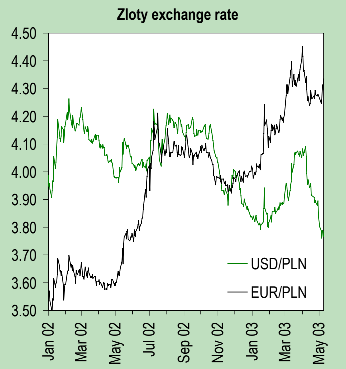
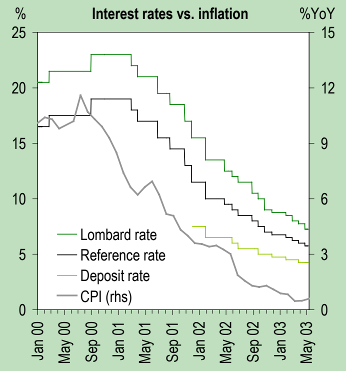
Bank Zachodni WBK

MACROscope

Polish Economy and Financial Markets

May 2003





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First step is the hardest

■ **In *Special focus* section we wrap up the first quarter results.** Similarly to the previous quarters, the trends observed in 1Q03 were ambiguous – some economic areas saw clear-cut positive symptoms of economic revival and growth dynamics, while some other sectors witnessed a continued stagnation, and in some cases substantial deterioration in results was recorded. However, there were no indicators leading to major changes of our expectations regarding the economic situation development in the remainder of the year.

■ **The moderate revival of the economic situation observed in Poland brings to mind that we have encountered a phenomenon defined as the so-called jobless recovery.** Although the industrial output has been growing increasingly faster and other indicators of economic activity have seen some improvement as well, employment in industry and the number of people employed in the entire economy goes down. The jobless recovery is accompanied by increase of the labour productivity, and due to the high labour cost in Poland, primarily the so-called non-salary labour cost, entrepreneurs are highly motivated to substantially increase productivity (i.e. to lower employment). One should not expect a significant employment increase, given that one can almost say that labour is discriminated against the other output factors in the Polish economy.

■ **Slow acceleration of the economic growth continues as a result of, among others, the existing expansive macroeconomic policy**, whose impact on the economic processes defers usually (sometimes for many months). The expansion of the macroeconomic policy continues – central bank continues to cut official interest rates, the zloty is weak, particularly against the euro and the government maintains a very high budget deficit (and some members of the government demand even higher demand impulse from the fiscal policy). Monetary condition index shows that after the period of substantial growth in the monetary policy restrictiveness from the beginning of 2000 to more or less mid-2002, substantial expansion was recorded which has (and is bound to have) a measurable impact on the economic situation development.

■ **A conflict between finance minister and economy minister continues.** It remains to be seen who would be victorious after the cabinet approves the ultimate shape of the programme. Meanwhile, the uncertainty regarding fiscal policy prospects would remain substantial. In particular, we still do not know whether budget deficit next year would amount to PLN40bn or PLN50bn and what would be budget spending level in 2004 (not to mention deficit and spending of the whole public finances sector). As we wrote in the previous MACROscope edition, both programmes have a lot of room for improvement.

Financial market on 30 April 2003

NBP deposit rate	4.25	WIBOR 3M	5.69	PLN/USD	3.8406
NBP reference rate	5.75	Yield on 52-week T-bills	5.15	PLN/EUR	4.2755
NBP lombard rate	7.25	Yield on 5-year T-bonds	5.00	EUR/USD	1.1132

Special focus

Jobless recovery

The data for the first three months of 2003 published by the CSO allow for summing up the first quarter results and for reviewing the projected economic situation development path against the actual achievements of the Polish economy. Similarly to the previous quarters, the trends observed are ambiguous – some economic areas saw clear-cut positive symptoms of economic revival and growth dynamics, while some other sectors witnessed a continued stagnation, and in some cases substantial deterioration in results on the end of 2002 was recorded. However, there were no indicators leading to major changes of our expectations regarding he economic situation development in the remainder of the year.

Clear-cut improvement in industry and exports...

The area of the most noticeable improvement was the Polish industry. In 1Q03, the sold industry output went up in real terms by 4.5% YoY on average, after the growth of 3.8% YoY in 4Q02, which was in line with a gradual growth track projected by us and started in 1Q02. The fact that this growth was driven mainly by a dynamically developing manufacturing industry sector, which in 1Q03 recorded growth of 5.3% YoY, was a particularly positive fact. The highest growth – even by a dozen per cent on the same period last year – was recorded in highly processed goods production branches (e.g. RTV and white goods, electric devices, machines and equipment, mechanical, etc.). Such growth of industrial output against branches suggests that the output acceleration is related to a large extent to good results of the Polish exports which in 1Q03 continued its expansion on the foreign markets, despite continuously poor economic recovery symptoms on the markets of our main trade partners, first of all including Germany. According to the NBP payment statistics, during the first three months 2003, exports expressed in euro increased on average by 6.6% YoY, growing at the pace similar to the one recorded on average in 2H02. At the same time imports turnover decreased – according to the NBP data, in 1Q03 it was 2.5% lower than a year ago. Although it is not yet clear to what extent it reflects the actual decrease in the demand for imports or the potential delay in part of payments related to the interim weakening of the zloty in February and March (even more so, as the CSO data for the first two months of 2003, based on customs statistics, showed a reverse trend – imports developed faster than exports). However, we assess that the balance of net exports included in national accounts improved in 1Q03, which had a positive impact on the economic growth dynamics early this year. Thus, industry sent us two positive signals for the projected economic growth dynamics in 1Q03. The demand side may witness positive contribution of a foreign trade to the GDP, along with the continuos decrease in negative balance of foreign trade, while on the supply side the growth in the gross domestic product was stimulated by growing dynamics of industry added value.

...but worse in construction & building and trade

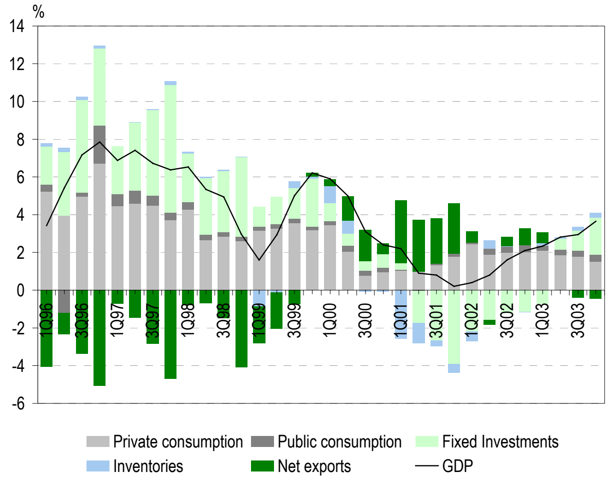
The data related to construction & building and retail trade as at year beginning turned out to be substantially less favourable. In January-March 2003, the value of the construction-assembly output was in real terms over 20% lower than that registered in 1Q02. It was a historically deep decrease, in particular if we take into consideration that it referred to the exceptionally low base (a year ago in 1Q02 a decrease of 16.6% YoY was recorded). Such poor results of construction sector, even if they partially resulted from the adverse weather conditions (long winter prevented from conducting construction work), had a negative impact on the GDP statistics in the first months of 2003 – added value in a construction sector recorded probably one of the deepest falls since the mid 1990's. Additionally, they suggest that investment activity continued stagnant and the expected revival in this area on previous quarters is still to come. The data on the retail trade were not over optimistic either: retail sales increased nominally in 1Q03 only by 2.2% YoY, after the growth of 5.3% in 4Q02 and over 6% in 3Q02. In real terms, this slow down was less turbulent, however, its implications were equally noticeable (see table below), suggesting that our earlier assumptions of the gradual deterioration in the individual consumption dynamics in 2003 may have started to materialise.

Economic activity indicators, % YoY

	1Q02	2Q02	3Q02	4Q02	1Q03
Industrial output	-1.4	-0.6	3.7	3.8	4.5
Ind. output (seasonally adjusted)	-0.6	-0.4	2.8	4.4	4.5
Construction-assembly output	-16.6	-9.6	-6.0	-9.3	-20.2
Retail sales (nominal)	7.1	2.5	6.1	5.3	2.2
Retail sales (real)	5.8	0.7	3.9	2.6	1.7*

Source: CSO, BZ WBK; ** BZ WBK estimates*

Contribution of various components to GDP growth



Source: CSO, BZ WBK

However, the GDP growth dynamics improved

Given all the above-mentioned trends, we adjusted economic growth dynamics estimates in 1Q03 slightly down. Private consumption – although poorer than in previous quarters – remained the major driver of the GDP on its demand side. As mentioned above, foreign demand, and being more precise net exports and total consumption (generated by a continuously high deficit of public funds) had a positive impact on the GDP. Unfortunately, the awaited investment activity revival is yet to come and the dynamics of gross outlays on fixed assets remained negative (it has been negative since 2Q01). Looking at the GDP dynamics from the other side, the growth in added value was generated, similarly to previous quarters, primarily by industry and market services. According to our estimations, clear-cut revival in this area – dynamics went up to the highest level since 3Q00 – was strong enough to offset with surplus the deep fall of added value in construction & building (given in particular that the share of added value generated in construction & building in the total added value in the first quarter is usually the lowest in a year, ranging from 4% to 5%). With a relative stabilisation of the added value dynamics in the other areas allowed for a slight improvement in the total GDP growth dynamics in 1Q03 on previous quarters. Therefore, the GDP growth in 1Q03 is assessed to be 2.3% against 2.1% in 4Q02 and 1.6% in 3Q02.

...and this trend will continue

Although January-March data describing economic activity were slightly different than projections, a general scenario of the economic situation development in Poland as by the end of this year has not changed substantially. The economic growth dynamics should continue to grow in subsequent quarters this year, responding to positive impulses from the monetary policy side and the fiscal expansion in place, which lead to the domestic demand recovery (see below). In our opinion, however, the major drivers of the Polish economy will gradually change along with the decreasing importance of the consumption demand, which will be replaced by a growing investment activity. It should be noticed, however, that despite the decrease, consumption demand will remain an important element of the GDP growth and its growth dynamics will not see any turbulent falls due to, among others, growth in real social benefits early this year with a positive inflation surprise. The positive impact of net exports will also gradually cease due to two factors: continuing stagnation in Germany and the investment imports revival in subsequent quarters. We sustain our projection that GDP should see a 3% increase in 2003.

The economic scenario expected in the following quarters, which we presented above, seems to be supported by business climate indicators, showing the activity of Polish enterprises in 2Q03, published recently. In research prepared by CSO, NBP or IBnGR we see expectations for higher industrial production, higher activity in construction sector, higher domestic orders, and a deterioration of business climate in retail trade, which suggests that investments should be the driver of economic growth. NBP research clearly shows that investment acceleration should be expected in the following quarters - index of investment activity sharply increase in 2Q03.

GDP growth and its components, % YoY

	1Q02	*2Q02*	*3Q02*	*4Q02*	*1Q03**	*2002*	*2003**
GDP	**0.4**	**0.8**	**1.6**	**2.1**	**2.3**	**1.3**	**3.0**
Private consumption	3.5	2.9	3.1	3.5	2.9	3.3	2.8
Public consumption*	0.4	1.6	1.8	2.1	1.4	1.5	1.6
Fixed investments	-13.2	-8.4	-6.3	-4.1	-5.0	-7.2	4.1
Inventories' change*	30.8	130.0	1.4	-5.0	-5.0	-27.6	474.9
Net exports*	-13.0	6.5	-17.0	-26.0	-13.0	-11.9	2.8
Value added	**0.5**	**0.9**	**1.8**	**2.0**	**2.3**	**1.3**	**2.9**
Industry	-2.1	-1.0	2.6	4.0	5.3	0.9	5.7
Construction	-12.9	-10.5	-2.7	-5.4	-15.0	-7.1	-0.3
Market services	3.8	3.6	3.5	3.1	3.0	3.5	2.9

*Source: CSO, BZ WBK; * BZ WBK estimates*

Jobless recovery

The recovery of the Polish economy has been mentioned for a couple of quarters. Slowly but regularly the recovery becomes fact which is revealed mainly in the improving industrial output started in 1Q02 and very good export results. The retail sales growth continued to stay at a relatively high level reflecting a stable growth in personal consumption. As a result, despite stagnation in investments, we have seen the GDP growth dynamics improvement since the beginning of last year. Does it mean the true recovery of the Polish economy materialised?

Answer to the above-state question depends on the point of view. From the common social perspective we could talk about the improvement in the economic situation only if we saw a substantial growth in employment and salaries. Only then will the society see the improvement in the economic situation. The economic history suggests that the growth in industrial output and retail sales were usually accompanied by the growth in employment and resultant decrease in unemployment. Changes in trends in the real economy sphere and labour market took place either simultaneously or within the period of a couple of months only. Although the industrial output has been growing increasingly faster in Poland and other ratios of economic activity have seen some improvement as well, employment in industry and the number of people employed in the entire economy goes down. This means that we have encountered a phenomenon defined as the so-called jobless recovery. It happened e.g. in the USA in the early 1990's. After the recession in 1990, economic activity ratios began to improve already in early 1991, however, the unemployment rate continued to grow and reached its maximum only in 2H92, i.e. almost 1.5 year after the economic recovery phase was announced to have begun based on the growth in industrial output and retail sales. This phenomenon occurs in the American economy today as well – output, sales and GDP go up while unemployment goes up as well.

In Poland, the so-called jobless recovery is obvious, as employment in the Polish industry had gone down (and unemployment had gone up) even when the economic growth was of 4%. Therefore, situation on the labour market deteriorates today as well, when the economic growth dynamics is relatively low and despite gradual growth amounts to only ca. 2%. Why the relatively high growth of the GDP in 1998-2000 and its gradual growth after the slowdown in 2001 does not translate into the improved situation on the labour market? This may not be justified only with demographic factors (demographic peaks of the turn of 1970's emerge on the market), because we witness not only the unemployment growth but the employment shedding as well. The jobless recovery in Poland is accompanied, similarly to the USA, by the labour productivity growth dynamics. When productivity grows up, it is extremely unlikely for the output growth to be accompanied by the employment increase. Due to the high labour cost in Poland, primarily the so-called non-salary labour cost (income tax, social security premiums, etc.) entrepreneurs are highly motivated to substantially increase labour productivity. One can almost say that labour is discriminated against the other output factors in the Polish economy. Thus, it is not strange that entrepreneurs avoid increasing headcount. They, however, want to increase their revenues and profits. They can achieve this thanks to a robust improvement in labour productivity, which will allow for extending the scale of output without the need to increase employment levels, hence without incurring substantial labour costs. This is exactly the case in Poland over the better part of transformation, i.e. from the beginning of the previous decade. In addition, it seems that the high labour productivity growth dynamics continues – in particular in industry, i.e. in this area of economy, which

Real economic activity indicators and productivity, %YoY

	4Q00	*1Q01*	*2Q01*	*3Q01*	*4Q01*	*1Q02*	*2Q02*	*3Q02*	*4Q02*
Value added*	2.1	2.2	0.9	0.9	0.2	0.5	0.9	1.8	2.0
Working population*	-1.3	-1.5	-2.5	-3.0	-3.6	-3.9	-3.5	-3.5	-2.4
Labour productivity*	14.9	10.5	9.1	7.0	7.0	8.3	6.9	5.8	4.6
Industrial production**	2.6	4.5	-0.7	-0.8	-2.6	-1.6	-0.4	3.3	4.6
Employment in industry**	-	-4.7	-4.9	-5.3	-5.7	-6.6	-6.2	-5.3	-4.2
Labour productivity in industry**	-	9.8	4.6	5.1	4.6	5.6	6.0	9.6	8.3
The number of unemployed	4.5	9.7	13.6	16.9	15.4	10.2	7.0	9.9	5.9

Note: * excluding agriculture ** in the enterprise sector
Source: GUS

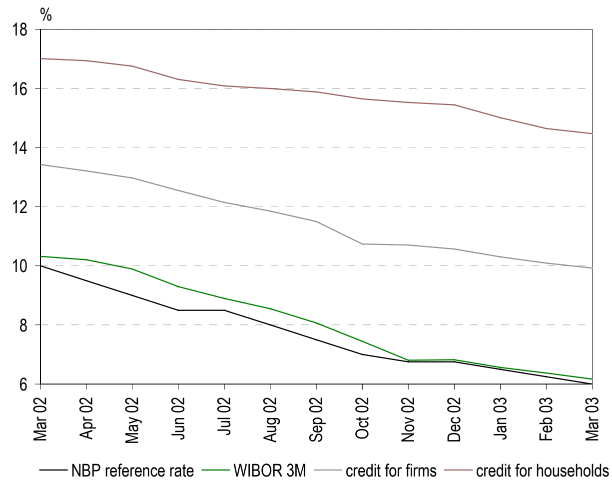
has seen the most dynamic development lately. It indicates that even if the economic growth dynamics goes up to the optimistic levels expected by some ministers (5-6%) in the future years, it will not necessary bring about a substantial growth in employment and the decrease in unemployment. Therefore, we will continue to talk about the economic recovery, but the situation of an average employee on the labour market will not improve pro rata to the growth in output, retail sales or the GDP. This requires many years of fast economic growth, driven not by consumption as such, as some would want, but primarily by effective investments. Assuming the maintenance of capital-labour relations at a regular level and continued improvement in labour productivity, employment growth will only be possible when the investment growth dynamics is higher than labour growth dynamics.

