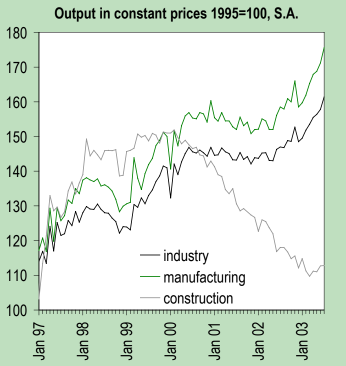
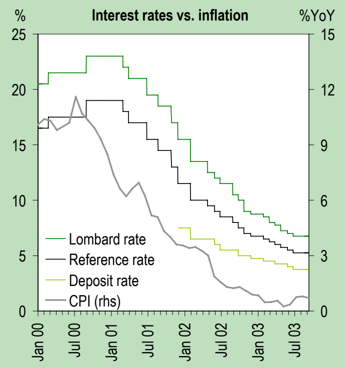
Bank Zachodni WBK

MACROscope

Polish Economy and Financial Markets

September 2003





Growth-time

■ The justification to the budgetary act read: "the 2004 budget will be another budget aimed at directing the economy towards the fast development path". **Unfortunately, if this is a "growth" budget than the growth refers to the increase in the budget deficit, the increase in the financial needs of the country, the increase in the public debt and a substantial increase in expenses** to the extent which cannot be justified by the requirement to finance the expenses related to European integration. Although, we should admit the economic growth will undoubtedly be recorded.

■ **According to the government, this is the first part of the public finance recovery programme for Poland.** The draft budget was sent for consultation with social partners and the government will ultimately adopt it on 26th or 27th of September. Another element of changes in public finances was to be a medium-term fiscal strategy, which was to be presented on 16th of September. As we wanted to present the assessment of the next-year's budget and the strategy we decided that this report would be published a little bit later. It turned out that the representatives of the government were not to be trusted – they failed to present the strategy. Therefore we decided to present only the (negative) assessment of the draft budget, whereas the strategy and the expenses rationalisation plan will be presented next month.

■ **Most of the data released last month confirmed ongoing "jobless recovery", a phenomenon, which we described in May's MACROscope.** Information from the CSO suggest that 2Q03 GDP growth exceeded 3% and the third quarter of this year started with very optimistic results for July (high output growth in industrial and construction sectors, high retail sales), suggesting that positive economic trends should continue. Also, business climate surveys showed persistence of positive moods in August. In July CPI inflation was stable at 0.8% confirming favourable inflation scenario in the short-term. Data from the labour market (persistently falling wage bill in corporate sector) and from monetary sector (weak growth of money and credit) show there is a lack of inflationary pressure from the demand side. Also no significant threats are visible on the supply side (low food prices). Indeed, CPI inflation is still below 1%, and we expect it will exceed this level until year-end only moderately (if any).

■ **In line with our expectations the MPC did not change interest rates at its regular monthly meeting in Au**gust. We do not change our forecast that the NBP reference rate will be cut only once until the year-end. We still think that September is the most likely timing, which is supported by statements of the MPC members from the so-called "dovish faction". However, the main question is whether the NBP president will decide to reduce rates amid maintained uncertainty connected with medium-term fiscal policy perspective.

In this issue:

Financial market on 29 August 2003					
NBP deposit rate	3.75	WIBOR 3M	5.14	PLN/USD	3.9944
NBP reference rate	5.25	Yield on 52-week T-bills	4.83	PLN/EUR	4.3588
NBP lombard rate	6.75	Yield on 5-year T-bonds	5.43	EUR/USD	1.0912

This report is based on information available until 12.09.2003

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Special focus

Assessment of the budget draft

On 9 September, The Council of Ministers approved the budget draft for next year. According to the government, this is the first part of the public finance recovery programme for Poland. The budget draft was sent for consultation with social partners and the government will ultimately adopt it on 26th or 27th of September. Another change in public finances was supposed to be a medium-term fiscal strategy, which was to be presented on 16th of September. As we wanted to present the assessment of the next-year's budget and the strategy together, we have decided that this report would be published a little bit later. It turned out however, that the representatives of the government were not to be trusted – they failed to present the strategy. Therefore we decided to present only the (negative) assessment of the draft budget, whereas the strategy and the expenses rationalisation plan will be presented next month.

