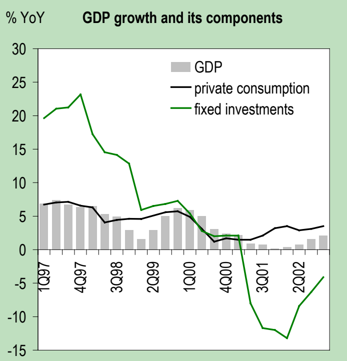
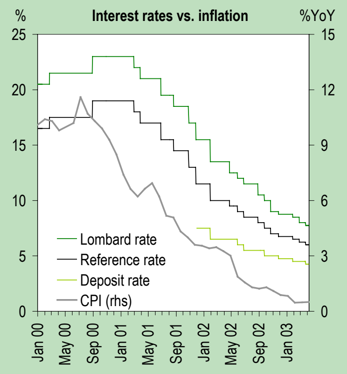
Bank Zachodni WBK

MACROscope

Polish Economy and Financial Markets

April 2003





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Inflation of programmes

■ **In comparison to January, which we called a month of records, February could be named a month of stabilisation** – at least as concerns of economic indicators. The better part of the February data published in March was in line with the expectations and did not have a substantial impact on the financial markets behaviour. Unfortunately, economic news was less important than politics and the term "stabilisation" could not apply to the political situation. High uncertainty was connected with the situation abroad (war in Iraq) as well as with domestic events – further changes in Leszek Miller's cabinet and conflicting programmes of the ministers responsible for economic affairs. Well, both programmes have a lot of room for improvement.

■ **Still no changes in the real sphere of the economy.** Industrial output and retail sales continue to grow while the construction sector output has seen another falls which suggests a continued negative investment dynamics. Business climate indicators are ambiguous as usual. The same applies to the money supply data which show different results depending which ratio you analyse (M3 falls down, M1 has seen increasingly fast growth). The data published in March do not make us change our projections. We expect a smooth economic recovery and we sustain our projection of the economic growth at 2.5% in 1Q03 and 3% in the entire year.

■ **As projected, CPI was at a very low level, while PPI was continuously influenced by the growing fuel prices**, although it should be noted that this trend has reversed recently. All core inflation measures, which are to show changes in price level after elimination of seasonal or one-off factors, are below the NBP inflation target. Moreover, two of them went negative on annual basis, which must have impressed especially those MPC members who warned against deflation. According to our projections, the annual CPI will not be negative this year (we do not mention deflation at all) and the lowest inflation rate will be in April 2003 (details in *Special focus* section).

■ **We describe inflation in details in the Special focus.** Annual inflation rate in Poland has been falling down almost continuously since July 2000. The MPC's March decision on yet another interest rate cut by 25bp may seem to be the continuation of the MPC policy, i.e. interest rates reductions on a very conservative basis due to concerns of the potential acceleration in price dynamics. However, given the change in rhetoric (of at least some) of the MPC members, which coincided with the recent interest rate cut, one can arrive at the conclusion that the March decision of the Council represented some breakthrough in the MPC policy. Indeed, it was for the first time the MPC members indicated so clearly that they would not see any threat to meeting the inflation targets for 2003-2004. Is the MPC right not to have concerns of such inflation bounce that would represent a threat to meeting the central bank's inflation target for 2003 and/or 2004? Will the inflation in Poland continue to fall? We try to answer these questions in our analysis.

Financial market on 31 March 2003

NBP deposit rate	4.25	WIBOR 3M	5.98	PLN/USD	4.0512
NBP reference rate	6.00	Yield on 52-week T-bills	5.55	PLN/EUR	4.4052
NBP lombard rate	7.75	Yield on 5-year T-bonds	5.25	EUR/USD	1.0874

Special focus

Guaranteed law of low prices?

The Polish annual inflation rate has been falling down almost continuously since July 2000. Over this period some marginal acceleration was only noted in four months. The second half of 2002 brought about a significant decrease in the inflation rate and in the first two months of 2003 CPI was merely 0.5% y/y. In the environment of the substantial decrease in the current inflation level and slow economic growth, the Monetary Policy Council (MPC) has been reducing the nominal interest rates for the last two years, however, on a very conservative basis due to concerns of the potential acceleration in price dynamics. As a result, the scale of consecutive interest rate cuts has been very modest.

At a first glance, the MPC March decision on yet another interest rate cut by 25bp may seem to be the existing MPC policy continued. This is indicated by the mere announcement of the Committee including the rationale behind its decision. As usual, the low current level of inflation and low inflation expectations of households and financial market participants were highlighted. Besides, the Council agreed that the economic recovery recently recorded is not strong enough to bring about any clear-cut inflation pressure. However, given the change in rhetoric (of at least some) of the MPC members, which coincided with the recent interest rate cut, one can arrive at the conclusion that the March decision of the Council represented some breakthrough in the MPC policy. Indeed, it was for the first time the MPC members indicated so clearly that they would not see any threat to meeting the inflation targets for 2003-2004. So far they would rather emphasise the necessity to apply a conservative approach to the monetary policy, warning mainly against the potential reversal of the positive supply shock on the food market.

Variable and sometimes different assessments of the inflation prospects (not only among the central bankers) make us consider the future path of inflation. Is the MPC right not to have concerns of such inflation bounce that would represent a threat to meeting the central bank's inflation target for 2003 and/or 2004? Will the inflation in Poland continue to fall? Let us try and answer these questions.

A starting point seems to be an answer to a question on the drivers behind the current historically low inflation levels. In our opinion this is an effect of the macro-economic policy in Poland applied over the last 5 years as well as a result of strong supply shocks. Since the beginning of its existence (i.e. since the 1998) the MPC had to counteract a growing external imbalance (high and growing current account deficit of the balance of payments) and internal imbalance of the Polish economy (a relatively high and regular inflation rate as at the end of 1990s). Due to that fact, since 1998 monetary policy has been focused on reducing the excessive domestic demand dynamics.

Selected macro-economic variables in 1998-2002

(%YoY)	*1998*	*1999*	*2000*	*2001*	*2002*
GDP growth	4.8	4.1	4.0	1.0	1.3
Personal consumption	4.8	5.2	2.6	2.1	3.3
Gross expenditure on fixed assets	14.2	6.8	2.7	-10.2	-7.2
The registered unemployment rate*	10.4	13.1	15.1	17.5	18.1
Annual average inflation	11.8	7.3	10.1	5.5	1.9
Current account deficit**	-4.8	-7.9	-5.6	-3.9	-3.8

* the number of unemployed a share of labour force
** as a share of GDP
Source: CSO, NBP

The emergence of an output gap in the Polish economy (i.e. a situation when a general supply exceeds general demand) and significant deterioration of the situation on the labour market prevented enterprises from increasing prices. Furthermore, a factor, which limited the pace of prices' growth, was a relatively strong PLN exchange rate which had direct impact on prices of imported goods and indirect impact on prices of domestic goods and services. The costs of imported raw material and components for domestic production were relatively low while imported cheap goods were strongly competitive in terms of prices against domestic goods. In 2002 the situation reversed and the real effective exchange rate of the zloty depreciated by almost 10%. However, the weakening of the zloty did not cause acceleration of inflation due to asymmetric influence of the exchange rate fluctuations on prices' dynamics. Amid low growth rate of demand depreciation of the zloty did not pushed upward the overall level of prices.

Nevertheless, the key factor impacting inflation were supply shocks, primarily on the food market. It is of high significance in Poland as in the recent years food products represented ca. 30% of the consumption basket (this reflects the structure of expenses of Poland's average household).

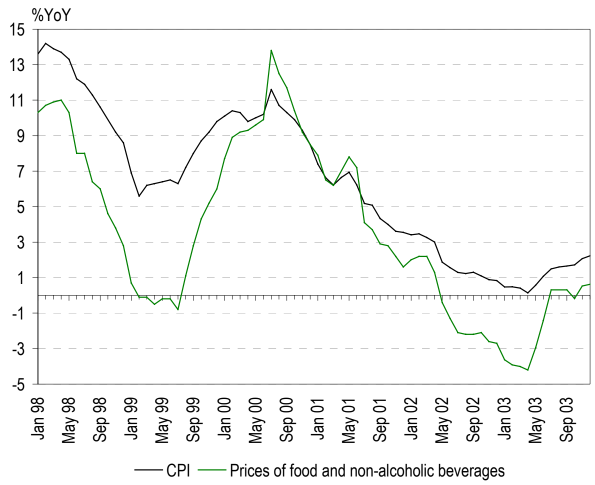
As a result, changes in the food prices have the largest impact on the general growth in the prices of consumer goods and services. Over the last two years, the agricultural output was very good both in Poland and in Central-Eastern Europe. This was followed by a considerable drop in food prices, which drove negative annual inflation in some countries of the region (e.g. in Lithuania, the Ukraine and the Czech Republic). Similarly in Poland, it was the negative annual dynamics of food prices that triggered the decrease in the inflation to record low level close to zero.

Weightings of the CPI basket in 1999-2003 (%)

Category	1999	2000	2001	2002	2003
Food and non-alcoholic beverages	31.62	30.44	30.10	29.70	28.20
Alcoholic beverages and tobacco	6.40	6.54	6.10	6.20	6.20
Clothing and footwear	6.96	6.56	5.90	5.50	5.40
Housing and energy	18.44	19.50	19.00	19.60	20.60
Household fixtures and fittings	5.09	5.19	5.10	4.70	4.80
Healthcare	4.45	4.68	4.80	4.80	4.80
Transport	7.82	7.48	8.30	8.20	8.10
Communication	2.36	3.04	3.80	4.60	4.80
Culture and recreation	6.12	6.48	6.50	6.40	6.40
Education	1.09	1.23	1.30	1.30	1.40
Hotels and restaurants	3.65	3.18	3.50	3.40	3.90
Other goods and services	6.00	5.68	5.60	5.60	5.40

Source: CSO

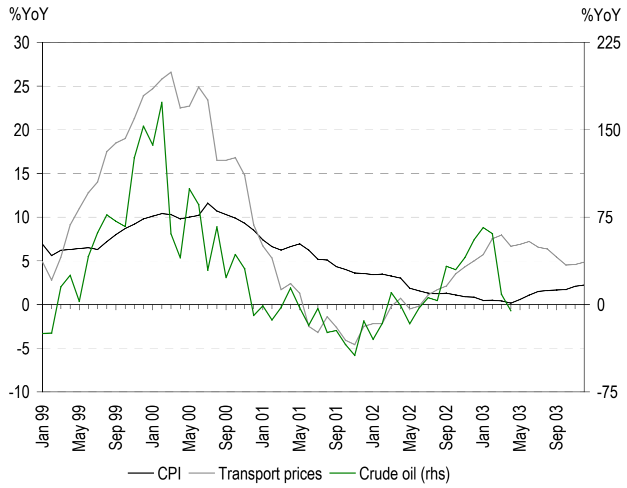
Annual growth rates of food prices and CPI



Note: for March-December 2002 period BZ WBK forecasts
Source: CSO

Over 2001 and half of 2002, the inflation was also driven by low of oil prices, which was related to low dynamics of “transport” prices (this was negative for majority of the year). Oil prices, which started to grow early last year, translated into acceleration of transport price in the second half of last year. However, the share of transport prices in the consumption basket is much lower than that of food prices. This is why although the dynamics of transport prices increased in recent months, general inflation kept falling to reach subsequent peak lows as it was driven by nearly 4%YoY fall in food prices. Additional factor which drove inflation to the level below 1%YoY in the end of 2002 was the reduction in excise tax on alcoholic beverages which was introduced in October last year. Since then, annual dynamics of prices of alcoholic beverages and tobacco has been negative which contributed to the decline of CPI.

CPI, transport prices and oil prices dynamics

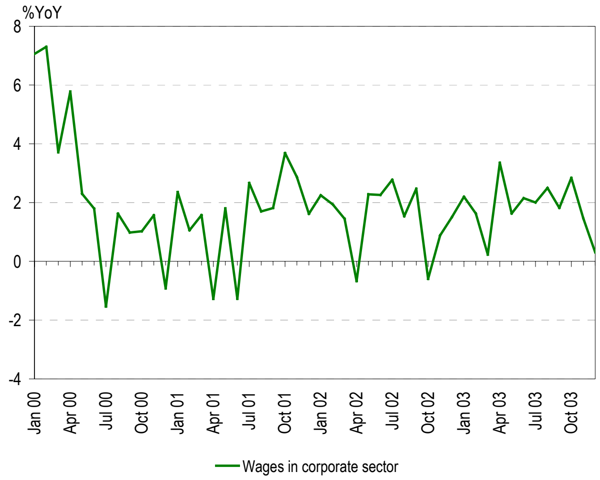


Note: for March-December 2002 period BZ WBK forecasts
Source: CSO

What will be the impact of the above-discussed factors on future inflation? Macroeconomic data for the beginning of this year indicates that the situation on the labour market is still very difficult, the economic activity is primarily driven by exports while the domestic demand dynamics are growing very slowly the reason being worse than expected improvement in investment activity. That means that a 17-fold reduction in interest rates from 19% in early 2001 to 6% at present did not boost domestic demand. It should also be remembered that not all of the effects of the interest rate cuts to date have become evident yet. On the other hand, it is unlikely that they will suddenly become evident this year and will dramatically trigger the improvement in the domestic demand and growth in the inflation pressure. Especially that for some time the MPC has been applying the so-called “small steps” approach, i.e. a strategy of gradual, marginal interest rate cuts.

The record low inflation noted over the recent months will not encourage employers to raise salaries. Additional argument for not doing that will be high unemployment rate that will limit salary demands from the employees. As a result, growth rate of wages in the enterprise sector should be similar as in the previous year. Thus, one may expect low wage pressure on inflation. As far as social benefits are concerned their dynamics should also be relatively low this year. If one assume that the households’ willingness to save will stay at a similar level as in the previous year, it should be stated that the dynamics of personal consumption this year would be lower against 2002. In such a macroeconomic environment, a substantial pressure on the inflation growth from demand-side is very unlikely.

Real wage growth in corporate sector



Note: for March-December 2002 period BZ WBK forecasts
Source: CSO

In the existing environment, it is difficult to talk about threat of import of inflation, either. It should not be expected that the inflation pressure in the UE would re-emerge soon. The economic growth forecast for this and the next year, presented by the European Commission in early April is not too optimistic. It says that the years 2003–2004 will not witness economic growth acceleration while GDP in the 15 EU member states will grow by mere 1.3% while previous projections indicated 2%. This year, Germany, Poland's main trading partner, will balance at the edge of recession (expected GDP growth at 0.4%). On the other hand, according to the International Monetary Fund, the economic conditions in the United States and Japan will also be worse than projected. If we additionally assume that PLN exchange rate in H2 will strengthen against the relatively low present level (primarily in view of the improvement in the investor sentiment after the positive outcome of the June EU accession referendum), then the threat of inflation import seems to be insignificant.

As Milton Friedman said "inflation is always and everywhere a monetary phenomenon". The broadest measure of money in Poland, M3 aggregate, has been falling in annual terms since the beginning of August 2002. It suggests that process of disinflation should be continued. However, one should also analyse dynamics of wider measures of money, e.g. M1 aggregate (cash in circulation and current deposits). Growth rates of the two money aggregates are completely different. Despite fall of M3 aggregate, wider measure of money has been accelerating for some time (see chart on page 11). This stem from decrease of term deposits in banks, as they become less attractive and households give a preference to more liquid forms of money (falling interest rates translates into lower alternative cost of holding less liquid form of money). The described trends in the structure of money supply imply that the fall in M3 aggregate observed since last August is not likely to have significant disinflationary impact. On the other hand, it is also difficult to definitely state that strong growth of M1 aggregate would lead to acceleration of inflation.

As this is the case, inflation acceleration could only be driven by negative supply shocks. In terms of the food market, the positive supply shock is likely to reverse in the mid-year at the earliest. The situation in the second half of this year is still uncertain. The assessment of the CSO with regard to and estimates of this year's harvest have not been published yet so it is difficult to estimate the agricultural output. If it falls significantly (as a result of crop failure), then the negative dynamics of food prices can quite quickly turn into a growth. However, it is worth highlighting that the impact of possible growth in food prices on the CPI would be mitigated by the above said low dynamics of households' income. Paralleled with the growth in food prices (with relatively inflexible demand for food), the purchasing power of the population will be on the wane, which will be followed by the drop in the food prices' growth rate. However, it is most likely that the agricultural output will be a few percent lower than in the last two years, which were exceptionally good in terms of the agricultural output. This is confirmed by preliminary estimates of some agricultural institutes (e.g. the Institute of Agricultural Economy) which indicate that this year's harvest will be lower against the previous year (which among other will be driven by winter losses). On the other hand, a major excessive supply on the meat market has been sustainable which will trigger a decrease in meat prices. Generally, agricultural trends mean that the food prices should continue to fall till mid-year and then they should marginally grow against the same period of the previous year. If this is the case, in the second half of this year, food prices will further lower the level of CPI, although their impact will be smaller than at present as their dynamics is negative at ca. -4%YoY. This will also be related to the fact that 2003 saw significant decline in the share of food in the consumption basket, from 29.7% to 28.3% (see the table on page 2). This change has already caused an upward adjustment of the inflation data for January from 0.4%YoY to 0.5%YoY.

In terms of supply factors, it seems that prices of industrial raw materials should not substantially grow this year. The most important will be the trends on the oil market. The Iraq war has been progressing favourably and it have already caused decrease in oil prices on the world's markets against the very high level recorded at the turn of last year. As a result, average oil price this year should be similar to the average price recorded last year. Then, annual growth in transport prices will not accelerate from the existing level (above 7%YoY). Later this year, the dynamics of transport prices will remain at relatively high level of ca. 5%YoY which will trigger the acceleration in CPI.

However, there is a question mark around the controlled prices. They have the largest share in the category "housing and energy", i.e. in this component of the CPI basket where over the last two year, prices have been growing most dynamically. To a large extent, owing to them, growth rate of prices in Poland has not become negative yet (this is confirmed by data on core inflation). This year, growth in prices under this category was the highest of all CPI components (next to the transport prices). However, this growth will be lower than last year. In the second half of this year, the electricity prices will be most likely raised. Power companies are now producing drafts of new tariffs, which will be filed for approval with the Energy Regulatory Authority of Poland (URE). At the end of June, the so-called tariff year for distribution companies is over and new tariffs need to be approved. In line with the Polish law, prices of power cannot grow faster than by 3% over the previous year inflation. The experience so far indicates that the President of URE, is an ally of the central bank in terms of curbing inflation as in the previous year he did not approve the price growth proposed by power companies and as a result the price growth was lower than the permissible level. For the time being, the President of URE states that it is too early to project an average growth in power prices in the subsequent tariff year, however, he declared that the prices should not grow by more than 2%-3% (last year, following the decision of the President, the prices increased by 5.7%). This will limit the relatively high dynamics in "housing and energy" prices, which have the second largest share in the consumption basket.

Taking account of all the above factors, we expect that the annual inflation will continue to be under 1% until the mid-year. We project that March will see further decrease in the inflation rate to 0.4%YoY and April should witness the lowest inflation rate this year, i.e. 0.1%-0.2%YoY. Later on, CPI should gradually accelerate to around 2% at the end of the year.