Macroeconomic policy – lower interest rates, weaker zloty and fiscal expansion

As mentioned above, slow acceleration of economic growth continues. This results, among others, from the existing expansive macroeconomic policy, whose impact on the economic processes is deferred (sometimes for many months). The expansion of the macroeconomic policy continues – central bank continues to cut official interest rates and the government maintains a very high budget deficit (while some members of the government demand even higher demand impulse from the fiscal policy).

1Q03 saw three interest rate cuts, and the NBP reference rate was decreased by the total of 75bp. The Monetary Policy Council (MPC) cut interest rates monthly, despite the fact that March witnessed a number of political risk factors both home and abroad. Those factors were clearly highlighted by the MPC members. MPC maintains its the so-called neutral bias to monetary policy, although its meaning has already depreciated substantially and given the current comments of the MPC members, one can hardly exclude subsequent interest rate cuts. Arguments we stipulate under *Central bank watch,* suggest that we should expect still a couple of interest rate cuts. The first cut may take place already in May, when we will see another historically low inflation rate, with subsequent ones likely to follow in 2H02, which would mean a reference rate fall down to 5%. Additionally, the scale of monetary policy expansion will be impacted by the decrease in the obligatory reserve rate (as well its potential for interest bearing) expected at the end of this year. According to the comments of the central bank representatives, it would be aimed at making commercial banks decrease further loan interest rates, and at the same time, it would help to eliminate the existing asymmetry – the decrease in deposit interest rates is faster than that of loans and in the case of households this discrepancy is higher than in the case of businesses. Another channel used by the central bank to exercise its influence was the purchase of bonds indexed to inflation, which was to support the banking sector and decrease the discrepancy of deposit and loan interest rates. However, it seems that a substantial reason of this asymmetry is poor economic situation and only a clear-cut market demand growth will have an impact on the decrease of business credit risk, and hence on the loan interest rates decrease.

Official interest rates vs. market interest rates



Source: NBP

The lower scale of loan interest rate decreases surely lessens the effectiveness of the monetary policy. It should be noted, however, that a bank loan does not represent the main source of financing any business operations, including investments. Based on the already mentioned business climate surveys of the NBP, it may be stated that the share of PLN bank loans in the sources of financing current activity was low – only 12.5% of the needs were financed with a zloty loan. Percentage share of financing investment expenses with a PLN loan was even lower (10.9%), while the better part of these expenses was covered with own funds (73%). Of course, an element impacting such a small percentage share could be the low availability of the loan, however, the problem was not common – according to the NBP "the data collected in the survey may indicate that in 1Q03 the improved availability of loans could bring about the higher penchant for undertaking new investment projects".

What is more, the quoted survey specifies also that the level of interest rates does not have a substantial impact on business operations (this represented a problem only for 4% of the surveyed against 19% a year before).

Of course the scale of monetary policy expansion was not impacted only by the scale of interest rate cuts, but also (and may be first of all) by the foreign currency movements, which were very favourable over the last months. As the table below shows, during a recent year the zloty depreciated against euro nominally by over 0.5 PLN. To a great extent it resulted from the change in the cross EUR/USD exchange rate (euro went up on USD from the average 0.88 in 1Q02 to 1.07 in 1Q03). It should be noticed that it was particularly favourable in terms of the Polish macroeconomic policy (reverse trends were observed in previous years). This is because the better part of export payments is settled in euro and a 15% depreciation against euro over the last 12 months was crucial for the Polish exporters. It should be noted, however, that the scale of zloty depreciation against euro may not be explained solely by the movement in the cross exchange rate, as the zloty depreciated also against the basket of the two currencies – by 1.3% in 1Q03 and by 4.5% in 2002. Similar effect was observed as far as the real effective exchange rate is concerned (given exchange rates of all trade partners and inflation differences), which weakened by over 15% from the beginning of 2002 (to compare, the exchange rate in Hungary and the Czech Republic did not change).

Exchange rates changes

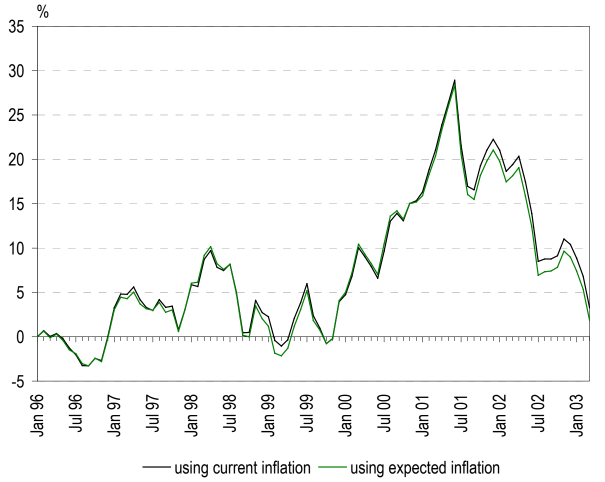
	Euro		*US$*		*basket 50/50*	
	average	*%QoQ*	*average*	*%QoQ*	*average*	*%QoQ*
1Q02	3.62	-	4.13	-	3.87	-
2Q02	3.72	2.7%	4.04	-2.1%	3.88	0.2%
3Q02	4.08	9.7%	4.15	2.6%	4.11	6.0%
4Q02	4.00	-2.0%	3.99	-3.7%	3.99	-2.9%
1Q03	4.19	4.9%	3.90	-2.2%	4.05	1.3%

Source: NBP, BZ WBK

The above-presented changes in exchange rates are particularly favourable against the above-mentioned NBP business survey, which queried entrepreneurs about exchange rate guaranteeing exports profitability. For USD, the average level was defined at PLN 3.86, which would mean, that after the recent euro appreciation against USD and the dollar decrease against PLN even below the level of PLN 3.80, exporters trading in USD could incur losses. However, as has already been mentioned, euro exchange rate is more substantial – almost 60% of export payments are settled in Euro, while it is slightly over 30% in USD. The NBP analysis suggests that the unfavourable Euro exchange rate from the export perspective is only PLN 3.85. It is almost 0.5 PLN stronger than the current levels, which represents an additional impulse for the Polish exports, and at the same time it supports the thesis of a positive impact of exports on the Polish economy t the beginning of this year. Especially as, the common European currency is still very strong against the dollar, which means that even despite strengthening of the zloty against the basket of the two currencies, Polish exporters may perform relatively well. Longer period of EURUSD rate at above 1.1 level has increased chances that the European currency will remain strong for another couple of months. This of course causes the change of nominal FX forecasts of the zloty against both currencies (new forecasts in the tables at the end of this report)

A measure that may present well the total change in interest rates and exchange rate, i.e. change in the monetary policy is the so-called monetary policy restrictiveness index. This index is a weighted sum of changes in the real interest rate and the real effective exchange rate (with the respective weights of 1/3 and 2/3). A real interest rate can be measured in two ways – using current inflation (ex post approach) or its expected level (ex ante), which may be important given the probable inflation growth in the following months. We would rather prefer the second approach, although one can find advocates of the first one even among the MPC members. For instance, Wiesława Ziółkowska in her interview for *Gazeta Bankowa* (of 5 May 2003) said that real interest rates in Poland are still "much above standards applied in the civilised world", providing examples of some European countries where the asymmetry between the main interest rate and the current inflation ranged from 1.8% to -0.4%. The chart below presents the index calculated in two ways. The fact that both lines are very similar indicates that inflation outlook (we used average inflation expected by banking analysts) are adaptive to a great extent and adjust along with the changes in the current inflation. What is most important, however, is the fact that the chart indicates that after the period of substantial growth in the monetary policy restrictiveness from the beginning of 2000 to more or less 1H02, substantial expansion was recorded which has (and is bound to have) a measurable impact on the economic situation development.

Monetary condition index



Note: higher value means higher restrictiveness of the monetary policy
Source: NBP, BZ WBK

Limitation of the monetary policy restrictiveness is accompanied by a continued fiscal expansion. The phenomenon is discussed in detail on many occasions, therefore in this case we focused on a few basic facts. This is another year in a row when budget deficit reaches (exceeds) 5% of the GDP, and budget expenses this year grow nominally by 5%, i.e. by almost 4% in real terms. All indicates that next year will be similar (or even worse) and the real growth in expenses may exceed the real growth in GDP again. Relation of the entire public funds sector deficit to GDP is even higher, due to faster growth of total public sector's expenses. It goes without saying that some of the expenses have a direct impact on the increase in domestic demand. Let us mention the growth in social expenses only, which accompanied by a positive inflation surprise gives a substantial impulse in real terms, visible in the form of a faster growth in consumption as the target group of the expenses features a relatively low propensity for saving. Of course, high fiscal deficit has very negative consequences for economic growth. High supply of treasuries may lead to the growth in long-term interest rates. If deficit is financed by foreign investors then the zloty appreciates resulting in a deteriorated price competitiveness of exporters. If it is financed on the domestic market, then money volume that could be allocated to financing business operations or consumption goes down.

Economic update

- **Industry expands, construction shrinks**
- **Signs of consumption weakening**
- **Exports keep growing, ambiguous data on imports**
- **CPI slightly up but core inflation fell again and there is not threat for inflation in the nearest time**

In the previous issue of MACROscope we focused on inflation outlook. This month we decided to look closer at real economy performance and in *Special focus* section we wrap up results of the Polish economy in 1Q03 as well as analyse economic growth prospects in subsequent quarters. In view of the above, as regards real economic activity indicators (industrial production, construction output, retail sales, and foreign trade turnover) below we discussed only March's data without any profound analysis of results in the entire 1Q03. Besides, as usual we describe current inflation performance (confirming the scenario presented by us a month ago), trends in monetary statistics (stagnant tendencies seem to be maintained) and performance of this year's budget (which has been seamless so far except for the low privatisation proceeds). Moreover, we present data published by the Polish Agency for Foreign Investment indicating the decrease of FDI inflow to Poland.

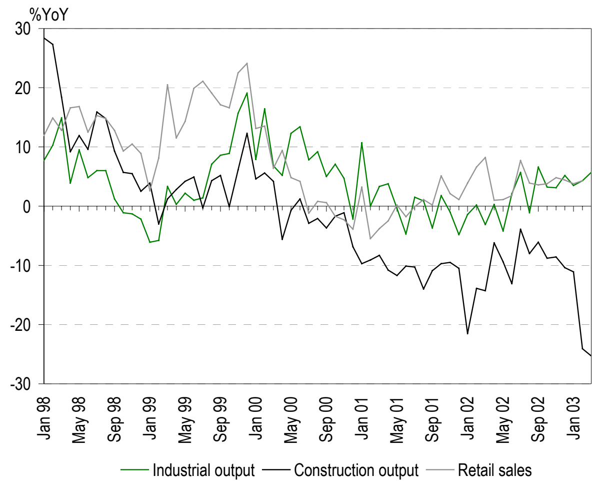
Better industrial output, construction much worse

Industrial output in March upsurged by 12.3%MoM, taking annual figure up to 5.7% against analysts' expectations at around 4%YoY. At the same time the CSO revised data for February - slightly up to 4.3%YoY from 4.1%YoY. Production in manufacturing rose by 7.2%YoY, in utilities grew by 1.7%YoY while in mining dropped by 8.0%YoY. Seasonally adjusted industrial production rose in March by 2.4%MoM and 5.4% in annual terms. The structure of industrial output growth across branches shows that it was driven to a large extent by exports. At the same time, investment activity remains stagnant, which is signalled by another month of slump in construction sector. Production in this sector increased by 16.1% on a monthly basis due to strong seasonal effect but in annual terms negative dynamics of construction output deepened to -25.3% from revised -24.1% in February.

Weaker retail sales

According to the CSO retail sales in March increased by 12.5%MoM and fell -1.7%YoY, following 4.2%YoY growth recorded in February. Even though we have anticipated some slight deceleration of sales growth amid gradual deterioration of private consumption demand, the data came as a surprise and were substantially weaker than predicted. In line with expectations retail sales growth rate was pushed upwards mostly by the sale of motor vehicles (6.7%YoY) and fuels (9%YoY). Food sales, which was another dragging force of the overall sales dynamics, decelerated to merely 0.7%YoY (from 22.4%YoY in February) – most likely due to the fact that this year Easter was in April. The deepest fall was recorded in case of clothing and footwear (-11.8%YoY), furniture and household appliance (-9.2%YoY), medicines and cosmetics (-4.5%YoY), which would suggest that indeed consumers' demand is getting weaker. We tend to believe that such deep deterioration of retail sales performance probably was also caused by one-off factors and therefore it does not fully represent a permanent shift of trend (we do not forecast retail sales to fall in annual terms in subsequent months). Nevertheless, it seems likely that our earlier presumption about gradually diminishing consumption growth has already started to materialise – retail sales' growth rate for February has been also revised down to 4.2%YoY (from 4.7%).

Economic activity indicators



Source: CSO

...and weak consumer optimism

Weak data on retail sales were accompanied by publication of April's consumers' optimism survey performed by Ipsos-Demoskop institute. The results confirm our view mentioned above about likely deceleration of private consumption during this year. All measures of consumers' optimism fell on both monthly and annual basis. The overall optimism index (WOK) fell by 3pts as compared to January, and what is more, the index fell also by 5.3% on annual basis. The decrease was driven mainly by lower propensity to consume (down by 1pt on monthly basis and by 3.5% as compared to April 2002) connected with complicated political situation and poor financial stance of households. The assessment of the overall economic climate was even more negative – it dropped by 8pts than a month ago and fell sharply on annual basis (by 13.3%).

Foreign trade turnover keeps accelerating

Contrary to weaker retail sales, results of Polish foreign trade reported by the CSO have not showed signs of weakness so far. According to foreign trade data on a customs basis Poland's trade gap in January-February period widened to €2.14bn from €2.0bn in the corresponding period of last year. Both exports and imports grew at relatively high pace. However, for the first time since several months the figures showed that imports dynamics was higher than exports growth rate (see table below). This is on contrast with central bank's statistics (described by us last month) presenting faster growth of exports than imports (and even falling imports in euro terms in February). Data on customs basis suggest that our hypothesis about postponement of some imports' payments amid weaker zloty in February might be true, but one have to wait for NBP's data for next months to see a confirmation (according to the central bank fall of imports was continued in March – details below). If it were true, it would indicate that investment activity keeps improving in 1Q03. Similarly to previous months, figures expressed in euro terms were lower than in other currencies as a result of significant euro appreciation.