The justification to the budgetary act read: "the 2004 budget will be another budget aimed at directing the economy towards the fast growth path". Unfortunately, if this is a "growth" budget than the growth refers to the increase in the budget deficit, the increase in the financial needs of the country, the increase in the public debt and a substantial increase in expenses to the extent which cannot be justified by the requirement to finance the expenses related to European integration. Although, we should admit the economic growth will undoubtedly be recorded as well.

Optimistic macroeconomic assumptions

Similarly as during the preparation of this year's budget, the government has adopted quite optimistic macroeconomic assumptions for 2004. Similarly as in the draft version produced by the former Minister of Finance, Grzegorz Kołodko, the GDP growth in 2004 is to be 5% and the stepping up economic growth (from 3.5% in 2003) is to be driven (according to the government) by, e.g., Poland's accession to the EU. However what is really controversial is not so much the assumed pace of economic growth (which, in favourable environment, can be achieved – we project GDP growth of 4.5%) but its structure. This is because a significant increase in the domestic demand has been assumed (by 5% against 2.9% in 2003), both as regards growth in private consumption (3.8%) and fixed investments (12.2%). To compare - we assume growth in those indices by 3.1% and 9.9%, respectively. The investments are to grow as a result of further interest rate cuts (substantial – according to the Ministry of Finance – see below), accession to the EU and the improvement of the financial standing of businesses (lower taxes), while the assumption of sizeable growth in private consumption is not that obvious. Especially that the Ministry has produced exceptionally optimistic estimates as regards the situation on the labour market – increase in average employment in the economy by 1% YoY paralleled by increase in average remuneration by 4% (real growth by 2%). In our opinion, the high increase in labour efficiency can hinder the improvement on the labour market estimated by the government for next year (we discussed the issue more broadly in the analysis *Jobless Recovery* in the May issue of MACROscope). And assuming stability of employment in the economy, the average pay can go up by less that two percentage points above inflation. Therefore, the income of households projected for 2004 might not justify such an optimistic assumption of growth in consumer demand. Of course, the assumption of economic growth driven by domestic demand is convenient from the point of view of budget planning, as it boosts the budget income. However, this may lead to unpleasant surprises in the course of next year – lower income from PIT and lower contributions to social security resulting in lower income of the Social Security Fund and the Labour Fund, which again (as this year) may be forced to increase their debts with the banks.

Macroeconomic assumptions for 2003-04

	2003 Budget Act	2003 P	2004 Draft
GDP, nominal in PLNbn	784.1	805.1	861.5
GDP, % YoY	3.5	3.5	5.0
Total consumption % YoY	2.8	2.7	3.3
Private consumption, % YoY	3.2	3	3.8
Fixed investments % YoY	5.6	2.5	12.2
Exports, %YoY	8.5	8.5	8.7
Imports, % YoY	7.8	6.4	8.5
Average inflation, %YoY	2.3	0.8	2.0
Average wages PLN	2 195	2 201	2 290
Average employment '000	8 909	8 643	8 733
Unemployment rate, %	17.7-18.3	18.4	17.8
Average intervention rate %	7.2	5.6	3.7
Current account deficit, USDbn	8.74	-6.5	-8.4
Foreign direct investments, USDbn	5.90	4.3	5.15

Note: P – planned realisation
Source: Ministry of Finance

The Ministry also assumes further reduction in the propensity to save and a substantial upsurge in the credit activity (both as regards consumer and investment loans) owing to a lower-interest rate environment. However the government assumes that despite lower personal savings and very high negative balance of savings in the public sector (high fiscal deficit), the current account balance deficit will go up merely to 3.7% of the GDP from 3.1% in 2003. Despite accelerating investments (which, in the Polish conditions are strongly import-consuming), the pace of import growth in the governmental assumptions accelerate "only" to 8.5% in 2004 from 6.4% in 2003 and it does not outpace the export growth. The Ministry estimates that the contribution of net exports in the GDP growth in 2003 will total 0.4 pp against 0.5 pp in 2002.