However, one should be remembered that inflation forecast for this year could be imprecise on view of the modifications to the CPI basket weight system. Unfortunately, the CSO has not published the index of monthly price changes last year in line with the new weightings prevailing since 2003 yet. As this is the case, the projected annual inflation rate in the subsequent months of this year may be altered. Depending on the month, the rate can be adjusted upwards or downwards. It may turn out, for instance, that April will see inflation of 0.3%YoY instead of 0.2%YoY, and in June CPI may be still below 1%YoY instead of increase to 1.1%YoY. However, such discrepancies will not have impact on the inflation trends in the nearest months and CPI forecast for the end of this year.

Economic update

- **Inflation very low, two core measures below zero**
- **Positive situation in industry, worse in construction**
- **Investment outlays still negative**
- **...and net export together with private consumption are the drivers of economic growth**

In comparison to January, which we called a month of record breaking, February could be named a month of stabilisation. The better part of the February data published in March was in line with the expectations and did not have a substantial impact on the financial markets behaviour. Economic news was less important than politics – domestic (further changes in Leszek Miller's cabinet, programmes of two ministers responsible for economic affairs) and foreign (war in Iraq). Of course, political situation, contrary to the monthly data publication, was far from stable, which had also triggered the significant price volatility on the financial markets.

As projected, CPI was at a very low level, while PPI was continuously influenced by the growing fuel prices, although it should be noted that this trend has reversed recently. All core inflation measures, which are to show changes in price level after elimination of seasonal or one-off factors, are below the NBP inflation target. Moreover, two of them went negative on annual basis, which must have impressed especially those MPC members who warned against deflation. According to our projections, the annual CPI will not be negative this year (we do not mention deflation at all) and the lowest inflation rate will be in April 2003 (details in *Special focus* section).

Still no changes in the real sphere of the economy. Industrial output and retail sales continue to grow while the construction sector output has seen another falls which suggests a continued negative investment dynamics. Business climate indicators are ambiguous as usual. The same applies to the money supply data which show different results depending which ratio you analyse (M3 falls down, M1 has seen increasingly fast growth). The data published in March do not make us change our projections. We expect a smooth economic recovery and we sustain our projection of the economic growth at 2.5% in 1Q03 and 3% in the entire year.

Inflation still on record-low level

In March the statistical office released final information about CPI growth in January and February 2003, confirming most of our earlier suppositions. First of all, the changes in weight system (based on households' consumption structure in 2002) showed quite a substantial decline of share of food and non-alcoholic beverages (from 29.7% to 28.2%), coupled with an increase of share of housing costs and energy (from 19.6% to 20.6%) in CPI basket. Those two major changes, in line with other less significant ones, lead to upward revision of January's inflation figure from 0.4% to 0.5%YoY. Secondly, the pace of consumers' price growth in February met our expectations and amounted to 0.1%MoM, amid slight reduction of food prices (-0.2%MoM), sizeable seasonal price cut in clothing and footwear (-1.2%MoM), and significant acceleration of transportation costs (1.7%MoM) caused by sharp hike of fuel prices (3.7%), while prices of other products and services remained fairly stable. As a result, inflation rate in February remained at very low level, and even at record-low level (as the previous record proved to be 0.5% not 0.4% as previously released).

Inflation data showed again that demand pressure on prices is benign, and there are no fundamental reasons for sharp inflation acceleration in the medium term. Therefore, it seems that CPI growth in subsequent months would be determined mainly by the behaviour of supply-side factors, out of which changes of food and fuel prices would be the most important.

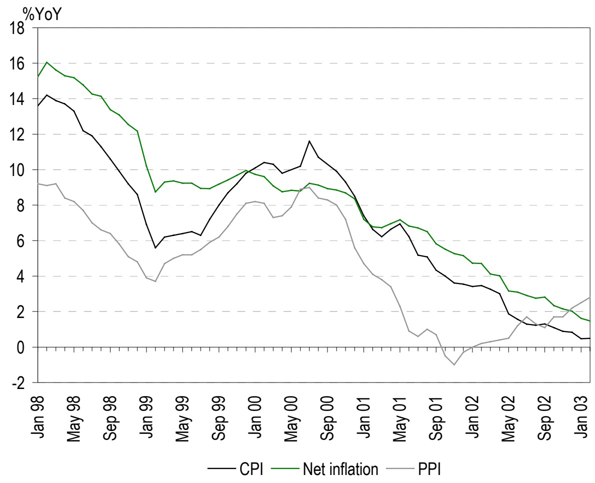
Average food prices growth in March amounted to 0.4%MoM and was driven mainly by fruits and vegetables prices, which confirmed earlier expectations. Alcoholic beverages and tobacco prices increased by 0.2%MoM in March. The rates of growth in those two categories were lower than in March 2002, which means their positive influence on annual rate of growth of CPI inflation.

At the same time, tendencies on the fuel market are much less favourable. As a consequence of rising oil prices on the global market, average monthly growth rate of retail fuel prices in Poland amounted to 3% in January-February period. While at the end of March - beginning of April oil prices fell significantly (as a result of positive development of Iraqi conflict), maintained weakness of the zloty in that period could neutralise this effect. The annual index of fuel prices is rising since several months and amounts already 15%.

Rising fuel prices, together with low statistical base effect, are also the reason of producer prices inflation increase. PPI increased by 0.5%MoM and 2.8%YoY against 2.5%YoY in January. It was slightly higher than our forecast of 2.7%YoY (market consensus pointed to 2.6%YoY), and stemmed from prices' increase of 7.0%MoM in the manufacture of coke and refined petroleum products sector. Such effect has been observed in most European countries (recently released data for Germany and France) and in the United States. While high oil prices might push PPI upwards also in next months (although the oil prices trend already started to reverse), it should not cause sharp acceleration of consumer prices, as producers and retailers are not likely to increase prices paid by consumers amid weak demand.

As we do not expect a significant pressure on prices from demand side of the economy, we forecast low inflation to be maintained in the following months. We expect 0.4%YoY in March and in April CPI growth should reach its lowest point this year (possibly 0.1-0.2%YoY), which will likely to support financial markets' expectations for interest rates reductions. Finance Ministry expects CPI inflation at 0.5%YoY in March and 0.4%YoY in April. We maintain also our inflation forecast for the remainder of the year – less favourable development on the food market should bring gradual acceleration of price growth, up to around 2%YoY in December.

Measures of inflation



Source: CSO, NBP, BZ WBK

Core inflation sharply down in January-February

In March, the central bank also published core inflation measures for two months - January and February. All five measures of core inflation followed the headline CPI rate, reaching their all-time lows in February. All measures were well below the lower end of the MPC's inflation target for 2003 (2-4%YoY). In fact the growth rate of only one core inflation index decreased less than CPI dynamics (over December-February period), one fell by exactly the same amount of basis points (35bps), while three remaining measures declined stronger (by 55-71bps). What is more, in line with our expectations, two out of five measures recorded negative annual growth rates for the first time in their history - they were CPI excluding controlled prices and CPI excluding most volatile prices and fuels, amounting to -0.55%YoY and -0.14%YoY, respectively. The highest one core inflation measure – net inflation excluding prices of food and fuels – fell from 2% in December 2002 to 1.5% in February 2003, being exactly in line with our estimation.

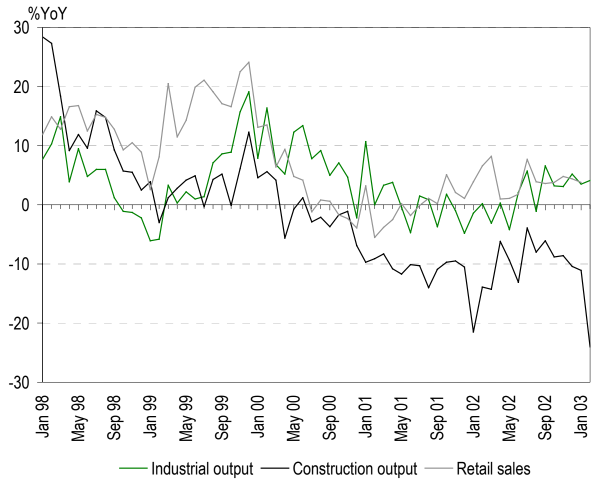
Core inflation figures made a very strong argument in favour of interest rate cut already in March. As they indicate no inflationary pressure in the medium-term, they would support expectations for rates' reductions also in the following months. The scale of core inflation decrease would surely appeal to those MPC members who were afraid of overly restrictive monetary conditions and openly warned against deflation.

Good results in industry, slump in construction

The industrial output in February declined by 1.7%MoM and rose by 4.1%YoY. The figures were slightly higher than expectations for 3.7%YoY growth but it resulted from revision of data for January (down to 3.5%YoY from earlier 4.2%YoY). This time the highest growth was recorded in the utilities sector (6.5%YoY). Manufacturing expanded by 4.2%YoY and mining grew a mere 0.7%YoY. Seasonally adjusted figure increased by 3.9%YoY (comparing with 4.1% in January) in the industrial sector and by 4% (4.9% in January) in the manufacturing sector. In general results of February's industrial output did not change our assessment of the economic situation. They confirm that the economy is growing but, similarly to previous months, at a slow pace. Such opinion was also expressed by Bogusław Grabowski and Dariusz Rosati from the MPC. The former predicts that GDP growth in 1Q03 will amount to 2.0-2.2% and the latter expects it to reach 2.0-2.5%. Our forecast is closer to the upper end of this range. Both of them think that the economic activity will improve in the remainder of the year after a successful end of war in Iraq.

Data for February brought also a worrying signal. Construction sector saw a 24% slump in annual terms in February (only 0.7%MoM rise). To some extent it is a consequence of severe weather conditions in February (and winter came back for while in April) and relatively high output in the corresponding period of last year (in February 2002 output in construction robustly grew after sharp slide in January), which may be offset in next months. However, it means that construction sector remains in deep crisis, suggesting that investment activity at the beginning of this year is still weak and its dynamics in 1Q03 might be negative again constraining GDP growth rate. On the other hand, net exports will positively contribute to GDP growth (below we write about GDP growth breakdown in more details).

Real growth



Source: CSO

Ambiguous data on retail sales in February

Retail sales in nominal terms fell by 3.7%MoM in February due to seasonal effect and rose by 4.7%YoY. The figures were lower than expected (we forecasted growth of 7.1%YoY), but they confirmed that consumption demand keeps expanding in 1Q03 at relatively fast pace. However, the structure of retail sales growth shows that private consumption dynamics is likely to weaken in subsequent quarters. Sales of foodstuff, alcoholic beverages and tobacco were very strong (30.4%), but in other categories we observed only moderate changes. In line with information revealed by a company monitoring car market in Poland car sales decelerated significantly in February against sharp growth in December and January. While one may expect that car sales will accelerate again in next months (data for March are positive again), a deterioration in retail sales of other durable goods does not bode well consumption performance this year. Furniture, appliances and electronics slipped for a second month in a row (-6.8%YoY) after a few years of robust growth. Moreover, following significant slowdown of annual growth in January, sales in clothing and footwear dropped in February (-3.9%YoY) for the first time since December 2000. To summarise, although the figures shows that retail sales keeps accelerating in 1Q03, February saw further weakening of demand for durable goods, which confirms our view that private consumption growth rate in 2003 may be lower than last year and GDP growth outlook this year depends mainly on developments in investment activity. Although, one has to remember that valorisation of pensions, which took place last month, will have higher purchasing power in real terms, as a result of positive inflation surprise (again!)

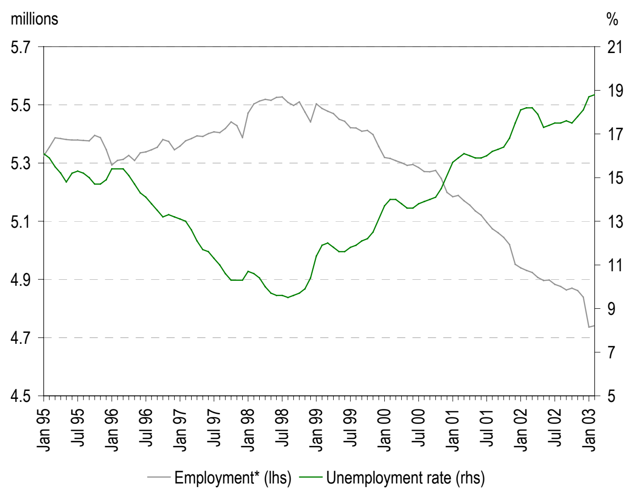
Business climate still diversified

Results of business climate survey for March brought some changes in previously observed trends. While indicator for industry showed optimism again (up 13pts in annual terms), index for construction sector returned into black (it was 1 point higher than a year ago) after January's fall and retail trade recorded negative dynamics for the first time since 11 months. Indicator for industry was the only one in positive territory at 4pts (the difference between answers indicating improving and worsening of business climate). Construction sector stood at -2pts and retailers remained gloomy at -28pts.

Unemployment slightly up, labour market still weak

Registered unemployment rate slightly increased in February to 18.8% (new record high level), in line with predictions of economy and social policy minister Jerzy Hausner (below our forecast of 18.9%). The number of unemployed reached 3.334m rising by 2.0%YoY against 2.1%YoY in January and 8.7%YoY in 2002. The figures were in line with trend observed in a couple of previous months showing that the pace of unemployment growth gradually diminishes. According to our estimation, from March onwards the unemployment rate will record seasonal dip to below 18% in May but it the remaining part of this year it should slightly increase again up to above 18% in December.

Unemployment rate and average employment in corporate sector



* Data adjusted for CSO's change in methodology in 2000.
Source: CSO, BZ WBK

In February the average employment in corporate sector increased 0.1%MoM, after deep 2.1%MoM fall recorded in January. The number of jobs was 3.9% lower than in February 2002 (against -4.1%YoY in January). At the same time wages in corporate sector dropped by 0.5%MoM, while their annual growth moderated to 2.1%YoY from 2.7% last month. The data showed that the situation on Polish labour market is still very difficult, and is surely not supportive for continuing expansion of private consumption demand. The nominal wage bill in corporate sector was 1.8% lower than in the corresponding month of 2002 (against -1.6%YoY in January). Labour market figures delivered also another argument that no fundamental demand-side inflationary pressure should be expected in the medium term.

Lower trade deficit

In February Poland's current account deficit reached €517m versus €704m in January. In dollar terms the deficit amounted to $561m versus $740m in the previous month. C/A deficit was smaller both against our forecast (€725m) and against market consensus (€572m). In relation to GDP 12-month cumulative current account deficit narrowed to 3.3% from 3.5% after January.

The amount of C/A deficit was a positive surprise, but much bigger difference between expectations and actual value in the case of trade gap was observed. The latter amounted to only €580m in February in comparison with €1.12bn in the previous month and our expectations of around €930m. This stemmed mainly from weakening of imports' dynamics, which fell to -5.1%YoY in euro terms. However, in zlotys and particularly in dollars imports were still growing in annual terms (see table below). Possibly, the slowdown of annual imports' dynamics in all currencies in February was related to a significant depreciation of the zloty exchange rate in that month, which might make importers to delay payments for goods bought abroad as they could expect the zloty to regain later on (which actually did not happen). This would suggest that imports growth rate will rebound in next months. On the other hand, it is also possible that weaker imports' dynamics is a sing of still contracting investment demand. Meanwhile, exports keep accelerating confirming that Polish enterprises unexpectedly well manage with slump of economic activity in Poland's main foreign trade partners. Moreover, recent zloty weakening suggests that positive performance of exports is likely to be continued in future.

Exports and imports growth rates, %YoY

		w USD	*w EUR*	*w PLN*
Feb. 2003	**Exports**	33.2 (27.9)	7.5 (6.2)	23.0 (20.6)
	Imports	17.5 (21.0)	-5.1 (0.8)	8.5 (14.2)
3-month average	**Exports**	30.1 (25.0)	9.0 (8.0)	23.2 (20.1)
	Imports	20.8 (20.5)	1.4 (4.2)	14.5 (15.9)

Note: Figures for January in parenthesis
Source: NBP

While trade gap was unexpectedly good in February, gap in services was higher than expected deepening to record high value of €268m from €149m in the previous month and €169m a year ago. Other elements of current account, including unclassified trade surplus (€323m), were broadly in line with expectations.

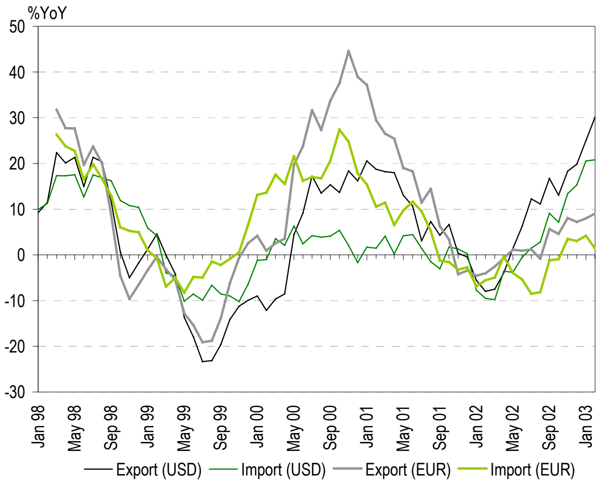
Interesting developments took place on financial account of the balance of payments. February saw record high inflow of portfolio capital (€2.65bn), mostly into debt instruments (€2.69bn). While this may be connected with Eurobonds issuance of €1.25bn, the inflow into domestic market investments was also significant. Please note that five-year bonds' yield recorded a drop of as much as 50bp in February (yield for two-year paper was down by some 30bp). However, the purchase of these papers was not fully financed by purchases of the zloty on the FX market, but also by swap transactions. It was suggested by capital balance figure, which showed an amount of €1.21bn in the category including this kind of transactions.

Also, the NBP revised balance of payments data for 2002. The revisions took place in all elements of current account and in almost all months of last year. While in most cases changes were very small, significant revision was done in unclassified trade balance for January 2002. It was revised downward from surplus of €296m to deficit of €131m. As a result current account in 2002 turned out to be higher than previously released €7.194bn (3.6% of GDP) and amounted to €7.614bn (3.7% of GDP).

... and still high trade turnover

In March the CSO' foreign trade statistics for the whole 2002 were also published. The figures confirmed previous statistics of the NBP. After further significant acceleration of exports in December (cumulative ratio for the whole year is markedly higher than those for the first eleven months of 2002) it recorded two-digit 13.6% growth rate in dollar terms in 2002 indicating increased competitiveness of Polish enterprises on foreign markets. Imports also considerably grew in 2002 suggesting some revitalisation of domestic demand. Similarly to previous months, figures expressed in euro terms were lower as a result of significant dollar depreciation in December and the whole last year. However, this does not change general conclusion that developments in foreign trade were the most positive feature of the situation in the Polish economy last year.