Foreign trade statistics

	Jan-Feb 2003		
	PLN	USD	EUR
Export (%YoY)	14.3 (21.8)	21.3 (30.4)	0.1 (6.8)
Import (%YoY)	15.7 (11.5)	22.7 (19.4)	1.4 (-2.0)
Trade balance (bn)	-8.8 (-6.9)	-2.3 (-1.8)	-2.1 (-1.7)

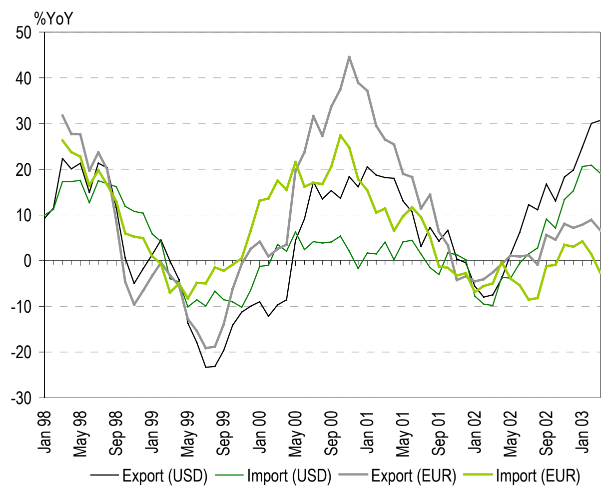
Note: Dynamics according to balance of payments data in parenthesis
Source: CSO, NBP

Low C/A gap, weak imports and high surplus in unclassified flows

The NBP published balance of payments data for March. The figures showed that both trade gap and current account deficit were much below market consensus forecast and our predictions. Current account deficit reached €237m compared to €483m in February, falling to the lowest level since 9 months. The cumulative 12-month current account deficit in relation to GDP fell to 3.1% after the first quarter of 2003, reaching the lowest level for more than five years.

One of the key reasons for C/A gap reduction was the decline of trade deficit (to €486m from €586m in February) amid still reasonably strong export performance and lower imports. Exports expressed in euro terms were 6.6% higher than in March 2002, while in US dollars the growth reached 31.4%YoY. Such results suggest that still there are no visible signs of Polish exports' deterioration despite very poor economic performance of our main trading partner, Germany. Annual growth rate of exports in the first quarter of this year was exactly the same as in March (6.6%YoY) and slightly above the average rate recorded in 2H02 (6.1%YoY), which has to be recognised as a positive news confirming earlier presumptions. However, there were also less encouraging results, as imports fell in relation to corresponding period of last year for the second consecutive month – the annual change amounted to -3.8%YoY against -5.1%YoY in February. One should be cautious with interpretation of this decline, because it was combined with sharp zloty depreciation recorded in that period. As we have written above, one possible explanation is that some importers, who believed zloty weakening was temporary, delayed some import payments awaiting reversal of the exchange rate trend (which indeed materialised in April). An alternative explanation is the deterioration of domestic demand, which also finds some evidence in other data (e.g. fall of retail sales and construction output recorded in March). This option would be surely less favourable for economic growth prospects.

Foreign trade turnover (3m moving average)



Source: NBP, BZ WBK

A positive feature of the data, contributing to the fall of current account deficit, was higher than expected surplus of unclassified flows. It reached €444m against €323m in the previous month and €159m in March 2002. In our opinion this resulted from two factors. First, still good results of unofficial cross-border trade. Second, it probably reflected the fact that economic agents took advantage of temporary weakening of the zloty in March to sell foreign currencies. On the other hand, as we expected, current account figure was negatively affected by negative income balance. It exactly matched our expectations amounting to -€298m, which stemmed mainly from high foreign debt interest payments in March.

Quite interesting were developments on capital and financial account of the balance of payments. Net inflow of FDI to Poland in March was only €59m, which has been the lowest level for several years. This reflects to a large extent slowdown of the privatisation process in Poland (only 3.0% of assumed revenues from this source were collected in January-March period) but also weakness of the global economy and falling attractiveness of Poland as a destination of foreign investments. Portfolio investment, which recorded exceptionally high inflow in February, fell by €94m in March. However, the worsening should not be perceived very negatively as it most likely resulted from temporary factors. Let us recall that March saw the breakdown of the ruling coalition in Poland and the beginning of war in Iraq. These factors led to outflow of short-term capital from Poland regarded as a higher-risk market. However, given the scale of capital inflow in February (€2.66bn) only €94m outflow in March does not seem to signal significant worsening of investors' attitude to the Polish market.

Falling inflow of FDI to Poland

Downward trend of foreign direct investment (FDI) inflow to Poland visible in the NBP data for the beginning of this year started already in 2002. The Polish Agency for Foreign Investment (PAIZ) said that inflow of FDI to Poland in 2002 amounted to US$6.06bn, down from US$7.14bn in 2001. In 1990-2002 period Poland has attracted US$65.1bn of FDI, mostly to manufacturing, financial, trade and communication sectors. The biggest investors have been France, the United States and Germany.

The deceleration of FDI inflow to Poland in 2002 was a consequence of both external and domestic factors. According to UNCTAD (United Nations Conference on Trade and Development) global FDI flows in 2002 fell for a second year in a row (by 27%YoY in 2002 alone) due to global economic slowdown and a drop in the number of cross-border M&A transactions. Of course, these unfavourable trends affected also Central and Eastern European Countries, including Poland. However, domestic factors seem to be of great importance as well. First of all, 2002 saw stoppage of privatisation process, which was important factor attracting foreign investors in previous years. Second, the reason for lower attractiveness of Poland as a direction of FDI inflow was a worsening of domestic macroeconomic situation in recent two years.

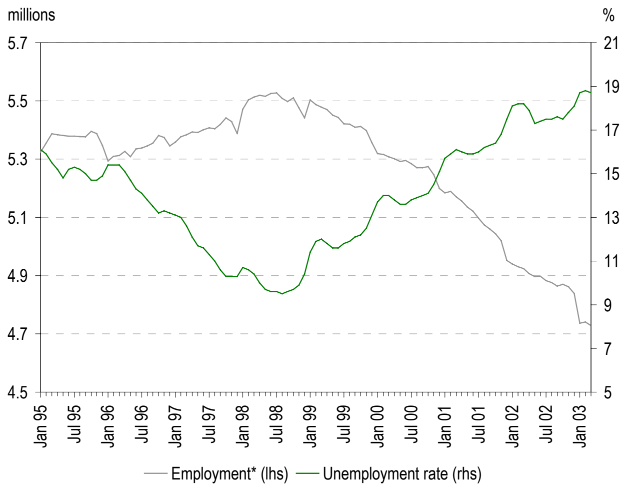
Deputy economy and labour minister Andrzej Szejna announced that this year FDI in Poland might reach US$7-8bn adding that their level would definitely not be lower than in the previous year. In his opinion the growth will be stimulated by, among others, new ways of attracting investors to Poland, such as changes to PAIZ and offset contracts. Well, we think that it would not be enough to boost FDI inflow in this year, particularly that realisation of offset contracts is not likely to start on a large scale in 2003. Moreover, there is high probability that privatisation process will be delayed also this year.

Unemployment rate slightly lower

Slow economic recovery is not sufficient to improve the situation on the labour market (among others due to reasons described by us in *Special focus* section). The registered unemployment rate in March declined slightly to 18.7% from 18.8% recorded in February, which was a bit above our expectations. The number of unemployed fell by 0.7%MoM, however it was still 1.9% higher than in the corresponding period of last year. The monthly decrease of the unemployment rate was driven mostly by the appearance of seasonal jobs, and as we have written before, still does not represent actual significant change of negative trend on the labour market. However, we predict that the unemployment rate in subsequent months will continue to fall amid continuing seasonal improvement. At the end of 2003 the registered unemployment rate should reach around 18%.

For the time being labour shedding process is continued. The average employment in the enterprise sector declined by 0.3%MoM. In annual terms drop of employment deepened again to -4.0%YoY from -3.9%YoY in previous month and -3.0%YoY on average in 4Q02. Such figures are surprising given very low statistical base. However, further reductions in employment are consistent with enterprises' declarations in business climate surveys pointing to further cut in employment in the course of this year.

The unemployment rate and average employment in corporate sector



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

Lack of wage pressure in the economy

The CSO said that average wage in the enterprise sector amounted to PLN2267.57 in March increasing by only 1.4%MoM and 0.7%YoY. This was lower than market expectations and it most likely stemmed from low scale of annual rises of salaries, which usually take pace in March. As we wrote many times in the past, employers most likely did not decide to increase wages substantially this year amid very low inflation and growing unemployment rate. As a result of low wages' dynamics and deep fall of employment, wage bill in the enterprises sector fell in nominal terms by as much as 3.3%YoY – the lowest dynamics ever – after only 1.2%MoM increase in March. In real terms wage bill slipped by 3.9%YoY.

March's CPI above expectations

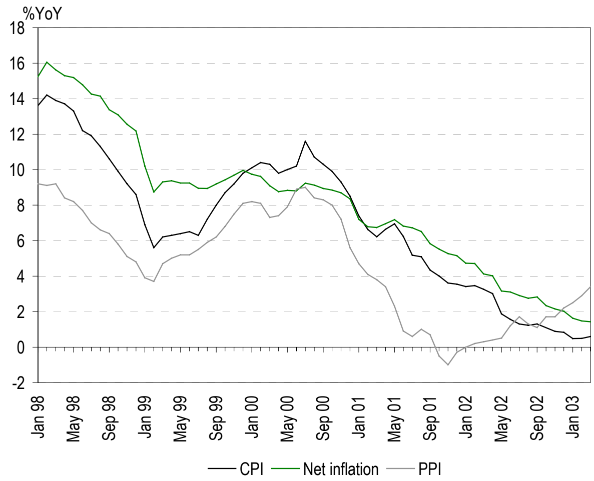
The CSO said that CPI in March grew by 0.3%MoM and 0.6%YoY. The figures were higher than our expectations and were in the upper end of market forecasts (ranging between 0.4% and 0.6% in annual terms with the average forecast at 0.49%). Higher than expected growth of CPI stemmed mainly from high increase of transport prices which reached 1.5% on a monthly basis and as much as 8.5%YoY being pushed upwards by strongly rising fuel prices (3.3%MoM and 17.4%YoY). However, this should be rather temporary phenomenon. In next months growth rate of transport prices should decline as oil prices on global markets began to fall amid positive course of conflict in Iraq. Other elements of CPI basket were broadly in line with expectations. Food prices increased by 0.3% on a monthly basis (preliminary data on food prices pointed to 0.4%MoM increase) and plummeted by 3.5% in annual terms dragging down the overall index of consumer prices. Alcoholic beverages and tobacco prices increased by 0.1%MoM and dropped by 3.6%YoY while clothing and footwear prices recorded 0.5%MoM and 2.1%YoY decreases. On the other hand, flat rents and energy prices grew by 0.1%MoM and 3.8%YoY.

All in all, March's inflation figures are consistent with recent trends and expected inflation path. Although annual CPI in March increased in comparison with two previous months, the CSO's data confirmed that inflation remains very low and there are no reasons for significant acceleration of inflation in the medium-term.

As food prices growth in April 2002 was the same as in April this year (preliminary CSO's data showed that they grew on average by 0.6%MoM) this factor will be neutral for annual inflation rate in April. However, there were two other strong sources of price growth last year, which are unlikely to repeat this time: prices of fuels and medicines. Fuel prices upsurged 3.1%MoM in April 2002, while this time they are likely to drop (by at least 1%MoM) amid positive sentiment after conclusion of the Iraqi conflict. In turn, prices of medicines and health services recorded 1.6%MoM hike last year amid the so-called "Łapiński's effect" – an introduction of new rules for refunding medicines (which according to the government was aimed al lowering drug prices). Those two one-off factors contributed to relatively high monthly increase of CPI in April 2002, and this "base effect" is likely to push annual inflation figure down in April 2003. We forecast annual CPI growth at 0.2-0.3%MoM and 0.3%YoY in April, down from 0.6%YoY recorded in March.

We still forecast that after drop of annual CPI in April inflation would gradually accelerate to around 2%YoY in December. Last month we wrote that expected inflation path for this year might change after the CSO have published modified (due to changed in consumer basket) index of monthly CPI changes in 2002, which could affect forecasts of annual CPI dynamics for consecutive months of this year. However, the modification turned out to be not significant enough to cause significant changes in forecasts of annual inflation path this year.

Measures of inflation



Source: CSO, NBP, BZ WBK

...but core inflation keeps falling

Core inflation measures released by the NBP proved to be very optimistic, confirming that there is no visible threat of inflationary pressure in Poland in the medium term. Annual growth rate of three out of five indices declined in March in relation to February (in fact even four if we take into account three decimal places). In case of one core measure that inched up a little – CPI excluding most volatile prices – the increase was much smaller than the corresponding growth of CPI dynamics (+0.05pp against +0.08pp). Two measures that fell into red already in February, i.e. CPI excluding controlled prices and CPI excluding most volatile prices and fuels, not only remained below zero but fell even deeper, reaching –0.55%YoY and –0.21%YoY respectively. And of course all of the measures remained well below 2% being the lower end of MPC's inflation target for 2003 (the highest one, i.e. "net inflation" reached 1.42%).

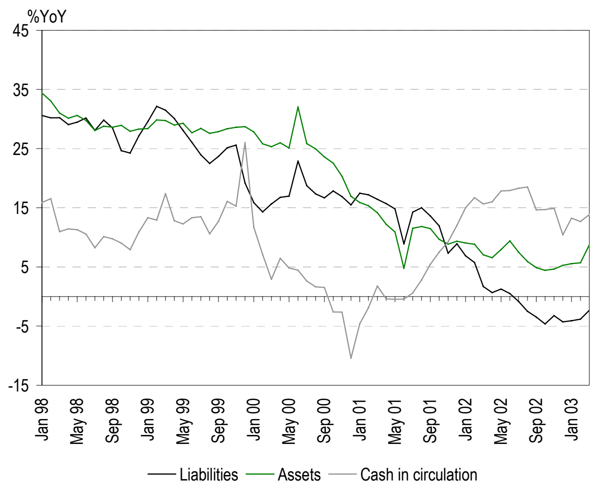
Oil prices boosted producer prices

Producer prices grew 0.7%MoM in March, bringing annual PPI up to 3.4% from revised 2.9% in February. Annual figure for March was much above market consensus of 2.9%YoY. As expected, the most important factor responsible for PPI acceleration was a growth of oil prices (4.1%MoM increase of prices in oil products industry). PPI inflation increase was surely also a result of last month's zloty weakening. Besides, similarly to recent months, rise in annual PPI stemmed from low statistical base effect. The latter phenomenon will be observed also in a few nearest months. Nevertheless, annual PPI should decelerate in months to come as oil prices on the global markets have already eased in April following success of allied forces in Iraq, and the zloty started to strengthen again. Therefore, in our opinion increase of PPI does not represent major inflationary pressure and as one-off phenomenon should not be interpreted as an argument against interest rates reductions. One should remember that amid weak demand temporary increase of producer prices is not likely to translate into rise of prices paid by consumers

Improvement in monetary statistics?

The NBP said that in March broad money decreased by 0.2%MoM while in annual terms money supply growth rate returned into black after seven consecutive months of contraction, growing by 0.4% compared to March 2002. Total deposits in the banking sector slipped by 2.5%YoY against 3.9%YoY drop in February, out of which the most important was fall of households deposits (-5.8%YoY against -5.5%YoY in the previous month). On the other hand, corporate deposits growth rate accelerated to 10.7%YoY from 9.4%YoY in February.

Assets and liabilities of the banking sector



Source: NBP

March saw some revitalisation on the credit market. Total loans dynamics grew to 8.7%YoY in March from 5.7%YoY in the previous month. This resulted mainly from improvement in corporate credits. It grew by 8.3%YoY after only 1.1%YoY in the previous month and 1.2%YoY on average in 2002. However, one should not forget that the improvement is to a large extent a result of low statistical base effect. The NBP changed a methodology of calculating money supply last year, and it seems that a part of business credit was classified as household credit in March 2002 (unfortunately the data were not revised). For the same reason, households' loans growth rate decelerated to 7.2%YoY from 9.3%YoY in the previous month - contrary to corporate loans this reflected relatively high base last year. All in all, the figures for March showed that the situation does not deteriorate anymore but there is still too early to talk about reversal of negative tendencies in monetary statistics.

Budget performance in line with expectations

The Ministry of Finance published official data on budget performance after three months of this year. Budget deficit after March reached PLN15.5bn, i.e. 40.0% of the plan for the whole year – less than in the corresponding period of last four years.

Budget revenues after three months amounted to PLN33.3bn reaching 21.4% of the plan. Annual growth of revenues decelerated to 6.5% from 5.9% after three months of this year. This resulted mainly from improvement in direct taxes dynamics. Revenues from CIT fell by 5.8%YoY in January-March period but it was much better result than 9.7%YoY drop after February (CIT revenues fell by 1.7% in March alone) while PIT revenues increased by 9.4%YoY from 7.7%YoY after February. On the other hand, annual growth rate of revenues from indirect taxes (VAT and excise tax) decelerated to 7.4% from 8.3% after two months of the year. Total budget revenues are still growing faster than on average in 2002 (3.2%) which suggest that there should be no major problems with revenues collection in 2003.