The question arises whether by projecting substantial increase in the credit delivery in 2004, the Ministry of Finance is not too optimistic as regards the reduction in interest rates. The Ministry assumes that the reference rate of the central bank will go down to 3.7% on average in 2004 against 5.6% in 2003. This would mean yet another cut by 25 basis points by the end of this year and three cuts of 50 bps in the first three months of 2004. The justification to the budgetary act reads: "taking account of the macroeconomic conditions it has been assumed that in 2004 the average annual interest rate for the open-market operations is at 3.7%". What is interesting, the rationale also reads that "further gradual loosening of the monetary policy in 2004 will be facilitated by the fact that the demand factors (high unemployment, low wages dynamics) will not put the achievement of the inflation target at risk". Does it not run counter to the assumed substantial growth in the consumer demand? The Ministry must have taken into account (apart from the relevant macroeconomic conditions) the new composition of the Monetary Policy Council, which will be appointed at the beginning of 2004. However, even assuming an increased appetite of the new MPC as regards monetary expansion, it seems overoptimistic to expect such aggressive interest rate cuts at the beginning of the year, parallel to the expected accelerated economic growth. They would undermine the credibility of the new Council right from the start of the term of office. This could lead to the increase in the inflation expectations of the financial markets which would be reflected in the higher yields of long-term bonds (which will anyway be under market pressure due to the uncertainty as regards the fiscal policy going forward). This could undermine the assumption made by the Ministry related to the lower costs of public debt service, which must have been the reason for such low interest rate projections.

It is assumed that the interest rates will have to be reduced due to low risk of substantial inflation increase. The Ministry of Finance has reduced the projection for average annual inflation down to 2% from 2.2% and it expects the inflation to hit 2.5% at 2004 year-end, which is consistent with the central bank target. The inflation growth is to be primarily driven by the increase in food prices. The inflation projections of the Ministry have been becoming more realistic, however the question remains: has the Ministry again (as in the case of GDP) submitted projections which are too optimistic from the point of view of budget income estimates? While we are projecting the average annual inflation in 2004 at the level only slightly lower than 2%, we think that there is more likelihood for this indicator to be even lower than higher. This would obviously mean lower budgetary revenues due to the lower tax base.

Contrary to last year's experience, the Ministry of Finance decided to present foreign exchange forecast for the next year. It assumes appreciation of the zloty against the euro (to the level of 4.25 on average in 2004 from 4.31 this year) and against the US dollar (to 3.78 from 3.84). This means that the zloty would be stronger against the basket of two currencies by some 1.5%. While the basket strength of the zloty is roughly in line with our prediction, we expect a strengthening of the dollar against the euro, which means that we expect the zloty to be stronger against the euro and weaker against the dollar, as compared with the Ministry of Finance's forecasts. What is interesting, annual average exchange rates forecasts of the Ministry assume a few percentage points strengthening of the zloty in the remainder of this year.

In the justification of the budget draft the government presented also macroeconomic forecasts for 2005-06, which are coherent with those published in the Pre-accession Economic Programme (PEP). GDP growth is expected to accelerate to 5% and 5.6% in two consecutive years, respectively, which will be driven mainly by domestic demand acceleration. This means that the government lowered growth forecast for 2005 from 5.4% presented in the previous PEP, while government's officials still maintain in their statements a view of GDP growth at 6% and 7% in 2005-06. . The justification to the budgetary act reads: "2005-06 will be a period of gradual macroeconomic policy tightening, especially in case of monetary policy". Does the government expect the new MPC to start raising rates in 2005? It seems so, although a planned increase is not significant – the government assumes annual average intervention rate at 3.8% and 4.0% in 2005 and 2006, respectively.

Very high spending = very high deficit

Next year's budget gap was set at PLN45.5bn with the revenues at PLN152.7bn and total spending at PLN198.2bn. This means that there were no significant changes to what had been presented so far – the deficit level as well as the amounts of spending and revenues are in line with previous announcements. However, despite Deputy PM Jerzy Hausner and finance minister Andrzej Raczko comments, the deficit was not lowered by additional PLN2-3bn. Well, it is worth noticing that even if this additional reduction happened (which would be undoubtedly a good news), this would not change the negative overall assessment of the budget draft – a change would be very moderate if the scale of fiscal expansion is taken into account.