Foreign trade turnover (3m moving average)

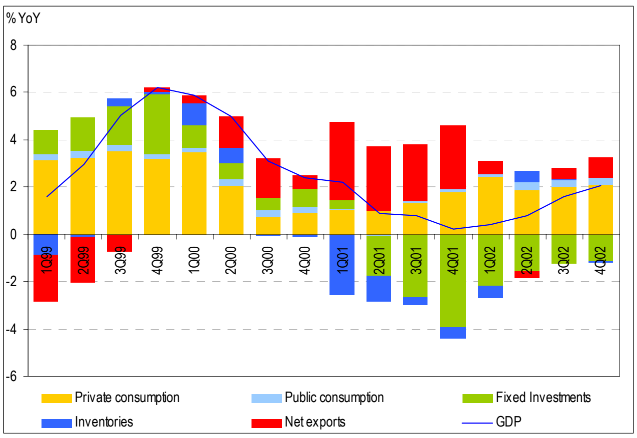


Source: NBP, BZ WBK

GDP growth in 4Q02 - no surprises

The CSO revealed final GDP growth figures for 2002 as a whole, including data for 4Q02, which were not published earlier. GDP growth last year was in line with preliminary estimations released in January and it reached 1.3%. Also components of GDP growth in the whole 2002 were the same as previously released. Private consumption increased by 3.3% while fixed investments slipped by 7.2%, which resulted in domestic demand growth of 0.8%. It means some improvement in relation to 2001, when the corresponding growth rates reached 2%, -8.8% and -1.7%.

Contribution of various components to GDP growth



Source: CSO, BZ WBK estimates

As regards the 4Q02 alone, both the overall GDP growth in that period and its structure were very close to our estimations based on preliminary data for the whole year. GDP in October-December period grew by 2.1% (slightly above our estimation of 2.0%) and it was driven mainly by private consumption which accelerated to 3.5%YoY in 4Q02 from 3.1% in 3Q02. Meanwhile, fixed investments kept on falling. While the rate of its fall moderated to -4.1% from -6.3% in 3Q02, the improvement in investment activity clearly delays. This is confirmed by recent data on developments in construction sector which suggest that dynamics of fixed investments will most likely remain negative also in 1Q03. Net exports positively contributed to economic growth again, adding 0.9 percentage point to GDP growth rate in 4Q02.

On the supply side GDP growth in 4Q02 was driven mainly by industry. It grew by 4.0% after falls in the first half of the year and increase of 2.6% in the previous quarter. Market services expanded by 3.1% but it was the slowest growth rate in 2002. After significant improvement in 3Q02 negative dynamics of value added in construction deepened in the final quarter of last year being another confirmation of delaying revitalisation in investment activity.

All in all, as GDP growth figures were in line with previous estimations they do not change expectations concerning the economic growth this year. It should gradually accelerate in the subsequent quarters of 2003. However, the acceleration would surely be slower than recorded last year. We expect GDP growth of 2.5% in 1Q03, with roughly the same GDP breakdown as in 4Q02. GDP growth in 2003 as a whole would not exceed 3%. Meanwhile, finance minister Grzegorz Kołodko said that the economic growth would exceed 3% already in 2Q03, keeping Poland on track to reach growth of 3.5% this year.

Better financial results of companies in 2002

Data on financial results of companies (employing over 50 persons) in 2002 published by the CSO last month might be an indicator for a possible investment revival. The data showed improvement of the companies' overall financial results as compared to the previous year, which means that positive tendency observed in 3Q02 was continued in 4Q02. The overall gross profits increased to PLN7.3bn from PLN6.4bn and net profits reached -PLN2.0bn against -PLN2.6bn in 2001. This resulted from faster decline of costs than total proceeds. Also other main indicators of financial stance slightly improved. This confirms that ongoing restructuring process of Polish companies brings the results increasing their competitiveness in difficult market conditions (weak domestic and foreign demand). 2002 saw further improvement of the situation of exporters. 66.3% of them recorded profits in 2002 while a year earlier this ratio amounted to 61.6%. Similarly to the previous year, main indicators of financial stance were better for exporters than for all companies. This confirms that the zloty exchange rate did not hamper export performance last year. In fact, the real depreciation of the zloty exchange rate positively affected financial results of exporters.

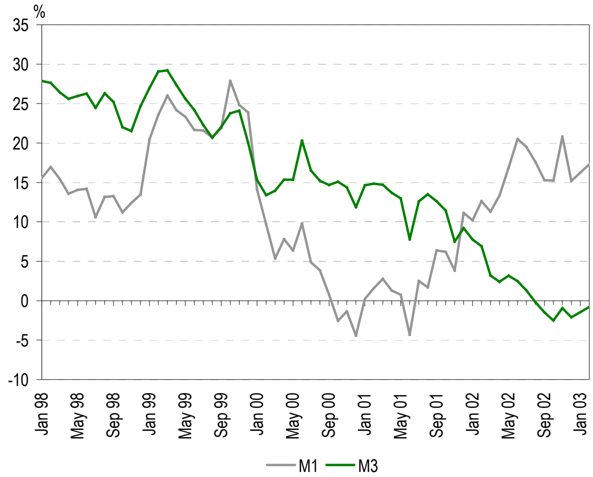
All in all, the data confirmed good FinMin's data on CIT inflows in 2002. Although financial situation of the largest companies remains difficult, it also improved last year, which suggest that in 4Q02 and subsequent quarters we should experience further gradual reversal of the negative trend in investment activity.

Broad money falls slower, but narrow money rises

Broad money increased 1.1%MoM in February, which brought the annual pace of fall to -1.1%YoY from January's -1.4%YoY, which was close to our expectations. Total deposits within banking system were falling -3.7%YoY against -4.1%YoY in January, out of which households deposits' fall was much deeper and reached -5.4%YoY (against -5.5% in January). What is worth mentioning, however, is that households' deposits inched up in relation to previous month (0.6%MoM) after the period of 8 months of continuous collapse. It is still too early to say the trend is over, however, it rises the probability that deposits will start growing in the subsequent months. Corporate deposits declined -0.7%MoM, in line with seasonal pattern and their annual growth reached 9.9%YoY. Credit market remained in stagnation, and despite the growth rate of total loans inched up to 5.7%YoY from 5.5%YoY in January, it was mainly the effect of very low statistical base. Especially corporate loans' market were very inactive, growing only 1.1%YoY (the same as in January) in nominal terms, which in practice implied it has contracted in real terms - producer prices increased in February by 2.8%YoY. Households' loans expanded 9.3%YoY against 8.7% in January, however there was also hardly any revival on this market (monthly growth was merely 0.3%), and the improvement of annual figure reflected mostly unusually weak performance in February 2002.

In total, the monetary figures did not show any clear and significant improvement of the situation, as we expected. Nevertheless, it is also clear that the situation does not deteriorate any more and the data should be rather neutral for the next monetary policy decision. Especially, as some inconsistency in terms of rate of growth of narrow (M1) and broad money (M3) still maintains. As the chart below shows, M1 measure (cash plus current deposits) has been accelerating, while broad money M3 had been decelerating for the several months, then it had been falling and finally stabilised in recent months. From the point of view of monetary policy, one should ask the question "how this indicates future inflation development". It is well ambiguous, particularly as demand for money function might behave completely different, depending which measure is used.

Broad and narrow money growth %YoY



Source: NBP

Budget deficit under control

Budget deficit at the end of February reached PLN11.7bn or 30.2% of the plan for the whole year. This is lower than after two first months of 2001 and 2002 (36.7% and 34.8% respectively) but in February alone the deficit was 11% higher than in the analogous period of last two years.

Budget revenues after two months amounted to PLN22.2bn reaching 14.3% of the plan. Annual growth of revenues decelerated to 5.9% from 12.2% after January. This resulted from lower annual growth of revenues from indirect taxes (8.3% versus 15.9% after January) and CIT (-9.7% against growth of 45.3% after January). However, total revenues are growing faster than on average in 2002 (3.2%) and after two months of the year it is too early to say that there might be problems with revenues collection in 2003.

Budget spending after two months of this year stood at PLN33.9bn or 17.4% of the plan. At the same time it was 2.2% lower than in the corresponding period of 2002. While annual drop of budget spending after February was smaller than after January its level is still relatively low compared to previous years. Still, robust growth of 37.8% (against average increase of 37.2% in 2002) was recorded in subsidies to Labour Fund, which is related to rising unemployment. Also, a substantial increase was observed in subsidies to local governments (8.2% against 0.2% on average in the previous year).

Central bank watch

- **Third interest rates reduction this year**
- **...and MPC members' comments suggest there is still room for more cuts**
- **Central bank critical about Kołodko's "reform" plan**

Cut, cut, and cut! ... No matter what

During last meeting the Polish MPC cut all main interest rates by 25bps. Since 27 March, the central bank's headline reference rate amounts to 6%, lombard rate is at 7.75% and deposit rate 4.25%.

The MPC's official statement released after the meeting consisted of standard description of economic data released last month and did not include significant hints as regards future MPC decisions (that is why we have decided not to include it in our report this time). The main reasons behind interest rate cut in March were, as usually: low dynamics of domestic demand, low current inflation (including core and headline measures) and inflationary expectations of both households and market analysts, no signs of recovery in the German economy. The MPC recognised the signals of gradual recovery in the Polish economy, confirmed by the recent data on industrial production, retail sales and foreign trade performance, nevertheless in central bank's opinion it was not surely strong enough to exert any serious pressure on inflation. The list of factors constituting a potential source of such a pressure was also a standard one and included: acceleration of PPI growth, strong zloty depreciation, risk of further growth of oil prices, probably higher than planned fiscal deficit in 2003 and uncertainty regarding fiscal policy in 2004. As stated above, the statement was not interesting at all and delivered no new information. Perhaps the only one issue worth noticing is the MPC's belief that further acceleration of industrial production growth in Poland would be possible only when investment demand accelerates. This is close to our view also, as we believe that growing investment demand would be the main driving engine behind economic growth in 2H03.

Really significant statements from the perspective of future monetary policy came at the very end of press conference after the meeting. Asked about a potential impact of zloty depreciation and growth of oil prices on inflation in Poland, Leszek Balcerowicz and Dariusz Rosati answered that according to simulations made by the central bank's staff, neither permanent zloty weakening nor some additional increase of oil prices, persisting even for three quarters, would make inflation exceed the upper end of its target in 2003-2004. This was probably one of the most explicit declarations from the central bank delivered so far, that in fact a room for additional monetary easing in the near- to medium term is still quite substantial. If the MPC believes that even under especially unfavourable external circumstances there is no significant threat for inflation rebound in Poland to above 3.5% (inflation target for 2004 is 2.5% ±1pp.), then if the environment proves to be more stable (which is very likely) – the zloty appreciates and oil prices risk disappear – there must be an option of cutting interest rates still without a significant harm for the projected path of inflation.

Taking this into account, we tend to believe now that NBP's main reference rate may go down to 5% within next 12 months (or even within the next three quarters). We expect that the next two interest rate cuts (25bps each) would be delivered in 2Q03 – probably in April-May, but the timing might depend on the political situation in Poland and abroad. However, if the above-mentioned uncertainties were not factors against rate cut in March, why should they be in April?

The main dilemma that in our opinion the Polish MPC was facing in March was that a decision to cut rates might have came nearly unnoticed by the majority of economic agents, who were more engaged in analysing the turmoil on the political scene in Poland and global uncertainty connected with war in Iraq. Therefore, we expected the MPC to postpone the rate cut decision. By delivering the rate cut when political uncertainty and weaker zloty were hawkish arguments (stated also by dovish MPC member), the MPC suggested that the latest cut could have been even deeper in "normal circumstances." The next MPC meeting will be held just after Easter, on 23-24 April. And perhaps this is the only circumstance that could delay the next interest rate cut – please recall that since March 2002 no rate cut was delivered only on July's and December's meeting just before Christmas, which might suggest that the proximity of holiday lowers the MPC members' will to cut rates.

MPC "quite strongly critical" about FinMin's programme

Two weeks after its regular meeting the MPC published its official opinion regarding finance minister's Programme for Restoration of Poland's Public Finance. The document was short and comprehensive and it consisted of two parts: the first part included the general assessment of FinMin's document, while the second one referred particularly to the issue of NBP's revaluation provision. The general assessment was – as one of the MPC members has put it – “quite strongly critical”. Only four elements of the plan were described as “directionally” correct (a very trendy phrase indeed! recently the government “directionally” approved Kołodko’s programme): liquidation of all tax deductions, liquidation of indexation mechanisms, liquidation of a few budgetary funds and agencies, decentralisation of public finances. The rest of the plan was considered as fiscal policy relaxation without institutional changes, necessary for lowering public spending in future. The MPC criticised the proposal of tax rates’ changes and GDP growth forecasts together with assumptions of better tax collection were recognised as overly optimistic. The MPC wrote that the reviewed “*Programme...*” cannot be described as a complete reform of public finance and to the contrary it raises serious concerns as regards prospective consolidation of public finance.

The second part was even more critical. The MPC unanimously and strongly rejected FinMin’s proposal to release part of NBP’s revaluation provision and transfer it to the budget (even though before some of the MPC members did not completely rule out spending some of the FX reserves on foreign debt repayment). The MPC agreed that the solution suggested by the ministry would breach the international standards of central banks’ accounting. Moreover, according to ESA95 standard the proceeds from revaluation provision could not be treated as budget revenue, but only provide financing of the deficit. And the monetary expansion implied by the transfer of the provision would have to be offset by higher volume of open market operations or reduction of FX reserves or increase of the obligatory reserves. In effect, such transfer would imply higher budget deficit in the following year because costs of open market operations would be higher than alternative costs of public debt servicing. Thus – said MPC – releasing revaluation provision is unjustified, as it would have no positive impact on fiscal policy, having detrimental effect on monetary policy.

...but Grzegorz Kołodko strikes back!

Such harsh opinion met with very prompt response from finance minister Grzegorz Kołodko. During the meeting with Sejm’s public finance committee he said that central bank’s policy is wrong, interest rates are far too high killing economic activity, and that in fact no one but the central bank is responsible for mounting budget deficit in Poland. “NBP’s policy is detrimental for the Polish economy and it would be good if the parliament took care of it” – said Kołodko, adding that perhaps NBP governor should testify before Sejm’s committee every month. Kołodko said also that FinMin would keep discussing the issue of using NBP’s revaluation provision despite negative opinion issued by the MPC. “There are no doubts that revaluation provision will be used in a right way, in line with those proposals included [in FinMin’s programme], it is just a matter of time.” – he added, suggesting clearly that the deal on use of revaluation provision will be made when the MPC members change. Kołodko’s attack on the central bank was backed by PM Leszek Miller who said in public TV that the current MPC members are unable to reform and it is very good that their term ends up pretty soon, as new members would surely conduct different policy, better for Polish companies and for economic development. Miller said also that finance minister would have to find “an effective antidote” against MPC’s refusal to free part of the revaluation provision.

Only ultra hawks against rate cut in January

Government’s Monitor published official results of voting at January’s MPC meeting. It confirmed previous information of the anonymous source cited by PAP agency that in January only two MPC members were against 25bps rate cut. They were Marek Dąbrowski and Jerzy Pruski who are regarded as the most hawkish members of the MPC. January’s decision was widely expected and well justified, so it is difficult to draw any conclusions for the future decisions of the MPC from the fact that other hawks (Bogusław Grabowski and Cezary Józefiak) supported the cut. However, as we wrote in the past, interest rates reduction in March (despite high uncertainty, substantial zloty weakening and oil prices increase) showed that the MPC sees more room for rate cuts in comparison with previous expectations.

Comments of the MPC members and central bank representatives

In March, the MPC representatives made numerous statements in the media which was facilitated by the economic and political developments – another interest rate cut, controversies related to the public finance reform draft of Grzegorz Kołodko (MF), high volatility on the FX market, breakdown of the ruling coalition and finally the outbreak of the war in Iraq.

Lots of statements and comments related to the concept of using the NBP revaluation provision by the budget, which is strongly supported by the Ministry of Finance. Leszek Balcerowicz, the NBP President, for the first time admitted that the Ministry of Finance and the central bank had been discussing this issue (earlier the MPC members denied that any negotiations were in place in that respect). The President said that the NBP would accept any proposal that would support the stability of the Polish economy, but he highlighted, however, that the NBP would not agree for any solution that would not be compliant with international standards and would not change the public finance situation for good. The concept of using the revaluation provision was heavily criticised by almost all MPC members. In its official statement the MPC unanimously rejected the concept of releasing the FX adjustment reserve and allocating it to the budget – for more details please see the section above. Moreover, Balcerowicz expressed his negative opinion on the potential slim-down of the Polish FX reserves, in particular in the situation of the continued uncertainty related to the domestic and foreign politics, as well as given the prospect of entering PLN to ERM-2 system. Dariusz Rosati allowed for the potential decrease in the level of FX reserves, although he admitted that this reduction must not be substantial.

Commenting on the economic results the MPC members were almost univocal observing that the data confirms a gradual economic recovery which, however, is relatively slow for the time being and should be in full swing only in 2H03. The MPC opinions on the war in Iraq were also consistent: a short war completed without substantial surprises will not harm the economy, and quite opposite it may warm up the investment climate; on the other hand, any longish conflict in Iraq may represent a threat to the economic recovery. The MPC members do not see any significant threats of inflation pressure (indeed, Wiesława Ziółkowska warned against deflation), even under the scenario of adverse and long-term changes on the FX and fuel markets. As the PLN weakening was assessed by the better part of the MPC members as temporary and not based on any macro-economic foundations, it may be assumed that they see potential for further interest rate cuts this year. This approach was openly stated by Wiesława Ziółkowska and Dariusz Rosati. Rosati did not even rule out the possibility of a once-off interest rate cut higher than 25bp later during the year. Ziółkowska believes that interest rates may be cumulatively cut by another 100bp by the end of year.