Budget spending after March stood at PLN48.8bn or 25.1% of the plan. It was 2.2% higher than in the corresponding period of 2002 against average growth of expenditure in the whole year planned at 6.3%. The highest growth of expenditures was observed in foreign debt servicing costs (up 95.1%YoY in January-March period against 19.5%YoY drop after February) which reflected higher than usual interest payments in March. Also, as expected, high growth of expenditures was observed in subsidies to Labour Fund (12.3%YoY growth after March) and subsidies to Social Security Fund (15.5%YoY increase after three months of the year).

Structure of budget deficit financing did not change in comparison with two first months of the year. Revenues from privatisation are still very low, accounting for only 3.0% of the amount planned in the budget for the whole year. Thus, the deficit was financed through increased issuance of treasury papers. The value of sold treasury bills reached 80.3% of the plan and the value of issued treasury bonds stood at 44.8% of the plan. After March the Ministry of Finance has used almost all funds from the previous year (97% of the plan).

Central bank watch

- **Fourth time a quarter**
- **...what is more, the MPC is still in dovish mood**
- **...and "hawkish faction" is not very stable**

Fourth time a quarter

In April the Polish Monetary Policy Council cut main interest rates for the fourth consecutive time this year. The reference rate was reduced by 25bps to 5.75%, Lombard rate fell by 50bps to 7.25% and deposit rate remained unchanged at the level of 4.25%. Similarly as in February the scale of rates' reduction aimed not only at lowering the nominal level of main central bank's interest rates, but also at narrowing the gap between Lombard rate and deposit rate, which determine the band for short-term interest rates fluctuations on the money market. The decision, as well as its explanation, met our expectations. After macroeconomic data releases, which confirmed that economic recovery is very slow without significant threats for inflation prospects in the medium-term, it was almost certain that the MPC decides to cut rates again in April. If they did it in March when there were some 'hawkish' arguments calling for more caution, why should they hesitate this time?

In the official statement describing the decision, the MPC listed out the conclusions from economic data released since previous MPC meeting, and they were almost exclusively factors leading to an improvement of inflationary outlook – oil prices' reduction, strengthening wage discipline in Polish corporations leading to lower growth of private consumption, low dynamics of M3 and stabilisation of cash growth, low inflationary expectations, weak perspectives of economic growth in the Euroland. As usual, the MPC pointed out the remaining potential sources of inflationary pressure: gradual increase of PPI amid zloty weakening, likelihood of exceeding this year's planned economic deficit of public finances and uncertainty regarding fiscal policy in 2004. Nevertheless they were not highlighted by the Council. Quite contrary, NBP president Leszek Balcerowicz scaled down the argument regarding PPI acceleration, saying that it was mostly caused by exchange rate depreciation, which is not persistent as the MPC anticipates a strengthening of the zloty. In our opinion, April's interest rate decision together with the MPC statement prove one more time that the Council is ready for more monetary easing, as its perception of economic situation in Poland assumes rather slow improvement of activity in the real sector without any significant pressure on the price growth in the medium-term. The MPC did not give a detailed inflation forecast, but Leszek Balcerowicz said it "does not differ much from market average" (according to the latest PAP poll market analysts expected CPI to reach 2%YoY in December 2003, 2,2% in March 2004 and 2.1% on average in 2004 as a whole).

This all suggests that the next interest rate cuts are in the pipeline and we do not change our scenario of one more cut in 2Q03 (possibly already in May, after the release of April CPI showing another record-low level inflation) and two reductions of 25 bp in 2H03. Additionally, the MPC is expected to lower obligatory reserves requirements in 2H03. At the end of this year we might see the NBP's reference rate at 5%. We believe the MPC would continue its "small steps" approach and subsequent reductions would not exceed 25bps, however both Janusz Krzyżewski and Dariusz Rosati suggested that MPC members are not unanimous as regards such gradual approach. Nevertheless, Leszek Balcerowicz strongly defended this strategy of small reductions during the MPC press conference, saying that relative scale of rate cuts (as a ratio to nominal level of interest rates) remained unchanged and therefore the scale of reductions cannot increase if nominal interest rates are lower.

Three MPC members against rate cut in February

Official results of voting at February's MPC meeting were published in the Government's Monitor. It showed that three members were against rates' reduction - Marek Dąbrowski (as usual), Cezary Józefiak and Wojciech Łączkowski. February's decision (similarly as January's) was widely expected, and therefore it is difficult to draw any conclusions for the future decisions of the MPC from the fact that other hawks supported the reduction. Namely, Jerzy Pruski, who voted against rate cut in January, supported the decision this time, while Wiesława Ziółkowska was absent. Voting results should not change expectations for next monetary policy decisions.

Comments of the MPC members and central bank representatives

At the beginning of April, most of the comments made by representatives of the Polish central bank concerned MPC's opinion regarding Programme for Restoration of Poland's Public Finance and the possibility (or rather the lack of it) to use the revaluation reserve, which we already described last month.

The comments of the MPC members, following the April's decision to cut interest rates, referred mainly to the inflation outlook and the overall situation of the Polish economy. The projections of the MPC concerning medium-term pace of inflation are still optimistic, whereas the short-term projections are diversified. For example, Janusz Krzyżewski brought the air of pessimism stating that in April inflation would go up to 0.8%YoY (even though he has been recently heard talking about deflation in Poland). In the environment of the gradual, not too fast economic recovery anticipated by the central bank, MPC members do not envisage any major threats to the inflation target. Nevertheless, according to the majority of them, the MPC should remain cautious in respect of its monetary policy, i.e. to continue small-step approach.

Representatives of the NBP also expressed their opinions regarding policy of the new MPC (which will open its term in the office at the beginning of 2004). Both MPC's Dariusz Rosati and deputy president of the NBP Andrzej Bratkowski agree that not too much room will be left for the new MPC in terms of interest rate cuts, due to expected acceleration of the economic growth and growing inflation. Rosati even went as far as to say that the new Council would have to increase interest rates as Poland was approaching equilibrium, i.e. the moment when both reduction and increase in interest rates are equally likely.

WHO. WHEN. WHERE	COMMENT
Leszek Balcerowicz, NBP governor; PAP, 24 Apr	We maintain a forecast of gradual recovery in the economy. Growth in industrial output and data on imports and exports are among factors that prove it. Roughly speaking a 2.5% GDP growth forecast prepared by the central bank is being confirmed. The strength of wage discipline increased and there is a connection between wage discipline and monetary policy. [...] Still low inflation expectations of households and bank analysts and low core inflation indicators advocated for interest rate cut. In reaction to our rate cuts banks on average reduced more interest on deposit than on loans. This discrepancy was higher as regards loans and deposits for households than entrepreneurs. [...] Such difference can occur because of lower competitiveness in case of [services for] households. [...] Increase of competition is therefore one of the ways to reduce this phenomenon. Additional, if interest on the obligatory reserve was introduced, it would also help in elimination of this asymmetry.
Reuters, 24 Apr	The sequence [of factors supporting interest rates cut] does not mean any hierarchy. Generally, we look at available inflation forecasts and make our decision basing on direct inflation targeting strategy. (...) We also closely observe monetary statistics.
PR1, 10 Apr	It may be concluded that implementing main points proposed in this document [public finance reform programme] is not sufficient to reach declared goals. […] yet, our point is to repair something permanently, in order that the growth would be much faster and persistent with keeping something that is really valuable for development and the people, namely low inflation, price stability. I hope that within further works the plan will be completed, so that it would be well known that the companies and new entrepreneurs would have much better conditions of operation, that tax burden would not increase, that spending would be in fact limited permanently and not with extemporarily cuts but with carefully planned reforms. [revaluation provision] It is a book-keeping entry. If one had to change this entry into real money than the money should be printed.
PAP, 9 Apr	The MPC adopted the opinion [on public finance reform programme] unanimously. It will be handed down to the ministry today and released on Thursday.
PAP, 8 Apr	The revaluation provision is a book-keeping entry. Money has to be created and this will stimulate inflation. The role of an independent central bank is to prevent it. The comeback of bad practices will not heal public finances. This will not help the budget. […] In this case the central bank would have to sell bonds paying to banks higher interest rates than that paid by the budget while it sells bonds. The budget would get less funds from NBP profit […] According to the EU accounting standards ESA 95 freeing of part of reserve would be perceived as budget revenues for deficit financing. […] It is not worth the trouble. Some people say the zloty should be weaker, but I do not share this opinion. In Poland we have high ratio of taxes into national income and therefore in the environment of weak growth, public finance reform should be consternated on the spending side. It would be beneficial for Poland to enter the Eurozone as soon as possible (possibly in 2007), later entry is worse than earlier entry. Fast euro adoption is the best strategy for candidate countries.
Jerzy Stopyra, deputy NBP governor; PAP, 4 Apr	There are no fundamental circumstances for the zloty to weaken, there are certain political factors, which may cause such weakening, but these are transitional factors.
Andrzej Bratkowski deputy NBP governor PAP, 30 Apr	When the new MPC forms at the beginning of 2004, there will be rather no room for interest rate reductions. Because one should not believe that under low inflation and growing GDP responsible economists would undertake a risk to lower interest rates even more. But if it happens anyway and interest rates are reduced in early 2004, it would probably lead to growth of inflation. Sooner or later it would enforce monetary tightening, being more costly than maintaining cautious monetary policy all the time. At the moment interest rates do not hamper economic activity any more, even 100bp rate cut would not change much in this situation. When it comes to foreign investors and their behaviour on our market, Poland is already in the EU. Would this process be stopped, would the outcome of the referendum be "NO", then foreign investments would flee and zloty would plummet sharply. If we sacrifice ourselves for staying outside EU, we would be doomed for stagnation scenario connected with the rise of market and real interest rates and upsurge of debt servicing costs. Then instead of GDP growth path of 4-7% p.a. we would have at most stagnation at 1-2%. Additionally strong expenditure cuts would be required in order to prevent total collapse of public finance amid sharp increase of debt servicing costs. Now it is hard to forecast what will be the zloty exchange rate in two years time, or at the moment of ERM-2 entry. One cannot rule out that [...] the exchange rate would be 4 zloty against euro, but it will depend on the economic situation, GDP growth, and also on the EURUSD exchange rate. One should not hurry too much with fixing this exchange rate, one should rather wait and analyse various scenarios. In the long term Polish currency would tend to appreciate. However the worst case for Poland would be the gradual appreciation followed by sharp depreciation. We can negotiate some level of the exchange rate and then it might turn out that the market disregards it. Therefore we have to seek for economic backing rather than setting this exchange rate arbitrarily. NBP's forecasts are close to market analysts' predictions, saying about ca. 2% inflation at the end of 2003. This year's bottom would most likely take place in April, when inflation might drop to 0.3%YoY.

PAP, 10 Apr	I do not exclude co-operation with government in active debt management like it was the case in operation on Brazilian debt. Freeing the reserve is money issuance no matter for what reason payment would be made. […] Such an operation cannot be treated as the way to decrease the gap between expenditures and revenues, because the provision is not budget revenue. Savings from lower public debt issue would be lower than transfers to the budget from the profit of the NBP. This operation would not make any sense in present economic condition.
Bogusław Grabowski; MPC member; Radio ZET, 11 Apr	I agree that public finance reform is needed, but the proposals included in minister Kołodko's programme cannot be treated as deep reform we needed. This reform should be supported by changes on the supply side of the economy and faster privatisation. Kołodko's plan will not lead to GDP growth acceleration, as there are no instruments presented, which would support such a scenario. This is not a complex, long-term solution of Polish public finance problems, and this plan only finds money to finance EU contribution. On the other hand, we have minister Hausner's programme, which shows some supply side elements, but it does not treat public deficit issue. Neither plan should be realised, but both should be a base for further discussion inside the government, between the cabinet and different political parties. If there is one plan, and there is a second plan, and they are presented by two ministers, being in personal conflict, one thing is certain the final result will be negative. There is no excess of money in revaluation provision, this is only accounting measure, which shows how much foreign exchange reserves increased on accounting basis, as a result of weakening of the zloty within the last 13 years. Any transfer of money from this reserve will lead to printing money [...] Public finance reform is needed, including cutting spending to make room for EU contribution payments. Because this is not only a question of 2004, it is a matter of 2005, 2006, the years when EU contribution will rise further. If we have a "filler" like this in 2004, which will have inflationary impulse, what will happen in 2005?Will we print money every year?
PR3, 9 Apr	It has to be recognised that [the programme of public finance reform] is still under construction. By no means it cannot be perceived accepted as a plan for restoration of public finance. Because what we have been presented is very negative. [...] First of all, it is a plan of relaxing rather than tightening fiscal policy [...]. We have ca. PLN50bn budget deficit per year. Although the minister declared he would like to reduce it by PLN10bn, so far he did not present any solutions. Thus, so far we are talking about PLN50bn budget deficit a year. [...] It is 20% higher than this year. It is PLN50bn of absorbing potential sources, which could be directed for financing companies. [...] There would be problems with financing such deficit. Even if it was financed, then it would be at the cost of zloty strengthening, because speculative capital would surely have to come. The competitiveness of Polish economy would deteriorate. Long-term interest rates, which are crucial for investment decisions, would have to remain high all the time. Undoubtedly it would hamper economic growth, modernisation of Polish economy and job creation. On the spending side we have ad hoc and short-term freezing of some expenditures, which is not an institutional and permanent reduction of budget spending. For example freezing social expenditures or pensions or freezing nominal expenditures on state administration [...]. Those are ad hoc measures. What would happen in a fourth consecutive year? In a fourth year those expenditures would explode and everything would return to the previous state. An besides during those three years we have relaxation of fiscal policy rather than tightening.
Cezary Józefiak, MPC member; PAP, 22 Apr	GDP growth in 2003 would be closer to 2.5% than 3%. We should not associate economic revival with consumption growth, but with investment growth, which in 4Q02 moved a little in relation to previous quarter. However in YoY terms it is still in red. [...] Consumption plays an important role now, but it is sustaining output rather than accelerating its growth. Monetary policy is not supposed to impact economic recovery, but it is rather to stabilise prices. From this point of view it should be still, supporting price stability. There are no planned meetings with finance minister [on the use of revaluation provision]. There are certain rules of accounting and it is clear that this provision is not money held for hard times, but it would have to be printed without a reason. From this point I do not believe this discussion is supposed to develop further.
Janusz Krzyżewski, MPC member; PAP, 24 Apr	[reducing interest rates in small steps] This opinion is not shared by all MPC members. The restrictive character of the monetary policy was maintained, the decision was not unanimous but there was an advantage of votes, which determined the easing. I favour a small-step policy as bigger reductions could cut with the foreign exchange rate.
PAP, 14 Apr	Inflation in April will go up by 20 bp to 0.8%, because this is the month when holiday shopping is large. I doubt that it may continue such a rapid growth, by 20 bp; I think it will grow at a slower pace. However, inflation pace may be faster after vacations. Then we will see more clearly the results of policy loosening. I do not believe it may exceed 2% at the end of the year and that is why I think inflation will be at 1.6-2%.
Jerzy Pruski, MPC member; PAP, 24 Apr	Our rates as of today are on a proper level. The MPC is predictable. There is no shift of accents. The way the situation is evaluated is the same and is unchanged. The MPC states that from 2004 we will deal with a stabilisation of inflation. Then, the picture of the situation should contain different economic data. Central bank can influence credit policy of sector of commercial banks to very limited extent. One of the way of influence, that was used, was repurchase of inflation indexed bonds. It was aimed at supporting banking sector and causing decline in difference between credits and deposits. […] Another factor is connected with business climate. Acceleration of economic growth, though weak, must translate into changing of assessment of the risk related to financing entrepreneurs by the bank.
Dariusz Rosati, MPC member; Reuters, 28 Apr	I just do not believe that the Parliament will pick megaoptimists and lunatics [for the new MPC members]; I think these will still be economists wary of the threats of reckless monetary policy. […] I also think that by next February interest rates will also be at a level, which leaves little room for drastic reductions, particularly given expectations that economic growth will accelerate and unemployment will fall. GDP growth in the first quarter was slower than expected while the softening of the jobless rate is symbolic and largely seasonal […] no inflationary factors are observed. […] There is no inflation pressure so there is room for further cautious rate reductions. Inflation will rebound slightly but generally it will be like in civilised countries, i.e. inflation will have to be stabilised and not carry on a disinflation policy that requires high real interest rates. In my opinion, in the future one will have to return to normal policy of interest rates, I mean raising rates in a period of growth revival and reducing during slowdown period. At last we are nearing a moment of equilibrium, a moment when interest rates may go up or down. I believe that in the future inflation consistent with fast economic growth can amount to 3-3.5%, or even higher. This will have less importance after entering the Eurozone, but before euro adoption, the central bank may have no choice but to act to contain that extra inflationary pressure.

