and inflation developments this year. Basing on the latest macroeconomic data they expect that acceleration of GDP growth will be moderate this year and inflation will remain below the lower end of the inflation target (2-4%). This leads them to conclusion that a strategy of gradual monetary policy easing can be continued.

WHO. WHEN. WHERE	COMMENT
Leszek Balcerowicz, NBP governor; PAP, Reuters, 28 Feb	Until the moment of entry into ERM-2, the best arrangement is the free float, which has worked quite well in Poland. The opinion that high inflation is necessary for high economic growth is wrong. If we interpret economic growth in a right way, which means growth in a longer term, then we could see that low inflation helps in achieving faster economic growth. If we have higher budget deficit then the situation for economic growth is very dangerous. We should meet Maastricht criteria, nothing more. It's in the accession countries' own interest. Low inflation and low budget deficit are beneficial for economic growth. [Regarding govt's idea of freeing revaluation provisions] I do not like to speak about events taking place away from where I am.
PAP, Reuters, 26 Feb	Current inflation level is not an argument. Our decisions are forward-looking and depend on factors, which may have impact on inflation within last 12 months. [...] The risk of deflation is minimal. The scope of rate cut shows that my statement about interest rates' adequacy was very close to be exactly correct. If we lower rates further, this statement is more and more valid. We also lower the spread between different rates and this strategy will be maintained. Most work is related to the fiscal criterion [of convergence] i.e. deficit curbing. Close perspective of EU integration brings the question about the next stage – the Eurozone entry. The MPC strategy is very clear with this respect – to enter the zone as soon as possible.
PAP, Reuters, 19 Feb	CSO's data [on industrial output] is consistent with expectations and are within the range of forecasts. GDP forecasts range in 2-3.5% band and NBP staff's prediction points to 2.5%. Maximum one-time growth of total price index after Eurozone entry will amount to ca. 0.4 percentage point, however some prices will grow while the others will fall.
PAP, Reuters, 14 Feb	Revaluation provisions is not a real money, it is just an account related to double entry book-keeping. Filling the budget with revaluation provisions would have negative effect for the Polish economy. There are some standards of civilised accounting, which we obey and we will obey. I am convinced that this issue will be resolved in line with the standards. Part of financial resources, which should be allocated for enterprises, if public finances stance were better, is not allocated for them. It is meaningful that share of treasury papers in banks' assets grew by 81% in last two years while credits increased by only 5%. The euro is more important for us than dollar, because 60% of our exports is denominated in the euro. Therefore, it is surprise to me that there are opinions about overvalued zloty, as its exchange rate against the euro is more favourable for exports [the real effective exchange rate of zloty weakened last year]. At the same time, Czech crown did not weaken last year and Hungarian forint lost 1%. If we will join the EU as it is scheduled – in mid-2004, then we can enter the EMU in 2007. If it was possible to shorten some decision-making processes, it could be 2006. It was possible in the case of Ireland. Transitory period lasted only 16 months. Inflation forecasts for the end of this year varies between 1 and 3%. It reflects uncertainty connected with the situation abroad. However, we will not stabilise inflation at the level of 0.8%, because it results from exceptional factors, but let say at around 2%. Food prices are always an uncertainty factor in our circumstances as it depends on weather and government's decisions. For instance, allocating PLN250m for additional intervention on the food market has some meaning and we are not able to predict it accurately.
Jerzy Stopyra, 1 st deputy president NBP; Rzeczpospolita, 4 Feb	We calculate NBP accounts in compliance with international accounting standards. Revaluation reserves have been creating for the last four years. After the change [when NBP enters ESCB] such reserves will not be created. The central bank will simply announce the value of foreign assets recalculated with current exchange rate. [If the government would like to use this money] this would be a creation of money. [After the EU entry] the NBP will have to keep the zloty within +/- 15% band with the certain parity against the euro. High FX reserves level is necessary in a case of speculative attacks on the Polish currency.
Andrzej Bratkowski, deputy president NBP; PAP, 7 Feb	The current level of the zloty exchange rate cannot be regarded as overvalued. Actually, it is slightly weaker than two years ago. The fact that before 2001 it was even weaker is not a reason for considering its current level as overvalued because the economy have already adjusted to higher level of domestic currency. (...) In my opinion strengthening of the zloty is more likely than weakening. Higher growth of labour productivity means that given stable exchange rate competitiveness of our country increases. In open market economy the increase of competitiveness leads to strengthening of the currency. If this process will occur in Poland we should expect strengthening of the zloty in the years before entering the EMU. (...) Weakening of the zloty could be triggered by above all political factors such as the negative outcome of the accession referendum, or serious turmoil on the global markets. However, the experience shows that even if foreign capital outflows, it comes back shortly after. The works of the joint team of the finance ministry and the NBP have not ended yet. I do not think that weakening of the zloty would be a good way to boost the economic growth. Such action could lead to structural regress of the economy. (...) If current level of the exchange rate allows for improvement of the balance of payments and exports accelerates, it means that there is a lot of enterprises, for which the current zloty exchange rate is good enough to assure profitability of production. I think that the reference period should include a few years before entering the ERM-2 system and its choice should take into consideration influence of different factors. I think that it should be rather 2-3 years than 5 years. (...) I am against setting the parity rate in ERM-2 system already now. (...) It should be announced just before entering the ERM-2 system, not earlier. If there were any distortions of the zloty exchange rate in the reference period, which were not related to fundamental factors then historical level of the exchange rate should be modified. With regard to length of presence in ERM-2 the European law is quite flexible and there are very different



interpretations of this issue. To some extent it depends on our view and here we have unanimity [of the NBP and the government] but the EU side stance is different as they believe that presence in the ERM-2 should be longer. Thus the length of presence in the ERM-2 system depends on the ECB stance. (...) 2007 is a realistic [as the date of entering the Eurozone] if we want it very much.

Considering potential of our exports, we can count on that its relatively high growth rate will be maintained, particularly that particularly that recent changes of the EUR/USD rate are favourable for the Polish economy. (...) If we will experience slight growth of domestic demand, then exports may rise at similar pace [as in 2002]. Of course, there are some risk factors connected with situation in Iraq and it always hurts international trade. The threat is economic situation in Europe and in the world. It was weak last year and its improvement delays. (...) Exports growth can be even higher if conflict in Iraq will be short lasting and global economic situation improve. (...) The ratio of current account level to GDP at the end of last year, regardless whether it was 3.6% or 3.7%, is a very good result.

It is important whether current level of interest is appropriate to the macroeconomic situation in 2004. Very low level of inflation in coming months should not be a reason for further monetary easing because the most important is the level of inflation in the next year. (...) Of course, it does not mean that interest rates will always be at current level. At present, in the MPC view, interest rates at the appropriate level, the view of the Council has to take into account several uncertainty factors related to long lags of some adjustments in the economy. The lower level of nominal interest rates the less room for further rates cuts and higher risk that demand may increase too fast leading to uncontrollable acceleration of inflation. (...) If we entered period of faster economic growth with too low interest rates will not be able to prevent inflation from acceleration, as possible rates hike done at that moment would have impact on inflation after 18 months.

We predict that inflation in the nearest months will remain at low level and subsequently it will gradually increase to ca. 2%YoY at the end of the year. It seems that this year there will be no temporary factors, which could lead to acceleration of inflation, unless the economic growth will rise more vigorously than expected. (...) Inflation target aimed at stabilisation of inflation will take into consideration influence of future economic recovery but it will not differ much from 2%.

Only in very optimistic scenario one can count on faster GDP growth than 3% in this year. So far, signals of the recovery have been quite shy. We still face constrained dynamics of investment. The scale of possible rebound may be also limited by effects of potential conflict in Iraq. Pace of the recovery will be affected by global economic situation and so far signals from abroad, particularly from Germany are pessimistic.

If the recovery in the next year will be gradual, which means that it will not exceed 4% then we should not experience any inflation threat. However, if the recovery will be more vigorous, then one should begin to think about hikes of interest rates than about another easing of monetary policy.

There is no economic justification for decreasing revaluation provisions. They have deep economic sense. (...)

Freeing it would mean additional issuance of money, which would have to be offset by more restrictive monetary policy in future.

Anonymous MPC member
PAP, 7 Feb

The Council may consider lowering of the inflation target for 2003. Such action would be reasonable not later than in 1H03, but so far it has not been included in the agenda of February's meeting of the MPC.

Bogusław Grabowski,
MPC member;
Reuters, PAP, 28 Feb

Export dynamics is much higher than import dynamics and that nominal GDP growth, and also higher than import growth in our main trading partners, which shows that Poland's export is competitive and that there is no problem with the exchange rate. There is still no reason to forecast weaker export performance. It seems that weaker than we expected performance of European economies is offset by zloty weakening. In 2H03 the recovery in our trading partners' economies should show up.

There are no talks between the NBP, the MPC and the Finance Ministry about revaluation provisions or about changing accounting rules regarding the reserves. The MPC will never agree to release the provisions, as this would mean printing money for budgetary purposes, which is unable to reform itself. This would be against the constitutional goal of the MPC and the NBP. I would like to remind that the MPC is an independent body, which decides about reserves provisions. Any legal changes leading to free these provisions would be against central bank's independence creating a risk for integration with the EU.

Revaluation provisions are not only a real money, this is only on paper. Freeing of this money could have serious negative monetary consequences, as this would be printing money.

PAP, 27 Feb

The food price growth, as well as current level of inflation have no impact on the monetary policy, effects of which are visible after several quarters.

PAP, 26 Feb

We are nearing the end of interest rates' cutting process but if the revival is delayed one can imagine the continuation of the strategy of cutting interest rates by small parts

TVN24, 19 Feb

One could consider introduction of uniform flat-rate tax [in Poland]. [...] We could afford for ca. 20% flat tax rate. Most of or all of tax deductions and write-offs have to be eliminated in one step, however at the same time overall tax burden have to be lowered as well as tax progression. I cannot imagine a situation when finance minister cancels out all the write-offs first, and then considers lowering tax rates when economic growth accelerates. The worst what might happen to our economy is increasing tax burden [...] when the growth is very slow. Now we need very strong tax stimulus for GDP growth.

In the next few months we can talk about small interest rate cuts, and their scale will largely depend on the scope of an economic recovery, which in turn depends on the overall global situation. The global economic recovery is still being delayed. The Iraq conflict does not help the investment climate.

[Will record-low inflation help in lowering interest rates?] Yes and no. January inflation shows what has happened in past. We are making decisions, which influence economy after several months. January inflation is among the factors that help us in forecasting future developments. In this sense it is an argument.

Supply factors have huge influence on inflation indicators. We have deflation in food prices ... [but] such deflation is no threat for the economy. There is surely no threat of inflation as a phenomenon hampering economic growth. Such data [on industrial output] support our forecasts that GDP growth this year might reach 2-3%. I believe it will be closer to 2% than 3%.

Gazeta Bankowa,
18 Feb

Central bank's reserves are not to solve the Ministry of Finance's problems. The ministry could have to accumulate high foreign currency revenues from privatisation, when it sold the best and the biggest firms. Most of those transactions were denominated in not in foreign currencies, but in zloty. The government's policy, quite intentionally, led to zloty appreciation, as those flows went through the FX market. The MPC, since the beginning of 1998 has been proposing the opening of special foreign exchange account in the central bank. But to accumulate privatisation revenues, the government would have to prepare a reform of public finances and lower budget deficit.