WHO. WHEN. WHERE	COMMENT
Leszek Balcerowicz NBP governor PAP, 26 Mar	Any interest rates decision has to take into account cumulative effects of all interest rates reduction delivered so far. This was already seventeenth within the last two years. We have estimations of the impact of zloty weakening on inflation, which shows that even if this weakening is persistent, inflation target would be met. I hope that we will not see another wave of attacks on the NBP, with an excuse that the MPC does not want to participate in the reform of public finances. Such proposals [to use revaluation provisions of the NBP] will not solve the problems of public finances.
PAP, 20 Mar	In current situation we are entering a period of higher uncertainty. [...] Our aim is to strengthen stabilising factors and to avoid sources of uncertainty. Foreign exchange reserves are our stabilising factor. In this respect [freeing revaluation provisions] we are in contact [with MinFin], but this is rather the subject of working contact. Everything, which aims at stability of the Polish economy is welcomed by the NBP, but it cannot be accepted by the NBP if it goes in the opposite direction being against standards. The NBP will not accept changes, which are against international standards and which do not solve the problems of Polish public finances. We presented our forecast of GDP growth at 2.5% this year and I think it is still realistic. There is a relationship between exchange rate and inflation, but we cannot precisely define its strength, it depends on persistency.
Bogusław Grabowski; MPC member; Reuters, 31 Mar	We should expect good exports dynamics not only because of higher competitiveness connected with weaker zloty, but also because of lower unit labour costs. This improvement should be much more stable. The results [of current account deficit] are very good They indicate higher exports dynamics, which exceeds not only GDP growth rate, but also imports dynamics among our most important trading partners. The recent data confirm that forecasts were correct. The trend shows slow improvement of domestic demand, acceleration of GDP growth and inflation stabilisation. In the following months we can see a continuation of gradual recovery without a significant inflation rebound. Although it may start to rise slightly in 2H03. It is absurd [FinMin's comments that a timely adoption of the euro depended on the central bank's willingness to release the paper provision]. It is obvious that releasing the revaluation provision...could destabilise inflation, delaying prospects of joining the euro zone. Kolodko's statement shows that his fiscal policy reform programme is based on printing money; that he does not know how to solve problems with the budget deficit without monetary expansion.
TVN24, 26 Mar	[In Kołodko's programme] wee see no spending decrease, and without reforming expenditure side our economy will not develop. Unrealised revenues [from revaluation provisions] cannot be transferred into the budget. There is no reason to worsen good principles of accounting. And without money from the NBP, it will be necessary to deepen changes of the public finance reform. Expectations [for rate cuts] are adjusting depending on current economic situation, and therefore we do not know what would be the level of interest rates at the end of the year. We are, if not at the end, very close to the end of easing cycle. Inflation in the nearest months will depend on many factors, but currently its changes do not have an impact on economic processes. We will not allow for inflation increase, which would require rates hike.
PAP, 26 Mar	There are no conditions to change good accounting rules. In the European system of central banks, the principles concerning revaluation provisions are even more restrictive than in Poland form the point of view of transferring exchange rate differences to the budget.
PAP, 24 Mar	The exchange rate of the zloty, depreciation of which followed the political tension in recent weeks, and not fundamental factors, will stabilise and will not continue to fall below the current level.
Puls Biznesu, 21 Mar	If the war is very quick, it improves investment climate. We already see growing optimism on the stock exchange market. Weaker zloty was caused by political factors. The market should stabilise after accession referendum, but the zloty is not likely to return to the levels of 4 PLN per euro and dollar observed a few weeks ago.
Reuters, 19 Mar	We see that the data [on industrial production] confirm gradual recovery. […] GDP growth in 1Q03 should be slightly higher than in 4Q02. I estimate it at 2.0-2.2%. If the war is not long, and global political conflict does not intensify leading to higher uncertainty on the market, it should not have negative consequences and we should realise the scenario of slow recovery.
Parkiet, Reuters, 14 Mar	What Kołodko presented are piecemeal actions, which do not fulfil the criteria of a deep public finance reform. The reform may not bring economic slowdown, but simultaneously it will not give a growth impulse. To be true, the tax reform is tragic.

Reuters, 12 Mar	Certainly zloty weakness has no fundamental character, it is mainly caused by global worries over a possible war in Iraq and domestic uncertainty ensuing coalition breakdown. But uncertainty over how long that weakness will last is a factor, which may limit scope for rate cuts.
PAP, 11 Mar	Revaluation provision is purely accounting measure allowing counting unrealised exchange rate differences. This is not a bag with bucks, which may be used to repay our foreign debt. Foreign assets of the NBP are foreign exchange reserves, and not revaluation provisions. One cannot repay anything from provisions, as it is accounting measure, not foreign assets. If someone postulate to use a part for FX reserves for foreign debt repayment, he has to prove that current level of FX reserves is excessive, and by how much. Taking into account the foreign trade turnover, high current account deficit, high foreign debt, and two-years period within the ERM-2 system, it is difficult to prove that FX reserves in Poland are too high.
ISB, 11 Mar	The Finance Ministry which planned to purchase of currencies on the market to service the country's foreign debt might change its "strategy" in the current situation and decide to buy a sum higher than expected by the financial markets. Starting the operation right now would only slightly depreciate the zloty exchange rate. The sum is also small. Thus, the purchase would be probably totally neutral for the market, as the market participants have already taken such a possibility into account, as the ministry announced earlier its plans The information itself was 'calculated' into the prices, but we still do not know the ministry's strategy of the purchase. It might, unfortunately, turn out to be a serious, cumulated purchase of currencies aimed at influencing the exchange rate. The ministry might e.g. purchase a sum that would enable repayment of the entire interest in 2003 or even of capital. If the ministry changes its market strategy and endeavours to influence the exchange rate, the market might react with uproar. If the ministry abstained from the purchase, it would thus prove the lack of its transparency and strategy, which would subsequently increase the risk in the eyes of investors. The Monetary Policy Council is the only body allowed to conduct monetary policy in Poland. If the activity of Finance Ministry were aimed at lowering foreign exchange reserves the central bank could start "compensating activity". The level FX reserves will not be determined by the government.
TVN24, 5 Mar	This [public finance reform proposal] is not a good direction. I mean, there are some positive elements, but a general direction is debatable and questionable. The most important thing to do in public finances' sector is the reform of spending side, which would allow to make budgetary expenditures more flexible and to decrease them. And there is no single word about it in the programme. It is positive that tax system will be simplified and, but this should be connected with lower tax rates, especially the highest rates, and not only reduction to 17% and 15% from 19%, which would not have an effect on GDP growth. If we look at instruments, there are no arguments for GDP growth acceleration. This programme is not friendly for enterprises, this is mainly a reform of tax system. Even majority government may have a problem with such a barrier. Support of opposition is needed.
Cezary Józefiak, MPC member; Puls Biznesu, 21 III	Quick war means lower costs, but too fast victory will not give sufficient impulse to stable recovery. [...] Long war means financial problems, lower investors' optimism. This could end with a collapse on global markets.
Reuters, 12 Mar	I think it is a temporary matter. The weakness of the zloty won't have any influence on interest rates, because we are taking a long-term strategic approach.
Wprost, 3 Mar	Year 2002 is the earliest possible date of Eurozone entry. Meeting Maastricht criteria should not be perceived as an impediment for our country. From the point of view of monetary policy, the MPC still thinks that direct inflationary targeting and floating exchange rate regime should be continued until ERM-2 entry. This would allow stabilising low inflation (at around 2.5%) and to accommodate negative shocks, lowering the risk of currency crisis.
Janusz Krzyżewski, MPC member; Gazeta Wyborcza, 26 Mar	I am a big opponent of such proposals [to use revaluation provisions]. These are not virtual money, but they are a guarantee for the money, which are on the market. A use a part of this guarantee could be a factor destabilising the zloty. But this would against the Constitution. A confidence for the zloty in Poland and abroad is not very high. And by allowing transferring a part of reserves into the budget, we could undermine this confidence even more. In my opinion, the MPC cannot do anything, which would be a risk factor for the zloty.
Puls Biznesu, 21 Mar	[war in Iraq] is too small conflict to change trends in global economy. Uncertainty on oil market has been taken into account by the MPC since several months. But at the moment prices are falling and inflationary pressure is decreasing.
Dariusz Rosati, MPC member; PAP, 27 Mar	After food prices release I expect inflation of 0.1-0.2%MoM, which would bring a stabilisation of annual index at 0.5%. One can expect inflation fall in April to 0.2%, which partly will be a result of low statistical base. In April one could have first estimation of grain crops, which will be a base for food prices forecast for 2003. A realistic date for the Eurozone entry is 2008. 2007 is possible only under extremely favourable circumstances. If someone thinks that by delaying the Eurozone entry we could avoid tiding our hands [a necessity to lower the budget deficit], one should remember that this will take pace already when we join the EU. Maintaining independent monetary policy would be the only advantage of delaying the Eurozone entry, but even this should be proved. The EU stance may be against earlier Eurozone entry of other countries. It is not sure that Poland will have an accord for FX rate fluctuations of +/-15% [within the ERM-2 system]. I heard about that this might be 15% up, but 2.25% down. I also had an impression that FX reserves are excessive. But we prepared research looking for Polish FX reserves relative to the size of broad money supply, cash in circulation, foreign debt or imports. We are at sixth-seventh place among accession countries. It is higher than OECD or EU average, but lower than Hungary or Slovenia. The perspective of EU accession and entry to ERM-2 mechanism would require that Poland maintained quite high level of FX reserves to secure itself against currency risk. Possibly, such high level as above US$30bn is not needed, but the ERM-s period will be very difficult. There is no precise answer [the question: what should be the level of FX reserves], Possibly not US$31bn, but US$25-28bn or US$22bn. But I do no think that lower than US$22bn, because in such a situation Poland might be treated as the country with higher investment risk. Hungary has higher FX reserves as compared with our country and it is perceived as less risky country. The proposal to use revaluation provisions of the central bank, independently on liking a possible of public finance reform programme, is very controversial from both economic and legal point of view.
PAP, 26 Mar	It seems that even if oil price growth and stabilisation of the prices' high level for 2-3 quarters is no threat to 2003-2004 inflation target. The only possible legal solution would be an allocation of the revaluation reserve for foreign debt repayment and not for the financing of the budget deficit or co-financing of EU programmes.
PAP, 25 Mar	There are such possibilities [of a one-off rate cut of more than 25 bps], not during the nearest meeting but in a further medium-term perspective, within a few months or till the end of the year, and I confirm this position. All macroeconomic data show that the economy is accelerating very slowly, inflation is very low, the level of real rates is still very high, and in real terms there is no inflationary threats, then you can think that there is some room, and that cannot be ruled out. […] On the other hand there is a war and actually a difficult domestic political situation, uncertainty over details of the public finances reform plan. There are some uncertainty factors that also have to be taken into account

	Weak zloty led to a monetary policy expansion, as restrictiveness depends on the level of interest rates and the level of the zloty. In fact, monetary policy has been loosened recently because of weak zloty and this did not depend on interest rates. We can expect that inflation will rebound a result of zloty weakening. Weaker zloty by 1% means inflation higher by 0.13-0.15pp in 1-2 quarters. Depreciation in recent months amounted to 5-8% and therefore inflationary impact may amount to 1ppin a few months. The zloty should remain in a similar mood within next few months, but in 2H03 it should return to its long-term trend and we will see Polish currency stronger. The zloty is weaker because of temporary factors – political situation in Poland, coalition collapse, conflict between Prime Minister and President, unclear perspective of public finances reform. On the other hand we have the war in Iraq. These are two main factors, and additionally the perspective of EU accession referendum and it still uncertain result. Inflationary pressure should not be substantial because of two reasons. Firstly, I do not think that the zloty could weaken further, unless we have a catastrophe. We can see high volatility, but there should be no clear trend for depreciation. What is more, in the environment of low ecoomic activity, the transmission mechanism from weaker zloty into prices is much more difficult than in the situation of high demand. Producers and importers cannot transfer zloty depreciation on retail prices easily, as there is a barrier of demand.
Puls Biznesu, 21 III	The war is a fact and uncertainty on financial market disappeared. [...] Now everything depends on military actions. If the war is quick and ends with a victory, we would see a return of optimism within a few weeks. Us dollar would be stronger and oil prices would fall. Positive impulse for the economy, and for the firm from anti-Iraqi coalition countries, will be a possibility to participate in Iraq reconstruction. On the other hand, if military action is longer and the conflict is expanding for other countries and we see terrorists' attacks – the uncertainty will come back to the markets. And this could lead to a postponement of improvement of global economy for 2H03.
PAP, 19 III	Industrial production data are in line with market expectations. It confirms forecast that the economy is start to expand, but very slowly. Trend of slow recovery is visible since six-seven months [...] and it is noticeable especially in the manufacturing sector. This is natural, because the export is the driving force behind GDP growth, and consumption demand. More significant improvement may take place in 2H03 driven also by lower global uncertainty. Demand impulse from abroad and investments rebuilding in Poland are also possible.
Reuters, 12 Mar	The reasons for the zloty's weakening are transitory, linked to the uncertain political situation and the prospect of war in Iraq. The fundamentals have not changed. There is room for the zloty rebound in the medium term.
PAP, 4 Mar	Present level of zloty FX rate is likely to maintain for several next months, which obviously results from increase in political risk after ruling coalition collapse and increased uncertainty concerning result of accession referendum. […] Nevertheless, in 2H03 the zloty should strengthen on condition of voting for joining EU in June's accession referendum.
Grzegorz Wójtowicz; MPC member; ISB, 31 Mar	Polish economy is developing quite properly. The current-account deficit is declining, thus improving external stability. […] Export simply shows that Poland's economy is recovering. […] Weak import was mainly fuelled by low investment demand in Polish economy. I am personally not concerned about this data. Import remains still fairly high, there is no breakdown. I see here no danger for the recovery process. This is phenomenon that we must keep. I upheld my forecast of economic growth in 2003 at 2-3%, with a 2.0% GDP growth in the first quarter. […] We should not expect miracles, however, as there are no sources for them. We have to unfortunately wait for higher growth.
PAP, 31 Mar	The current account deficit fell in February to 3.3% of GDP for the past 12 months from January's 3.5%. […] These data prove that the economy made another step towards balance. I maintain my forecast of a slight rise of C/A at the end of 2003 to some 4% of GDP compared to 3.6% last year. […] Exports will not disappoint us in the coming months.
Życie Warszawy, Reuters, 13 Mar	We cannot say that a change in the government changes the monetary policy perspective. Monetary policy depends on several factors including budget and fiscal policy. Past experience shows that minority government has some problems with parliamentary acceptance for its bills proposals. That's why uncertainty on the financial markets, including FX market, is higher. Each time the government will try to find support for its bills in the parliament we will have a nervousness on the market. Taking into account that part of budgetary spending is legally determined (fixed), majority of changes should be done in this respect. Proposals presented by minister Kołodko concern mainly revenues side, which is not good if adjust revenues to spending. Foreign exchange market focuses on large amount of information – both true and rumours. It will also analyse information from the Finance Ministry, trying to find out the final effect of Kołodko's proposal. I do not think that partial information could influence the market, and this is a kind of information we have at the moment.
Wiesława Ziółkowska, MPC member; PAP, 24 Mar	Uncertainty linked with conflict in Iraq and political situation in Poland will make it difficult for the MPC to cut interest rates in March. […] I have growing doubts as to the chances for rate lowering in March. It is difficult to foresee influence of conflict in Iraq on this year's inflation level, however the chance for interest rate cuts this year did not disappear, though the room for them is smaller than it seemed earlier and it amounts to some 100 bps. I still maintain my opinion that the MPC introduced tactics of small steps too early, nevertheless at present moment cuts deeper than 25 bps would be unlikely.
PAP, 7 Mar	I expect that inflation in February was not higher than in January and amounted 0.3-0.4%YoY. At the end of this year it will be most below inflation target of the MPC. Low inflation confirms lack of demand pressure in the economy and means that there is room for another interest rates reduction already in March. „Small steps approach" assuming only 25bps rate cuts reductions was implemented too early but it should not be changed now as it could cause some confusion on the market. It is difficult not to see uncertainty connected with a war in Iraq and weaker zloty, which could bring inflation up to the lower end of inflation target. This implies that it is too early to think about a change of this year's inflation target.
Wprost, 3 Mar	Since the beginning of 2002 we observe falling food prices (...) and we are just before a deflation. I predicted current situation a long ago together with professor Stanisław Gomułka. Unfortunately, our forecasts materialise. High unemployment and low domestic demand support low prices. Fortunately, deflation should not be long, as there are many factors contributing to prices' increase – for example accelerating demand amid better business climate in Poland and abroad. I cannot asses whether last MPC's decision on rate cut will contribute to counteract deflation.

OPINION OF MONETARY POLICY COUNCIL ON PUBLIC FINANCE REFORM PROGRAM

This opinion is based on the document draft, which Monetary Policy Council received on 25 March 2003.

I. General comments

1. In the opinion of the council, the current state of national finances demands implementation of deep reform. The strong imbalance of the public-finance sector and the increase in the deficit and public debt are the result of the absence of indispensable adjustments in this sector for many years. The basic problems of the sector are the high level of public spending and its high rate of growth, the high proportion of so-called fixed spending items (including social spending) and the low proportion of pro-development spending. This all occurs alongside a high degree of public-finance sector revenues in GDP and a high level of fiscal burden, at least in terms of the current level of economic development (GDP per capita). The result of the crisis in public finances is a limitation on corporate investment outlays, a reduction of spending on infrastructure, continual under-financing of basic state functions and, as a result, a halting of economic growth and the creation of high unemployment.
2. Steps assumed in the Program [the ministry's Public Finance Reform Program] that would lead to a rise in flexibility in spending (liquidation of indexation mechanisms and 'unstiffening' of defence spending), to the institutional consolidation of spending (liquidation and consolidation of para-budgetary funds and agencies), and to the decentralisation of spending (increasing the percentage of local government generated revenues as a portion of local government spending) all must be seen as appropriate in their direction. These steps constitute an attempt to meet the formal criteria of European Union entrance and create mechanisms for structural fund absorption. The called-for liquidation of tax breaks and write-offs would also need to be judged positively, if they were to be accompanied by a reduction in effective tax rates.
3. In the Program no arguments are presented to support the optimistic assumptions concerning GDP growth. There is also a lack of supply-side actions that might result in the forecast increase in economic growth rates. The factors of economic growth listed in the Program ("further decrease of interest rates and the gradual release of NBP reserves for currency risk" or "controlled budget deficit level") testify to the focus placed on domestic demand stimulation for short-term economic recovery without building lasting supply-side foundations for long-term economic development.
4. Proposed changes to the tax system are intended to simplify the system. This would not, however, be furthered by the introduction of new personal income tax levels. The planned rate of reduction in nominal corporate and personal income tax rates will be unequal to the lost benefits from the lifting of breaks and write-offs and the freezing of tax brackets. The presented proposals for changes in personal income tax levels will likely bring about an increase in the effective PIT rates, especially for tax-payers in the higher tax groups, and bring about at least a maintenance of 2002 effective rates in corporate income tax. New solutions in PIT do not eliminate the severe progression in taxation. To the contrary, instead of the desired flattening of tax rates, there is an increase in progression. In conjunction with increasing indirect taxation and with tax on capital gains, it can be claimed that the tax reform will lead to an increase in the fiscal burden. In effect, the increase in the tax burden could negatively affect savings trends in the private sector.
5. The Program does not foresee systematic changes to bring lasting limitations to budget expenditures. The proposed steps for reducing expenditures are very limited and temporary (for example, the nominal freezing of social transfers and the so-called 'remaining expenses' or the reduction from 35% to 30% of the portion of fuel excise targeted for road construction and maintenance). Thus, the projected degree of fiscal consolidation is decidedly insufficient.
6. The concept of an "open deficit" as presented in the Program raises serious doubts. The document takes the figure PLN 40 mln as the state budget deficit that can be financed, and then additionally points to a hole that is some PLN10bn in expenses not covered by revenues. Admittedly, it is declared in the document that additional work will be undertaken with the goal of eliminating this hole, but the fact that both new revenues and spending reductions are given equal treatment without consideration of the variable macroeconomic results of such steps is unsettling. The solution to this question is the basic condition for a judgement of fiscal policy in the coming years. A serious threat of further increases in fiscalism and/or increases in public-finance sector imbalances, with their negative consequences for the economy, are becoming visible. An increase in the state budget deficit in 2004-06 to roughly PLN50bn annually would represent a loosening of fiscal policy accomplished in conditions of assumed growth in economic growth and would also represent a crossing of the next legally mandated warning threshold in terms of public debt to GDP.
7. The budget deficit level actually put into the Program could even be larger in light of the budget-revenue projections based on the assumption of a strong increase in economic growth and significant improvement in tax collection. 8. The Public Finance Reform Program presented by the Finance Ministry cannot be considered a complex program of steps tending towards a deep and lasting improvement of finances. On the contrary, in its current shape it raises serious questions regarding the called-for degree of public-finance consolidation, to the means of its implementation as well as its durability. The government document cannot be treated as a final collection of solutions in the area of public finances.