As compared with this year budget, budgetary revenues are up in nominal terms by 1.9% (if we compare this to planned this year's realisation an increase amounts to 0.5%), and spending rise by 2% (by 4% if compared with planned realisation in 2003). The problem is, however, that the amounts of budgetary income and expenditures are incomparable with the levels from 2003 because of methodology change, which brings the deficit level down and the deficit in 2004 computed the same way as this year is much higher. While comparison of budgetary revenues is difficult because of higher share of local governments budget in total tax revenues, the spending side is underestimated. Namely, all transfers to private pension funds (OFE) of PLN11.4bn should increase this amount, as they are excluded from budget spending. Also, some payments related to EU accession on top of transfers to OFE has been put "under the line" (PLN3.6bn) as well as credit for restructuring of the coal mining sector (PLN1.3bn financed from the World Bank's credit) . This gives total deficit of PLN61.8bn or 7.2% of GDP. If the above-mentioned elements were taken into account, budgetary spending would increase by above 10% as compared with the plan for 2003, but by 12.5% (10% in real terms!) in comparison with this year's planned realisation. What is more, even if we exclude all spending connected with EU integration (of PLN8bn as deputy finance minister said), annual growth of budget expenditures amounts to some 8%.

It is difficult to assess such shape of the next year budget as a step towards public finance sector reform and a attempt to rationalise (not to mention the word „cut") of public spending . As a result of lack of necessary changes on the expenditures side, budget deficit and financing needs of the government increases.

Budget deficit in 2004

	PLNbn
Expenditures (budget draft)	198.2
Revenues (budget draft)	152.7
Deficit (budget draft)	45.5
Transfers to pension funds	11.4
EU accession related spending	3.6
Coal mining sector credit	1.3
Budgetary spending	**214.5**
Budget deficit	**61.8**

Source: BZ WBK, Finance Ministry

What is more, there is a risk that some spending are underestimated (e.g. above-mentioned costs of public debt servicing) and that revenues are overestimated. Namely, the justification to the budgetary act reads: "budget revenues forecast should be treated with a risk of further corrections, as a result of possible parliament's changes in the budget accompanying laws". While both CIT and PIT revenues are lower in nominal terms as compared with this year's figures, it is difficult to estimate how much the above-mentioned methodology change influence the forecasted incomes level. On the other hand, government's assumption on indirect taxes (VAT) revenues might be too high amid optimistic macroeconomic assumption. In line with previous plans, VAT rate is planned to increase for musical instruments and for children articles and clothes (from 7% to 22%), and rate in the construction sector will be adjusted (increase to 22% for construction materials). Also, in terms of indirect taxes, we will see an increase of excise tax rates. Contrary to Finance Ministry's excise department chief, Edmund Cichowski, statement - about a planned reduction of excise tax on beer and wine by 20-30% - the budget draft assumes an increase of the tax on fuels, alcoholic beverages, beer and wine (on average by 1.1%) and on tobacco products by 9.1%.

Lower taxes for enterprises

In line with earlier declarations the government decided to reduce CIT rate to 19% from 27% binding in 2003. Moreover, ministers agreed to introduce 19% rate for small companies, which so far have paid taxes according to progressive PIT scale. The new tax solution will not be obligatory. Entrepreneurs will have the choice: to remain in the old system or pay flat 19% PIT rate. However, the latter would be accompanied by elimination of all tax allowances and exemptions. In practice, this means that there should be not a single enterprise in Poland paying taxes with effective rate higher than 19%, although the government plans some restrictions for those who are planning to become self-employed. According to government's estimates introduction of flat rate tax for all firms will mean a loss in budgetary revenues of PLN2.2bn. The government decided that this would be offset by a decrease in subsidies to the Labour Fund (PLN800m) and a resignation of increasing tax-free income (PLN1.4bn). The former may mean in practice that part of budget deficit will be pushed out of the central budget and will increase deficit of the whole public finance sector, as it is difficult to expect a significant improvement on the labour market, which could lead to better financial situation of the Labour Fund (this year's Fund subsidy has been spent until August). Nevertheless, the economy minister assured that inflow of EU aid funds will compensate for lower subsidies to the Labour Fund from the state budget. He also counts on an improvement of the situation on the labour market.

What about public debt and total public finance sector deficit?