If there is a surplus in outflow of money for debt servicing and EU contribution, and inflow of foreign exchange



revenues, the government should decide to buy currencies on the market, not in the NBP, to not create monetary consequences. However, this should be officially announced and transparent. Market participants have to be aware, what amount of money and when will be purchased. Unacceptable, or even scandalous, would be a purchase of currencies concentrated in time, which would have nothing to do with debt servicing payments, which would influence the FX market. Unacceptable is the MinFin's policy, which refuse to confirm or reject the hypothesis about MinFin's activity on the market. The government is not able to depreciate the zloty constantly, unless its policy leads to higher investment risk of the country.

Inflation may slightly accelerate, but it will not sharply increase, will not go out of control. However, we are not the central bank, which could adopt normal monetary policy, adjusted to business cycle. We are finishing the process of permanent disinflation and inflation stabilisation at low level. That is why it is worth to be cautious in monetary policy. Of course if we look at short-term costs, there are reasons to complain. Especially for politicians, who prefer higher GDP growth in the short-run with not doing the basic things to achieve it.

I see no reason to change inflation target this year. Direct inflation targeting means inflation targeting, not target targeting. If the target is not met, the central bank's role is to reliably explain the reasons and to describe monetary policy's reaction to such a situation. That's all. I think that despite the fact that the MPC used to miss the short-term targets, is trustworthy. And the prove is higher and higher influence on inflation expectations.

Cezary Józefiak, MPC member; PAP, 13 Feb	[FinMin's purchases on the FX market] This is factor, which constrains appreciation pressure on the zloty. However, it does not create any trend but only affects fluctuations. Moreover, one should not exaggerate its influence on inflation.
Janusz Krzyżewski, MPC member; Reuters, 28 Feb	[using a part of NBP's reserves] It would be an excessive money supply impulse, which would be risky and it had not been taken into account by the central bank in its policy guidelines. [...] Such a release would be in violation with the law, as it was not a part of the MPC's monetary policy guidelines for this year or years to come, which under the constitution are binding for the central bank.
ISB, 13 Feb	Perhaps, investors too optimistically evaluated Poland's economy, which is now leading to disappointment and thus interest in Polish papers sinks. The investors are not encouraged enough to open long positions on the zloty. The situation in Hungary might be of importance, as Kolodko talks about such solutions very often. The market worries that one day Kolodko might force Balcerowicz to follow the Hungarian example. [...] However, one should not lay claims to finance minister, since he sees hope for impulse accelerating growth, which is not close to my opinion. Another factor behind the zloty's stable value or even its weakening would likely stem from the uncertainty connected with the EU referendum planned for the middle of 2003.
PAP, 11 Feb	I think that we have cut the rates to such an extent to achieve the target of some 2% inflation, and that the target could be met in these conditions if it had not been for the external factors of unfavourable market conditions, which cause that price falls are deeper. [...] What we have achieved by lowering interest rates will direct us towards the level of 2% [in December 2003] although I will not be surprised if it is 1.6%.
Dariusz Rosati, MPC member; Rzeczpospolita, 28 Feb	Commercial banks do not have to think about individual clients, as they have other possibilities to invest the money. They are not under pressure, which would create competition on the market. This is also an attempt to offset losses connected with bad loans. The situation may improve if general economic climate gets better, but not earlier than 2H03. Personally, I do not think that consumer credit will be cheaper. They are usually more expensive than business credit.
Polish Radio 1, 27 Feb	This is [3.5% GDP growth] absolutely the highest possible out of the most optimistic forecasts. A few months ago I thought that this is ambitious, but realistic figure. But based on new data, especially concerning German and other European economies. Recovery in Europe will come later and as a result Polish GDP growth will be also lower.
Puls Biznesu, 25 Feb	Indeed, the MPC faces a dilemma. We cannot take decisions, which would limit the next MPC policy. On the other hand, our today's decisions will have an effect on the situation in 2004-05. Also, we have to show what would the monetary policy in the medium term for financial markets. Food prices' fall in the last two years is very untypical and we cannot expect that this trend maintains in the next years. In that sense, this should be perceived as temporary phenomenon. However, low economic activity caused by high interest rates was the most important reason behind low inflation. GDP growth of 3.5% is the upper range of realism. It may be better next year. However, taking into account that our decisions will influence next year's scenario, we have to be very careful. We live in a free country and finance minister is allowed anything he wants, assuming it is legal and does not undertake country's credibility. Verbal interventions are a normal practice. But permanent zloty weakening is possible only by significant decrease of Poland's credibility. Announcement of MinFin "interventions" on the market may have only short-term effect. The zloty may be volatile within next six months, but structural tendencies will be more important in the longer run. The zloty will be stronger amid EU integration process.
ISB, 21 Feb	The faster the government decides on the date of our accession to the euro-zone, the sooner we will know how to run the monetary policy without burdening the economy with unnecessary costs, hampering inflation with excessively restrictive policy, while the date of the euro-accession would be put off Keeping inflation at a level allowed by the Maastricht criteria requires a restrictive monetary policy all the time, though in the long run it hampers the growth Fulfilling the nominal convergence criteria requires a restrictive policy, i.e. maintaining interest rates on a higher level than the level consistent with full employment and development possibilities, for the growth path it means being not optimal, i.e. that we do not catch up with the European Union's (EU) countries the central bank is ready for talks with the Finance Ministry and would like to start them as soon as possible. The ministry however, seems not to be prepared for such talks yet. If we politically agree that cutting the deficit below 3.0% in 2006 is impossible, the NBP and the Cabinet should both agree on a later date. The problem with curbing the budget deficit is deeply rooted in politics, as Poland's budget deficit cannot be cut without reducing the expenditures, i.e. limiting some privileges. The possibility of decreasing the domestic demand plays no major role in this case. Our deficit is at 4.3-4.4% according to ESA 95, thus reaching 3% within two years seems feasible
PAP, 19 Feb	The figures [on industrial output in January] are in line with expectations. They confirm the economy is recovering although at an anaemic pace. They are consistent with the information received so far, i.e. low inflation, low monetary statistics, weak recovery in industry and possibly a seasonal fall of employment in industry.
PAP, 17 Feb	The data [on inflation in January] is somehow surprising because we had growing oil prices already for two months. They mean there is completely no threat for inflation, and even low wage growth experienced in January did not translate into price growth. There is no threat for inflation target in this and in the next year, however the situation is so uncertain that everything is possible at the end of year. [...] We can see more declines of CPI index. In April it can be even lower than currently. After April I believe inflation will grow.



PAP, 10 Feb	Previously I said that if there would not be reversal of inflation trend, then there would be room for another interest rates reductions. However, one should be cautious taking into account presently low level of interest rates and uncertainty connected with oil prices due to possible conflict in Iraq.
PAP, 5 Feb	[New] medium-term inflation target will be continuous – this will be different system and different central banks' reaction on it. The level of new target is not set yet, but if this was 2% +/- 1%, we would like to keep inflation in this range all the time, and not only in December. The central bank will not have to react to supply shocks in order to prevent inflation from exceeding target for one particular month. Monetary authorities could wait for a few months or even quarters until the shock reversed. Supply shocks would be accommodated by monetary policy only if they could influence inflation expectations or wage-prices spiral. [With current inflation target] when there is shock and inflation in December is different than our target, we were criticised for over/undershooting, despite the fact that inflation trend was appropriate. Continuous target is better as it allows assessing the monetary policy from longer perspective. The MPC would not have to explain why in December indicator was bad and in November and February it was OK. The MPC strategy will begin to gradually shift from targeting CPI to inflation measure used in the EU, i.e. HICP (Harmonised Index of Consumer Prices) indicator. This process may take a few years. The new strategy would also assume that the MPC would focus more on average annual inflation instead of year-to-year prices' changes for one month, as Maastricht criterion regarding inflation is based on average annual inflation measured by HICP. We would like to have HICP index computed already now, but this would be perceived as additional information. Gradually, as the market will use to it, we will increase its importance.
Reuters, 3 Feb	I regret that Kołodko had not implemented the reform [of public finances] during two month after he took over the post in the government. He (Kołodko) came to the government completely unprepared. He presented two disgraceful bill, leaving all important decisions for later. So far, he has only proposed a politically uncontroversial capital gains tax. Kołodko will probably have to wait with his proposals until after the accession referendum scheduled for June. Proposed reform could be negatively perceived by society and lead to lower support for the EU membership. Later, there will be a tough battle and there will be very little time for rational debate...on next year's budget. Despite expected political disputes the economy should accelerate in 2003, reaching 3-3.5% in the final quarter against .1.3% in 2002, fuelled by a pick up in corporate investment and sustained domestic consumption and exports. (...) Inflation should stabilise at 2-2.5% towards the end of 2003, compared with 0.8% in December 2002. Such level of inflation means that further interest rates cuts are still possible.(...) Of course, this is all barring unpredictable events, such as an unexpectedly bad impact of a possible war in Iraq or a loss in the EU entry referendum. Poland's accession to the EU in 2004 and to the Eurozone as early as two years later will force the country to cut its budget deficit to below 3% of GDP from this year's planned 3.9%. (...) Reducing social security spending is crucial to free up government funds for investment needed to achieve high growth so that Poland can catch up with much wealthier current EU member states. KRUS is an ulcer on the whole pension system. It cannot be sustained. We will not escape from gradually increasing farmers' contribution to the system. The new MPC will take over...in a better situation, when the economy will be growing by 4%, unemployment will be falling, inflation will be low and... rates will probably be lower. I see little danger from its [new MPC's] decisions.
Grzegorz Wójtowicz, MPC member; PAP, 28 Feb	[using a part of NBP's reserves] It would be delay the Eurozone entry, as we would have to do again what was just achieved – to lower inflation. This is a proposal of printing money, and nobody would decide to do this in current situation. Such policy would undermine zloty credibility, which was built during the long period of time. Rising inflation would be a result, weakening of the zloty would also take place.
PAP, Reuters, 26 Feb	Inflation target for this year remained unchanged and this is the reply to the question whether or not the Council is afraid of deflation. Everything points to the fact that 1Q will be similar to 4Q. [...] Economic growth may total some 2%. In the whole 2003 I feel inclined to growth of 2.5-2.8%.
PAP, Reuters, ISB, 17 Feb	Inflation at 0.4% in January is an inflationary bottom. In February and March we should see CPI rebound, it could reach 0.5%YoY in February. [...] Considering monthly growth of 0.4% in January 2003 as well as 0.1% and 0.2% in February-March 2002, one could expect that it was a floor for inflation in January. Uncertainty factors for CPI are fuel and food prices. [...] Additionally, since January some of controlled prices are changing, while inflation's reaction to this factor might be distributed in time. At the end of this year still 2% inflation is possible. Talk of deflation has become trendy, but it is unjustified or at least much premature in the case of Poland because it is not a country with shrinking domestic demand. Deflation might take place under fall of demand, meanwhile consumption demand is growing in Poland.
Wiesława Ziółkowska, MPC member; PAP, 13 Feb	There is big probability that inflation this year will be lower than bottom end of the inflation target of 2-4%. But there is some risk related mainly to oil prices and situation in agriculture. (...) Assuming that inflation at the end of 2003 is slightly below the lower end of the inflation target, changing this year's target by 0.5-1.0pp has no sense. Inflation target beyond 2003 will be set at 2.5% +/-1pp. I think that it may bring us closer to meeting Maastricht criteria.
Adam Czyżewski, head of NBP's research dept.; Gazeta Bankowa, 11 Feb	We have the biggest problems with predicting decisions of consumers and investors, i.e. with demand side of the economy. The reason is a lack of statistical information. Recently it turned out that consumption demand grew much faster than we predicted. Opposite situation occurred in investment demand. However, we are able to quite accurately forecast GDP growth rate, which is product of both of them. For quite a long time we have been preparing for publication of our forecast, the same as it is done by other central banks. (...) It is not enough to have tool for forecasting, because forecast have to past a series of "confidence" tests conducted by decision-makers – in our case by members of the MPC. (...) Approval must be given at the stage of creating the tools. Afterwards it would too late. Finally, if we have some model it has to be checked in practice, i.e. ex post errors of forecasts should be small. Thus, work on model used for forecasts, which are make public later need to last at least two years.