II. Release of revaluation reserves

1. The National Bank of Poland resolves revaluation reserves upon realising a transactional gain. The mechanism is in accordance with central-bank accounting standards accepted throughout the world. However, the Finance Ministry proposals contained in the Program represent a transfer of the revaluation reserve as an unrealised gain for the financing of current budget expenditures and those violate the accounting standards.
2. Transferring revaluation reserves to the budget would constitute an equivalent monetary expansion, which would require an adequate increase in open market operations resulting in an increase in interest rates and/or a reduction in the level of currency reserves and/or an increase in mandatory reserves.
3. In accordance with ESA95 standards, the transfer of revaluation reserves cannot constitute budget revenues but only a means of financing a deficit. It would furthermore contribute to an increase in the public-finance deficit in the next year, because with short-term interest rates at levels higher than that appropriate for longer-term periods, the NBP's open market operation costs would be higher than the budget savings on debt servicing.
4. The transfer of revaluation reserves in violation of the previously accepted and internationally standardised means of their creation would reduce the credibility of the central bank.
5. The Monetary Policy Council therefore sees no justification for proposals presented in the Program for the transfer of the revaluation reserve as such a transfer would offer no benefits in terms of fiscal policy, but would bring about numerous negative consequences in the area of monetary policy.

Source: Interfax, NBP

Government and politics

- **Government "directionally" approved Grzegorz Kołodko's fiscal reform programme**
- **...but minister of economy has contradicting opinion in several key aspects of the plan**
- **Changes in government day by day**

Green light for Kołodko's programme

In the second half of March, after a very long meeting, the cabinet "directionally" approved finance minister's programme of so-called public finances reform accepting macroeconomic forecasts of inflation, GDP growth and budget deficit (see tables below). At the same time the government advised finance minister to undertake consultations and modification of the programme as regards change of tax system, fixed budgetary spending, financing of local governments, liquidation of budgetary funds and agencies, liquidation of indexation. It means that the ministry of finance will have to rethink all main points of its programme. The cabinet said that further consultations should be conducted with social partners and the central bank (possibly on the use of revaluation provisions). Finance minister has been given one month to prepare a final version of the document, including all the conclusions from the first government's meeting.

Macroeconomic assumptions for 2003-2006

	2003	2004	2005	2006
GDP growth	3.5	4.9	5.4	6.0
Consumption	3.0	3.3	3.9	4.3
Investments	5.6	12.2	12.8	13.5
Exports	8.1	8.9	8.8	9.1
Imports	7.4	8.8	9.3	9.8
Inflation	1.6	2.6	2.8	2.9

Source: Ministry of Finance

Basic budgetary parameters for 2003-2006

	2003*	2004**	2005**	2006**
1. Revenues	155.7	160.2	169.2	178.8
2. Expenditures (after adjustments)	194.4	210.1	219.0	225.1
3. Deficit	38.7	40.0	39.5	35.9
4. Expenditures which can be financed (1+3)	194.4	200.2	208.7	214.7
5. Gap (4-2)	-	-9.9	-10.3	-10.4
Public debt as % of GDP	51.2	52.6	53.0	52.7

Notes: * Budget Act, ** forecast
Source: Ministry of Finance

...but "reform" programme still full of controversies

Full text of Grzegorz Kołodko's Programme for Restoration of Poland's Public Finance has been published on the finance ministry's website. The document consists of more than 60 pages and some 10 appendices; nevertheless the list of new significant details that it brings is very short one indeed. Most of the issues covered by the document were announced already before and we have written about them in our reports (e.g. in previous MACROscope), while there were very few information dispelling existing uncertainties and controversies. Among the most important new information that we found in the programme is that the uniform tax on all kinds of capital gains that would be applied since the beginning of 2004 would have a flat rate of 20% (earlier a level between 15% and 20% was suggested). This means that dividend tax would increase by 5pp. Also, there seemed to be changes to the proposed tax reform (as compared to what minister Kołodko showed in his public presentation at the end of February). In all three variants of the proposed PIT modifications, tax rates reductions in the new document are smaller than proposed earlier. Disregarding this, the document still claims that the proposed changes in tax system are neutral for households' finances and for the budget.

The programme includes also the table with basic budgetary parameters for 2003-2006 (see on the left). Compared to the version of budget assumptions that finance minister presented in early March, there appeared a mysterious "gap" between forecasted budget revenue and expenditure "after adjustment". This "gap", totalling PLN30bn in 2004-06 period (or even reaching PLN40bn in the scenario assuming the reform of local government's finances is implemented) tops up a budget deficit amounting PLN40bn each year. Contrary to what one might expect, there is no single word of explanation in the whole document what means the "gap" or the spending "after adjustment". It is also completely unclear how the ministry is going to fill it up.

Another confusing issue is a possibility of use of the NBP's revaluation provision (one could suppose that it is revaluation provision, which is to fill the "gap", but the fact is that it is too small for this purpose). The document itself is inconsistent in this regard. At one point it says that only one third of the provision (ca. PLN9bn) is going to be used by the government, and it would be entirely spent for paying Poland's contribution to EU. A bit later there is a proposition of using "the second part of the provision" (another PLN9bn) for subsidising local governments to help them absorb EU structural funds. There is also another option of using revaluation provision for repayment of Polish foreign debt. On the subject of using revaluation provision by the government we have elaborated in March edition of

MACROscope, while this month in the *Central bank watch* section above we present the MPC's approach to this issue.

...and minister Hausner has his own vision of economic recovery

The ministry of economy, labour and social policy prepared its own economic programme. The programme aims at reviving the Polish economy (minister Jerzy Hausner forecasts 5% GDP growth already next year), fighting the poverty, employment promotion and effective use of EU support funds.

According to the official declarations, economy ministry's plan is not a competition but rather a "solid ground" for rescue package prepared by Grzegorz Kołdoko, and the two programmes are "to a large extent consistent". Nevertheless, minister Hausner's comments clearly suggest that there are clear differences of opinions between the heads of two major economic ministries, as regards the key economic issues. In one of the radio interviews Hausner explicitly said that there is a dispute "based on merits" between him and finance minister as regards "the line of economic policy". Hausner said that in his opinion one should not eliminate all indexation mechanisms in budget spending (which is proposed by Kołodko), particularly in spending for old age and disability benefits and that social spending for the poorest group of citizens cannot be reduced. Minister was also critical about Kołodko's proposals as regards tax changes and suggested tax cuts should be much deeper (he proposed reduction of CIT to 19%). Fundamental disagreement referred also to the pace of budget deficit reduction. In Hausner's opinion fast euro adoption "is a bad line of the economic policy, as it implies tightening of the fiscal policy and, in fact, resigning from factors stimulating economic growth". He believes that budget deficit could be reduced only after economic growth in Poland accelerates significantly.

More information as regards the outcome of conflict between Hausner and Kołodko should be known at the turn of April and May, because then – as PM Leszek Miller declared – the government is supported to accept the final version of public finance reform programme. On the one hand, some of Hausner's postulates would surely find support within the government and finance minister will be forced to embed them into his programme (e.g. it is already known that Kołodko has resigned from cancelling indexation of pensions). On the other hand, one should also remember that it is Grzegorz Kołodko who is deputy PM supervising economic policy of the government and he is not likely to accept many views clearly contrasting with his owns.

Doubtful success of minority government

The Lower House voted over the no-confidence motion against deputy Prime Minister and infrastructure minister Marek Pol. Actually MPs voted it twice, as just after the first voting it has been discovered that two SLD deputies voted not only for themselves but also on behalf of their absent colleagues. All four deputies have been kicked out of the SLD caucus and the case went to the prosecutor. The voting has been repeated and – similarly as at the first time – it was successful for minister Marek Pol. At the first glance it could be interpreted as a success of the minority government (small parliamentary groups and non-affiliated deputies joined SLD-UP coalition). However, the question is whether such a situation would not have much more negative effect on minority government's policy (and its public support) than a possible removal of deputy PM Marek Pol.

And this was not the end of opposition's attempts to put minority government to the test. In a few days time parliament debated over no-confidence motion (in fact even two motions) against internal affairs minister Krzysztof Janik. He also survived the voting, but as in the previous cases it reflected the weakness of the opposition rather than the strength of the government.

It seems that financial markets already got used to such situations (which are likely to repeat, because the opposition tries very hard to make PM Miller's life more difficult) and voting over no-confidence motions in parliament did not increase volatility even in the short term.

Changes in government day by day

On 1 April, healthcare minister Marek Balicki stepped down from the post. Balicki quit after only two and a half months in the post (he replaced previous healthcare minister Mariusz Łapiński on January 17). The direct reason of Balicki's decision was Aleksander Nauman's appointment for the chief of the National Healthcare Fund (which replaced regional healthcare funds since 1 April). New chief of the Fund will be responsible (starting from the next year) for the management of money worth PLN30bn a year. Therefore, in interview in public radio, finance minister Grzegorz Kołodko said that he has to have influence on the nomination of deputy chief of the Fund, responsible for finances. Ewa Kralkowska who was supposed to become new healthcare minister (replacing Marek Balicki who resigned) refused to accept the nomination. Therefore, Prime Minister Leszek Miller appointed on this post Leszek Sikorski who was deputy healthcare minister so far.

There were also changes in the treasury ministry. Earlier rumours were confirmed and treasury minister Sławomir Cytrycki resigned and was replaced with Piotr Czyżewski, who was deputy treasury minister before, responsible for industrial policy. The privatisation of Gdańsk Refinery and/or PZU was supposed to be a reason of this replacement. Changes in the treasury ministry raised uncertainty as regards realisation of this year's privatisation revenues. Especially, that even finance ministry does not believe any more in the PLN7.4bn inflows from privatisation planned in the Budget Act. At the end of March deputy finance minister Ryszard Michalski said that privatisation revenues should reach PLN4-4.5bn this year. Of course this would imply additional supply of treasuries later this year. What is more, new treasury minister's privatisation plans presented at the beginning of April suggest that in the pessimistic scenario even Michalski's forecast might be hard to achieve, because almost all major privatisation deals are scheduled at earliest for the turn of 2003/04.

Preliminary privatisation plans of treasury ministry

Company	Sector	Stake (%)	Timing
TPSA	telecoms	14.61	4Q03-1Q04
PKO BP	banks	30	4Q03-1Q05
PZU	insurance	Oct-20	4Q04-1Q05
BGZ Bank	banks	minority stake	2004
PGNiG	utilities	minority stake	2004
WSiP	publishing	35	4Q03-1Q04
Polmos Bialystok	alcoholic beverages	majority stake	2004
Pharmaceutical Holding	pharmaceuticals	majority stake	2004
Ciech	chemicals	52	4Q04-1Q05
Ruch	retail distribution	85	4Q04-1Q06
PKE	energy	20-40	4Q04-1Q07

Source: PAP, DM BZ WBK research

Next general election to be held in June 2004?

At the same time the last changes in the government were announced, PM Leszek Miller announced that he had agreed with President Aleksander Kwaśniewski that the term of current parliament should be shortened and early elections would take place in June 2004, together with elections to the European parliament. This is consistent with our view presented in the MACROscope last month. Moreover, Prime Minister declared after consultations with his ministers that there would be no more changes in the government. Miller's decision accepted by the President is aimed at stabilisation of political situation in Poland. It is to be seen whether it is successful.

FinMin ready for buying hard currencies on the market... but is unlikely to do until zloty is weak

Deputy finance minister said in the middle of March that the Ministry is ready for buying foreign currencies on the FX market. Let's recall that FinMin wanted to buy currencies for interest payments of Polish foreign debt, which was aimed at helping in zloty depreciation. Interest payments related to Poland's foreign debt total ca. US$1bn in 2003 and are divided into several instalments of various amount.

In our analysis published in February issue of MACROscope we have written that due to tight budget constraints FinMin would aim at weakening zloty at as low expense as possible, which suggests buying currencies when their value approaches a local minimum. This line of reasoning has been confirmed by minister Michalski, who said that the ministry would not make FX transaction as long as zloty remains weak. Michalski suggested that such transactions would be possible if zloty appreciated ca. 5% "from the current level" (ca. 4.3-4.35 against euro). An obvious market reaction to those comments was immediate zloty appreciation, because investors just love to test patience and credibility of policymakers.

Interest payments of Polish foreign debt (US$m)

	2003	2004	2005	2006	2007	2008	2009	2010	2011 and beyond
INTEREST PAYMENTS	**1 014**	**890**	**816**	**749**	**671**	**575**	**475**	**438**	**1 612**
Loans	558	455	404	342	269	178	83	51	161
Paris Club	380	330	292	244	185	107	24	3	5
Financial institutions	171	120	108	95	82	69	57	47	152
Other	7	5	4	3	2	2	2	2	4
Bonds	456	435	411	407	402	397	392	387	1 452
Brady bonds	149	152	150	145	140	136	131	125	1 086
Foreign bonds	308	283	261	261	261	261	261	261	366

Source: Ministry of Finance, data as for 29 November 2002

Comments of the government members and politicians

Last month saw lots of turbulent developments in Poland and abroad, which were reflected in the numerous comments of the Government and parliament representatives. Leszek Miller, Prime Minister, had to strive for the support of the minority Parliament groups in difficult political voting sessions, defending numerous opposition attacks and ensuring that he did not intend to resign from his office, which was openly demanded by the representatives of the shadow parliament (also by the former allies from PSL).

Of course the media were most frequently visited (as usual now) by the representatives of the Ministry of Finance management who very pro-actively promoted the public funds improvement programme developed by Grzegorz Kołodko everywhere. Deputy ministers of finance and their head Grzegorz Kołodko repeated on numerous occasions that some negotiations were held between the Ministry of Finance and the NBP in respect of using part of the NBP FX revaluation reserve and appealed to the central bank for its consent to allocate part of the reserve to "non-inflationary support" of the Polish economy, e.g. for the repayment of the foreign debt or payment of the premium to the EU budget. They also presented doomsday scenarios of an economic crisis Poland is bound to face should the presented reform programme be rejected. Grzegorz Kołodko personally strove for the support of the reform project among different parties, including his own cabinet, threatening, among others, that he would resign from his office should relevant elements of the reform be rejected. It turned out, that even the cabinet is not unanimous as far as the assessment of this plan is concerned. Although the government approved the "direction" of the main postulates of the Ministry of Finance, it still recommended further work and changes to some key points of the programme. What is more, Jerzy Hausner, the minister of economy, labour and social policy openly admitted that he has a different view on some substantial issues and criticised the solutions proposed by Kołodko.

Jerzy Hausner would like, among others, to delay substantially Poland's entry to the Euro zone, as he reckons that would allow for avoiding the reduction in the budget deficit and would enable the economy to step into the fast economic growth track. Grzegorz Kołodko, in turn, sustained the declaration to meet the Maastricht fiscal criteria by 2006 but he agreed that "this would not be a tragedy" if Euro implementation was delayed until 2009.

The Minister of Finance was finally satisfied with PLN exchange rate which weakened substantially and in March it fluctuated at the level of 4.35 against EURO which Grzegorz Kołodko believes is an "ideal" €/PLN exchange rate. Ryszard Michalski, the deputy minister of finance, who very recently equalled his boss in promoting the need for weakening PLN, expressed his concerns with the too dramatic depreciation when the PLN/ EUR rate fluctuated on the "ideal" rate only by 0.05 PLN. Michalski announced that the Ministry of Finance had been ready to purchase foreign currencies on the market (for the repayment of interest on the foreign debt), however, it would withhold the transaction as long as PLN remained so weak. Much as Grzegorz Kołodko was satisfied with the exchange rate behaviour, he was far from being happy with the monetary policy and the level of interest rates.

WHO, WHEN, WHERE	COMMENT
Aleksander Kwaśniewski, President; PAP, 20 Mar	I guarantee my support for the plan [of public finance reform] and I expect that all political forces will take part in serious discussion about public finance improvement. This is the last moment to do this and decisions should be taken. The fact that this government wants to take responsibility should be met with understanding and support. It has to be deep and brave programme. The question about parliamentary support for this programme is much more difficult, but I believe the answer is yes.
Leszek Miller Prime Minister; Polish Radio 1, 24 Mar	I am not going to quit or to do anything that would deepen political destabilisation in our country. The government still counts on good, constructive co-operation with President because it would be beneficial for Poland.
PAP, 20 Mar	The programme of public finance reform was accepted by the government without disapproval of any single minister, although the discussion was very long and interesting. [...] We have to be aware of the limitations [Constitution] if our activity is to be effective. [in the project of public finance reform] There were some proposals, which would require a change of the Constitution, for example liquidation of the National Broadcasting Council. The Council of Ministers decided to not propose solutions being against the Constitution. Kołodko did not propose this [the liquidation of the Monetary Policy Council], but if such a proposal appears, it requires a change of the Constitution. In terms of indexation, we envisage solutions, which would not be a subject of Constitutional Tribunal's intervention Professor Kołodko has one month for consultations, but he will work on bills proposals at the same time. After this period some amendments to these proposals will be given, and then depending on consultations, bills would be sent to the parliament.
PAP, 11 Mar	The government confirmed its strategic goals (...) The government will realise its legislative programme this year. EU referendum is the most important political target of our government. We have to prepare our structures for European funds' use. Programme of public finances' reform will be discussed during the cabinet's meeting on 19 March, and it will be presented for social partners the next day. The government will not repeat its initiative of road tax to built highways in Poland. This conception has no chance to be accepted by the parliament.
Polish Radio 1, 10 Mar	The Sejm (lower house of parliament) does not consist only of big political parties. There are also smaller groups... We have received signals they might be interested in formalising the relationship. This week is favourable for such decisions. Parliament meets and everybody is here. The question arises whether the constitutional changes should liquidate bodies such as the National Broadcasting Council or Monetary Policy Council.
PAP, 8 Mar	I do not want to say that another coalition with PSL is impossible. But such a coalition would be possible only without people, who thinks that it is possible to be at the same time in the coalition and in the opposition, as it used to be. If we are talking about early elections, all will depend on the situation, whether the Sejm could work normally, whether the government could work normally. One thing is positive for the SLD – decision without our support is impossible in this respect. I would not rule out a possibility of earlier parliamentary elections, but the SLD will decide about the date. If we talk about early elections, we can start from our old statement – elections on spring 2005.
Radio Zet, 5 Mar	I used to think that it is impossible to be PM of minority government, or that it is very difficult. However, when Jerzy Buzek was in such a situation, I was told that it is well possible. I think they were right [...] and Buzek's government lasted until the end. A lot of things are happening in Poland for the first time, our constitution creates possibilities, which are verified by political practice. Former government proved those constitutional possibilities gives a way for minority governments to survive. If assumptions of this reform [of public finances] were presented, in mid-March the government will accept a programme and ten we will have the bills' proposals. This will be a test for politicians who talk that they are interested in this programme.