The budget draft justification lacks of two very important chapters – public debt and balance of total public finance sector. As regards the former, the justification reads: "consultations between ministries, connected with an exact amount of money, which will be needed in 2004, to prefinance programmes of EU funds and the Common Agriculture Policy, make it impossible to precisely estimate the public debt level in 2003 and 2004". In terms of the public finance sector: "calculations are not finished yet". Well, it is hardly an explanation, especially as in recent years the deficit of total public sector is much higher than the state budget deficit, which increases expansiveness of fiscal policy and the level of public debt. And the government seems to agree with this statement, as it said that next year subsidies together with own resources will not be sufficient for budgetary funds. The justification reads: "to ensure flexible payments of pensions and other social allowances, it will be necessary for the Social Security Office (FUS) to have a loan in the banking sector" and "Labour Fund's financial plan was set with the assumption of new credits (in the commercial sector)". What is interesting, revenues of the Labour fund are planned at lower level as compared with this year, but if we take into account optimistic government's forecasts as regards labour market situation, commercial credits might be needed to a greater extent than it is forecasted. As in the budget draft the government did not present estimation of total deficit of public finance sector nor public debt, below we present forecasts published in the above-mentioned Pre-accession Economic Programme (PEP).

Public finances in 2004-06 (% of GDP)

	2004	2005	2006
Deficit of public finance sector (ESA 95)	5.0	4.0	3.4
Deficit of public finance sector (Polish methodology)	5.8	4.8	4.0
Revenues of public finance sector (ESA 95)	42.9	42.2	42.1
Revenues of public finance sector (Polish methodology)	42.3	41.5	41.5
Spending of public finance sector (ESA 95)	48.1	46.3	45.5
Spending of public finance sector (Polish methodology)	47.9	46.2	45.5
Debt of *general government* sector (ESA 95)	46.9	49.2	49.1
Public debt including expected payments connected with government's guarantees	54.5	57.1	57.2
GDP growth (% YoY)	**5.0**	**5.0**	**5.6**

Source: Pre-accession Economic Programme

PEP assumes a reduction of public spending in the following years, however it does not indicate sources of this decrease. Economy minister Hausner is expected to present plan of spending rationalisation until the end of September. In the meantime, the government said that economic deficit of public finance is forecasted at 5.6% of GDP (as compared with 4.7% in 2003). Possibly, this figure will be underestimated again.

The government's estimation of public debt presented in the PEP clearly shows the cabinet easily agreed to balance on the line of 55% debt to GDP ratio. To exceed this level, it is sufficient that the zloty depreciates substantially. The PEP reads: "the precondition to maintain public debt to GDP ratio at safe level is a successful reform of public finance sector, including the spending side of the budget, which will lower the deficit". After the analysis of the next year's budget draft, and taking into account the assumed high growth of budget expenditures, it is clear that the government did not decide to start a reform from 2004, but only from 2005. The question is whether it will be successful in the election year.

Better to exceed 55% public debt level in 2004

Possibly, you remember very similar box from our budget draft assessment presented last year. The only difference is that now we are talking about the second safety threshold, 5pp higher,

According to the estimation presented in the Pre-accession Economic Programme public debt including expected payments connected with government's guarantees will amount to 55% of GDP in 2005. Paradoxically, in our opinion, it would be better if public debt to GDP ratio exceeds this threshold already next year, because from economic point of view, there is no difference between 54.5% or 55.5% figure. However, there is a difference from the perspective of planning budget for 2006. According to the Public Finances Law, if public debt exceeds 50% (which will undoubtedly happen this year), the planned budget deficit (in this case for 2005) would be constrained by special prudential measures (e.g. the ratio of deficit to revenues could not be higher than in previous year in both central and local governments' budgets). When the public debt exceeds the second threshold (55% of GDP) the government has to prepare the budget, which will ensure at least stable debt of the state budget, while deficits limits for local governments are set with higher restrictiveness. What is more, the cabinet presents a reform programme to the parliament.

Therefore, possibly it would be easier for the Ministry of Finance to prepare more restrictive budgets for the following years, if safety threshold were reached earlier. Public debt into GDP will exceed 55% threshold anyway, but if this happens in 2005, the prudential measures will be introduced when planning the budget only for 2007. And then the public debt would be very close to 60% constitutional limit, which, if exceeded, means the necessity of balancing budget (sharp spending cut, higher taxes, no funds to absorb EU aid etc.)