TVN24, 24 Apr	We expect that in 2H03 the acceleration in growth will be very clear and that in 4Q the economy will rise at 4% and the unemployment will be significantly lower than at the beginning of the year and the inflation will rise slightly, but so much to endanger inflationary target, i.e. to ca. 2%. […] The worst period for Poland is over. The MPC was cutting interest rates in the way not to increase inflation and at the same time to help real sector. […] Could we cut by more than 0.25 pp.? The opinions differ, maybe we could, but the MPC have proved many times that it is very cautious.
Reuters, 24 Apr	Given the current situation and the line-up of the MPC it is hard to imagine cuts deeper than 25 basis points.
PAP, 17 Apr	Production growth in March does not represent a sharp recovery, because no rebound of investment can be seen. GDP growth, which reached 2-2.2% in 1Q03 is an effect of high exports growth and consumption growth. In 2Q03 economic growth would accelerate and in 4Q03 it should reach 3.5-4%, contributing to GDP growth by ca. 3% in 2003 as a whole. Growth of producer prices in March is a consequence of oil price hike and depreciation of zloty. It was expected and is not a persistent trend.
Puls Biznesu, 16 Apr	I notice lack of co-ordination within the Council of Ministers, the disagreement between minister Jerzy Hausner and Grzegorz Kołodko has been building up for several months. It is not good that two programmes come out of the government and are disclosed the same day at two different press conferences. Neither of those programs is a public finance reform, because there is no correct diagnosis. The structure of expenditure is the problem – huge share of social benefits and very small investment and pro-development spending. Another problem is high fiscalism. [...] Before the referendum I do not expect not only any reform but also any announcement of it. [...] I support many Hausner's proposals but I wait for consistent economic programme. Time plays for the government – the economic cycle pushes GDP growth higher and higher. Structural reforms are necessary to push it higher even more.
TVN24, 1 Apr	Within next 2-3 months the zloty should strengthen, unless we have an unexpected failure in the referendum. With the zloty at around 4.4 against euro, I think that both current and previous finance minister should be happy, as they were dreaming about this level. We can achieve 3% GDP growth this year.
Grzegorz Wójtowicz, MPC member; PAP, 30 Apr	For the past 12 months C/A deficit might be estimated at 3.1% of GDP, which is record [low]. For the whole year [it should amount to] 3.5% of GDP. Those figures confirm what was happening in preceding months. They show that both exports and imports keep developing well, confirming that we are facing some pro-growth factors in the economy. Export growth in the whole year should be favourable. Acceleration of growth, especially in investments, delays. One should suspect it would take place in 2H03.
PAP, 17 IV	Data [on industrial production in March] are optimistic, and show that 1Q03 should not be worse than 4Q02, and perhaps it was even slightly better. It is a green light signalling that those pessimists saying Polish economy was not expanding were all wrong. Industrial output fluctuates from one month to another. We used to expect that subsequent quarters should be better and better. Such expectations have been embedded in the construction of inflation target, therefore there are no surprises in this respect.
Rzeczpospolita 15 Apr	Present growth of prices is too small to affect long-term inflationary expectations. In the near term inflation might be a subject of changes to food prices and zloty exchange rate. Zloty weakening might cause price hikes of the imported goods, but this effect usually shows up with a time lag.
Reuters, 14 Apr	It is hard to say whether [inflation growth] was an effect of statistical round-up or any deeper changes. [...] It is not a substantial change. Previous forecasts saying that price growth would be gradually accelerating until year-end up to 2% are still up to date. One should not be too much concerned about current inflation. [...] The question MPC is trying to answer is how it influences the future.
PAP, 9 Apr	This year, GDP growth will range between 2.5-3.0%. In 2004 GDP growth will be closer to the upper limit of government forecasts [4.9%], and the stimulus will be Poland's entry of the European Union and an entry-related growth of investment.
Rzeczpospolita, 1 Apr	I know there are such suggestions [that new MPC members' appointment influence current, more dovish MPC decisions] , but in my opinion we can treat them only as provocative speculations. There is no connection at all with current MPC policy and expectations concerning our successors.
Wiesława Ziółkowska, MPC member; PAP, 14 Apr	A slight drop of inflation to 0.5-0.6% in April will stem from the statistical base. Inflation at the end of the year will be below the inflation target, which means it will not exceed 2%. It seems that increase in fuel prices will not appear amid finishing Middle East conflict. […] In 2Q fluctuations in inflation of 0.2-0.3% are likely and they were forecasted earlier. Despite the fact that there is still room for interest rates cuts the reduction in April is unlikely. We will see how public finance reform programme will be accepted.
PAP, 9 Apr	The discussion [on public finance reform programme] was stormy and our opinion concerns the original draft we had obtained for a RPP meeting in March.

Government and politics

- **Kołodko's modified his programme, but gave no additional information**
- **The government will discuss it later**
- **Hausner-Kołodko conflict to be continued**
- **...and support for the government rides down the hill**

Big show, little new information

On 8 May finance minister Grzegorz Kołodko held special press conference, which was believed to reveal many new details of fiscal reform programme modified by the Ministry of Finance after the series of consultations carried out with various groups and institutions. Unfortunately, this loudly pre-announced conference was not very informative. Most of information that appeared during the presentation were already known and have been cited by the media before and we have also written about them in our earlier reports. The biggest disappointment was that we have not seen a word about projected budget expenditures' level, while the attention was once again focused almost entirely on budget revenues. Even though there was information that budget deficit should reach 4.7% of GDP in 2004 (4.8% according to ESA-95 methodology employed in the European Union), it remained unclear where is the famous 'gap' that appeared in the previous version of the programme (amounting to PLN10bn p.a.) and what would be the actual level of budget spending. What is more, planned budget revenues remained unchanged despite the fact that a few tax changes would clearly lower budget revenues.

Amendments referred to the tax system were officially confirmed. Finance Ministry resigned from cancelling the automatic indexation of old-age and disability pensions and agreed to leave the possibility of mutual tax settlement for married couples and single parents with a child. Nevertheless all other tax write-offs and allowances would be removed completely. In exchange there will be the new PIT tax rate introduced for the poorest, amounting to 17%. Corporate income tax will be reduced to 19% from the current level of 27%, but in return all the allowances and write-offs for companies would be removed and all the entrepreneurs would be forced to pay CIT (whereas at present some of the SME pay taxes according to PIT scheme and some use other simplified taxation rules). Also there will be uniform tax on all kinds of capital gains equals to 19%.

As regards two major conflicts – with NBP on the use of revaluation provision and with Jerzy Hausner on the line of macroeconomic policy – Kołodko strongly underscored that he was not going to give up easily in the battles. Finance minister said that despite the consensus with central bank as regards the use of NBP's revaluation provision had not been reached, he was sure that those proceeds would be employed in a way the government intends, which is not against the law nor good economic principles. He also said clearly that income from releasing the revaluation provision would surely be included in the budget draft for 2004. Kołodko also heavily slashed the ideas promoted by economy and labour minister Jerzy Hausner. He said delaying Eurozone entry for the sake of maintaining large fiscal deficits in the subsequent years would be completely wrong and pointed out that such proposals are in fact implausible, as the Growth and Stability Pact requires maintaining fiscal discipline by all EU countries, not only those adopting the common currency. Kołodko firmly stressed such way of thinking would never find his approval, suggesting that in this regard he would not go for a compromise. Although one could have expected that after recent Kołodko's approval of Hausner's proposal to lower corporate income tax to 19% (he previously proposed 24%), the two programmes are getting closer.

Well, it seems that the disagreement between Kołodko and Hausner as regards the main line of macroeconomic policy is indeed substantial and it remains to be seen who would be victorious after the whole cabinet approves its ultimate stance. Meanwhile, the date of government's decision in this respect is delayed again to allow introduction of some additional improvements (possibly we will see a longer conflict between finance minister and economy minister in the media, as a result). This suggests that the tension is quite high and the approval of Kołodko's programme is indeed far from pure formality. Until the government's decision, the uncertainty regarding fiscal policy prospects would remain substantial. In particular, we still do not know whether budget deficit next year would amount to PLN40bn or PLN50bn and what would be budget spending level (not to mention deficit and spending of the whole public finances sector).

Different schools of thinking

Minister of economy continues his attacks on finance minister's programme. A disagreement is still important and was described by Hausner as "different schools of thinking", "a fundamental conflict" or "two kinds of logic". The main arguments are still the same – Hausner still sees a room for additional demand impulse from the fiscal policy side (quite strange given two consecutive years of huge deficit of total public finance sector), while Kołodko tries to bring fiscal deficit down within next few years to Maastricht criterion level (unfortunately, by higher tax burden to a large extent). According to Kołodko, demand impulse on the consumption side is sufficient, as private consumption rose by 3.5%YoY in real terms in 4Q02. On the other hand, Hausner would like to see an additional stimulus and “the incomes of the lowest income groups should not be reduced”. And each we can see more differences between the two programmes. Hausner proposed that tax-free personal income should be increased to 4000PLN from 2800PLN proposed by Kołodko, giving an extra consumption impulse of PLN4bn. And a macroeconomic risk of such an operation could be reduced by freezing wages in the public sector and old-age and disability pensions. Well, this would be a good proposal (Kołodko has also supported it today), assuming it is the permanent solution, but it is to be seen whether this could be politically acceptable. If freezing public wages and social spending applies only for one year, there would be no support for the budget given low inflation level expected in 2004.

Government’s popularity riding down the hill

According to the April’s survey made by CBOS institute the support for present government and PM Leszek Miller nose-dived in April, recording all-time lows. Only 16% of Poles supported Miller’s cabinet in April, down from 24% in March. Only 12% (against 24% in March) appraised positively cabinet’s work. Even deepest fall was recorded as regards the assessment of PM Miller himself – the ratio of positive answers plummeted to 16% from 31% last month. According to CBOS institute no other cabinet recorded such negative results before. Perhaps the conclusion of our way towards EU and expected positive outcome of accession referendum would help the government to regain some of its popularity. Nevertheless, it is obvious that such sharp fall of government’s popularity does not increase the chances for success of public finance reform.

Comments of the government members and politicians

Last month we heard a lot of comments from members of the government. The summary below presents only the key issues to which they referred. The dispute over the economic reform of the government between the minister of finance and the minister of economy was still evidenced (and continued in May – see above). The table below is dominated by the two gentlemen; the comments refer also to (or rather dismiss) the possibility of introducing a potential change to the government and they "promote" (and, most likely, will keep promoting until something happens) the possibility of using the revaluation reserve. We skipped a number of repeating comments, nevertheless, the size of the table is still substantial.

The Ministry of Finance changed its macro-economic projections. The previous 1Q03 GDP growth projection publicised by representatives of the Ministry in various media gave the figure of 2.2%. According to Grzegorz Kołodko, GDP growth in 1Q03 reached 2.1%-2.2% whereas in 2Q it was in excess of 2.6%. According to Kołodko (though if you look at the table, it becomes clear that a lot of other politicians share his opinion) the NBP, running too rigid and destructive policy, is, to a large extent, to blame for the fact that his previous hurrah-optimistic growth projections were not met.

A lot of comments referred to the foreign exchange policy. The minister of finance is still in favour of EUR/PLN parity rate at 4.35, however, he emphasises that this rate is adequate only for the existing conditions and the most adequate parity for 2007 should be between 4.4 and 4.5. It might have been another attempt to reverse the recorded appreciation tendency of the zloty, which started following the quite unfortunate statement of the deputy ministry of finance. As we already mentioned last month, Ryszard Michalski said that the Ministry of Finance would start buying foreign currencies only when the zloty strengthened by ca. 5%. One of the reasons for the conflict between Kołodko and Hausner is also the date of entering the Eurozone. Kołodko thinks the year 2007 is a good year for Poland's entrance to the euro-zone, although the date is not as important for him as the ultimate parity against the euro. Hausner, on the other hand, thinks it would be wrong to run an economic policy the only objective of which is to enter the Eurozone. Moreover, the minister of finance expressed his concern that the European Commission and the European Central Bank might want to delay the entrance of the new EU member states to the Eurozone. Kołodko expects that in a year or two, the EU institutions might say that the economies of the new member states are not strong enough to get them admitted to the Eurozone even if they have met the nominal convergence criteria defined in the Maastricht treaty.

WHO, WHEN, WHERE	COMMENT
Aleksander Kwaśniewski Poland's president PAP, 4 May	Until the referendum i.e. 7-8 June there will be no changes in the government. I guarantee that. Of course I would prefer the government had higher popularity now. However any proposals of government replacement or any discussions in this regard 30 days ahead of the referendum are simply very silly. And any manipulations within the government would be highly irresponsible.
Leszek Miller, PM; PAP, 14 Apr	In my opinion they [real interest rates] are definitely too high and undoubtedly they lead to investment slowdown. The same concerns to exchange rate of the zloty, but leaders of Polish exporters probe that it is possible to overcome these difficulties.
Gazeta Wyborcza, 12-13 Apr	There would be only one [government's economic] programme. It would be "refined" Kołodko's programme, enriched with some of the Hausner's proposals. One has to remember that it is Grzegorz Kołodko who is supervising all economic policies of the government and that the cabinet "directionally" accepted his programme, while Hausner's programme was not even debated by the Council of Ministers. We cannot wait [with public finance reform programme], the cabinet would present complete programme of public finance reform somewhere in the middle of May, as consultations will end at the beginning of May.
TVP1, 10 Apr	The MPC is non-reformable, and it is good that its terms expires this year. […] I hope that new MPC members will conduct a different policy, which gives more chances to Polish businessmen, and abandons a very restrictive monetary policy. It will bolster investment but we have to wait for this. Minister Kołodko will have to think out how to find an effective antidote [given MPC's refusal to transfer money from the revaluation provision]. It complicates work on public finance reform programme, but cannot stop it. […] It is a pity that the MPC refuses to co-operate for repairing public finances due to very doctrinal reasons. [about his resignation] I do not foresee such a situation, there are no reasons. […] Yesterday the government proved again that in fact it is majority government and not minority one.
Polish Radio 3, 3 Apr	In terms of finance minister's programme, which was preliminary accepted by the cabinet and is consulted with various partners, I think that it may be accepted within three weeks by the government, when the results of consultations are known. This programme concerns mainly public finance. In term of minister Hausner's proposals, which were not discussed yet by the cabinet and this are only minister's proposal, it is focused on labour market situation and enterpreneurship. When I talked about earlier elections together with elections to the European Parliament, I mentioned about three assumptions. [...] I mean public finance reform accepted by the parliament, activity towards higher GDP growth [and this is the second package which should be applied] and budget for 2004. If one of these elements is not accepted by the parliament, the idea of early elections may be undermined.
Government Information Centre, 2 Apr	I have talked with all the remaining ministers today. I have asked if somebody plans to quit. And I say: there will be no more changes in the composition of the Council of Ministers. As a result of today's changes, in the government there are only those who can, want and are able to act on their positions for Poland's advantage, who have my full confidence and confide in each other. As Prime Minister and SLD chief, I think that new democratic legitimacy for the parliament and the government would be needed. In such circumstances, parliamentary elections could take place on 13 June together with the elections to the European Parliament.
Grzegorz Kołodko, deputy PM, finance minister; www.mf.gov.pl, 30 Apr	[Revaluation provision is not a virtual money] It exists and I ensure you that it would be employed in line with public interest, in line with macroeconomic logic and according to existing legal regulations. The assumptions of Budget Act for 2004 would be discussed by the government on 10 June in order to be passed to social partners for consultations until 15 June. In 2Q03 GDP will grow at least 2.6%, and perhaps even more [...] I forecast industrial production to grow 5.4% in 2Q03. This is "as much", however still too little to boost GDP growth above 3%. It will happen only in 2H03. [...] Why do we expect slightly lower economic growth now than several months ago? For two major reasons: One, bad economic climate in our trading partners, especially Germany, deteriorates even more. Second: NBP continues its wrong monetary policy, hampering economic activity and economic growth. If it was less restrictive, then GDP growth would be already above 3%. I have to add that 0.8% out of GDP growth is a consequence of government's programme of companies' financial restructuring [...]. Until the end of this year the unemployment rate would fall by 0.4 pct. point, which is a result of ongoing revival. I do not appeal to the NBP because I am not used to calling in vain. I just repeated [...] that there is room for [300bps] interest rate reduction. I have no doubts such step would not be taken by the MPC, which believes in wrong economic principles and recognises different objectives – not supportive for economic growth acceleration.