INFORMATION FROM A MEETING OF THE MONETARY POLICY COUNCIL, 25-26 FEBRUARY 2003

On 25-26 February 2003 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, in the public finance sector, the money supply, loans and interest rates and the structures of pricing and inflationary expectations, as well as the anticipated rate of inflation.

Decision of the Monetary Policy Council

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

- a) Indicates. Strengthening signs of a continuing low growth rate in domestic demand:
 - Maintenance of a low salary growth rate in the industrial sector,
 - a further decline in the employment rate,
 - a further declining growth rate in construction, reflecting a continuing very low investment demand,
 - the annual growth rate of monetary aggregates – M3 and loans – remains low, the cash growth rate has levelled off,
- b) Confirms. That the German economy shows no signs of an upturn: both entrepreneur and consumer optimism have remained low for another month, and the economic results of German industry in January were also poor,
- c) Shows. That the current inflation has again been reduced, inflationary expectations of natural persons and bank analysts are lower.

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 over-run in the level of economic deficit in the public finance sector as envisaged in the draft 2003 Budget Act and uncertainty underlying the fiscal policy for 2004,
- risk of escalation in oil prices fuelled by the impending military confrontation in Iraq,
- steady growth in the sold industrial production index to 2.5% in January 2003,
- confirmation of a tendency towards a gradual increase in industrial output in January.

The Monetary Policy Council resolved:

- to reduce the lombard rate from 8.50% to 8.00% p.a.,
- to reduce the re-discount rate from 7.25% to 6.75% p.a.,
- that the National Bank of Poland will conduct open market operations for 14-day maturities with a profitability rate of at least 6.25% p.a.,
- that the interest rate on term deposits taken by the NBP from banks will be held at 4.50% p.a.,

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

The Monetary Policy Council adopted "The Monetary Policy Strategy after 2003"

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

I. Assessment of the economic situation

In January and February 2003, consumer and entrepreneur confidence in the USA and the Eurozone continued to be influenced by political risk. Consumer confidence suffered the most. Both the USA and Europe saw a drop in household confidence indicators (in the USA, the University of Michigan ratio dipped from 86.7 in December 2002 to 82.4 in January 2003 and the European Commission indicators for such countries as France and Great Britain fell from -17 and -6 in December 2002 to -20 and -9 in January 2003, respectively).

No improvement was observed in the optimism of business circles in the USA and the euro zone. Nevertheless, as in the 4th quarter 2002, American entrepreneurs showed more optimism than their counterparts in the Eurozone.

The attitude is evidenced by poor results generated by the processing industry in the main economies of the Eurozone (for example, in December 2002, the output of the German processing industry fell by 0.5% in comparison with December 2001 in contrast to a 2.8% increase in November (year on year), similarly, there was no major improvement in the industrial orders portfolio in January).

Poor demand in the production sector delays the long-awaited breakthrough in the negative investment growth rate in the Eurozone, which had prevailed since the second quarter 2001.

Global oil prices continue to be a big question mark. In January 2003 the average price of Brent crude oil reached USD 31.3 a barrel and was 10% higher than in December 2002 and over 60% higher than in January 2002.

As in January, further growth in oil prices was fuelled primarily by political factors such as a possible war with Iraq and a strike in Venezuela's oil sector, now in its third month. The likelihood of a war in the Persian Gulf results in serious concerns about continued supply of oil from the region. Thus far the political situation has not had impact on oil production levels. In January 2003 Iraqi oil continued its uninterrupted flow (at 2.5m. b/d).

The Venezuela crisis gobbled up oil reserves in OECD countries in January 2003 by 90m. barrels down to 2.5bn barrels, the lowest level in five years. It was compounded by a drop in oil product reserves, in particular heating oil, as a result of the inclement cold weather conditions in the north-eastern part of the USA. The low oil reserves put additional pressure on the increase in oil prices, which are already exposed to political risk.

No upturn in the industrial production trends was reported for January 2003. Year to year growth in total industrial output fell from 5.1% in December 2002 to 4.2%, while the growth rate in the processing industry dropped from 6.7% in December 2002 to 4.7% in January 2003; however, the drop rather resulted from imponderables connected with severe weather conditions, rather typical of this time of year, than from changes in the key factors affecting output. In January 2003, sales generated by the "electricity, gas and water production and supply" industry grew by 2.6% compared to January 2002, while sales figures for the industry in the consecutive months of the second half of 2002 were not higher than their last year equivalents.

Out of 29 industrial divisions, 18 reported an increase in production and 11 conceded a decline. As in the previous months, the highest production growth was observed in industries with a high and increasing share of export sales.

Cold weather conditions in January contributed to a further decline in construction output. The decline again exceeded 10% compared to January 2002.

December 2002 saw another drop in the current account deficit, by EUR 50m against December 2001. It came as a result of a growing positive balance of unclassified current account transactions, a decrease in the commodities trading deficit and an increase in the current transfer surplus; at the same time the negative balance of revenues and services increased.



In comparison to December 2001, the commodities trading deficit fell by EUR 76m. in December 2002 (by 14.3% compared to December 2001) as exports growth rate exceeded imports growth rate (compared to December 2001 exports grew by 14.3% and imports by 8.6%). The total receipts from 2002 exports expressed in EUR were 2.9% higher than in 2001, whilst the value of imports payments was 2.4% lower than in 2001.

The 4th quarter 2002 saw markedly accelerated growth in both exports and imports, at 7.4% and 2.7% respectively (viewed against 4th quarter 2001).

Both payment statistics and tangible statistical indicate accelerated exchange at the end of 2002. Preliminary figures after the first 11 months show that exports rose by 6.8% and imports by 3.7% compared to the same period of 2001.

Since the beginning of 2002 the strongest increase in sales has been reported in machinery and transportation equipment. The trend continued in the 4th quarter 2002. At that time, high growth rate of exports in this group stemmed primarily from increased sale of car parts, ships (mainly as part of ship overhaul services) and passenger cars (where an almost 18 month downward trend in the value of exports was finally halted).

The upturn in exports observed in 4th quarter was fuelled by continued growth in sales to the developed countries, in particular to European Union member states, Italy and Great Britain. Likewise, high exports rate to France remained stable. By contrast, exports to Germany suffered a decline. Like in the 3rd quarter 2002 there was a considerable slowdown in the growth in exports to the countries of the Commonwealth of Independent States.

According to a Central Statistical Office survey of a sample of six thousand enterprises conducted at the end of January 2003, the general economic situation is not deemed to be good. The same is borne out by negative values of the indicators measuring various aspects of the economic situation (including domestic and foreign demand, orders portfolio, goods sold, output level and the potential for settlement of financial liabilities, payment delays).

However, it should be emphasised that the prevalence of negative opinions over positive ones is declining, especially in the industrial processing section. The trend is manifest when compared to January 2002 and in some cases, also with January 2001 (e.g. the assessment of the financial situation in the processing industry and in trade and the assessment of demand in the processing industry and the volume of goods sold in the commercial sector).

The forecasts for the next three months indicate that negative indicators continue primarily in the construction industry and in trade, although the same are less negative than in the same month of last year.

On the other hand optimistic forecasts for the future prevail amongst entrepreneurs from the industrial processing sector (with indicators turning positive). In particular, the prospects for demand for this sector's products are deemed to be extremely favourable, and in January the indicator climbed to one of the highest levels in two years. According to this group of respondents, foreign demand should recover. On the other hand, foreign demand-related forecasts are volatile and change from month to month, which is understandable in view of the current political situation around the world.

Entrepreneurs of all industrial sectors share the opinion that downward trends in prices and employment will continue in the nearest future.

II. Situation of public sector finances

In January 2003, the State budget was in a better condition than in January 2001. In addition to tax and non-tax revenues climbing highly above the previous years' levels, expenditures were lower as well. In consequence, the budget deficit remained PLN 2.8 Bn below the January 2002 level at PLN 3.36 Bn.

Both receipts from indirect taxes (115.9%) and corporate income taxes (145.3%) showed a very high annual growth. These categories of budget receipts are the most susceptible to economic conditions and their increase, when compared to the same period of 2002, is partially due to the economic improvement. The continuing low growth of receipts from natural persons (102.6%) reflects the employment market conditions. Rise in non-taxable receipts may be attributable to the additional receipts from the restructuring fee.

The state budget expenditures incurred in January 2003 remained below the level of the previous years and reached PLN 15.7 Bn, i.e. by 8.7% below their total for January 2002. The plan was followed in 8.1%, which is considerably below the percentage reported in the past two years.

The estimated economic deficit of the whole public finances sector should amount to about 5.2% of GDP, constituting a slight diminution when viewed against the previous year's figure.

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

In January 2003, the M3 money supply fell by PLN 3.7 Bn (1.1%) below that of December 2002. The annual growth rate of the M3 aggregate amounted to -1.4% in January 2003. Such a low growth rate of M3 comes as statistical outcome of shifts in the deposit structures caused by the introduction of the interest income tax in November 2001. The drop in the M3 aggregate in January 2002 was mainly caused by the decrease in deposits from enterprises by PLN 2.6 Bn (4.7%), which is a normal January action on the part of enterprises. Compared to the January drops in previous years, this year's drop was definitely smaller, as was the decrease in the amount of cash in circulation (by PLN 0.6 Bn - 1.3%). Decrease in cash, a January standard, was not as strong as such decreases in previous years. The annual cash growth rate remains at about 14%, as it has been for the past five months. Household deposits typically grow in January in consequence of seasonal payment of additional fees and salaries, but in the current year dropped by PLN 0.9 Bn (0.5%). The annual growth rate of household deposits included in the M3 aggregate declined to -5.5% and to about 1% including deposits with maturity dates of over 2 years.

On the money-creation side, the annual growth rate of the amounts due from households has remained stable at about 8% for six months (and 8.7% in January 2003) in parallel to the continuously low annual growth rate of the amounts due from corporations at 1% (1.1% in January).

In January 2003, the zloty showed high volatility. A slight appreciative trend prevailed in the first half of the month, supported by investors' expectations with regard to the interest-rate reduction, only to decline in the second half of January. General deterioration of market conditions and a drop in the zloty exchange rate at that time was affected by the currency interventions by the Bank of Hungary in order to weaken the forint. Uncertainty on the currency market and the increasing volatility of the Polish currency were additionally undermined by verbal interventions made by the Ministry of Finance aimed at weakening the zloty.

IV. Prices, inflationary expectations

In January 2003, prices of consumer commodities and services grew by 0.4% (against 0.1% in December 2002 and 0.8% one year ago). For 12 months, growth in consumer prices deteriorated further to 0.4% in consequence of decrease in the price of food and non-alcoholic drinks (by 3.5 percentage point at the annual level), alcohol and tobacco (by 3.4 percentage point) as well as a drop in the prices of clothes and footwear (by 1.4 percentage point). On the other hand, prices increased in transportation (by 5.7 percentage points) primarily as a result of a considerable increase in fuel prices and in the cost of residential flats and the consumption of primary sources of power (by 3.9 percentage points) throughout the year.