How to finance the shortage?

It is not surprising that with such shape of the budget draft, as presented above, the government financing needs will rise substantially in 2004. The government will have to finance not only the deficit of PLN45.5bn, but also all "under the line" items (transfers to OFE and a part of spending connected with EU integration) as well as compensation for lack of wages indexation in the budgetary sector in the past (PLN1.5bn). However, not the whole increase will be visible on the Polish market of treasuries, as the government plans higher privatisation receipts. Revenues from privatisation are assumed to reach PLN8.8, out of which PLN7bn will be transferred to the budget (PLN5.5 in line with pension funds reform and PLN1.5bn for above-mentioned compensation). Because privatisation revenues will not be sufficient to cover some other items, in the budget draft we find a category of "negative balance of privatisation revenues" amounting to PLN5.9bn.

In terms of deficit financing on the international markets, contrary to previous deputy finance minister's, Ryszard Michalski, comment - saying about PLN15bn supply on the international markets - the budget draft assumes the issuance of only PLN10bn in 2004 (some PLN7bn lower than in 2003). As a result, net issuance on the international markets will decrease to PLN2.3bn in 2004 from PLN4.1bn this year. We do not know yet the whole strategy of public debt management, but it was partly presented in the PEP, which said that the share of foreign debt in total Polish government's debt will decrease from 33.1% in 2002 to 30.2-30.9% in 2005. Foreign debt issuance will be limited to an extent, which will be implied by maturing debt, taking into account an accumulation of foreign debt repayments in 2004-09. Possibly, this government's reasoning is connected with the risk of breaking threshold levels of public debt in a case of zloty depreciation (causing an increase of foreign debt denominated in local currency).

Scale of financing needs in 2004

	PLNbn
Budget deficit (budget draft)	45.5
Transfers to pension funds	11.4
EU accession related spending	3.6
Compensation	1.5
Privatisation	-7.0
Total	**55.0**

Source: BZ WBK, Finance Ministry

As the above table shows, it seems that we did not take into account the whole shortage. The table of financing needs presented in the justification to the budget draft (see next page) suggests the total amount of almost PLN56bn. What is more, total borrowing needs of the government will be even higher if we take into account financing needs of the Labour Fund and the Social Security Fund, which we described in the previous section. Therefore, the total crowding out effect of the private sector from the credit market by high deficit of public finances might be even more significant than suggested by financing needs on the financial markets.

The Ministry of Finance is still preparing the strategy of public debt management, but, as Arkadiusz Kamiński from public debt department said, there should not be significant changes in the structure and the timing of this year's treasuries supply.

Net issuance on the domestic market will amount to PLN53.6bn and will be covered by 90% from domestic financing. The government is expecting that its financing needs will meet higher demand of both domestic and foreign investors. According to the Ministry of Finance, above a half of domestic market treasuries will be bought by non-banking institutions amid an increase of higher assets of pension funds, higher potential of investment funds and insurance institutions, as well as a result of higher bonds amount sold for households. Comparing to this year, the Ministry of Finance plans lower share of banking institutions and higher share of foreign investors in financing the next year's deficit on domestic market. In nominal terms, foreign investors are planned to buy the doubled amount of treasuries, as compared with planned realisation in 2003. According to the budget justification high interest of foreign investors in buying Polish fixed interest rates papers will be driven by interest rates disparity and lower investment risk (Poland joining the EU). However, in our opinion, foreign investors will need a credible plan of public finance reform to buy net amount of treasuries of PLN7.6bn, and at the moment, the government failed to deliver it.