PR1, 30 Apr	The CSO thinks that GDP in 1Q03 increased by some 2.1%YoY, the same as in 4Q02. I think this may be a bit higher – 2.1% or 2.2%, but it is lower than previously assumed. [about MPC members] Some of them are good, others are better and others could be a little better and understand more what is going on. I respect independence of the central bank. And they cut rates only by 0.25 pp, though they could cut by 2-3 pp easily, which would be noticed by entrepreneurs.
PAP, ISB, 24 Apr	It is important that there will remain the mechanism of indexation of old-age and disability pensions, which allows for suspending of its functioning [for some time]. Today I propose – wage indexation should be zero, because inflation is very low. Next year the growth rates of budget spending and revenue might be similar to this year's. At the moment one should not expect any significant changes, although I still count on the possibility to lower budget deficit relatively [...] In nominal terms the deficit will be slightly higher, but in relative terms, if we are able to keep the economic recovery, it might be some fraction of percentage point lower than present 4.8% of GDP. The strategy is aimed at curbing spending expansion, to have its growth below GDP growth. In 2004-2006 expenditures will be growing slower than GDP. [Programme of fiscal reform] is a question whether to be or not to be for this government. In 2Q03 we have GDP growth rate close to 3%. In 1Q03 it was ca. 2.2% and in 4Q03 it would oscillate around 4%. I hope lowering CIT would not result in higher deficit. [...] If tax reduction was to boost the deficit, it would be irresponsible. All entrepreneurs that undergo economic business would pay a linear tax, low, reduced, without any tax deductions and exemptions and therefore they would have more money for investment and for consumption.
PAP, 23 Apr	After conversation with President I conclude that probably we will propose, in view of the elimination of all tax relief and write-offs, that the rate of the corporate income tax should be lowered to 19% and at the same time all entrepreneurs should be CIT payers. The 8-point cut would result in the state budget with PLN4bn, but an agreement on the elimination of all tax relief and write-offs is necessary. Revenues from in 2003 will total at least PLN5bn, and this is what we know for sure. We'll see what we'll be able to realise later. […] I am not for stepping up privatisation due to fiscal and income reasons. The budget law envisages for PLN9bn in revenues from privatisation. For the time being it seems that we'll have at least PLN5bn. This has influence on public finance, public debt and deficit financing.
PAP, 17 Apr	The FX rate will be fluctuating as it has been the case for some time. And the closer to the euro/zloty rate of 4.35, the better because it favours growth of exports, production and employment. If we met the Maastricht criteria now, then I think that the rate of PLN4.35 per euro would fairly well accelerate competitiveness of Polish companies, and would be close to a long-term balance price. […] It will turn out what it will be like in 2006. The rate should be made real; I would say that it will be 4.35 adjusted for accumulated inflation in 2004-2006, and therefore we have this suggested figure of between 4.4-4.5 for the euro. We will see what it will be like in a few years' time.
Reuters, 16 Apr	Macroeconomic situation is good. After 1Q03 industrial output grew ca. 4% and GDP growth reached 2.2-2.4%. April would be the first month when unemployment falls. Realisation of this year's budget is not under threat and there will be no need for the amendment. I am afraid that in a year or two doubts will arise whether new countries are strong enough for euro adoption, even if they meet required criteria. 2007 would be a good year of Poland's entry to the Eurozone, but I am not attached to this date. Decision must allow for competitiveness of Polish business.
Reuters, 12 Apr	The central bank is most of the time pushing the government to be even more cruel than we want to cut spending. I think the central bank is overreacting. There is still room for downward adjustment. If I was the governor of the central bank I would cut 300 basis points. I think the only way to convince them is to further cut the fiscal deficit so I will attempt to do my part of the exercise and I expect others to follow suit. I think that the rate of exchange that we have had recently is good and good for Polish industry, but there is objective pressure on the zloty in the pipeline so I expect appreciation over more time. I'm betting for that date [2007 as euro adoption]. If the fiscal adjustments are executed along my plan then I will be bullish and positive but if it is not we will have difficulties.
PAP, 10 Apr	I told it to them [government members] and I will tell it to them again explicitly. Either they accept this programme or Prime Minster will have to change his view or they will implement this programme or they can join opposition parties. […] When the government accepts this programme, which I count for, the second part will begin – carrying it over through the parliament. The central bank was leading in its policy to growing deficit, it was the bank that lead to a situation from which we try to find the way out, killing economic activity, narrowing tax base and causing fall in state budget revenues. […] I have nothing against implementing such an instrument, such an institution, for example in 2008 or 2009, that the NBP Governor should testify before Sejm's committee once a month like it is in the US. […] If there is a prospect of increasing budget deficit, I want to inform, as deputy PM, the independent central bank is entirely responsible for it. […] NBP's independence becomes more and more irresponsibility.
PAP, 9 Apr	At slightly lower turnover, companies' proceeds and profits are also slightly lower, and therefore there might a shortage of some budget revenues, but some items on the expenditures side may be lower as well. Speaking in real terms, a lower inflation is positive, if not for this year's budget, then surely for public finances. On the spending side there are the amounts, which are a function of the level of inflation, and I see no major threats after the first quarter for the implementation of the budget in 2003.
PR1, 9 Apr	Q: The European Commission said “unemployment rate will exceed 20% this year” and you said it falls A: The Commission is wrong. They should be ashamed of formulating such unprofessional forecasts. If they want to know about future unemployment rate in Poland, they can always call and ask me. Unemployment rate in Poland will be lower than currently, and in April it is lower than in March, and in May would be lower than in April. And this trend will continue in the following months. In 2Q03 GDP growth is higher than 2.5% and it is close to 3%. I think that at the end of this year GDP growth may be above 4% - if the Programme for Restoration of Public Finances is realised.
PAP, Reuters, 8 Apr	We may count that the 2004-2010 growth rate will be at least 5% a year. We may count on seven years of plenty after a few lean years. In second quarter this growth will be over 3%, and in the last quarter of the year it will be around 4%. […] In March-April unemployment should begin to fall. Joining the EU by Poland will positively influence economic growth, adding 1.5% a year to growth rate.
www.mf.gov.pl, 2 Apr	The level of final parity against the euro is more important than timing because this would be the unchangeable conversion. If it turns out that from long-term growth point of view, a delay is advantageous, we cannot exclude such a possibility. However, I disagree with a delay of Eurozone entry until 2010 already now.

Ryszard Michalski, deputy finance minister; www.mf.gov.pl, 29 Apr	Given an announcement of the CSO we had to lower our GDP forecasts for 1Q03. […] Everything suggests that average annual inflation rate will amount to ca. 1.1%, and at the end of April inflation rate YoY will amount to 0.3%. Also, it is optimistic fact, that unemployment rate is falling. To a large extent it results from seasonal factors, but also from our restructuring efforts, credit support for export and creating adequate business climate. Q. Has the MinFin bought foreign currencies on the market, yet? A. Not yet, given favourable market conditions.
www.mf.gov.pl, 8 Apr	[when joining the EU] Insufficient absorptive capacity of Polish institutional and economic structures for support funds will be our biggest problem. […] It may appear that we are not able to generate enough investment projects within supportive programmes agreed with the European Commission despite great needs in field of transport and communal infrastructure. Also, there might be a problem with gaining money for contribution from beneficients. From technical point of view, 2007 is the earliest possible date of euro adoption. This means that we will meet Maastricht criteria until that moment. Undoubtedly, the most difficult negotiations with the EU side will concern the setting final parity of the zloty against euro […]. This will be the key factor for the level of economic activity in Poland. If the rate is too high [zloty too strong], we could witness economic slowdown. On the other hand, too low rate [too weak zloty] may result in inflation acceleration being risky for Maastricht criterion. I think that the present price of the zloty against foreign currencies favours Polish exports, positively raises the cost of imports and recommends caution contracting foreign currency obligations, especially without proper hedging. Therefore, I see no need to lower the price for the time being but I see it necessary to stabilise it Q. At what stage are the negotiations with the NBP about revaluation provision? A. At the stage of technical problems, since the management of both institutions have already told everything. Q. At what FX rate is the MinFin going to buy foreign currencies for interest payments?; A. We want to purchase as cheap as possible directly on the market, let's say – by at least 5% below present quotations.
PAP, 2 Apr	The euro rate at 4.35-4.4 zloty helps boost exports and limits imports. I would be not afraid of further drop in the value of the zloty as basically the Polish economy is sound. Revenues from privatisation at the level of PLN4-4.5bn are feasible and will help us finance the deficit. We are used to cope with lack of funds from privatisation.
Andrzej Sopoćko, deputy finance minister; www.mf.gov.pl, 16 Apr	I believe that the compromise [between FinMin and the NBP with regard to revaluation provision] is necessary. Still, these are the most important bodies for the whole economic policy, not only financial policy. Despite the fact that two independent bodies exist, we have only one Polish economy. Now the revaluation provision is too high. We need this money to finance direct expenditures connected with participation in the EU. Spending revaluation provision for this purpose could not be characterised as inflationary outflow of money. It would be OK if present base [reference] rate of the NBP would be below 3%. Please don't treat this comment as a task for the Monetary Policy Council to do at its nearest meeting. Q. Will production be still rising by 4%? A. I suppose that the growth rate will be higher. It is usually the case that at the start of a process of economic pick-up growth accelerates above average expectations.
Halina Wasilewska-Trenkner, dep finance minister; PAP, 24 Apr	Next year, budget deficit will amount to some PLN40bn. It may range in between PLN39.5-41bn. To large extent it depends on economic growth rate.
Reuters, PAP, 3 Apr	The situation requires activity connected with reforming public finances and this is needed when budget for 2004 will be planned, which means very soon. These are challenges, which the economy put behind politicians. Without these changes, situation in 2004 would be very difficult. Some changes, which are necessary in the tax system, should be accepted by the parliament earlier. To be binding in 2004, some bills have to be accepted this year and a part of programme with an effect in 2005 should be accepted in 2004. According to our calculations, in favourable circumstances the Polish economy could grow by 2-2.5% annually, which means that catching up process with Greece or Portugal would take 37 years. If we grow by 5-6% this period shortens to 11-15 years.
Jacek Krzyślak, FinMin's research dep. PAP, 25 Apr	We lower our inflation forecast for April to 0.3%YoY from previously predicted 0.4%YoY. In May, annual CPI growth will increase to 0.6-0.7% due to deflation in May 2002 (low base effect).
PAP, 14 Apr	We maintain our earlier prediction that inflation in April will fall to 0.4%. In May only due to deflation in May 2002 YoY inflation will go up to 0.8%. We estimate that MoM inflation in May will go up by 0.2-0.3% as compared to April.
Jerzy Hausner, economy and labour minister; Puls Biznesu, 23 Apr	I induce the finance minister to more significant lowering tax burden […]. Let's do it in the safe way, however, I mean we should determine middle-term policy together. If I was asked if a temporary increase in budget deficit would be admissible as a result of my proposals I would say yes, it would be. It would be the temporary increase in deficit, but as a result of economic growth it would decline quickly. So, I would admit slightly higher budget deficit, but only as a result of lowering taxes, i.e. important factor of reviving economy. I believe it would be a mistake to conduct economic policy with entering the Eurozone as the only goal. […] Poland should aim at the Eurozone and there is no contradiction here. However, joining the zone should be a result of strengthening of economic fundamentals. I don't think that there is a contradiction between the plan of activity of my ministry and the task of reforming public finance. That is because I definitely support the reform and I will support the finance minister in this work.
Radio ZET, 17 Apr	I suggest [...] revising program of fiscal reform by [including] ministry of economy's action plan, which is oriented towards revitalising entrepreneurship, job creation, and economic revival. I suggest accepting those proposals, considering real tax reduction. [...] It is all about revitalising consumption demand and investment demand. [...] I believe it can be resolved. But if we two [Hausner and Kołodko] cannot agree – and I cannot rule out that we would not be able to agree on several issues – then there is prime minister and the government to reconcile this. I want to make it clear: I will obey political decisions of the government.
PAP, 10 Apr	I would prefer the climate between the government and the MPC to be the climate of joint solutions not of criticism. I would like the MPC to refrain from criticising the government actions especially if these actions have not been finally approved. Lower taxes would be an impulse for demand growth. I mean a significant CIT reduction, which would give a possibility to exclude PIT from CIT rate. The level, starting from which it is possible, is 19%. Increasing of investment demand is very important issue, but the question is "how to do this?". It seems that via lower taxes, and the scale of reduction may be discussed. Low consumption demand is also a barrier. To increase demand, especially of social groups with the lowest incomes, it would be reasonable to increase tax-free income. It is simpler solution comparing with introduction of 0% tax rate. Liquidation of all tax deductions is not possible. The proposal of finance minister was set to achieve as much as possible. This is only hypothetical proposal and I do not think the FinMin will insist to cancel all tax deductions. Also in 2Q03 and 3Q03 the economy is driven by exports, which shows its competitiveness. But is it sufficient to achieve 5% GDP growth in 2004? Infrastructure investments have a lot of potential, but effects are not visible in the short-term. Without investment acceleration there is no possibility for achieving such high growth rate. Public finance reform is necessary, but we have to define areas [...]. One of the issues will be lowering the share of fixed spending by disindexation and liquidation of valorisation mechanism, with some exceptions.

Reuters, PAP, 9 Apr	The year-end's unemployment rate will surely be lower than in December 2002. This year is a year of reversing trends. A 3.5% growth of GDP in 2003 is feasible and ambitious but difficult to achieve. We will surely achieve a 3-percent growth. In this economic situation the lowering of taxes is a condition necessary to achieve economic growth.
RMF FM, 5 Apr	Deputy PM Kołodko thinks that conditions for higher GDP growth in the longer run will be created by tighter fiscal policy and by higher tax burden. I do not think so. For me the target is to revive the economy and to achieve high GDP growth because only in such circumstances we can meet macroeconomic criteria. I think about structural policy, and Kołodko about macroeconomic policy. We agree that budget deficit in 2004 should be higher. But I think that it should be even higher, although of course I am against such a policy in 2005-06. Lower budget deficit cannot be achieved when the economy is stagnating, as it is at the moment. We can do this only when the economy starts to pick up. And that is why the problem of economy reviving is the most important for me. These activities [aimed at reviving enterpreneurship, job creation, higher growth] will be presented in line with my schedule, which starts in April and ends in 3Q03. I think that tax burden should be lowered. To realise the second part of the programme, we need a contribution of infrastructure and treasury ministers.
Małgorzata Okońska-Zaremba, deputy economy and labour minister; PAP, 1 Apr	We are finishing preparing the report about enterpreneurship in Poland and the conclusions will be helpful in preparing the second part of *Enterpreneurship First* programme. We think that main assumptions will be discussed by the cabinet at the end of April. This package will not only be a continuation of last year's programme, but will focus on much wider perspective. We would like to remove all barriers from entrepreneur's live.
Jacek Piechota, deputy economy and labour minister; PAP, 1 Apr	The programme prepared by the Economy Ministry is not competitive with finance minister's programme. It concerns different aspects of the economy. Kołodko's programme includes macroeconomic situation, general finance conditions for business activity. Our programme focuses on microeconomic problems connected with business activity. I am certain that deputy PM Kołodko, who claims very often that his programme aims at economic recovery, will take into account the opinions, which underline lower effective tax burden for firms and households. The government set the time schedule for the second stage of Ministry of Economy's programme and decided that one of the committees will discuss it in the near term.
Piotr Czyżewski, State Treasury minister; Rzeczpospolita, 29 Apr	[about privatisation revenues in 2003] I think that an amount of PLN5bn can be treated as realistic, though I do not exclude that we will be successful in reaching PLN7.4bn.
PAP, 2 Apr	I am taking an organised office and I think that I could implement the adopted programme without difficulties.
Danuta Huebner, minister for European affairs; PAP, 15 Apr	At earliest after one year of ERM-2 membership we would be able to decide about the date of the Eurozone entry and consider pros and cons of euro adoption at a right moment. [...] After one year we would see what happens to economy, finance, exchange rates, we would see what would be the parity. [...] Poland is a big economy and should not shorten the period of ERM-2 membership.