Due to annual changes in the weighting system (weightings adapted to the household expenditures structure of the preceding year), the presented CPI figures for January 2003 should be regarded as provisional. The announcement made on CPI for January by the Main Statistical Office comprises no specific price indexes, either. In consequence, base inflation indicators cannot be calculated.

A twelve-month sold-product price growth ratio for industry increased by 2.5%. Prices rose most steeply on the part of producers in those sectors where market forces have not yet taken effect. Electricity, gas and water supply-sector production prices rose 6.4% and in mining and quarrying the same rose by 3.2%. In industrial processing, prices grew by 1.9%. January was the fifth subsequent month of deteriorating prices in the construction and assembly production. The reported drop was equal to 0.6% compared to December 2002 and to 0.4% over the twelve-month period.

In February 2003 the structure of replies to questions from an Ipsos-Demoskop survey, based on which the analysis is conducted of individuals' inflationary expectations, improved slightly in terms of the impact on the quantification of the expected inflation rate. At the same time, February witnessed a further decline in the current rate of inflation. Owing to these two factors, the quantified measure of inflationary expectations of individuals declined in comparison with the replies of a survey conducted in January 2003, reaching a level of 0.6%.

Meanwhile, the inflation rate expected by banking analysts in the month preceding the same month of next year (i.e. December 2003) fell by 0.3 percentage points to reach 2.3%, whilst the average annual inflation rate for 2004 is estimated to be 2.5%, or 0.2 percentage point below January's forecast. The expected 2003 year-end inflation rate was 2.3%.



Government and politics

- **The break-up of the ruling coalition – minority government survived the first test in the parliament**
- **Is PM considering getting rid of the MPC?**

The ruling coalition collapsed – new ministers in the cabinet

The last day of February was also the last day of the ruling coalition of the SLD-UP with the Peasants Party (PSL). Since the beginning of March a minority government has been functioning in Poland. Possible consequences of this fact for economic policy, particularly for chances to carry out public finance reform, are discussed in *Special focus*.

The break-up of the coalition forced some changes within the government. PSL leader Jarosław Kalinowski who was agricultural minister and his colleague from the party Stanisław Żelichowski who was environment minister were replaced with Adam Tański and Czesław Śleziak, respectively. New ministers have large experience on the Polish political scene – Tański was agriculture minister in the most liberal Polish government in 1991, while Śleziak was deputy minister before coalition collapse. Adam Tański is regarded more as a technocrat than a politician, which could suggest that finance minister may find his support in planned reform of farmers' social security system (KRUS). While there is no doubt that Tański is competent as agriculture minister, it is to be seen whether he will be able to settle down emotions of protesting farmers.

The first probation survived, the next to follow

The minority government has already positively overcome the first test in the parliament after the collapse of coalition with PSL. The Lower House denied amending the agenda of one of its session by introduction of voting over the resolution calling PM Leszek Miller to step down from the post. Nevertheless, one could argue whether it should be called a government's success or an opposition's failure, because the motion has been rejected with the majority of 221 votes against 202, with more than 30 opposition's deputies being absent. The next important tests will follow very soon, as opposition is likely to submit another resolutions against the government. The most important will be the no-confidence vote for deputy PM and infrastructure minister Marek Pol (the motion has already been submitted and the voting is expected during the next session of the Lower House between on 26-28 March). Last time Marek Pol

survived the no-confidence vote in September. However, the PSL was in the coalition at that time. Now, PSL is in opposition to the government and to minister Pol himself (as voting on road tax proposed by Pol indicated). Therefore, the result of voting might be unfortunate for the government this time. This is one of the reasons causing that political risk will remain high in March.

Does PM suggest liquidation of the MPC?

"There is a question, whether changes in Constitution should be made, removing the National Broadcasting Council or the Monetary Policy Council." – said PM Leszek Miller in an interview with public radio. This sentence triggered a wave of comments whether the government is seriously considering getting rid of the MPC and when the change could take place. We believe that this sentence was not signalling any serious attempts from the government, aiming at liquidation of the Monetary Policy Council. It looks rather like it was just an attempt to distract journalist's attention from the troublesome subject of National Broadcasting Council (being charged for political influence). It is obvious that at some point of time in the future the Polish MPC will have to disappear, and this point would be defined by the time of euro adoption. There is hardly any sense in eliminating the Council before the Eurozone entry, even from the perspective of the government. First of all, at the beginning of 2004 the term of office of the existing MPC members will finish and nine new members would be appointed (Sejm, Senate and Poland's President nominate 3 members each). Obviously since 2004 the left-wing SLD could expect to have bigger influence on monetary policy if the new Council conducted it rather than if it was in hands of the NBP board headed by Leszek Balcerowicz. Of course any attempts to legally curb down central bank's independence have to be ruled out, considering our accession to the European Union. Therefore, we argue that the perspective of removing the Polish Monetary Policy Council from the scene is still very distant and PM Miller's comment should not be taken as a real threat. Liquidation of the MPC before the Eurozone entry seems to be very unlikely.



Comments of the government members and politicians

As usual, the most of comments on economic issues were given by deputy PM and finance minister Grzegorz Kołodko. And as usual he did it in a very characteristic way, e.g. referring to mythology and physics. Among others, talking about the law of gravitation Kołodko said that economic laws should cause fall of irrationally high interest rates. In our opinion these rules should be rather applied to other macroeconomic parameters, such as taxes, budget spending, budget deficit, public debt, etc. Of course, most of finance minister's statements concerned planned reform of public finances, which we analyse in *Special focus*. Basic assumptions of finance minister's programme were positively assessed by president Aleksander Kwaśniewski and PM Leszek Miller. Also, minister Kołodko was reiterating his opinion that the zloty is overvalued (until it weakened to 4.35 against the euro) and interest rates were too high.

The most surprising comments last month were the ones on inflation given by finance ministry officials. According to deputy finance minister Halina Wasilewska-Trenkner and deputy finance minister Ryszard Michalski annual average inflation in 2003 will stand between 1.5 and 1.8% compared to 2.1% assumed in the budget. We think that these forecasts are unrealistic because they mean that CPI in the second half of this year would have to increase to around 4%YoY. Meanwhile, the most of other forecasts (including predictions of FinMin's research department's chief Jacek Krzyślak who even did not exclude a few months of negative value of annual inflation) suggest that CPI will remain very low for most part of this year.

WHO, WHEN, WHERE	COMMENT
Aleksander Kwaśniewski, President; Polish Radio 1, 28 Feb	[Public finance reform] It is an interesting, mature programme, necessary for Polish public finances. I believe that public finances is the area where one has to come out from those opposition-coalition trenches for the sake of thinking about Poland's perspectives. Good projects included in this programme could win the support not only from coalition partners, but also from those opposition camps, which feel responsible for the country. Hesitating from doing it now would impose very hard obligation for the future government. Clarifying public finances should precede Poland's accession to EU, because it would strengthen us as a country and as an economy.
Leszek Miller, Prime Minister; PAP, 26 Feb TVP1, 21 Feb	I always welcome lowering interest rates but I always maintain that there is room for deeper interest rate cut. I could only repeat what I said many times. Ministers, not officially during the cabinet's meeting, but during free chat will conduct the first discussion about necessary public finances' reform. First of all, we have to think how to improve business conditions and Poles' financial stance.
Grzegorz Kołodko, deputy PM, finance minister; PAP, Reuters, 28 Feb	We propose the use of means of the NBP revaluation reserve, which, under the binding law, is owned by the state and belongs to the budget. [...] We want to create a new instrument in the form of a revolving fund, which may in part pre-finance means coming from the European Union, and in part capitalise NBP. [...] Negotiations with the NBP are held and I am optimistic on it. [...] I think that one-third of the revaluation reserve could be used to co-finance contributions to the EU budget. GDP growth exceeded 2% in 1Q03, I estimate it at 2.3%. We will meet Maastricht criteria in 2006, to ask for euro adoption in 2007. Proposed changes in taxes are neutral for the budget, but taxes' construction will be different for different groups of people – poorer people will have some preferences.
Polish Radio 1, 26 Feb	In the first year we would like the effect of the tax reform to be neutral, that is the budget will not gain any revenues in effect of the elimination of tax allowances and deductions, but taxpayers will gain.
TVP1, 25 Feb	In 2004 we will spend no less than PLN200bn and the budget deficit will be at about PLN40bn. As regards 50% tax rate, there is no such idea [...] We are going in the direction of lowering tax rates under the condition that it would be matched with elimination of unnecessary write-off and allowances and with simplification of tax system.
PAP, 24 Feb	We stand by our 3.5% growth prediction. [...] There is also a less optimistic scenario. Unless monetary policy changes and the programme of mending the public finances gets under way and fast the 3.5% growth target may be at risk. I do not alter the 3.5% prediction for now.
PAP, Reuters, 22 Feb	I am not surprised with entrepreneurs' discontent in a situations where contributions for public finance are defined in more than 50 bills and consist of various positions which we estimated in a number of 1200. It is not strange that entrepreneurs get angry. It has to be clarified.
Polish Radio 1, 19 Feb	National Healthcare Fund bill causes some shortage of budgetary revenues and the question is: how to finance this gap? In this respect we prepare reform of public finances. As for now, the situation is under control, as restructuring programme gives positive results. The budget in the first month of 2003 was realised very positively and there is no reason for at this stage (of course this is only the first month out of twelve).
www.mf.gov.pl, 12 Feb	[when Poland will be ready for Eurozone entry?] When it fulfils formal Maastricht convergence criteria, which is possible not earlier than in 2005. Then we could introduce euro in 2007. It is still possible. I'm not afraid [of deflation]. Very low inflation in Poland is an effect of deep fall of food prices and this trend is unlikely to continue also this year. Therefore I expect inflation to fluctuate in 1-2% band in case there are no unpredictable external shocks. Next year's [budget] deficit will be a function of several factors. First of all, growing industrial production, second growing burden related to upcoming EU membership and the results of prepared restoration of public finances. Considering the volume of our contributions to EU budget it is obvious that next year's budget deficit in nominal terms can by no means be lower than this year. Zloty is overvalued and the government – using its abilities – will be supporting its depreciation, because it's good for strengthening Polish economy. More favourable zloty exchange rate means higher exports and lower imports, and therefore higher level of output, more jobs and higher revenues of companies and individuals. However it means also – and that is the problem – lower profits of speculative capital. Our policy is supporting the capital, if the capital is supporting our economic development. Therefore we try to encourage foreign direct investments, which is also interested in weaker zloty, because the labour force is relatively cheaper then. [...] Zloty will be weaker, so if someone considers buying hard currencies, then now is the best time to do, because in a while dollars and euros will be more expensive. I don't [save in foreign currencies] because I spend all my fairly small revenues on the go, boosting the economic climate this way. If I had savings, then in the long term I would place them in Polish bonds, while in the short term I would exchange [zlotys] into dollars or euro.
PR 1, 12 Feb	Polish economy is now like a dry sponge, which needs to be soaked with money in order to revitalise the circulation in the financial system in corporations and whole economy. Therefore Polish economy needs more money. However, [...] there is no question about printing more money, because we do not finance budget deficit by printing



money, but by extending public debt, by public issuance of treasuries. [...] And if banks buy those treasuries then they have less money to lend for Polish households or for companies. Therefore, if interest rates in banks were lower, then it would support the recovery that is already taking place.