Grzegorz Kołodko, wicepremier, minister finansów;	Nothing tragic would happen if Hungary or Poland join Eurozone only in 2008 or 2009. But joining the Eurozone later than in this decade would be negative. The most important would be not the exact date, but the exchange rate, at which we are going to adopt euro.
PAP, Reuters, 28 Mar	Monetary policy in Poland is still overly restrictive, which is not good for the economy. Poland now has the lowest inflation rate and the highest interest rates in Europe. Such low inflation is not good, considering the costs that it induces – high unemployment and slower economic growth. The government is trying as hard as possible to curb down budget deficit and it expects that NBP's monetary policy would take it into account. The level of NBP's revaluation provision is excessive and " completely ridiculous". The government and independent central bank have to find a solution [...] but economic arguments are on our side.
PAP, 26 Mar	Average inflation in 2003 is estimated at 1.1%, while GDP growth forecast for this year is 2.3% in 1Q03, above 3% in 2Q03 and above 4% in 2H03. The unemployment rate will start to fall. In March it will be lower by 0.1 pp, I hope, and by 1 pp until the year-end.
www.mf.gov.pl, 26 Mar	We have been witnessing the weakening of the zloty for the last few weeks, which has a good effect for export production, and general development dynamics and employment. The rate may further weaken. Industrial production in the first quarter will go up by 4%, and the GDP by nearly 2.5% and investment begins to rise again. The thing is not to lower CIT rate further but to reduce real interest rates that are still the highest in the Europe, repressing possible to reach pace of growth. The most difficult thing [to enter the Eurozone] is to meet Maastricht criterion of budget deficit. Currently, this deficit measured consistently so-called EU ESA95 methodology amounts to 3.9% (according to our measure it is at 4.8%). There is a chance – if we realise my programme and the independent central provides good policy – that we meet this criterion in 2006. If this is the case, euro could be introduced in Poland as soon as in 2007. This would require an agreement with the EU side on the level of the parity. By the way, I still think that the exchange rate, which guarantees competitiveness of Polish companies and long-term external stability, is at some 4,35 against the euro. Is suggested this already in May last year, and the rate is very close to this level. And this is good. [The MPC has just cut interest rates by 0.25%, are you satisfied with their decision?] I knew it. Such were the expectations of the market and the MPC likes to meet them. I have said half an hour ago that I do not expect the reduction to be a considerable one, and I do not expect anything like that in the coming months even if, as we know, there are obvious grounds for further cuts.
Polish Radio 1, 26 Mar	This programme does not include any proposals that would require a change in the Constitution. These proposals require only legislation changes. According to our estimates in order to introduce it is necessary to introduce or amend 117 laws so this is a very difficult task. And that is why I count on support above political divisions, as this is not a party programme. […] All our proposals are compatible with the Constitution and honour the acquired laws, mainly relieves and write-offs. They are also compatible with the legislation of the EU. [...] What we propose (in terms of use revaluation provisions] is very reasonable from economic point of view and it has its very profound justification. And if we are to give authorities, which you know, there is Mr Witold Orłowski economic advisor of Mr President, who shows it is economically justification and possible from formal and legal point of view. Also, the practice of many countries shows the similar approach. I would like to remind that when Germany were joining the Eurozone, exchanging Deutschmarks for euro, the German parliament decided about revaluation of gold stocks, [...] this was aimed at equalling accounting value to real market value and not to values which paid a long ago. Such profit was transferred into the budget to finance the costs of euro introduction. There are many of such examples.
Polish Radio 1, 19 Mar	I would like to inform you that this year's budget is realised smoothly on both revenues and spending sides. The first quarter is a good indication for the future. Possibly, already in March – although we do not have monthly statistics – GDP growth would be above 3% and it is still realistic to increase GDP by 3.5% in 2003 as a whole. I think that unemployment rate will start to fall in March, as a result of more jobs in more competitive sectors of the economy, and less jobs in old, non-competitive industries.
www.mf.gov.pl, 18 Mar	From macroeconomic point of view, the use of revaluation provisions is fully acceptable – some 1/3 of it to finance costs of EU accession or/and foreign debt repayment. Money supply would not increase as a result, and there would be additional inflationary pressure. If there is no agreement between the central bank and the government, we would have to find additional sources of money – drastic cuts in budgetary spending for social purposes and for investments or taxes increase. We should not do this, and I think the central bank thinks the same, and therefore I try to reach agreement. Flat tax rate is against main assumptions of the strategy for the Polish economy development, because this is against an increase of savings and domestic capital formation, which should be a source for investment expansion. This is also against fair income distribution expected by the society. Financial restructuring saved 200 thousands of jobs and now we have a chance to combat unemployment and to increase employment. If the programme is accepted, the unemployment rate may fall by 1 pp each year to 12-13% in 2006. If the programme is rejected, unemployment rate may exceed 20%. Unemployment may be lowered only in the environment of high GDP growth, which I propose, but not via higher social transfers and spending all taxpayers money.
PAP, 17 Mar	It is possible that low inflationary pressure (of some 1pp) will be visible amid flows form the EU. But there is no risk of a rebound of inflation. Let's assume that we have PLN8.7bn of revaluation provisions and we buy €2bn. It is sufficient amount to pay contribution for the EU budget and to cover other costs of integration in the first year after accession. Money supply will not increase a result, similarly to the effect of foreign debt repayment. Btu if there are no money from revaluation provisions, we will have to lower spending or to increase taxes to buy these €2bn.
Przegląd, 17 Mar	If the programme [of public finance reform] is to be deconstructed or delayed, Poland will face a serious crisis, not only economic crisis. If liquidation of some administrative districts is not accepted, this would not mean a failure yet. But if such changes are more numerous, if everything, which is necessary would be impossible to adopt. I would say, "thank you".
ISB, 13 Mar	If the government approves of my program, and I assume that it will, it will only be the beginning. Changes will have to be made to over 117 laws. Soon after there will coma a critical moment – time for approving budget bill for 2004 – amid full awareness of needs related to Poland's EU accession. The only chance for support [for the fiscal reform] is PO. This is a historic moment. If PO feels responsible for the country, it would be stupid for its MPs not to use this chance.
www.mf.gov.pl, 13 Mar	The zloty weakened sharply, which is positive for the Polish economy, and now I am waiting with calm what the market will say. We are not threatened by deflation even given the restrictive monetary policy. At the end of the year annual inflation will be between 1.7% and 2%. [Why economy minister said that only GDP growth at 3% is possible, does it mean a change of government's

	forecast?] No. Maybe it is based on ministry of economy analysis based on different assumptions. We will be closer to this figure if we have a progress on lowering bureaucracy in the economy, further supporting of enterpreneurship, better firms' management, efficient public support for certain sectors. As for now, the situation is improving, as GDP growth in 1Q02 increased by a mere 0.5% and by 2.3% in 1Q03. But still there is a long way to go until 3.5%. This acceleration is especially the result of efficient financial restructuring in above 60 thousands of companies, and higher exports expansion driven by weaker zloty. [Are you concerned by zloty depreciation?] No. [Will minority government survive until the whole term of office?] No. Realisation of the programme [of public finances' reform] requires a stable majority in the parliament. We have to look for it. With or without PSL, but we have to find another strategic political partner, which really cares about efficient integration with the EU and tax system favourable for Polish enterprises. Some people think that PO may be such a partner. I would like to believe this, and that is why I asked Lower House speaker Płażyński for the meeting with PO parliamentary club to discuss the programme.
PAP, Reuters, 12 Mar	Currently, there are various tax rates from capital revenues, we suggest a unified tax level closer to 20 percent (the current tax on bank deposits) than to 15 percent. If inflation is 0.3% in March and 0.4% in February - for which the data are about to be published - we have to give up automatic (inflation) indexing.
Polish Radio 1, 12 Mar	[Does Minfin plans to intervene on the FX market?] No. We think that current zloty exchange rate (versus the euro) is very beneficial for the economy. It also encourages increase in exports. As you remember, in May last year I indicated the rate of 4.35 as optimal for the Polish economy. Some people say it materialises. Yes and no. It is not the rate which holds forever, as we have floating exchange rate regime. The zloty rate is favourable for exporters leading to higher production, and unemployment should start to fall soon. I heard rumours that I may resign to weaken the currency. Well, if it is so easy maybe I could try to weaken it, because this would be a factor strengthening our economy. There is no doubt that we will have to increase public debt to an extent. This is also the assumption of medium-term strategy, which was the attachment to budget act for 2002. But EU integration will be also very important. If we try to cure public finances according to proposed project, we could use EU structural funds for infrastructure and also EU is interesting in this solution because our road structure would integrate with the EU. [How revaluation provisions would be used?] From the final effect point of view, we can say that the same effect will be the same if they are used for foreign debt repayment or for financing EU projects. The NBP and the MPC are right saying that if money is transferred to the Polish budget increasing money supply, this could be connected with some inflationary pressure. But, if the provisions were used to buy for example €2bn from the central bank, foreign exchange reserves would decrease to some US$28bn as a result. This could be spending for contribution to the EU budget or to repay our foreign debt. There is no decision yet how to spend the money. This is so-called public secret that there are consultations, talks in this respect. Yes, we are discussing with the president of independent central bank Mr Balcerowicz. With our colleagues from the MPC, deputy ministers with deputy presidents, experts with experts.
PAP, Reuters, 11 Mar	At the moment we are finishing preparing public finances' reform programme. We would like to have the highest possible support for this programme [...] above political divisions, as this is fundamental instrument to revive the economy. This is not a package of fireworks, which would cause a lot of smoke and little effect. This is not a package of fireworks, which would cause a lot of smoke and little effect. IMF mission supported the direction of reforms and the Fund thinks that GDP growth may accelerate to 4%, or even above this level next year. I agree, but the main assumption is to start with majority of public finances programme. In the quarter, which is just ending, I expect growth will be no less than 2.3 percent. This acceleration is obviously good news [...] We are at the turning point in unemployment combating, and it should decrease. [Referring to revaluation provisions] there are working consultations and technical talks with the NBP, also at the highest level, which means between NBP president and finance minister. We are looking for a solution, which should be acceptable from macroeconomic point of view, and I am certain there is such a solution. Our partners from the central bank think about it, as this should be done in line with the Polish law. If both sides find satisfactory agreement, this operation will be gradually and consequently realised.
PAP, Reuters, 7 Mar	There is still a chance of achieving 3.5 percent growth this year...but that would be impossible without the quick implementation of fiscal reforms. If the programme [of fiscal reforms] breaks down before implementing, then we would not have the chance, moreover the perspective of approaching 5% next year and exceeding 5% in next years would also disappear. [...] It would also be much easier for us to achieve that goal [of 3.5% GDP growth] with lower credit costs, but that requires action from the central bank. [...] We maintain dialogue, we are in good contact and count that monetary policy will continue to rationalise, boosting the economy. The need for realisation of this [fiscal reform] programme is for me absolutely unquestionable. [...] There comes the time of hard trial not only for me but also for modern thinking deputies from opposition, on whose support I am also counting. I am open to discussion, but the fiscal reform package must be coherent and comprehensive and I cannot accept a situation in which someone comes and picks out things they don't like. The cabinet will debate the final version of the fiscal reform plans on March 18 ... the ministers have the right to give me their suggestions of things that could be changed.
PAP, 5 Mar	Once I said that the good zloty rate to the euro should be 4.35. There are some doubts, especially of speculation capital, but let the speculation capital worry about itself, as I have to think about public finances. […] What is going on the currency market does not make any problem for us, and even helps us as it makes export production more profitable. It would not be bad if the zloty was at the current level to the euro, and not at the level reported a few weeks or months ago.
Polish Radio 1, 5 Mar	I would like the majority of bills [connected with public finances' reform] to be discussed now. This is a question of 1H03, but not all decisions will be made in this period. This will be the whole package, and the cabinet and Prime Minister will decide about the schedule. This is would positive if a special commission could analyse this package. I would like to prepare new budget, for the first year in the EU, based on new regulations. Therefore, this political cycle has started and 2Q03 and 3Q03 are the most important quarters, not only from political, but also legislative point of view. I hope that pro-reform groups in the parliament, not only from the coalition, but also from opposition, would support this programme. Especially, as a lot of suggestions included in my programme are similar to what did civic Platform or Samoobrona propose.

Jerzy Hausner economy and social policy minister PAP, 27 Mar	On Tuesday I will propose the plan of activity for my ministry, which would be aimed at boosting the economic growth, stimulating enterpreneurship and combating unemployment. This is not an alternative programme to what was presented by finance ministry.
Reuters, 14 Mar	The [Monetary Policy] Council has never wanted and does not want to be the government's partner, even the most demanding partner and not a supreme and infallible arbiter. What has been done cannot be undone. Bad things have happened... Now even a large one-off rate cut cannot help much. What the Council can do right now is to reach a sensible compromise with us over its [FX] reserves. This proposal has been put forward but met with no positive response. Being stubborn harms us all, including MPC's and NBP's reputation.
PAP, Reuters, ISB, 12 Mar	Today there is no great room for manoeuvre on cutting rates; the zloty rate is not a problem. It is not true that the new Council will differ fundamentally from the current one. It should be responsible, but may be less restrictive. There is a room for discussion with the central bank about revaluation provisions. Poland faces a dilemma; either to join the euro zone as soon as possible, or another choice; to revive enterpreneurship, ease the fiscal burden, believe business will invest - and join the euro zone with sound fundamentals. I favour the second option. The unemployment rate in February will inch up to 18.8% and this will be the maximum level. It but should start easing from March onwards. Economic growth of 3% this year is realistic.
Adam Tański, agriculture minister; Radio Zet, 4 Mar	State's interest is the most important. But also very important is the interest of agriculture. I do not promise any campaign against the government. I hope that after analysing budget capabilities, after analysing the possibilities of saving financial funds that are already flowing to agriculture, the promised level of direct subsidies would be maintained. It is very important, because farmers that are already subject to unrestricted competition with EU [...] must have support, because they face competitors who have such support. This present system [KRUS – social security system for farmers] plays crucial role, because it means huge social support for the countryside. But [...] minor part of the rural farms, more than ten percent, has good financial condition and does not heave the reason for such big subsidies to social security. However, another part, the majority, needs constant support. Therefore the reform should make the better-off farms pay much more [...]. I am against ad hoc, enforced interventions, which give wrong signals. Because then there is a vicious circle of interventions: we force the subsidies, boost the production and in subsequent year we have the problem with excess supply again. Therefore it must be a system, which does not give false signals for the market and I hope [...] that we will present such clear system for the farmers. Because farmers long for the stability and clarity regarding future.
PAP, 3 Mar	Today I have recognised that those challenge that agriculture is facing perhaps need my person. I will try to cope with them. [...] First objective that I put to myself is calming down the moods in the agriculture, stabilisation of situation and preparing farmers for EU accession. [...] There was always hard situation in the agriculture, but now it is particularly difficult.
Danuta Huebner; minister for European affairs; PAP, 5 Mar	When we join the Eurozone in 2008, as the central bank and the ministry of finance agree, the final parity rate of the zloty against the euro may be at around 4. Inflation will have to stabilise at low level in this period. It seems that the most important problem may be connected with budget deficit criterion and that is why meeting all Maastricht criteria will not be easy. [After EU entry] higher imports' growth will be driven also by real zloty appreciation. In 2005-07 GDP growth will be driven by higher consumption and investments, but this will be also a period of high current account deficit and worsening trade balance. In 2008-10 GDP growth based on demand may be stopped. This would be difficult period of lower consumption, GDP and investments, but also lower exports' dynamics. This may be the period of lower support for EU. Only after 2011 the Polish economy will start the path of high GDP growth, some economic stabilisation should be expected, which will be connected with ERM2, but meeting convergence criteria will not be easy. [If Poland stays outside the EU] would mean lower transfers for the economy, lower investors' confidence, slowdown of modernisation of the economy, weaker zloty (even by 15%). Weakening of the zloty against the euro could be maintained in 2004, which would lead to higher inflation as compared with the accession scenario. I am afraid of referendum result, as we have no tradition of referenda in Poland. As I was afraid of referendum in Ireland in 2002, the only thing I'm afraid this year is referendum in Poland. I am scared of destabilisation scenario, which would last for many years.
Halina Wasilewska-Trenkner, deputy finance minister www.mf.gov.pl, 24 Mar	Tax on capital gains we estimate at ca. PLN1.8-2.0bn a year. It will be higher on faster pace of economic growth. [Shall we gain planned annual privatisation revenues?] Rather not, unfortunately. But the budget will have to contract additional debt, i.e. more Treasury bonds will have to be sold. Such a situation is observed over the last three years. Privatisation revenues usually are gained in the fourth quarter and during the whole year we finance expenses from the budget that under the law should be financed by privatisation revenues.
Ryszard Michalski deputy finance minister www.mf.gov.pl, 27 Mar	[We plan bonds issues] not only on American market. This year we plan to issue ¥20bn of Samurai bonds, €1bn of eurobonds and US$250m of Yankee bonds this year. Both American and Japan bonds will be offered in June, and I see no risk of delay. We plan also to expand the offer on the domestic retail market by releasing new attractive products for individuals, able to compete for the clients with commercial banks' bonds and investment funds. They are going to be introduced in 2H03. No, we do not plan this [to buy foreign currencies for foreign debt repayment with current exchange rate], because there is no reason for that.
PAP, 12 Mar	The Ministry of Finance did not intervene on the market yet, as current rate is satisfactory from our point of view. Sharp depreciation is worrying, as this is temporary trend.
TVN24, 11 Mar	We want to use these funds [the central bank's revaluation provisions] in a non-inflationary manner, transferring them to the EU budget or using them to co-finance EU-sponsored projects. We ask the central bank to help in a very special situation when EU entry will entail exceptionally large one-off expenditures, such as annual EU budget contribution. We claim that some transactions between us (NBP and MinFin) were not reflected in a change of revaluation provisions, and NBP profit was not transferred into the budget.
PAP, 5 Mar	We are satisfied with the current rate of the Polish currency to the euro. Inflation will be lower than the one planned in the budget and will amount to 1.5-1.7%. Poland plans to issue around 250 million USD worth of bonds on the Japanese market in June. […] The European market is the most significant for us and thus we will keep to this market, depending on the situation, including the result of the Iraqi conflict.