EU Integration watch

- **The Accession Treaty signed**
- **Parliament decided about two-days referendum**
- **EU integration - more benefits than costs**

The Accession Treaty signed

On 16 April the officials from all 15 EU member states and 10 candidate countries signed the Accession Treaty during EU summit in Athens. The document summarises terms and conditions of European Union enlargement that will take place on 1 May 2004. For Poland the Treaty was signed by PM Leszek Miller, foreign affairs minister Włodzimierz Cimoszewicz and European affairs minister Danuta Huebner. Also president Aleksander Kwaśniewski participated in the ceremony, whose one day earlier signed into law the bill regulating land sale in Poland, setting restrictions for sale and ownership of rural areas for Poles and foreign citizens. The approval of this bill especially pleased peasants' parties. Jarosław Kalinowski – head of PSL, former coalition partner, said that after the bill has been accepted his party should say YES for Poland's EU accession, which is surely good news before the accession referendum, as it might increase the chances for the positive outcome.

The parliament decided about two-day referendum

One day after the Treaty as signed, the Polish Lower officially ordered accession referendum in Poland. During the special session the deputies finally decide on the date and duration of the accession referendum. The referendum was scheduled for two days on 7th and 8th June. Two-day referendum was supported by those who are afraid that the turnout of the referendum will be lower than 50% and it is supposed to increase the turnout making the results binding. Another idea is to publish the turnout results during the referendum (after the first day), which brought positive effect in Lithuania.

Rising support for the accession, turnout uncertain

According to the latest TNS OBOP public opinion poll carried out at the beginning of April, two months before the accession referendum, Poles' support for the EU membership increased. 71% of those declaring the will to participate in the referendum would support the accession (against 66% in March), 20% would be vote NO (23% in the previous months) and 9% was still undecided. While the results are optimistic the thing which concerns presently is the turnout in the referendum. In April 49% of Poles were certain that they would take part in the referendum and another 29% said that they would rather participate in the voting. 8% of polled persons were sure they will not go to vote and 8% declared they would rather not do it. 6% of Poles still do knot know whether they will go to vote. Results show very strong support for the EU membership but it is not sure whether people will go and vote, which would lengthen the process of the accession treaty ratification in Poland.

Report on benefits and costs of the EU accession

In April, during the regular meeting the government discussed (although did not accept it as the official document) the report on the balance of benefits and costs of Poland's membership in the EU. The document was prepared by independent research institutes and academics on the order of the European Integration Office (UKIE). The time horizon of macroeconomic analyses included in the report covers 2004-2014 period, i.e. 10-years period starting from the first year of Poland's accession to the EU. According to the report, already in the first years of EU membership (2005-2007 period) Poland will experience investment and consumption boom (12-14% and 4% growth rates a year respectively). This will lead to acceleration of GDP growth to 5% and increase of current account balance to around 5% of GDP. However, authors of the report believe that it will not create threat for external stability of the Polish economy, particularly that they expect rising inflow of net transfers from the EU. Therefore, current account deficit will diminish to 4% of GDP in 2008-2010. Polish enterprises will undergo restructuring process during that period and the economic growth will slightly decelerate to 4%. Nevertheless, GDP growth will speed up again after 2010 to above 5%. Inflation in the whole period after EU accession is envisaged to remain relatively low at 3-4%. All in all, GDP per capita in Poland in 2014 will increase to 55% of the average in the EU from 41% in 2004.

The report presents also alternative scenario assuming that Poland does not enter the EU. In this case GDP growth in Poland is not likely to be higher than 4%. Moreover, the zloty exchange rate will significantly depreciate (up to above PLN7.0 against the euro in 2014) leading to acceleration of inflation (above 5%). Overall, the difference in economic development between Poland and the EU would considerably increase. The document unambiguously speaks for the EU membership, which may be helpful before the accession referendum, particularly that it was prepared by independent researchers.

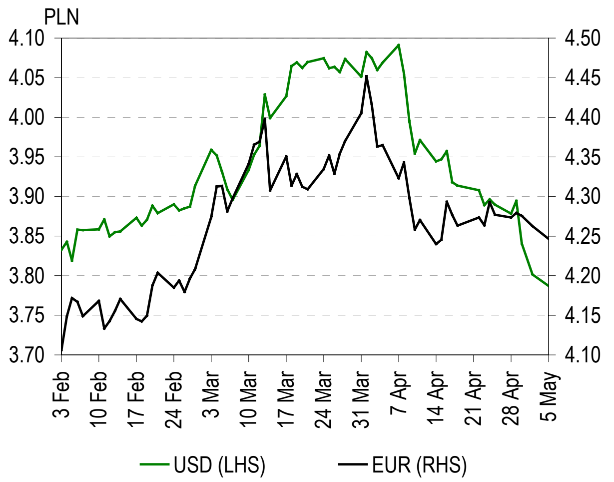
Market monitor

- **The zloty catches up on its March losses**
- **The dollar trades the weakest in last four years against the euro**
- **Treasuries strengthen on the bonds market**

The zloty impacted by ministers' comments

April was less turbulent on the Polish FX market than March that witnessed four waves of zloty weakening. However, trade was relatively robust given Easter in the second half of April, which was followed shortly by a long weekend in May. Moreover, contrary to March, the zloty recorded ca. 4% growth against the dollar-euro basket, thus it caught up on its March weakening. The zloty strengthened in particular against the dollar, which weakened globally against major currencies, and EURUSD exceeded the level of 1.12 at a month-end. Despite the completion of the war in Iraq, sentiment for the dollar remains negative due to poor recovery recorded by the American economy.

Zloty FX rate in recent 3 months

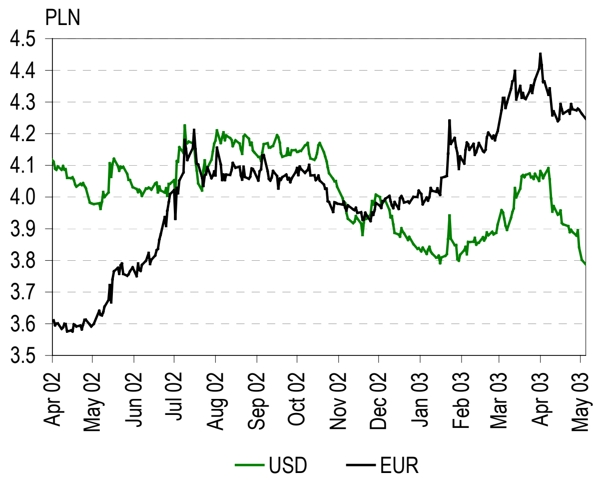


Source: NBP

According to the NBP fixings, in April the dollar traded from PLN3.8406 (on 30 Apr) to PLN4.0910 (on 7 Apr) and PLN3.9633 on average (against PLN4.0095 in March). The euro traded from PLN4.2390 (on 14 Apr) to PLN4.4518 (on 1 Apr) and PLN4.3020 on average (vs. PLN4.3342 in March). The zloty returned to stronger rates faster than we expected, therefore the average exchange rates of both currencies were lower than those projected in the previous issue of MACROscope - 4.03 and 4.35, respectively.

Still on 31 March there was a sale wave that brought about a 1.7% fall of Polish currency within three hours. However, since 1 April the zloty has started to grow from a very low level that was perceived by foreign investors as favourable for buy. At first this movement was rather slow, and it accelerated on 9 April in reaction to Michalski's (deputy minister of finance) comment on exchange rate. In turn, in the beginning of a week before Easter the zloty appreciation trend was distorted by some uncertainty related to the conflict between the finance minister and the economy minister in respect of the government's economic policy (see *Watch* section).

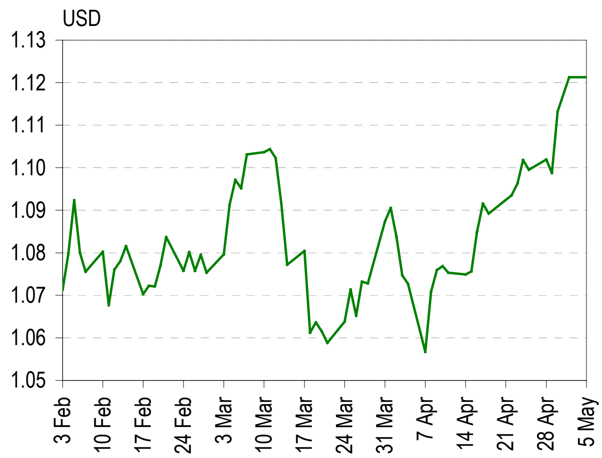
Zloty FX rate in recent 12 months



Source: NBP

The period between Easter and a long weekend was relatively active on the market. Zloty exchange rates were stable although the last days of April saw appreciation against USD with a significant demand and EURUSD surge.

EUR/USD FX rate



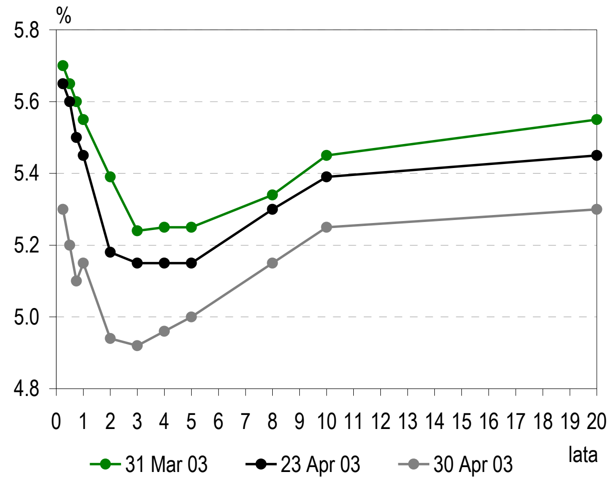
Source: NBP, BZ WBK

Early May the zloty continued strengthening against the dollar, as EURUSD exceeded 1.145. In one day (7 May) Polish currency depreciated by 1% against the currency basket after another reveal of Kołodko-Hausner conflict.

Yield drops after interest rates cut

Treasuries strengthened over the entire month. By the MPC decision date, i.e. 23 April, yield decrease was slow and gradual except for 2-year sector, which recorded a significant growth after the new benchmark tender held on 2 April. On the second day of the MPC meeting, still before the decision announcement, some weak supply was created by those who did not expect a cut. After the decision was made, there was a substantial demand for treasuries and the yield curve bent down. This trend continued up to the early May, which indicates that the MPC decision surprised a large group of investors who started to buy bonds after the decision.

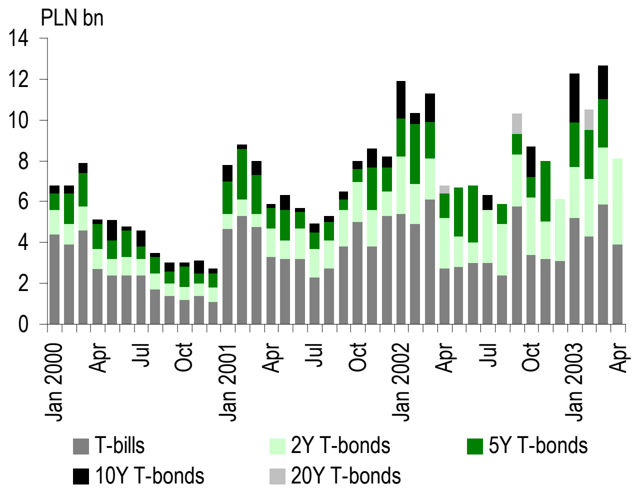
Yield curve



Source: BZ WBK

At the tender of 16 April, despite a significant supply (PLN3bn), the Ministry of Finance sold all 5-year bonds PS0608, and the demand totalled PLN11.4bn. The average yield went down to 5.218% and was below the expected level, but it was higher than on the secondary market. The following day, in the course of a supplementary tender, the demand was very high and all treasuries offered were sold (PLN600mln), as the average price of the first tender was prevailing (it was lower than the current market level). Wednesday, 7 May there was a OK0405 2-year benchmark tender. Bonds totalling PLN2.8bn were offered and the demand (PLN7.5bn) was clearly higher than supply, however, it was substantially lower than that recorded during the recent 2-year treasuries auctions. Of course, all bonds offered were sold and the average yield went down to 4.812%, reaching the level close to expectations and market quotations. A supplementary tender was not organised, as the budget debt needs are lower in May.

Supply of Treasuries



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

The Ministry of Finance announced that at the auction on 21 May supply of 5-year PS0608 bonds would range in between PLN2.0-3.0bn.

Treasury bill auctions (PLN m)

	OFFER (SALE)			
Date of auction	13-week	26-week	52-week	Total
07.04.2003	300 (300)	-	1,000 (1,000)	1,300 (1,300)
14.04.2003	300 (300)	-	1,000 (1,000)	1,300 (1,300)
17.04.2003	300 (300)	-	1,000 (1,000)	1,300 (1,300)
April total	900 (900)	-	3,000 (3,000)	3,900 (3,900)
05.05.2003	-	-	800	800
12.05.2003	-	-	700	700
19.05.2003	-	-	800	800
26.05.2003	-	-	900	900
May total	-	-	3 200	3 200

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	3,600	3,600	-	-	-	-
May	07.05	OK0405	2,800	2,800	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	-	-	-	-	-	-	-	-	-	-

* with supplementary auction

Source: Finance Ministry

International review

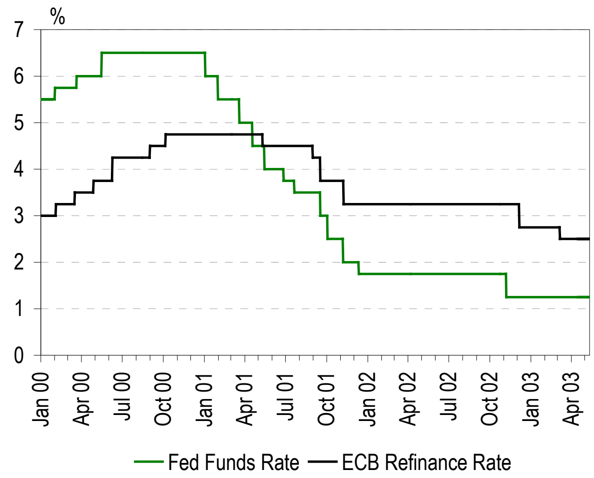
- **Interest rates remained unchanged**
- **Inflation in the USA above the European one**
- **GDP growth in the USA below expectations**

Less restrictive definition of price stability

At the meeting on Thursday 8 May, the Council of the European Central Bank did not change interest rates. The decision matched analysts' expectations. After the latest rate cut in March, main Eurozone's interest rate – refinance rate – stands at 2.5%, which is the lowest level since the fourth quarter 1999. The Council decided that in future it would aim at keeping inflation rate in the Eurozone around 2%. Despite the fact that the ECB did not change present meaning of price stability i.e. price growth rate below 2%, in practice the decision means the modification of the definition. Eurozone's M3 money supply growth rate amounted to 7.9%YoY in March so it remained unchanged from February's level that was revised from 8.1% released previously. Analysts expected that money supply growth would amount to 8.1% in March.

At the meeting two days earlier Federal Open Market Committee left interest rates in the United States unchanged, as well. Similarly, this decision matched market expectations. Federal funds rate remained at 1.25%, the lowest level for 40 years. In the statement the Fed warned that there was still a risk of slow economic growth in the American economy. Such stance can suggest that in June interest rate cut will be implemented if signals of economic revival are weak.