We should boost domestic demand in a non-inflationary way, because production is growing. Whether the demand would grow depends on whether the economy has enough money.

It's not that the government wants to exploit it [the revaluation reserve], because it depends on the will to co-operate and to support pro-development policy by the independent central bank. Surely it would be better if there was more of it such will.

PAP, Reuters, 10 Feb

If our efforts would weaken the zloty, the better it is for Polish economy and one should not be surprised, but rather should expect that we undertake such actions. [...] Our goal is to attain the proceeds for foreign debt servicing as cheap as it is possible, therefore we will buy as much as we want in appropriate time, appropriate structure of currencies and in appropriate place. And the market will be informed about it in appropriate form and in appropriate time.

Exchange rate is overvalued, it does not reflect the actual condition of Polish economy, but rather is a source of short-term capital speculations, which are encouraged by the interest rate differential.

Interest rates will go down in Poland, but when and by how much will be decided by the independent central bank.

Interest rates must fall, because as Newton discovered once that apple falls from the tree, [...] similarly what is irrationally puffed up must go down due to the law of economic gravitation, and it will go down.

The question is not when but under what exchange rate we will be entering Eurozone. [...] We have to be sure that this entry is made under appropriate exchange rate – the one that would allow for successive economic growth.

Poland may enter EMU with economic growth at 5% in 2007. Meeting fiscal criteria is not a goal by itself but a vehicle for achieving [higher] growth. In our the most optimistic scenario, which is still realistic, budget deficit will reach 3.2% of GDP in 2005, assuming we will manage to undertake fiscal reforms. [...] It will happen only when it will not imply killing domestic economy.

PAP, Reuters, 6 Feb

If there is no inflation in Poland – because we had 0.5% [CPI growth] in January – and interest rates are irrationally high, then we are in hell rather than in heaven.

In the coming few months inflation will remain below 1% and after that it will oscillate around 1.2%, which should not be hurting consumers. [...] I am glad we have the problem of inflation practically behind us, which nonetheless requires maintaining budget discipline and appropriate monetary policy. Now we will focus primarily on unemployment. [...] Very low inflation is a consequence of food prices fall. I don't think 2003 will be another year with falling food prices; they should begin to rise, although this won't be strong growth.

The Polish economy is accelerating; so I think that in the first quarter of this year economic growth will rise by nearly 2.5%. We can build on that a rational optimism and act in a way that will lead us to increase GDP growth to 3.5% in 2003.

The difference between the main central bank rate and inflation amounts to six percent. This is deadly for Poland's economy and irrationally overvalues the zloty. Undoubtedly, there is scope to lower interest rates by as much as three percentage points given Poland' economic reality. I also have no doubt that the independent central bank will not do this. I regret that because it is harmful for the Polish economy. [...] Rates are irrationally high and contribute to the overvaluation of the Polish zloty, which is harmful to currently increasing Polish exports. Export increases won't last if the zloty's exchange rate isn't more competitive. The easiest way to make it so is a radical reduction of interest rates.

January's unemployment rate amounted to more or less the same as in December; so I think that it will further remain around 18.2%. But we can see trends for a decrease of unemployment in certain regions and sectors of the Polish economy. I think that we are approaching the turning point when unemployment will begin to fall.

Polish Radio 1, 5 Feb

The 2002 public debt amounted to 47.5% of GDP, and it is possible that it will exceed 50% this year. Public debt will increase in coming months and years. Our public debt, measured in accordance with our accounting standards, measured 47.5% at end-2002, but according to EU standards ... this debt amounts to only 44% of GDP. [...] Public debt will be growing in the upcoming months and years. It is likely that it would exceed 50% of GDP this year.

Jerzy Hausner
economy and social
affairs minister
PAP, 21 Feb
PAP, 20 Feb

When I was mentioning before that unemployment would be growing until the turn of 2002/2003, I meant early spring, because winter is always the worst. In the spring there will be an improvement and I am convinced that it would not be only seasonal but permanent uptum and the trend will reverse. Unemployment will be falling very slowly, and the unemployment rate at 6% will be visible only in 10 years.

The [Kołodko's] plan is for a cut of both tax rates and write-offs. For me, the priority is that [the tax changes] have to increase domestic demand. We seek the solutions to lower tax burden, which means that we want to reduce CIT and PIT rates. First of all, taxes for the poorest should be reduced. Kołodko accepts that.

The economic recovery has been repeatedly delayed. We are waiting for what was to happen in the third quarter, then fourth quarter of last year and then this quarter. We are still waiting for this moment.

PAP, 14 Feb

I think that GDP growth in 1Q03 will be higher than in 4Q02, which means above 2% Growth of 3.5% this year is realistic.

The project of the bill about repayment debt towards OFE by the Social Security Office will be in the parliament in March.

PAP, 5 Feb

The economic recovery signalled by improving indicators over recent months was not yet self-sustaining and I cannot find elements of present macroeconomic policy, which could boost the growth.

I do not want to start the discussion over monetary policy. [...] I personally don't agree with the course of monetary policy, which is carried out in Poland, but my job is not to quarrel with the Monetary Policy Council. Anyway, interest rates are a smaller problem now. The exchange rate is the key issue.

I want to propose a bill, which would employ commercial banks' provisions on irregular credits to finance economic activity in the several sectors of the Polish economy, chosen by the government. I have noticed that on the one hand banks have large bad-loan portfolios and on the other hand, crediting of domestic firms is at a very low level. That is how the idea of freeing up a part of reserves for this purpose came about.

25-40% of unemployed do not look for job but for social benefits. Unemployment benefits could be limited while more financial resources should be allocated to active forms of combating unemployment. In particular, labour offices should act more like unemployment agencies – they should not only register unemployed and pay them benefits. In January unemployment rate increased by some 0.2-0.3pp, I hope that since March the unemployment rate would begin to decline and the end of this year should fall below 17%.

Jan Czekaj,
deputy finance
minister;
Gazeta Wyborcza,
18 Feb

If we change current tax system, we would like to simplify the form of taxing capital incomes profits. Most likely, lump-sum tax will be applied. It is difficult to talk about its level at the moment.



Ryszard Michalski deputy finance minister www.mf.gov.pl ; 20 Feb	I think that on the FX market the Finance Ministry is exactly the same client as other entities, and in a situation of legal and consistent with the market's rules activity, there is no reason to talk about a threat. I do not see a threat, but what is more I think that the ministry may be important player on the market, which decides about favourable trends against foreign currencies.
	I do not agree with a pessimistic scenario, as the Eurozone entry in 2007 is „practically impossible”. I would like to remind, that timing of the Eurozone entry depends on some „automatically rules” of the accession treaty. The solution adopted for Poland is based on derogation. It means that if we meet Maastricht criterion, we enter the Eurozone automatically. Of course, some technical discussion is necessary, but it is impossible to introduce additional criteria. I would like to stress that neither GDP growth nor unemployment rate are listed among these criteria in Maastricht Treaty.
Andrzej Sopoćko, deputy finance minister; PAP, 26 Feb	NBP informed they will repurchase remaining inflation-indexed bonds and we are waiting for it since it will increase accessibility of credit form companies. This PLN5bn worth operation would result in increase in money supply of ca. 8%. [interest rate cut by 25bp] This is no reduction at all but even reduction of 50 bps would not bring about effects expected by the government.
Halina Wasilewska- Trenkner, deputy finance minister; PAP 25 Feb	In the optimistic scenario you may expect average annual inflation to fall to 1.7-1.8% provided that no price shocks linked with food and fuel prices occur. The January was low, it seems that will be low as well, which influences the whole year.
Jacek Krzyślak, head of research dept. at FinMin; Reuters, 17 Feb PAP, 7 Feb	We think that inflation will stabilise at very low level in February. Some conclusions should be drawn from this fact, particularly by monetary policy. On the other hand, we are slightly reserved in our reactions because it means that economic recovery is not so dynamic as dynamic as we would like to. After changes in GDP estimates by CSO, which in fact took us by surprise, the forecast [budget] deficit is 4.7 percent of GDP this year. [...] The side effect is a lower forecast of the budget deficit and the public debt ratio to GDP. There is now less danger that the ratio will exceed 50 percent.
Ludwik Kotecki Deputy director at FinMin's research dept. PAP, 20 Feb	We estimate that GDP growth in 1Q03 will stand at ca. 2% but we expect faster economic growth in the second half of this year. We still do not see rebound in investment, which is shown by weak situation in construction.
Piotr Marczak, deputy head of FinMin's public debt dept.; PAP, 13 Feb	Our projections are based on current situation and that is why we decreased the supply of bonds in February. The prices depend on the situation on the market. We can choose the instruments depending on demand. If we have a deterioration of the sentiment on the longer end of the curve, we can move to the short end. Within the next months, two factors will be important on the Polish market – first, EU (and EMU) accession causing convergence play, especially on the short-end of the curve and second, interest rates scenario globally, especially European market. Current situation is driven by expectations on a possible war in Iraq, which, paradoxically, cause interest rates ' decrease in the developed economies, and an increase in Poland. One should assume a change in the structure of foreign capital buying Polish papers expecting lower share of banks' and investors with short-term view and higher share of long-term money driven by lower investments risk of our country, as there will be always disparity between Polish and German or American rates. According to auctions' calendar, the next auction of 20-year bonds will take place in September. Nothing changes, and we do not know what will be the market situation in September.
Jarosław Skowroński, FinMin's spokesman Gazeta Wyborcza, 7 Feb Reuters, 3 Feb	In case of foreign exchange market, exemplifying high volatility, there is no such custom to inform market participants in advance about the planned transactions, in particular about the amounts, currencies and specific terms of purchase. [...] The Ministry of Finance will not inform about the ways of conducting operations on the FX market and about the entities engaged in it. The issue [proposition to release some of central bank's revaluation reserve] is now at the stage of proposals and postulates. It is too early to discuss details.
Zbigniew Kuźmiuk head of PSL caucus; Reuters, 25 Feb	We face a far-reaching reform [of public finance]. If we could have delayed this then, looking at the political costs, we might have tried to. [...] But we cannot postpone many issues because we are up against the wall. We have to find money to pay our EU membership dues and co-finance EU-backed projects. First there must be an improvement in farmers' incomes, then a restructuring of KRUS. That means not in 2004. [NBP's revaluation provisions] This is a gigantic amount of money, which has been stored up over years at the cost of lower inflows to the budget. [...] This provision should be partially released, perhaps if the current Monetary Policy Council will not allow it, the next one will take a different approach. [...] No finance ministry would expect a radical cut in the provisions, but they should be lowered to an adequate level.
Gazeta Wyborcza, 21 Feb	Eurozone entry should be carried out over a longer period of time. [...] Examples of such counties like the UK or Denmark prove economies which are not bind with tiff restrictions of Maastricht Treaty can effectively compete on the EU markets. [...] It should be a natural transition, without the need for additionally restrictive fiscal or monetary policy. [...] Poland doesn't need more shock therapy.
	We support idea of 50% PIT rate. The Ministry of Finance has carried out simulation, which shows that it could bring additional PLN1.2-1.5bn. (...) I have heard so [that finance minister Grzegorz Kołodko would like to reduce tax rates from currently 30% and 40% to 28% and 38%]. I also hear some voices that deputy PM Kołodko (...) would like to abolish tax free income threshold and introduce 0% tax rate for those who earn the least. However, it seems that changes in the tax system proposed by deputy PM Kołodko are far-reaching. Far, far reaching. I cannot imagine we can afford such changes. (...) Deputy PM seems to be preparing revolution, because he wants to hand over tax revenues to local authorities. I do not details of this proposal but many questions arise with this regard. [Substantial changes in tax system are not possible] unless, there is dramatic change in monetary policy. In my opinion it will take place since January 2004. Yes, it could be significant stimulus for the economic growth (...) New people will come, who will understand monetary policy in other way than the current Monetary Policy Council. (...) PSL has at least a few high level macroeconomists. (...) In the autumn we will show that we have vision of monetary policy for next years. We want to calm down financial markets. [Monetary policy will be] Different that conducted so far. The new MPC will co-operate with the government in order to support the economic growth and reduce unemployment. Also, interest rates should be higher than inflation by 1-2pp at most.