Andrzej Sopoćko deputy finance min. Reuters, 10 Mar	I am not sure whether from a technical point of view it will be possible to float PZU this year. Chances are slim. From a technical point of view it is difficult, but attainable.
Jan Czekaj, deputy finance minister; PAP, 20 Mar	There is no possibility of stimulating GDP growth by radical decrease of taxes. Spending are less sensitive on GDP growth. The necessity of indexation means that spending cannot adjust to the revenue side of the budget. The main burden of public finance reform is on the spending side. The liquidation of valorisation mechanism is necessary, as there is no other possibility to decrease deficit, as via lower share of fixed spending in the budget
Jacek Piechota, deputy economy minister; PAP, 5 Mar	Reform of public finances authored by deputy prime minister Grzegorz Kolodko does not show determination, which would be desired by Polish businessmen and foreign investors. That is why in the opinion of the Economy and Labour Ministry this reform raises many doubts. It is difficult not to agree with opinions voiced by businessmen that this reform is not far-reaching enough to make it possible to achieve the expected economic growth in a planned period. And I must say that I agree with opinions by entrepreneurs' organisations that this is too little
Marek Wagner, PM chancellery chief; Radio Zet, 19 Mar	I think that compromise is possible in respect to many things. There are several things, which for finance minister starting to reform public finances, have to be solved in line with his proposals. Kołodko knew that not everything can be accepted by the cabinet.
Anonymous governemnt official PAP, 19 Mar	The fact that the government gave one month for finance minister to improve the program means that there were “fundamental divergences”, connected mainly with valorisation of social spending. The government will never agree on liquidation of the indexation for pensioners. [Decision about “directional” approval of Kołodko plan] is aimed at financial markets’ stabilisation, which are nervous after the coalition collapsed, on rumours about another reshuffle.
Jarosław Kalinowski PSL leader PAP, 13 Mar	If three bills are not accepted by the parliament [direct subsidies for farmers, general bill about the agriculture sector and bio-fuels], PSL will not say “yes” in the referendum.
Longin Pastusiak, Senate’s speaker; PAP, 3 Mar	In current environment [of minority government] Senate become a guarantee of stability. At the moment 74 senators [out of 100] represents SLD-UP parliamentary club. SLD minority government will also find support in the Senate. If the Lower house accepts the bill, which would be against government’s interest and policy, the Senate can always propose an amendment, which is difficult to reject, as it requires absolute majority. President can use his authority, and he has large social support. By his contacts and talks with the opposition, he can find a support for specific proposals. If the parliament accepts the bill against SLD policy, president can veto it. I cannot exclude a possibility of pessimistic scenario. Although I am not afraid that majority will be against the EU accession in the referendum. I am rather afraid about the turnout.
Zyta Gilowska; Civic Platform; Reuters, 13 Mar	We don't see our proposal as competing with Kolodko's, we think of it as complementary. We will support changes, which make the tax system more transparent, scrap wasteful off-budget funds and do away with the automatic indexation of expenditures. But it all has to make sense as a whole and not increase the burden on society. Here we are not so sure about Kolodko's plans.
Witold Orłowski, President’s economic advisor; Reuters, 25 Mar	Part of the revaluation provision, that are predestined for defence of zloty’s exchange rate, could be released, very cautiously and upon an agreement between the finance ministry and the central bank. There are many techniques of releasing the revaluation provision. For instance, the government could buy dollars from the central bank one-day and sell them back on the following day. I agree with the arguments from the NBP, that FX reserves cannot be diminished in any way given present international situation.
PAP, 7 Mar	Sometimes it is difficult to take a decision and find a support, if this should be done by quarrelling coalition partners. Now, this government has a chance for more efficient policy than previous coalition government. The coalition could negatively influence public finances’ reform, because consensus between the parties seemed almost impossible.

EU negotiations watch

- **The European Parliament approved the Accession Treaty**
- **...and the signing is scheduled for 16 April, during the special EU summit in Athens**
- **Direct payments for Polish farmers will cost Polish budget PLN2bn a year**

Getting closer to the European Union

On April 9, the European Parliament by a vast majority of votes approved the Accession Treaty, in this way accepting accession of Poland and nine other candidate countries to the European Union from May 1, 2004. Deputies voted for each of the 10 accession countries separately and in each case the outcome of the referendum was positive. For Poland the result was as following: 509 votes for 'yes', 25 votes against and 31 deputies abstained. Czech Republic and Cyprus had lower support while the most "popular" among deputies to the European Parliament were Latvia, Slovenia and Hungary.

On the same day, the Polish government formally decided that Poland would sign the Accession Treaty. The decision came as no surprise, as the government has always recognised the EU accession as one of its top priorities. The Accession Treaty – very extensive document recapitulating the terms and conditions under which Poland and nine other candidate countries would enter the European Union on May 1, 2004 – has to be signed by representatives of all 25 countries (all current members of the EU and all accession countries). The official signing of the Treaty is scheduled for 16 April, during the special EU summit in Athens. Poland's representatives in Athens will be Prime Minister Leszek Miller, foreign affairs minister Włodzimierz Cimoszewicz and European affairs minister Danuta Huebner. President Aleksander Kwaśniewski will also be present there.

... but still waiting for the accession referendum

Of course signing of the Accession Treaty does not complete our way towards the European Union, as we will be facing the most important challenge – the accession referendum. One day after signing the Accession Treaty special session of the Lower House of the Polish parliament will take place, at which MPs will finally decide on the exact date and duration of the referendum (one or two days). At the same time, the government is going to start more intensive campaign for the EU membership.

But as far as it goes, the support for the European integration remains safely high in Poland. According to OBOP polling institute in the first half of March 66% of Poles declaring the will to participate in the EU accession referendum would vote 'yes', 23% would be against and 11% were still undecided. In March almost a half of Poles (49% - 2pp less than a month ago) were certain that they will take part in the referendum. Another 30% said they would consider participation in the voting. 7% of polled persons were sure they will not go to vote and 6% declared they would rather not do it. 8% still do not know whether to take part in the referendum.

Subsidies for farmers will cost Polish budget PLN6.6bn in 2004-2006 period

According to deputy finance minister Ryszard Michalski, in 2004-2006 period PLN6.6bn will have to be paid from the Polish budget for direct payments for farmers. Michalski added that finding these funds is one of the aims of public finance reform, being worked out by the Ministry of Finance.

We have already written about serious burden for the Polish budget connected with direct subsidies payments in the analysis of financial costs of Poland EU membership in our monthly report MACROscope in January. The amount mentioned by Michalski unambiguously suggests that actual level of direct subsidies for Polish farmers will be clearly lower than maximum level negotiated at the EU summit in Copenhagen in December 2002 (55%, 60% and 65% of "full subsidies" in three consecutive years). According to our estimations, payment of subsidies in a maximum allowed level would have to cost almost twice as much as Michalski announced. Particularly high value of direct subsidies from state budget would be scheduled for the next year, as in 2004 the government will have to pre-finance payments from the EU budget, which will be returned by Brussels with one year delay. We estimate that direct subsidies payments in 2004 may cost Polish budget around PLN3bn.

Market monitor

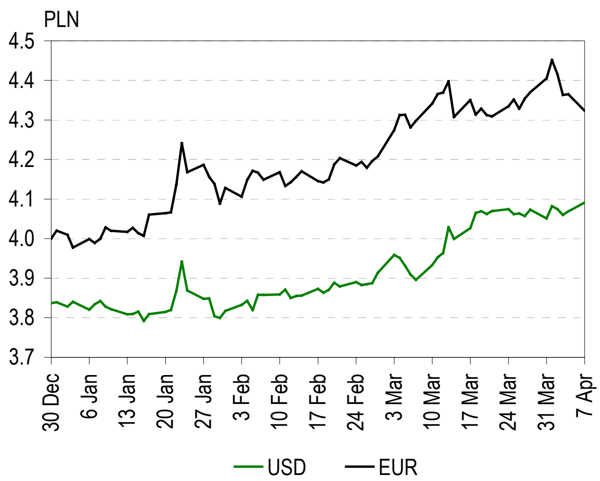
- **Four waves of sell-off the zloty in March**
- **T-bond market much more stable**
- **Record supply and demand at 2-year T-bond auction**

Earthquake first, then suspense continued to grow

Following quiet February on the FX market in Poland, March began with a panic sell-off of the zloty amid the break-up of the ruling coalition. During the month other three waves of selling-off the zloty passed across the market, mainly as a result of continued uncertainty on the political scene. Despite the fact that corrections appeared in the meantime and the Polish currency was strengthening, at the end of the month it was weaker by some 4% against dollar-euro basket as compared to end of February. Also, on global market significant volatility was observed. EURUSD rate recorded large fluctuations influenced by successive pieces of information on conflict in Iraq both before war break-out and in course of it.

According to the NBP fixings in March the dollar was traded between PLN3.8959 (on 7 Mar) and PLN4.0746 (24 Mar) and the average rate was PLN4.0095 (against PLN3.8666 in February). The euro rate ranged from PLN4.2741 (on 3 Mar) to PLN4.4052 (31 Mar) and the average rate was at PLN4.3342 (while at PLN 4.1652 in February). The average rates were above our forecasts published in the previous MACROscope at 3.94 and 4.31, respectively.

Zloty FX rate in recent months



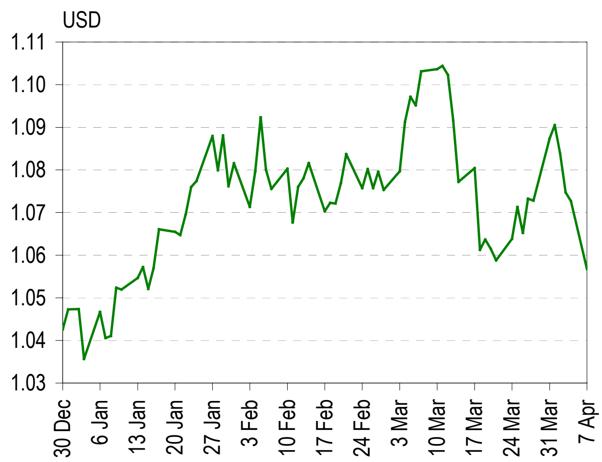
Source: NBP

At the beginning of March second this year's turmoil on the market took place. In response to break-up of the coalition during the weekend, on Monday 3 March the zloty opened weaker by 1.5% as compared to Friday and the sell-off lasted till Tuesday, when the euro exceed finance minister's dream level of €/PLN rate 4.35 for a moment.

During the next days the zloty strengthened temporarily, but as early as on Monday it started to fall given fears of approaching war in Iraq. At the beginning of the week (10 Mar) domestic uncertainty restarted to contribute, following the comment from the PM on possible liquidation of the MPC and rumours on changes in the government. The price of the euro was above "Kołodko's level" for a few days. On 12 March the zloty rate exceeded 4.40 against the euro and 4.00 against the dollar, which was a culmination of this wave of the weakening.

Undoubtedly, in March the market was very sensitive for bad news and there were a lot of them given turmoil on political scene. That is why third wave of sell-off appeared on Monday 17 Mar, following the press interview with minister Kołodko (see in *Watch* section), who questioned his future in the cabinet. This time around zloty weakening was only short-living, as on next day it made up for the losses. After a break-out of the war stagnation occurred on the market and the zloty was traded in very narrow ranges.

EUR/USD FX rate



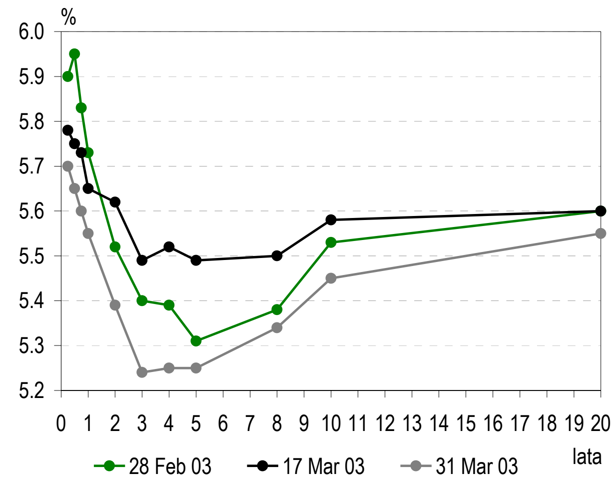
Source: NBP, BZ WBK

In the last week of the month, the zloty was weakening slowly on little active trading, which mainly resulted from rising uncertainty on the political scene. On the last day of March, for a fourth time in March and fifth this year, a wave of selling-off the zloty appeared that caused 1.7% depreciation within just three hours. Certain calm down of the moods took place at the beginning of April after common press conference of the President and PM, and during the second week the zloty started to strengthen, after the comment from deputy finance minister (see in *Watch* section).

T-bond tender with records

Fixed income market was also under pressure of events on political scene and situation in Iraq, however its reactions were much more calm and short-living. The market responded to coalition break-up with weak opening, but afterwards it was strengthening within the whole week. Only in the second week of March, when uncertainty intensified, the yield curve was moving upwards for a few days and the highest level was reached on Monday 17 March after the interview with finance minister. In the remaining days of March strong trend of fall in yields was observed and it was disturbed only temporarily, as a result of turmoil between President and PM. The market strengthened after the war brake-up and another interest rate cut, since investors assessed that this decision suggested a possibility of deeper further reductions. The sell-of on 31 March on the FX market did not reflect on T-bond market.

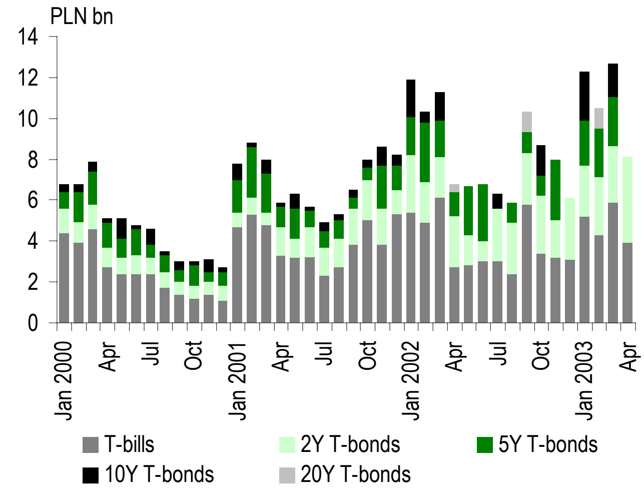
Yield curve



Source: BZ WBK

At the auction on 12 March the Ministry of Finance sold all the offered 10-year DS1013 bonds. The demand was two times higher than supply and average yield was below expectations and below level of the secondary market. At the next auction on 19 March the ministry sold 5-year PS0608 T-bonds worth of PLN2.24bn only out of PLN2.4bn offered, though the demand amounted to as much as PLN5.17bn. On the other hand, yield fell below quotations from the secondary market. On Wednesday, 2 April first auction of 2-year benchmark OK0405 was held. Record high supply (PLN3.5bn) met record high demand (PLN15.1bn), so the ministry sold all the offered papers easily, as well as PLN700bn worth of the bonds at supplementary auction. Average yield fell to 5.201%, again below expectations and current market level.

Supply of Treasuries



Note: Apr 2003 without 5-year bonds
Source: Finance Ministry, BZ WBK

The FinMin said that at the auction on 16 April supply of 5-year PS0608 bonds would amount to PLN2.0-3.0bn.

Treasury bill auctions (PLN m)

	OFFER (SALE)			
Date of auction	13-week	26-week	52-week	Total
03.03.2003	-	200 (200)	900 (900)	1 100 (1 100)
10.03.2003	-	200 (200)	900 (900)	1 100 (1 100)
17.03.2003	-	200 (200)	1 000 (1 000)	1 200 (1 200)
24.03.2003	-	200 (200)	1 100 (1 100)	1 300 (1 300)
31.03.2003	200 (200)	-	1 000 (1 000)	1 200 (1 200)
March total	**200 (200)**	**800 (800)**	**4 900 (4 900)**	**5 900 (5 900)**
07.03.2003	300	-	1 000	1 300
14.03.2003	300	-	1 000	1 300
17.03.2003	300	-	1 000	1 300
April total	**900**	**-**	**3 000**	**3 900**

Source: Finance Ministry

Treasury bond auctions in 2003 (PLN m)

Month	First auction				Second auction				Third auction			
	date	T-bonds	offer	sale	date	T-bonds	offer	sale	date	T-bonds	offer	sale
January	08.01	OK1204	2,500	2,500	15.01	DS1013	2,400	2,400	22.01	PS0608	2,200	1,959.1
February	05.02	OK1204	2,800	2,114.3	12.02	WS0922	1,000	0	19.02	PS0608	2,400	2,000
March	05.03	OK1204	2,750	2,750	12.03	DS1013	1,600	1,600	19.03	PS0608	2,400	2,236.8
April	02.04	OK0405	4,200	4,200	16.04	PS0608	-	-	-	-	-	-
May	07.05	OK0405	-	-	21.05	PS0608	-	-	-	-	-	-
June	04.06	OK0405	-	-	18.06	PS0608	-	-	-	-	-	-
July	02.07	OK0405	-	-	9.07	DS1013	-	-	-	-	-	-
August	06.08	OK0805	-	-	-	-	-	-	-	-	-	-
September	03.09	OK0805	-	-	10.09	WS0922	-	-	17.09	5Y	-	-
October	01.10	OK0805	-	-	08.10	DS1013	-	-	15.10	5Y	-	-
November	05.11	OK0805	-	-	19.11	5Y	-	-	-	-	-	-
December	03.12	OK1205	-	-	-	-	-	-	-	-	-	-

Source: Finance Ministry

International review

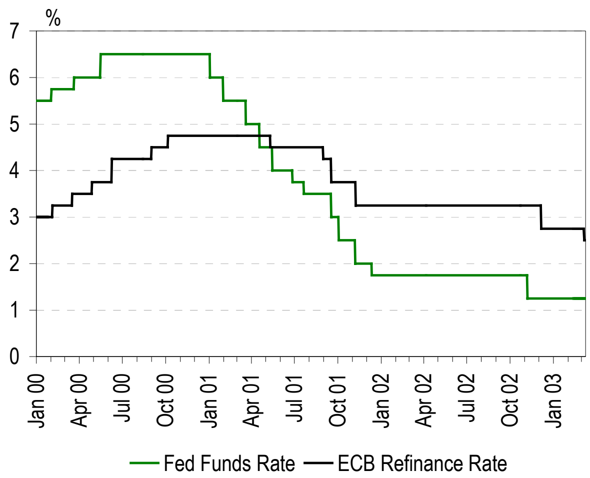
- **No rate cuts this time, but they will come**
- **High energy prices responsible for higher inflation**
- **Lower and lower growth forecasts in the Eurozone**
- **Consumer confidence lower before war in Iraq, it is to be seen how it changes after the war**

No interest rate reductions

On March meeting, in line with market expectations, the Federal Open Market Committee left interest rates in the United States unchanged at 1.25%. In the statement Fed said that it is difficult to determine if the economy is threatened by price increase or rather by economic slowdown at the moment. At the same time Fed announced to watch economic situation carefully, which might mean that the Fed is inclined to cut interest rates even before next meeting on 6 May if the war in Iraq negatively influences economic condition. However, recent development of the situation in Iraq supports a scenario of relatively quick solution of the conflict.

Also, the decision of the Council of the European Central Bank was not a surprise, as interest rates remained unchanged. After the last month rate cut of 25 bp main Eurozone's interest rate – refinance rate – amounts to 2.5%. It is the lowest level since October 1999, but there is high probability of another reduction in the near future.