Interest rates in the USA and Eurozone



Source: Reuters

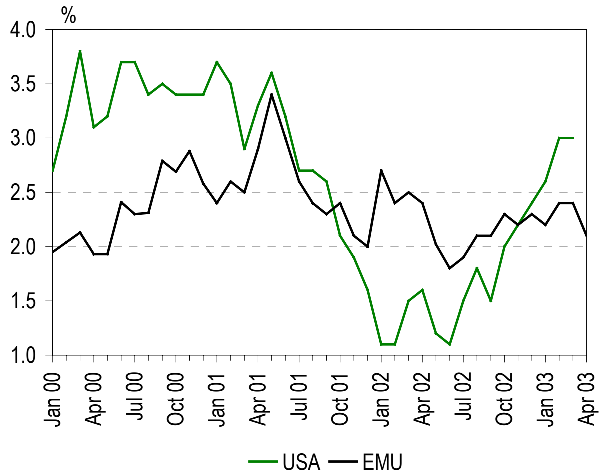
Inflation in the USA much higher than in the Europe

According to final calculations, inflation in the Eurozone amounted to 0.6%MoM in March. Annual inflation rate did not change since February, amounting to 2.4%, which matched preliminary estimations. Analysts expected inflation at 0.5%MoM and 2.4%YoY. According to preliminary estimations, in April Eurozone's annual inflation rate declined to 2.1%, while forecasts pointed to its fall to 2.2%. April was a ninth consecutive month with inflation above 2.0%, i.e. target ceiling imposed by the ECB, as an indicator of price stability. However, as we write above, at the beginning of May the bank introduced some modification of the definition.

In March, producer prices increased by 0.2%MoM, which matched analysts' expectations. Annual growth rate of prices declined to 2.4% from 2.7% a month earlier, and this figure was below average market forecast of 2.5%.

In March consumer prices in the United States increased by 0.3%MoM, slightly slower than analysts' forecasts of 0.4%, which translated into remaining annual inflation rate at February's level of 3.0%. Producer prices increased by as much as 1.5%MoM in March, following also significant increase of 1.0% in February. Expectations pointed to increase in prices of 0.4%. Annual rate of producer inflation accelerated to 4.2% from 3.5% in February.

Inflation YoY



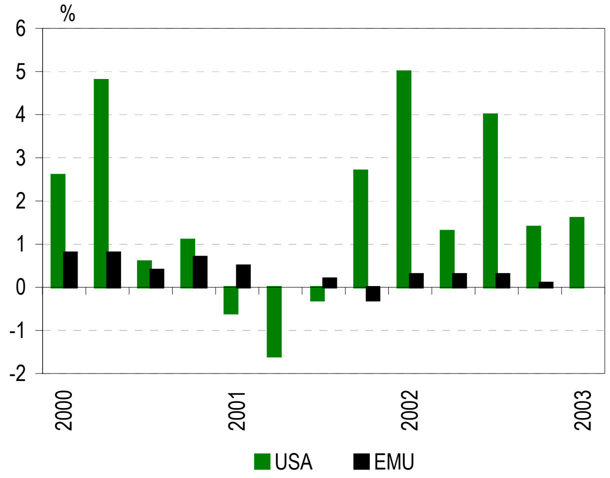
Source: Reuters

Weaker than expected growth in the USA in 1Q03

Data on Eurozone's economic growth in the fourth quarter last year were revised downward in the third, final release. According to the latest estimates, Eurozone's GDP grew by 0.1%QoQ and 1.2%YoY in this period against 0.1% and 1.3%, respectively, published previously. The revision has matched analysts' expectations. The forecasts of the European Commission for first and second quarter 2003 remain unchanged. The Commission expects GDP growth in a range of -0.2 to 0.2%QoQ in 1Q03 and 0.1 to 0.4% in 2Q03.

According to advanced information, GDP growth in the United States amounted to 1.6%QoQ in first quarter 2003. The data were clearly weaker than analysts' expectations of 2.3% and only slightly better than 4Q02 figure of 1.4%. The American Trade Department explained such a weak performance with less consumer expenditures and investments due to the war in Iraq and severe this year's winter.

GDP growth QoQ



Source: Reuters

Data on industrial output in the Eurozone were stronger than forecasts. In February production increased by 0.2%MoM and 1.8%YoY, compared to forecasts of -0.3% and 0.5%, respectively.

On the contrary, information from the United States on industrial production was much worse than expected. Production declined by 0.5%MoM in March, which was the worst figure since December last year, while a fall of 0.2% only was expected. In turn, retail sales recorded a figure much better than forecasts and the best since October 2001. It rose by 2.1%MoM following a fall of 1.3% (revised from 1.6%) in February. Analysts' expectations were at 0.6%. Such a high increase in the sales resulted mainly from significant acceleration in growth rate of car sales.

Higher unemployment

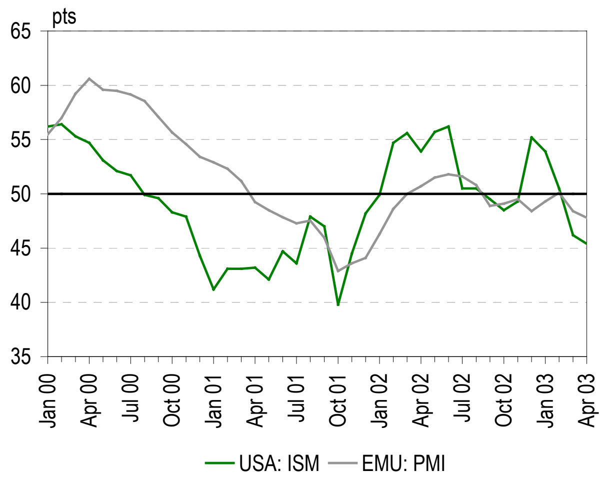
The unemployment rate in the Eurozone increased to 8.7% in March, i.e. to the highest level in last three years, from 8.6% in February (revised from 8.7%). Analysts expected unemployment rate to reach 8.8%. The highest unemployment rate was recorded in Spain (11.5%) and the lowest in Luxembourg (3.4%).

In the United States unemployment rate increased to 6.0% in April, from 5.8% in March, while analysts expected it to increase to only 5.9%. Number of jobs fell by 48,000, while a fall of 53,000 was forecasted, and the figure was better than a reduction by 124,000 recorded in March.

Deterioration in economic activity

In April economic activity in the industry of the Eurozone fell more than in March and in the service sector it was falling at the same pace as a month earlier, while in both cases analysts expected faster pace of deterioration in activity. Reuters PMI index decreased to 47.8 pts from 48.4 pts in March, while expectations pointed to a rise to 48.5 pts.. Reuters Services index amounted to 47.7 pts unchanged from previous month, while an increase to 47.9 pts was expected.

Activity indicators



Source: Reuters

In the United States economic activity in the industry was falling faster than in previous month, while slower fall was expected. In service sector an increase in activity was recorded, while analysts expected only slower than in March pace of deterioration in activity. ISM index recorded a fall to 45.4 pts in April from 46.2 pts in March. The figure was worse than 47.3 pts foreseen. ISM Non-manufacturing index reached 50.7 pts in April against 47.9 pts in March and 49.1 pts expected.

In April, Americans' sentiment improved rapidly following the end of the war in Iraq. American consumer confidence indicator recorded a very fast increase to 81.0 pts from 61.4 pts (revised from 62.5 pts) in March. Analysts expected the index to amount to 69.8 pts.

What's hot this month

Monday	Tuesday	Wednesday	Thursday	Friday
5 May POL: T-bill auction	**6** *EMU: Producer prices (Mar)* *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)*
12 POL: T-bill auction	**13** POL: MPC meeting *USA: Foreign trade (Mar)*	**14** POL: Inflation (Apr) POL: Money supply (Apr) *FRA: Industrial output (Mar)* *ITA: Industrial output (Mar)* *USA: Retail sales (Apr)*	**15** *GER: GDP (1Q)* *ITA: GDP (1Q))* *USA: Producer prices (Apr)*	**16** POL: Wages & employment (Apr) *FRA: Inflation preliminary (Apr)* *ITA: Inflation final (Apr)* *EMU: Inflation final (Apr)* *USA: Inflation (Apr)*
19 POL: T-bill auction	**20** POL: Industrial output (Apr) POL: Producer prices (Apr) *EMU: Industrial output (Mar)* *EMU: Foreign trade (Mar)*	**21** POL: T-bond auction PS0608	**22** POL: Retail sales (Apr) POL: Unemployment (Apr) POL: Business climate (May)	**23** POL: Core inflation (Apr) *FRA: Inflation final (Apr)*
26 POL: T-bill auction	**27** POL: Food prices (1H May) POL: MPC meeting *EMU: Balance of payment (Apr)*	**28** POL: MPC meeting (decision) POL: T-bond switching auction *EMU: Inflation preliminary (May)* *EMU: Money supply (Apr)*	**29**	**30** POL: Balance of payment (Apr) *ITA: Inflation preliminary (May)*
2 June POL: T-bill auction *EMU: Economic sentiment (May)* *EMU: Business climate (May)* *USA: ISM (May)*	**3** *EMU: Producer prices (Apr)* *EMU: Unemployment (Apr)*	**4** POL: T-bond auction OK0405 *EMU: Retail sales (Mar)*	**5** *GER: Unemployment (May)* *EMU: ECB meeting* *EMU: GDP (1Q)*	**6** POL: Food prices (2H May) *USA: Unemployment (May)*

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	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	29	-	-	-	-
Money supply	14	14	14	14	14	13	14	14	-	-	-	-
NBP balance sheet	7	7	7	7	7	6	7	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

		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	May 03
GDP	%YoY	x	x	0.8	x	x	1.6	x	x	2.1	x	x	2.3	x	x
Industrial production	%YoY	0.3	-4.2	2.1	5.7	-1.1	6.6	3.2	3.1	5.2	3.5	4.3	5.7	6.5	7.2
Retail sales ***	%YoY	3.1	1.8	2.5	8.6	5.1	4.7	5.1	5.9	4.9	4.1	4.2	-1.7	4.1	3.2
Unemployment rate	%	17.9	17.3	17.4	17.5	17.5	17.6	17.5	17.8	18.1	18.7	18.8	18.7	18.4	17.8
Gross wages ** ***	%YoY	2.3	4.2	3.9	4.1	2.8	3.8	0.5	1.8	2.4	2.7	2.1	0.7	3.0	1.7
Export (acc. to NBP)	USDm	3 038	2 833	2 797	3 177	2 727	2 912	3 182	3 004	3 223	2 761	2 636	2 976	3 155	3 060
Import (acc. to NBP)	USDm	3 879	3 722	3 508	3 791	3 642	3 826	4 241	4 090	4 166	3 895	3 219	3 462	3 600	3 744
Trade balance (acc.to NBP)	USDm	-841	-889	-711	-614	-915	-914	-1 059	-1 086	-943	-1 134	-583	-486	-446	-685
Current account balance	USDm	-716	-613	-451	-119	-284	-529	-580	-753	-484	-711	-483	-237	-186	-265
Budget deficit (cumulative)	PLNbn	-20.0	-23.0	-25.0	-25.7	-27.3	-29.8	-34.0	-37.1	-39.4	-4.1	-11.7	-15.5	-18.0	-23.6
CPI	%YoY	3.0	1.9	1.6	1.3	1.2	1.3	1.1	0.9	0.8	0.5	0.5	0.6	0.3	0.6
PPI	%YoY	0.4	0.5	1.2	1.7	1.3	1.1	1.7	1.7	2.2	2.5	2.9	3.4	3.2	3.2
Broad money (M3)	%YoY	2.4	3.2	2.5	1.3	-0.2	-1.5	-2.5	-1.0	-2.1	-1.4	-1.2	0.4	1.0	1.0
Deposits	%YoY	0.6	1.3	0.5	-0.8	-2.5	-3.5	-4.6	-3.2	-4.3	-4.1	-3.8	-2.5	-0.2	-0.3
Credits	%YoY	6.6	7.9	9.4	7.5	5.9	4.9	4.4	4.6	5.3	5.5	5.7	8.7	9.3	8.9
USD/PLN	PLN	4.06	4.05	4.03	4.12	4.18	4.15	4.12	3.95	3.91	3.84	3.87	4.01	3.96	3.74
EUR/PLN	PLN	3.59	3.71	3.85	4.09	4.08	4.07	4.04	3.96	3.99	4.08	4.17	4.33	4.30	4.30
Reference rate *	%	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	5.50
WIBOR 3M	%	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	5.60
Lombard rate *	%	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	7.25
Yield on 52-week T-bills	%	9.56	9.22	8.54	8.35	7.86	7.25	6.77	5.88	5.78	5.74	5.83	5.67	5.43	4.70
Yield on 2-year T-bonds	%	9.22	9.03	8.27	8.12	7.60	7.16	6.62	5.78	5.75	5.55	5.66	5.52	5.16	4.80
Yield on 5-year T-bonds	%	9.02	8.90	8.17	8.11	7.62	7.07	6.57	5.91	5.67	5.57	5.58	5.36	5.15	4.95
Yield on 10-year T-bonds	%	8.19	8.02	7.55	7.63	7.29	6.79	6.22	5.89	5.69	5.62	5.67	5.52	5.41	5.20

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	802,0	177,9	188,8	190,5	212,2	182,9	195,5	199,2	224,3
GDP	%YoY	4,0	1,0	1,3	3,0	0,4	0,8	1,6	2,1	2,3	2,8	2,9	3,7
Total consumption	%YoY	2,4	1,8	2,8	2,5	2,8	2,6	2,8	3,2	2,6	2,5	2,5	2,2
- Private consumption	%YoY	2,6	2,1	3,3	2,8	3,5	2,9	3,1	3,5	2,9	2,8	2,7	2,6
Fixed investments	%YoY	2,7	-10,2	-7,2	4,1	-13,2	-8,4	-6,3	-4,1	-5,0	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	4,5	5,8	5,0	4,2
Retail sales (real terms)	%YoY	1,0	0,2	3,3	2,6	5,8	0,7	3,9	2,6	1,7	3,0	3,0	2,6
Unemployment rate *	%	15,1	17,5	18,1	18,2	18,2	17,4	17,6	18,1	18,7	17,8	17,8	18,2
Gross wages (real terms)	%YoY	1,3	1,6	1,5	1,7	1,9	1,4	2,3	0,3	1,3	1,8	2,2	1,6
Export (acc. to NBP)	USDm	28 255	33 823	34 746	35 055	7 853	8 668	8 816	9 409	8 373	8 224	8 829	9 629
Import (acc. to NBP)	USDm	41 423	46 848	45 712	45 772	10 847	11 109	11 259	12 497	10 576	11 028	11 297	12 871
Trade balance (acc.to NBP)	USDm	-13 168	-13 025	-10 966	-10 717	-2 994	-2 441	-2 443	-3 088	-2 203	-2 804	-2 468	-3 242
Current account balance	USDm	-9 952	-7 992	-7 188	-7 517	-2 659	-1 780	-932	-1 817	-1 431	-2 103	-1 358	-2 626
Current account balance	% GDP	-5,6	-3,9	-3,6	-4,0	-4,0	-3,6	-3,6	-3,6	-3,1	-3,3	-3,5	-3,9
Budget deficit (cumulative)*	PLNbn	-15,4	-32,6	-39,4	-38,7	-16,4	-25,0	-29,8	-39,4	-15,5	-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	-5,0	-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	0,7	1,6	2,0
CPI*	%YoY	8,5	3,6	0,8	2,2	3,3	1,6	1,3	0,8	0,6	1,2	1,6	2,2
PPI	%YoY	7,8	1,6	1,0	2,7	0,2	0,7	1,4	1,9	2,9	3,2	2,3	2,6
Broad money (M3)	%YoY	15,2	12,1	1,7	2,2	5,9	2,7	-0,1	-1,9	-0,7	1,2	2,9	5,4
Deposits	%YoY	17,2	13,5	-0,2	1,2	4,8	0,8	-2,3	-4,1	-3,5	0,1	2,5	5,7
Credits	%YoY	24,7	11,3	6,8	9,3	8,3	8,0	6,1	4,8	6,7	8,8	8,9	13,0
USD/PLN	PLN	4,35	4,09	4,08	3,76	4,13	4,04	4,15	3,99	3,90	3,79	3,67	3,69
EUR/PLN	PLN	4,01	3,67	3,85	4,22	3,62	3,72	4,08	4,00	4,19	4,31	4,24	4,12
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	5,02	9,64	9,11	7,82	6,14	5,75	4,94	4,70	4,70
Yield on 2-year T-bonds	%	17,37	13,97	7,94	5,02	9,27	8,84	7,63	6,05	5,58	4,92	4,80	4,80
Yield on 5-year T-bonds	%	14,00	12,59	7,86	5,13	9,09	8,69	7,60	6,05	5,50	5,02	5,00	5,00
Yield on 10-year T-bonds	%	11,79	10,74	7,34	5,32	8,28	7,92	7,24	5,93	5,60	5,27	5,20	5,20

Source: GUS, NBP, BZ WBK

* at the end of period

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