EU negotiations watch

- **The first accession referendum**
- **Support for the EU membership is high in Poland**
- **...and there is hope that the turnout will be sufficient for the referendum to be binding**

Malta said “YES” to the EU...

The first accession referendum in current wave of the EU enlargement is behind us. It was held in Malta – the country that was viewed as one of the most eurosceptical among candidate countries. The result turned out to be positive. 53.6% of voters supported the accession and 46.4% was against. The turnout was very high – it amounted to 91%. Although the outcome of the referendum in Malta was given a warm welcome by European affairs minister Danuta Huebner, we think that it will not have significant influence on Poles’ attitude to the EU membership. Some “domino effect” may be rather expected in case of referenda in Slovenia, Hungary, Lithuania and Slovakia, where they will also be held before June 8 – the most likely date of referendum in Poland (for detailed schedule of referenda in all accession countries see the table below).

Schedule of the remaining accession referenda in candidate countries

Country	Date	Outcome	Min. turnout
Slovenia	23 March 2003	Non-binding	Not required
Hungary	12 April 2003	Binding	Not required
Lithuania	10-11 May 2003	Binding	50%
Slovak Rep.	16-17 May 2003	Binding	50%
Poland	8 June 2003	Binding	50%
Czech Rep.	15-16 June 2003	Binding	Not required
Estonia	14 September 2003	Non-binding	Not required
Latvia	20 September 2003	Binding	50%
Cyprus	No referendum	-	-

Source: Reuters

...and Poles declare they will do the same

Recent public opinion polls in Poland suggest that there is high probability that the outcome of the referendum will be positive, and what is most important there is a chance that the turnout will exceed 50%, which is required for the referendum to be binding. According to TNS OBOP polling institute at the beginning of February 69% of Poles declaring the will to participate in the EU accession referendum would vote YES, 20% would be against and 11% were still undecided (the level of support was the same as in January). In February 47% of Poles were certain that they would

take part in the referendum and another 31% said they would consider participation in the voting. 7% of polled persons were sure they will not go to vote and 7% declared they would rather not do it. 8% still do not know whether to take part in the referendum.

Also according to CBOS opinion poll performed at the beginning of March 69% of Poles planning to participate in the referendum support EU integration, which is only 1pp lower than in February. Only 21% of Poles (the same as in February) are against the accession. Also, the risk of low turnout in the referendum seems to be relatively low at the moment, as 74% of Poles plan to participate (3pp less than a month ago) and 62% are certain to vote (4pp less than in February). The support for EU integration is still above 50% (58%, 2pp less than a month ago) even if the whole polled group is taken into account (those who want to participate, who will not participate and undecided).

Still positive results of public opinion polls concerning suggest that there is minimal risk of a negative outcome of the accession referendum in Poland. There are only some concerns for the level of the turnout. However, even if it were lower than required for the referendum to be binding, it would not mean failure of the accession process. As we wrote in January’s MACROscope the draft Referendum Act, which is now being developed, stipulates that if the turnout were too low, the government would have the right to withdraw from the parliament the accession treaty and renegotiate it. Then, the referendum could be held once again, because it would refer to a different treaty. Unless the Council of Ministers withdraws the treaty in time, Sejm can take another decision by way of a resolution, whether to organise another referendum to ratify the treaty or to go the legislative path. In the latter case, the authorisation for the President to sign the accession treaty would have to be given by the majority of 2/3 votes in each of the houses of parliament. Given current preferences of parties in both houses of parliament achieving even such high majority should not be a problem. However, there is still a question whether in such an important matter as the EU membership Poles will actually give their voice to politicians.

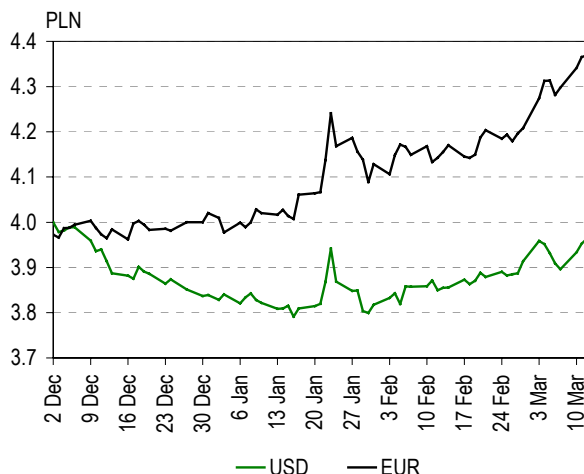
Market monitor

- Weakness on the currency market continues
- Bonds market freed from the supply pressure
- 20Y bonds not sold
- Record swap auction

Silence between the storms

After the confusion and panic sell outs of the zloty recorded in the second half of January, February was relatively calm. For most of the month, turnover was stable and daily FX rate fluctuations were marginal. The zloty gradually became weaker both relative to the dollar and the euro. At the end of February it was weaker by 2.3% relative to the basket of both currencies against the end of January. In the global market, after two months of fast growth, EUR/USD rate stayed flat at ca. USD 1.08.

Zloty in recent months



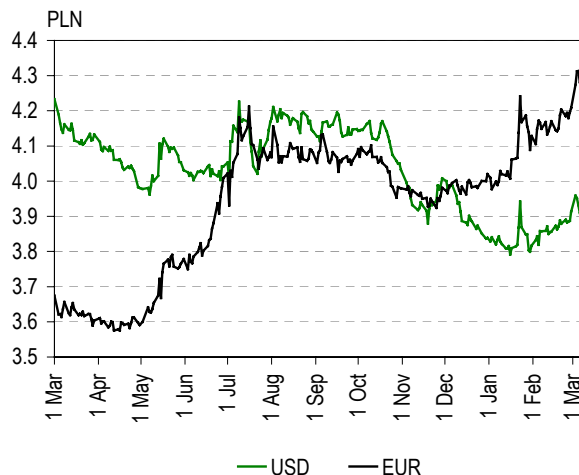
Source: NBP

According to the NBP fixings, in February, USD was at PLN 3.8191 (05/02) and PLN 3.9135 (28/02) with the average of PLN 3.8666 (against PLN 3.8308 in January). Euro was at PLN 4.1060 (03/02) up to PLN 4.2083 (28/02) and with the average of PLN 4.1651 (January PLN 4.0693). The average rates in February were up on our projections presented in the previous MAKROskop, which amounted to 3.80 and 4.07, respectively.

The first two decades of the month were rather calm. Initially, for a couple of days, the rates were moderately unstable paralleled by slight depreciation. Then, the rates stabilised and stayed low for most of the time. The market recovered on 20 February influenced by the orders to sell zloty placed by foreign investors realising profits. The profits increased and within one day zloty lost as much as 0.75% against the currency basket. In the subsequent days, the Polish currency partially

made up for the loss, however, in the last week of February, the zloty depreciated twice as a result of realising a large order, although this time the movement was much weaker.

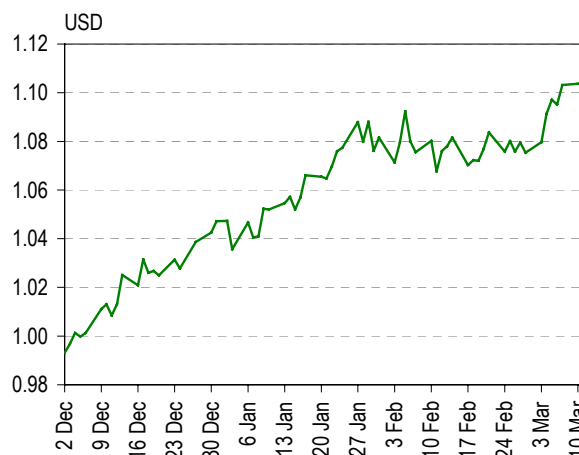
Zloty in the last year



Source: NBP

The beginning of March saw another (second in this year) confusion on the FX market. In response to the break-up of the ruling coalition announced at the weekend, Monday, March 3, saw zloty weaker at the opening (by 1.5% relative to the currency basket against Friday). The anxiety was recorded until Tuesday, when EUR rate hit its highest level since November 1999 and exceeded the 'dream' level of finance minister Grzegorz Kołodko, i.e. 4.35.

Euro against dollar



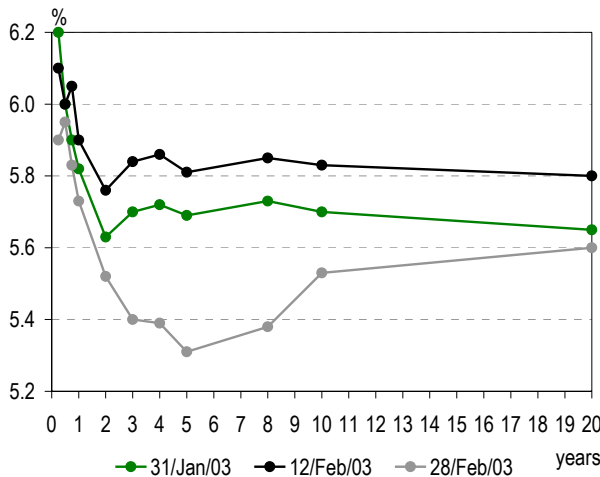
Source: NBP, BZ WBK

Breakthrough on the treasury securities market

At the beginning of February, similarly to the entire January, the secondary market of Treasury securities was under pressure from the primary market. Before and after the first two auctions the yield curve disclosed an upturn. However, soon after the second auction (12

Feb), at which no bonds were sold at all, there was a breakthrough. The market responded with strengthening to the information of the Ministry of Finance saying that the supply of bonds in February would be reduced. As of this day, the upturn trend was recorded on the market, even though it was distorted by, e.g. ambiguous results of the 5Y bonds auctions. One day following the MPC decision to cut interest rates the yield hit the lowest levels: 5.26% for 5Y and 5.48% for 2Y.