Interest rates in the USA and Eurozone



Source: Reuters

The ECB said that M3 aggregate grew by 8.1%YoY in February, up from revised 7.2%YoY in January. The 3-month average in December-February period amounted to 7.4%YoY compared to revised 7.0%YoY after January. The figures were well above the ECB's guidance level for money supply level of 4.5%YoY.

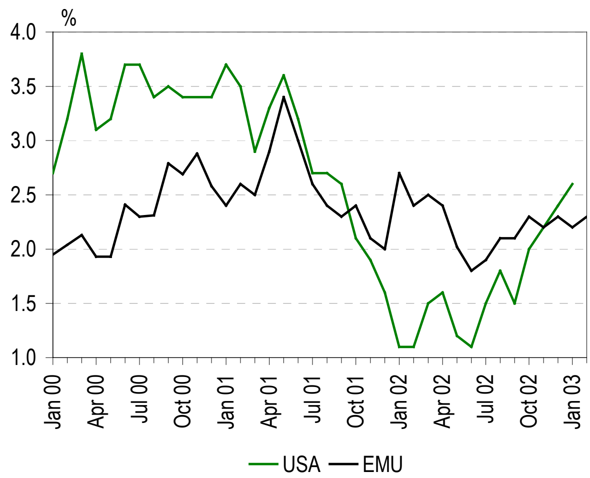
Inflation influenced by higher energy prices

In February Eurozone's inflation proved to be higher than expected. Headline HICP index increased 0.3%MoM and 2.4%YoY against preliminary figure 2.3%YoY and January's level 2.2%YoY. Thus, for the seventh consecutive month inflation in EU-12 countries remained above the ECB's ceiling level of 2%, and in February the rate was at the highest level in 11 months. Among the most significant factors pushing inflation up were the energy prices, which in February hiked by 1.8%MoM and 7.6%YoY. However, also core inflation increased to 2.1% in February from 2% in January.

According to preliminary estimations, in March Eurozone's annual inflation rate remained unchanged compared to February at 2.4%, while forecasts pointed to its fall to 2.3%. Inflation in Germany amounted to 0.1%MoM, which resulted in fall in annual inflation rate to 1.2% from 1.3% in February. On the other hand, preliminary estimations point that in March consumer prices increased by 0.3%MoM in Italy and annual inflation rate accelerated to 2.7% from 2.6% in January. The data were in line with market expectations.

In the Eurozone producer prices increased by 0.4%MoM in February, which matched analysts' expectations. Annual growth rate of prices amounted to 2.7% and it exceeded forecast at 2.4%, however this divergence resulted from revising January's growth to 2.0% from 2.3%.

Inflation YoY



Source: Reuters

Also in the United States producer prices increased by 1.0%MoM, which was higher than analysts' expectations for 0.7%MoM rise. This was a consequence of 7.4% surge in energy prices, the largest increase since October 1990. On the other hand, the so-called core inflation, i.e. PPI excluding food and energy costs dropped by 0.5%MoM. This means that there is little sign of inflation outside the energy sector. Consumer prices report presented more complete picture of inflation processes. In February they increased by 0.6%MoM, which was slightly higher than market expectations of 0.5%. Such a result led to substantial CPI inflation acceleration on annual basis – to 3% from 2.6% in February.

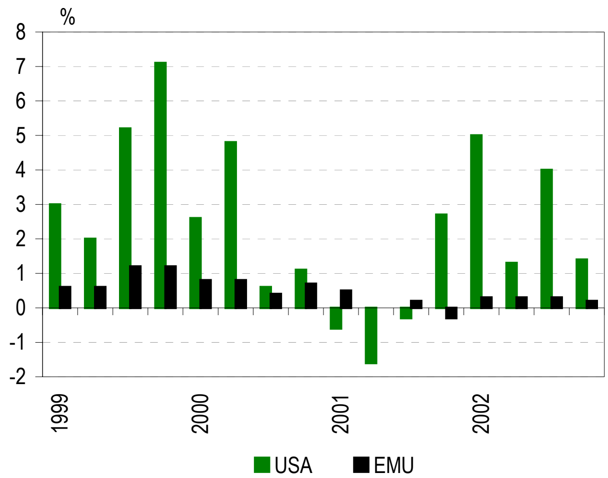
The Fed will look very closely at CPI and PPI figures during its meetings. However, it is likely to have little impact on the decision, as Fed officials have already said they are not particularly worried about inflation.

GDP forecast down again in the Eurozone

Data on Eurozone's economic growth in 4Q02 were revised downward. According to latest estimations, Eurozone's GDP increased by 0.1%QoQ and 1.3%YoY in this period against 0.2% and 1.3%, respectively, published previously. Analysts expected a confirmation of earlier estimations. Moreover, the European Commission published new, lower growth forecasts for 1Q03 and 2Q03. The Commission expect GDP growth of -0.2-0.2% QoQ in 1Q03 and 0.1-0.4% in 2Q03, while a month ago the forecasts were higher by 0.1 pp.

According to the Commerce Department's final data on GDP growth in the United States, it grew by 1.4%QoQ in 4Q02 after 4% growth in 3Q02. There were only small, offsetting revisions to some components of the GDP. For the year as a whole the US economy expanded by 2.4%. In line with expectations the figures were unchanged from preliminary data released a month ago.

GDP growth QoQ



Source: Reuters

Unemployment rates quite stable

The Eurozone's unemployment rate (seasonally adjusted) increased to 8.7% in February or the highest level in last three years, from 8.6% in January. Analysts expected it to remain unchanged. The highest unemployment was recorded in Spain (11.9%) and France (9.1%), and the lowest in Luxembourg (2.8%). In Germany unemployment rate (non seasonally adjusted) fell to 11.1% in March from 11.3% a month earlier, so a bit slower than forecasted fall to 11.0%. However, seasonally adjusted data point to increase in number of unemployed persons of 52,000 to 4.414m, while an increase of 40,000 persons was expected.

In the United States unemployment rate amounted to 5.8% in March, unchanged from February, while analysts expected it to increase to 5.9%. Nevertheless, the data on change in number of jobs in American economy was disappointing. In March the number of jobs fell by 108,000, while a fall of 29,000 was forecasted, but on the other hand, the figure was better than a fall of 357,000 recorded in February.

Economic activity indicators influenced by war

In March, index of economic activity in the industry of the Eurozone – Reuters PMI decreased to 48.4 pts from 50.1 pts in February, while expectations pointed to a less deep fall to 49.5 pts. Following only one-month break the index returned below level of 50 points, which means that activity was falling again. Similarly, analogous index for the United States (ISM) recorded a fall to 46.2 pts in March from 50.5 pts in February. The figure was worse than 48.6 pts foreseen. The economic activity in American industry fell for the first time since October.

The US Commerce Department reported that February's retail sales fell by 1.6%MoM, which has been the deepest drop since November 2001 and was observed across a wide range of sectors. The figures confirmed that war fears constrain propensity to consume in the world's largest economy. Especially, as in March Americans' sentiment was still deteriorating. American consumer confidence indicator recorded a fall to 62.5 pts after dramatic fall to 64.8 pts in February. The poll was conducted before beginning of the war and high oil prices and stagnation on the labour market also influenced the sentiment. Also, the University of Michigan index of consumer sentiment fell for a third month in a row in March to 77.6pts, the lowest level since September 1993, from 79.9pts in February. According to analysts, April's measure of sentiment would better reflect the impact of the war in Iraq on consumer confidence.

What's hot this month

Monday	Tuesday	Wednesday	Thursday	Friday
31 March 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 OK0405 *EMU: Retail sales (Jan)* *USA: Factory orders (Feb)*	**3** *GER: Unemployment (Mar)* *EMU: ECB meeting*	**4** *EMU: Producer prices (Feb)* *USA: Unemployment (Mar)*
7 POL: T-bill auction POL: Food prices (2H Mar)	**8** *GER: Industrial output (Feb)*	**9** *GER: Inflation final (Mar)*	**10** *EMU: GDP (4Q)* *USA: Foreign trade (Feb)*	**11** *FRA: Inflation preliminary (Mar)* *USA: Retail sales (Mar)* *USA: Producer prices (Mar)*
14 POL: Inflation (Mar) POL: Money supply (Mar) POL: Wages & employment (Mar) POL: T-bill auction *ITA: Inflation final (Mar)* *ITA: Industrial output (Feb)*	**15** *FRA: Industrial output (Feb)* *USA: Industrial output (Mar)*	**16** POL: T-bond auction PS0608 *EMU: Inflation final (Mar)* *EMU: Industrial output (Feb)* *USA: Inflation (Mar)*	**17** POL: Industrial output (Mar) POL: Producer prices (Mar) POL: T-bill auction	**18**
21 **Easter Monday**	**22** POL: Retail sales (Mar)	**23** POL: MPC meeting POL: Core inflation (Mar) POL: Business climate (Apr) *FRA: Inflation final (Mar)* *EMU: Foreign trade (Feb)*	**24** POL: MPC meeting	**25** POL: Food prices (1H Apr) *EMU: Retail sales (Feb)*
28 *GER: IFO (Apr)* *EMU: Money supply (Mar)*	**29** *FRA: GDP (4Q)* *EMU: Balance of payment (Mar)*	**30** POL: Balance of payment (Mar) *ITA: Inflation preliminary (Apr)* *EMU: Inflation preliminary (Apr)* *EMU: Economic sentiment (Apr)* *EMU: Business climate (Apr)*	**1 May** **Labour Day** *USA: ISM (Apr)*	**2** *EMU: PMI (Apr)* *EMU: Producer prices (Mar)* *USA: Unemployment (Apr)*
5 POL: T-bill auction	**6** *EMU: Unemployment (Mar)* *USA: Fed meeting*	**7** POL: T-bond auction OK0405 POL: Food prices (2H Apr) *GER: Unemployment (Apr)*	**8** *EMU: ECB meeting* *EMU: GDP (4Q)*	**9** *GER: Industrial output (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	23-24	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	31	-	-	-	-	-
Money supply	14	14	14	14	14	13	14	-	-	-	-	-
NBP balance sheet	7	7	7	7	7	6	7	-	-	-	-	-
Business climate indices	22	21	21	23	22	24	22	22	22	22	21	22
Food prices, 1-15	-	7[d], 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

		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	Apr 03
GDP	%YoY	0.4	x	x	0.8	x	x	1.6	x	x	2.1	x	x	2.5	x
Industrial production	%YoY	-3.1	0.3	-4.2	2.1	5.7	-1.1	6.6	3.2	3.1	5.2	3.5	4.1	3.8	4.5
Retail sales ***	%YoY	9.9	3.1	1.8	2.5	8.6	5.1	4.7	5.1	5.9	4.9	4.1	4.7	3.8	9.0
Unemployment rate	%	18.2	17.9	17.3	17.4	17.5	17.5	17.6	17.5	17.8	18.1	18.7	18.8	18.6	18.2
Gross wages ** ***	%YoY	4.8	2.3	4.2	3.9	4.1	2.8	3.8	0.5	1.8	2.4	2.7	2.1	1.9	3.5
Export (acc. to NBP)	USDm	2 793	3 038	2 833	2 797	3 177	2 727	2 912	3 182	3 004	3 223	2 769	2 637	3 059	3 242
Import (acc. to NBP)	USDm	3 594	3 879	3 722	3 508	3 791	3 642	3 826	4 241	4 090	4 166	3 891	3 217	3 700	3 848
Trade balance (acc.to NBP)	USDm	-801	-841	-889	-711	-614	-915	-914	-1 059	-1 086	-943	-1 122	-580	-641	-605
Current account balance	USDm	-743	-716	-613	-451	-119	-284	-529	-580	-753	-484	-704	-517	-491	-415
Budget deficit (cumulative)	PLNbn	-16.4	-20.0	-23.0	-25.0	-25.7	-27.3	-29.8	-34.0	-37.1	-39.4	-4.1	-11.7	-16.3	-20.5
CPI	%YoY	3.3	3.0	1.9	1.6	1.3	1.2	1.3	1.1	0.9	0.8	0.5	0.5	0.4	0.1
PPI	%YoY	0.3	0.4	0.5	1.2	1.7	1.3	1.1	1.7	1.7	2.2	2.5	2.8	2.8	2.6
Broad money (M3)	%YoY	3.2	2.4	3.2	2.5	1.3	-0.2	-1.5	-2.5	-1.0	-2.1	-1.4	-1.2	1.0	1.7
Deposits	%YoY	1.7	0.6	1.3	0.5	-0.8	-2.5	-3.5	-4.6	-3.2	-4.3	-4.1	-3.8	-0.7	0.5
Credits	%YoY	7.1	6.6	7.9	9.4	7.5	5.9	4.9	4.4	4.6	5.3	5.5	5.7	7.4	8.0
USD/PLN	PLN	4.14	4.06	4.05	4.03	4.12	4.18	4.15	4.12	3.95	3.91	3.84	3.87	4.01	4.03
EUR/PLN	PLN	3.63	3.59	3.71	3.85	4.09	4.08	4.07	4.04	3.96	3.99	4.08	4.17	4.33	4.35
Reference rate *	%	10.00	9.50	9.00	8.50	8.50	8.00	7.50	7.00	6.75	6.75	6.50	6.25	6.00	5.75
WIBOR 3M	%	10.32	10.20	9.89	9.30	8.89	8.55	8.07	7.45	6.81	6.82	6.56	6.37	6.17	5.95
Lombard rate *	%	13.50	12.50	12.00	11.50	11.50	10.50	10.00	9.00	8.75	8.75	8.50	8.00	7.75	7.50
Yield on 52-week T-bills	%	9.62	9.56	9.22	8.54	8.35	7.86	7.25	6.77	5.88	5.78	5.74	5.83	5.67	5.50
Yield on 2-year T-bonds	%	9.32	9.22	9.03	8.27	8.12	7.60	7.16	6.62	5.78	5.75	5.55	5.66	5.52	5.22
Yield on 5-year T-bonds	%	9.11	9.02	8.90	8.17	8.11	7.62	7.07	6.57	5.91	5.67	5.57	5.58	5.36	5.22
Yield on 10-year T-bonds	%	8.25	8.19	8.02	7.55	7.63	7.29	6.79	6.22	5.89	5.69	5.62	5.67	5.52	5.45

Source: CSO, NBP, BZ WBK

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

Quarterly and annual economic indicators

		2000	2001	2002	2003	1Q02	2Q02	3Q02	4Q02	1Q03	2Q03	3Q03	4Q03
GDP	PLNbn	712.3	749.3	769.4	801.6	177.9	188.8	190.5	212.2	183.2	195.0	199.1	224.3
GDP	%YoY	4.0	1.0	1.3	3.0	0.4	0.8	1.6	2.1	2.5	2.7	2.9	3.6
Total consumption	%YoY	2.4	1.8	2.8	2.4	2.8	2.6	2.8	3.2	2.6	2.3	2.4	2.2
- Private consumption	%YoY	2.6	2.1	3.3	2.7	3.5	2.9	3.1	3.5	2.9	2.6	2.6	2.5
Fixed investments	%YoY	2.7	-10.2	-7.2	4.4	-13.2	-8.4	-6.3	-4.1	-3.5	3.5	6.0	7.5
Industrial production	%YoY	6.7	0.6	1.5	4.9	-1.6	-0.4	3.3	4.6	3.8	4.6	5.2	6.1
Retail sales (real terms)	%YoY	1.0	0.2	3.3	3.2	5.8	0.7	3.9	2.6	4.0	3.0	3.0	2.6
Unemployment rate *	%	15.1	17.5	18.1	18.2	18.2	17.4	17.6	18.1	18.6	17.8	17.8	18.2
Gross wages (real terms)	%YoY	1.3	1.6	1.5	2.0	1.9	1.4	2.3	0.3	1.8	2.4	2.1	1.5
Export (acc. to NBP)	USDm	28 255	33 823	34 746	35 147	7 853	8 668	8 816	9 409	8 465	8 224	8 829	9 629
Import (acc. to NBP)	USDm	41 423	46 848	45 712	46 004	10 847	11 109	11 259	12 497	10 808	11 028	11 297	12 871
Trade balance (acc.to NBP)	USDm	-13 168	-13 025	-10 966	-10 857	-2 994	-2 441	-2 443	-3 088	-2 343	-2 804	-2 468	-3 242
Current account balance	USDm	-9 952	-7 992	-7 614	-7 798	-3 085	-1 780	-932	-1 817	-1 712	-2 103	-1 358	-2 626
Current account balance	% GDP	-5.6	-3.9	-3.8	-4.0	-4.2	-3.8	-3.8	-3.8	-3.2	-3.5	-3.6	-4.0
Budget deficit (cumulative)*	PLNbn	-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	-2.2	-4.3	-5.1	-4.8	-9.2	-13.2	-2.5	-4.5	-5.1	-5.0	-5.0	-4.8
CPI	%YoY	10.1	5.5	1.9	1.2	3.4	2.1	1.3	0.9	0.5	0.6	1.6	2.0
CPI*	%YoY	8.5	3.6	0.8	2.2	3.3	1.6	1.3	0.8	0.4	1.1	1.7	2.2
PPI	%YoY	7.8	1.6	1.0	2.2	0.2	0.7	1.4	1.9	2.7	2.6	1.6	2.0
Broad money (M3)	%YoY	15.2	12.1	1.7	2.8	5.9	2.7	-0.1	-1.9	-0.5	1.9	3.6	6.1
Deposits	%YoY	17.2	13.5	-0.2	1.9	4.8	0.8	-2.3	-4.1	-2.9	0.8	3.2	6.5
Credits	%YoY	24.7	11.3	6.8	8.3	8.3	8.0	6.1	4.8	6.2	7.5	7.7	11.7
USD/PLN	PLN	4.35	4.09	4.08	3.90	4.13	4.04	4.15	3.99	3.90	4.00	3.83	3.85
EUR/PLN	PLN	4.01	3.67	3.85	4.12	3.62	3.72	4.08	4.00	4.19	4.28	4.03	3.98
Reference rate *	%	19.00	11.50	6.75	5.00	10.00	8.50	7.50	6.75	6.00	5.50	5.00	5.00
WIBOR 3M	%	18.78	16.10	9.09	5.62	11.02	9.80	8.50	7.03	6.37	5.72	5.32	5.10
Lombard rate *	%	23.00	15.50	8.75	6.50	13.50	11.50	10.00	8.75	7.75	7.25	6.50	6.50
Yield on 52-week T-bills	%	17.77	14.77	8.18	5.29	9.64	9.11	7.82	6.14	5.75	5.43	5.10	4.90
Yield on 2-year T-bonds	%	17.37	13.97	7.94	5.20	9.27	8.84	7.63	6.05	5.58	5.21	5.10	4.90
Yield on 5-year T-bonds	%	14.00	12.59	7.86	5.23	9.09	8.69	7.60	6.05	5.50	5.21	5.20	5.00
Yield on 10-year T-bonds	%	11.79	10.74	7.34	5.42	8.28	7.92	7.24	5.93	5.60	5.42	5.35	5.30

Source: GUS, NBP, BZ WBK

* at the end of period

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