Yield curve

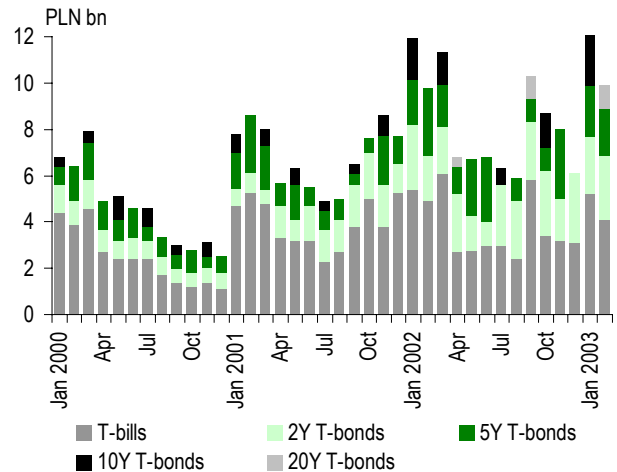


Source: BZ WBK

At the auction held on 12 February, the Ministry did not sell 20Y WS0922 bonds at all. The supply (PLN 1bn) outstripped the demand of PLN 953.9m. Moreover, the investors offered too low prices and all of their offers were rejected. The last time the Ministry of Finance decided to take such a step was in the case of bonds auction in August 1999. Two subsequent auctions were successful. At the first one, on February 19, all of the offered PS0506 securities totalling PLN 2bn were sold and the average yield was below the expectations and the level of the secondary market. However, one day later, at the additional tender, no demand was voiced. At a subsequent auction, on 5 February, the demand for the supplied PLN 2.5bn worth of OK1204 bonds totalled as much as PLN 9.5bn. Of course all of the

supplied securities were sold, including the bonds of PLN 250m at an additional auction one day later. The average yield declined to 5.543%, i.e. below both the expected level and the current market rates.

Supply of Treasuries



Source: Ministry of Finance, BZ WBK

At the bonds switching auction held on 26 February the number of concluded transactions hit a record high, i.e. almost PLN 1.5bn. The prices approved by the Ministry of Finance indicate strong determination to reduce the number of securities maturing in the next months. The value of bonds maturing in April was reduced by over 10%.

Treasury bills – auctions (PLNm)

Date of the auction	OFFER (SALES)			
	13-week	26-week	52-week	Total
03.02.2003	-	100 (100)	800 (800)	900 (900)
10.02.2003	-	100 (100)	800 (800)	900 (900)
17.02.2003	-	300 (300)	900 (900)	1 200 (1 200)
24.02.2003	-	400 (400)	900 (900)	1 300 (1 300)
February total	-	900 (900)	3 400 (3 400)	4 300 (4 300)
03.03.2003	-	200	900	1 100
10.03.2003	-	200	900	1 100
17.03.2003	-	200	1 000	-
24.03.2003	-	200	1 100	-
31.03.2003	200	-	1 000	-
March total	200	800	4 900	5 900

Source: Ministry of Finance

Treasury bonds in 2003 (PLNm)

Month	Auction I				Auction II				Auction III			
	date	bonds	offer	sales	date	bonds	offer	sales	date	bonds	offer	sales
Jan	08.01	OK1204	2 500	2 500	15.01	DS1013	2 400	2 400	22.01	PS0608	2 200	1 959,1
Feb	05.02	OK1204	2 800	2 114,3	12.02	WS0922	1 000	0	19.02	PS0608	2 400	2 000
Mar	05.03	OK1204	2 750	2 750	12.03	DS1013	-	-	19.03	PS0608	-	-
Apr	02.04	OK0405	-	-	16.04	PS0608	-	-	-	-	-	-
May	07.05	OK0405	-	-	21.05	PS0608	-	-	-	-	-	-
Jun	04.06	OK0405	-	-	18.06	PS0608	-	-	-	-	-	-
Jul	02.07	OK0405	-	-	9.07	DS1013	-	-	-	-	-	-
Aug	06.08	OK0805	-	-	-	-	-	-	-	-	-	-
Sep	03.09	OK0805	-	-	10.09	WS0922	-	-	17.09	5Y	-	-
Oct	01.10	OK0805	-	-	08.10	DS1013	-	-	15.10	5Y	-	-
Nov	05.11	OK0805	-	-	19.11	5Y	-	-	-	-	-	-
Dec	03.12	OK1205	-	-	-	-	-	-	-	-	-	-

Source: Ministry of Finance

International review

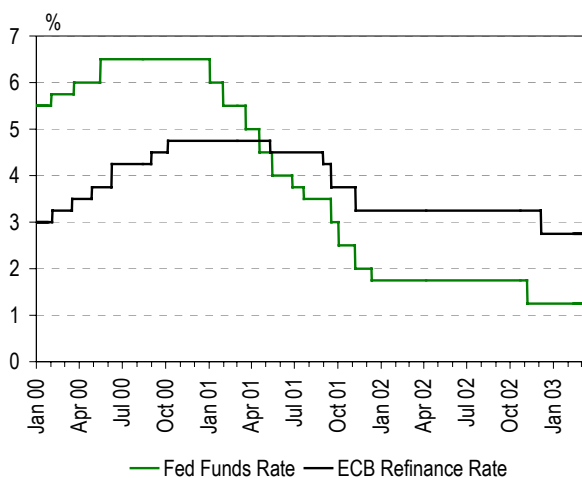
- Interest rate cut in the Eurozone
- Inflation in the US higher than in the Eurozone
- Possible recession in Eurozone in 1Q03
- Not so deep slowdown in American economy

Moderate interest rate reduction in the Eurozone

During its meeting on the 6th of March the Council of the European Central Bank decided to lower interest rates by 25 bps. The decision matched expectations of financial markets, however some investors were disappointed since they expected 50-bp rate cut. Since 7 March main Eurozone's interest rate – refinancing rate – amounts to 2.50%, which is the lowest level since October 1999. During the press conference ECB president Wim Duisenberg said that prospects of economic growth had deteriorated significantly compared to earlier forecast mainly due to geopolitical tensions and a rise in oil prices. Therefore, in his opinion, one should expect very low rate of the economic growth this year. Moreover, he stated that at present uncertainty was significant and situation could change very quickly, which means that the ECB opens itself the way for further cuts.

There was no Fed's Open Market Committee meeting in February and the federal funds rate remains at 1.25% – the lowest level in last 40 years – since the last cut than took place on 6 November. The next Fed's meeting is scheduled for 18 March and the situation related to war in Iraq may have significant impact on decision, although no interest rates cut is expected.

Interest rates in the USA and Eurozone



Source: Reuters

US inflation above the level of European

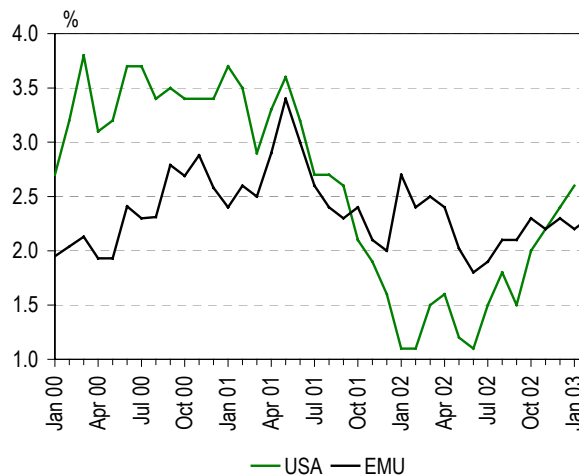
According to final data, inflation in the Eurozone amounted to 0.0%MoM in January, which translated into a fall in annual inflation rate to 2.2% from 2.3% in December, while preliminary estimations pointed to deceleration even to 2.1%YoY. Analysts expected inflation at 0.3%MoM and 2.1%YoY. In turn, according to preliminary estimations, in February annual inflation rate returned to the level of 2.3%, though the forecasts pointed to 2.2%. Inflation remains above 2.0% level, i.e. target ceiling imposed by the ECB, for seventh consecutive month, which might be used by the central bank as a risk factor for more significant rate cuts.

In January producer prices in the Eurozone increased by 0.8%MoM, which translated into acceleration in annual growth rate to 2.0% from 1.5% a month earlier. These data were very close to analysts expectations at 0.8%MoM and 2.1%YoY.

US consumer prices increased 0.3%MoM in January, in line with market expectations. It was the highest growth since April 2002, however it was driven mainly by energy prices (rising 4%MoM). In general it was evaluated as only moderate and calmed down fears about building inflationary pressure that might have arisen after surprisingly strong PPI hike. In annual terms CPI increased 2.6%YoY and core inflation grew 1.9%YoY.

American producers' prices hiked 1.6%MoM in January against forecasted 0.5%MoM, mostly amid sharp increase of energy prices (4.8%MoM). It was the highest PPI growth since January 1990.

Inflation YoY



Source: Reuters

Would GDP in the Eurozone fall in 1Q03?

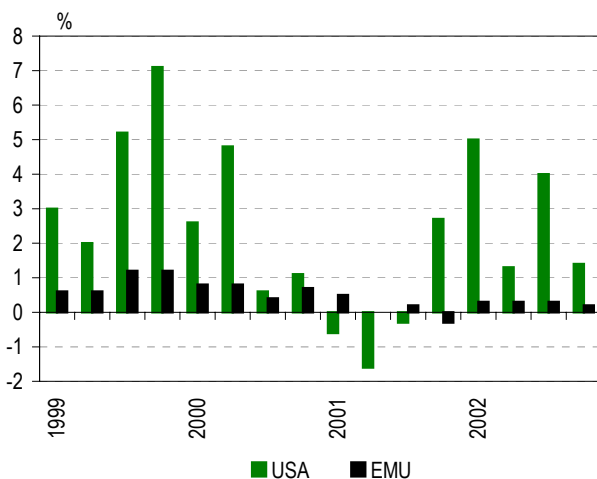
Data on economic growth in the Eurozone for 4Q02 appeared to be close to market expectations and were



close to a lower end of the European Commission's forecasts range of 0.1-0.4%. GDP rose by 0.2%QoQ compared to 0.3% growth recorded in the third quarter. On annual basis Eurozone's GDP increased by 1.3% accelerating from 0.9% in 3Q02. At the same time the Commission lowered its GDP growth forecast for 1Q 2003 to -0.1-0.3%QoQ and released the forecast for 2Q03 at the level of 0.2-0.5%. The Commission reserved that foreseen acceleration in 2Q is at significant risk due to possible war in Iraq.

According to preliminary data on economic growth in the United States, in 4Q last year GDP rose by 1.4%QoQ, which was a significantly faster rate than the one released a month ago in advanced information, when the growth was estimated at 0.7% only. Analysts expected slightly less significant revision in data to 1.0%. These data mean that significant deceleration in growth rate took place from 4.0% recorded in 3Q02.

GDP growth QoQ



Source: Reuters

The latest data on industrial output and retail sales in the Eurozone were weaker than forecasted. In December production fell by 1.5%MoM and 0.5%YoY, compared to forecasts of -1.6% and 1.1% respectively. Retail sales decreased by 1.1%MoM and 1.9%YoY, against expected -0.1% and 0.3%, respectively. In turn, industrial production in the US was much better than expected. Industrial output rose 0.7%MoM in January against expected 0.3%. US retail sales fell in January by 0.9%MoM after 2%MoM growth (revised up from 1.2%) in December. Such result was below market expectations pointing to -0.6%, which was caused among others by sharp fall of sales of new cars.

Unemployment grows...

In line with analysts' expectations, the Eurozone's unemployment rate increased to 8.6% in January from 8.5% in December. The highest unemployment was recorded in Spain (12.1%), Finland (9.0%), France (9.0%) and Germany (8.6%), and the lowest in Luxembourg (2.7%).

US unemployment rate increased in February to 5.8% from 5.7% in previous month, while analysts expected 5.9%. Nevertheless, the data on employment in American economy was very disappointing. In February the number of jobs fell by 308,000, which was the deepest collapse since November 2001 and came after 185,000 growth recorded in January.

...but economic activity does too

In February, index of economic activity in industry of the Eurozone increased for the first time in six months. Reuters PMI index increased to 50.1 pts from 49.3 pts in January, while expectations pointed to a smaller rise to 49.6 pts. For the first time in the last six months the index exceeded the level of 50 points that separates development from recession. Analogous index for the United States (ISM) recorded a fall to 50.5 pts in February from 53.9 pts in January. The figure was worse than 52.4 pts foreseen, and it approached 50-point limit, so an increase in activity was moderate.

In Eurozone's service sector economic activity decreased in February, while in January it remained unchanged and forecast for February pointed to slight increase. Reuters Services index fell to 48.9 pts from 50.0 pts a month ago, while analysts expected an increase to 50.4 pts. In the United States the activity increased at slower pace than in January but faster than it was foreseen. ISM Non-manufacturing index reached 53.9 pts against 54.5 pts in January and 53.4 pts expected.

Major business climate indicator for German economy – index of entrepreneurs' sentiment IFO – unexpectedly recorded a second consecutive rise in February to 88.9 pts from 87.4 pts in January, while analysts' forecasts were at 87.2 pts. Chief of IFO institute assessed, that there are visible signals of improvement in economic situation, however only after the third consecutive increase in index, one would be able to talk about an economic revival.



What's hot this month

Monday	Tuesday	Wednesday	Thursday	Friday
3 March POL: T-bill auction ITA: Inflation preliminary (Feb) EMU: PMI (Feb) USA: ISM (Feb)	4 EMU: Unemployment (Jan) EMU: Retail sales (Dec)	5 POL: T-bond auction OK1204 EMU: Producer prices (Jan)	6 EMU: ECB meeting EMU: GDP (4Q02) USA: Factory orders (Jan)	7 POL: Food prices (2H Feb) USA: Unemployment (Feb)
10 POL: T-bill auction ITA: GDP (4Q)	11 GER: Industrial output (Jan)	12 POL: T-bond auction DS1013 FRA: Industrial output (Jan) USA: Foreign trade (Jan)	13 ITA: Inflation final (Feb) USA: Retail sales (Feb)	14 POL: Inflation (Feb) POL: Money supply (Feb) POL: Wages & employment (Feb) FRA: Inflation preliminary (Feb) USA: Producer prices (Feb) USA: Industrial output (Feb)
17 POL: T-bill auction	18 EMU: Inflation final (Feb) EMU: Industrial output (Jan) USA: Fed meeting	19 POL: Industrial output (Feb) POL: Producer prices (Feb) POL: T-bond auction PS0608	20	21 POL: Retail sales (Feb) POL: Business climate (Mar) USA: Inflation final (Feb) FRA: Inflation final (Feb) ITA: Industrial output (Jan)
24 POL: Core inflation (Jan & Feb) POL: T-bill auction EMU: Foreign trade (Jan)	25 POL: MPC meeting EMU: Retail sales (Jan)	26 POL: MPC meeting	27 POL: Food prices (1H Mar) GER: IFO (Mar)	28 EMU: Money supply (Feb)
31 POL: Balance of payment (Feb) POL: T-bill auction ITA: Inflation preliminary (Mar) EMU: Inflation preliminary (Mar) EMU: Economic sentiment (Mar) EMU: Business climate (Mar)	1 April EMU: Unemployment (Feb) EMU: PMI (Mar) USA: ISM (Mar)	2 POL: T-bond auction OK1204 EMU: Producer prices (Feb)	3 EMU: ECB meeting	4 USA: Unemployment (Mar)

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	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	30	30	-	-	-	-	-	-
Money supply	14	14	14	14	14	13	-	-	-	-	-	-
NBP balance sheet	7	7	7	7	7	6	-	-	-	-	-	-
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

		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	Mar 03
GDP	%YoY	x	0.4	x	x	0.8	x	x	1.6	x	x	2.0	x	x	x
Industrial production	%YoY	0.2	-3.1	0.3	-4.2	2.1	5.7	-1.1	6.6	3.2	3.1	5.2	4.2	3.7	3.4
Retail sales ***	%YoY	6.7	9.9	3.1	1.8	2.5	8.6	5.1	4.7	5.1	5.9	4.1	6.4	7.1	5.8
Unemployment rate	%	18.2	18.2	17.9	17.3	17.4	17.5	17.5	17.6	17.5	17.8	18.1	18.7	18.9	18.7
Gross wages ** ***	%YoY	5.5	4.8	2.3	4.2	3.9	4.1	2.8	3.8	0.5	1.8	2.4	2.7	2.6	2.4
Export (acc. to NBP)	USDm	2 140	2 447	2 695	2 610	2 674	3 175	2 669	2 850	3 130	3 007	3 312	2 870	2 750	3 025
Import (acc. to NBP)	USDm	2 950	3 148	3 437	3 414	3 354	3 763	3 556	3 758	4 162	4 085	4 255	3 960	3 750	4 125
Trade balance (acc.to NBP)	USDm	-810	-701	-742	-804	-680	-588	-887	-908	-1 032	-1 078	-943	-1 090	-1 000	-1 100
Current account balance	USDm	-816	-652	-634	-557	-429	-108	-265	-534	-612	-744	-519	-720	-780	-970
Budget deficit (cumulative)	PLNbn	-13.7	-16.4	-20.0	-23.0	-25.0	-25.7	-27.3	-29.8	-34.0	-37.1	-39.4	-4.1	-11.6	-16.3
CPI	%YoY	3.5	3.3	3.0	1.9	1.6	1.3	1.2	1.3	1.1	0.9	0.8	0.4	0.4	0.4
PPI	%YoY	0.2	0.3	0.4	0.5	1.2	1.7	1.3	1.1	1.7	1.7	2.2	2.5	2.7	2.7
Broad money (M3)	%YoY	6.9	3.2	2.4	3.2	2.5	1.3	-0.2	-1.5	-2.5	-1.0	-2.3	-1.4	-1.2	1.0
Deposits	%YoY	5.7	1.7	0.6	1.3	0.5	-0.8	-2.5	-3.5	-4.6	-3.2	-4.3	-4.1	-3.3	-0.5
Credits	%YoY	8.8	7.1	6.6	7.9	9.4	7.5	5.9	4.9	4.4	4.6	5.3	5.5	5.9	7.6
USD/PLN	PLN	4.19	4.14	4.06	4.05	4.03	4.12	4.18	4.15	4.12	3.95	3.91	3.84	3.87	3.94
EUR/PLN	PLN	3.64	3.63	3.59	3.71	3.85	4.09	4.08	4.07	4.04	3.96	3.99	4.08	4.17	4.31
Reference rate *	%	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	6.25
WIBOR 3M	%	10.83	10.32	10.20	9.89	9.30	8.89	8.55	8.07	7.45	6.81	6.82	6.56	6.37	6.22
Lombard rate *	%	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	8.00
Yield on 52-week T-bills	%	9.68	9.62	9.56	9.22	8.54	8.35	7.86	7.25	6.77	5.88	5.78	5.74	5.83	5.75
Yield on 2-year T-bonds	%	9.37	9.32	9.22	9.03	8.27	8.12	7.60	7.16	6.62	5.78	5.75	5.55	5.66	5.45
Yield on 5-year T-bonds	%	9.26	9.11	9.02	8.90	8.17	8.11	7.62	7.07	6.57	5.91	5.67	5.57	5.58	5.30
Yield on 10-year T-bonds	%	8.34	8.25	8.19	8.02	7.55	7.63	7.29	6.79	6.22	5.89	5.69	5.62	5.67	5.50

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	801.4	177.9	188.8	190.5	212.2	183.1	195.0	198.7	224.6
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	4.6	-1.6	-0.4	3.3	3.8	3.8	4.2	4.8	5.7
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	18.2	18.1	17.4	17.6	18.1	18.7	17.8	17.8	18.2
Gross wages (real terms)	%YoY	3.3	1.3	1.6	1.5	2.8	1.9	1.4	2.3	0.6	2.2	3.0	3.1	2.7
Export (acc. to NBP)	USDm	26 349	28 255	30 275	32 998	36 695	6 893	7 979	8 694	9 449	8 645	8 800	9 300	9 950
Import (acc. to NBP)	USDm	40 728	41 423	41 950	43 292	48 835	9 512	10 205	11 077	12 502	11 835	11 800	11 900	13 300
Trade balance (acc.to NBP)	USDm	-14 379	-13 168	-11 675	-10 294	-12 140	-2 619	-2 226	-2 383	-3 053	-3 190	-3 000	-2 600	-3 350
Current account balance	USDm	-11 553	-9 952	-7 166	-6 734	-9 105	-2 336	-1 620	-907	-1 875	-2 712	-2 250	-1 430	-2 714
Current account balance	% GDP	-7.4	-6.3	-4.0	-3.6	-4.4	-4.0	-3.6	-3.5	-3.6	-3.7	-4.0	-4.1	-4.4
Budget deficit (cumulative)*	PLNbn	-12.5	-15.4	-32.6	-39.4	-38.7	-16.4	-25.0	-29.8	-39.4	-16.3	-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	-5.1	-5.0	-5.0	-4.8
CPI	%YoY	7.3	10.1	5.5	1.9	1.1	3.4	2.1	1.3	0.9	0.4	0.6	1.4	1.9
CPI*	%YoY	9.8	8.5	3.6	0.8	2.1	3.3	1.6	1.3	0.8	0.4	1.1	1.5	2.1
PPI	%YoY	5.7	7.8	1.6	1.0	2.1	0.2	0.7	1.3	1.9	2.7	2.5	1.5	1.9
Broad money (M3)	%YoY	24.6	15.2	12.1	1.6	2.8	5.9	2.7	-0.1	-1.9	-0.5	1.9	3.6	6.1
Deposits	%YoY	26.4	17.2	13.5	-0.2	2.2	4.8	0.8	-2.3	-4.1	-2.6	1.1	3.6	6.9
Credits	%YoY	28.6	24.7	11.3	6.8	8.4	8.3	8.0	6.1	4.8	6.3	7.7	7.8	11.8
USD/PLN	PLN	3.97	4.35	4.09	4.08	3.88	4.13	4.04	4.15	3.99	3.88	3.95	3.83	3.85
EUR/PLN	PLN	4.23	4.01	3.67	3.85	4.10	3.62	3.72	4.08	4.00	4.18	4.22	4.03	3.98
Reference rate *	%	16.50	19.00	11.50	6.75	5.50	10.00	8.50	7.50	6.75	6.25	5.75	5.50	5.50
WIBOR 3M	%	14.73	18.78	16.08	9.09	5.96	11.02	9.80	8.50	7.03	6.38	6.12	5.73	5.60
Lombard rate *	%	20.50	23.00	15.50	8.75	7.00	13.50	11.50	10.00	8.75	8.00	7.25	7.00	7.00
Yield on 52-week T-bills	%	12.95	17.77	14.77	8.18	5.54	9.64	9.11	7.82	6.14	5.77	5.55	5.50	5.35
Yield on 2-year T-bonds	%	12.41	17.37	13.91	7.94	5.39	9.27	8.84	7.63	6.05	5.55	5.40	5.35	5.25
Yield on 5-year T-bonds	%	10.87	14.00	12.59	7.86	5.32	9.09	8.69	7.60	6.05	5.48	5.30	5.25	5.25
Yield on 10-year T-bonds	%	9.60	11.79	10.74	7.34	5.42	8.28	7.92	7.24	5.93	5.59	5.40	5.35	5.35

Source: GUS, NBP, BZ WBK

* at the end of period



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