Financing budget deficit (in PLNm)

	Projected performance *2003*	Structure *(%) 2003*	Budget Draft *2004*	Structure *(%) 2004*
Deficit financing	38 734.0	100.0	55 884.9	100.0
1. Domestic	34 662.0	89.5	53 625.6	96.0
1.1. Banking sector	10 563.2	27.3	13 034.8	23.3
1.2. Non-banking sector	19 400.0	50.1	27 600.0	49.4
1.3. Foreign investors	3 700.0	9.6	7 600.0	13.6
1.4. Privatisation	4 500.0	11.6	-	-
1.5. Net amount from previous year	-3 501.0	-9.0	5 390.8	9.6
2. Foreign	4 072.0	10.5	2 259.3	4.0

Source: Ministry of Finance

Net domestic treasuries issuance (in PLNm)

	Projected performance *2003*	Budget Draft *2004*
Total treasuries	34 662.0	53 625.6
1. Market treasuries	41 197.9	47 909.0
1.1. T-bills	1.870.4	3 403.4
1.2. T-bonds	39 327.5	44 505.6
1.2.1. variable interest rate	-706.8	919.4
1.2.2. fixed interest rate	44 244.7	43 586.2
1.2.3. denominated in USD	-4 210.5	-
2. Savings bonds	-1 488.1	2 223.0
3. Non-market bonds	-2 972.4	-1 758.5

Source: Ministry of Finance

It is worth to remind the government's assumptions from last year. In the justification to the budget draft for 2003 the government planned that foreign investors would have to buy PLN5.4bn, while today's planned realisation is lower by PLN1.7bn. The question is whether a similar difference is not likely to appear also in 2004, as the perspective of fiscal policy in Poland significantly deteriorated.

Total gross supply on the next year auctions is planned at PLN58.4bn for t-bills and PLN77bn for fixed interest rates T-bonds. The net issuance is presented in the table above, which shows an increase of supply of both T-bills and T-bonds, but it is assumed that fixed rate T-bonds net supply will be lower than in 2003. However, it is worth to remember that planned net supply of these bonds for 2003 amounted to PLN33.8bn, while today's planned realisation is higher by PLN10bn. This means that next year's *de facto* offer, which will drive yields on the market, might be higher than today's government's plans.

Economic update

- **Economic recovery clearly visible in 2Q03 statistics**
- **... and data for July suggest it should be continued also in the remainder of the year**
- **However money sector and labour market still show no significant upturn**
- **... and so there is no inflationary pressure**

Most of the data released last month confirmed ongoing economic recovery. Information from the CSO suggest that 2Q03 GDP growth exceeded 3% amid revitalisation of investment activity. In turn, the third quarter of this year started with very optimistic results for July (high output growth in industrial and construction sectors, high retail sales), suggesting that positive economic trends should continue. Also, business climate surveys showed persistence of positive moods in August.

In July CPI inflation was stable at 0.8% confirming favourable inflation scenario in the short-term. Data from the labour market (persistently falling wage bill in corporate sector) and from monetary sector (very weak growth of money and credit) show there is lack of inflationary pressure from the demand side. Also no significant threats are visible on the supply side (low food prices). Therefore we predict that inflation rate will be only marginally above 1% in December this year.

Positive hints on 2Q03 GDP figures

Official statistics of economic growth in 2Q03 will be released on 19 September. However, already during press conference in August the CSO vice-president Janusz Witkowski gave some hints on this subject. According to the statistical office GDP growth in the second quarter was “considerably better” than in 1Q03, so that it could have approached 3% in the first half of this year (let’s recall that it reached “merely” 2.2% in 1Q03). We estimate that economic growth in 2Q03 reached 3.3%. Witkowski said also a visible revitalisation in investment activity had been recorded, quoting the data on new investment outlays in 1H03 in companies with 50 and more employees. According to those statistics the first two quarters of this year saw only a minor drop in investment outlays of -2.2%YoY, while in 2002 a downfall amounted to 16.6%YoY. At the same time the estimated value of newly started investments went up 30.7%YoY in 1H03 and the number of new investment tasks increased 30.6%YoY (in manufacturing even nearly 50%YoY).

There are two issues connected with the new investment data. First, the statistical office never computes compatible figures for the first quarter of a given year, so it is impossible to compare those numbers directly and say whether there was an improvement in 2Q03 alone or the investments were still falling. Second, the data are not fully comparable with fixed investments data in national accounts, because they refer only to companies employing 50 and more people and because they are given in nominal (not real) terms. Nevertheless, even taking into account those factors, the released figures seem to be supporting our expectations for gradual pick-up of investment activity throughout this year, with more significant increases in the second half of this year. This presumption was also backed by CSO vice-president’s remark that in July (likewise in several previous months) the highest output growth was recorded in companies producing investment goods.

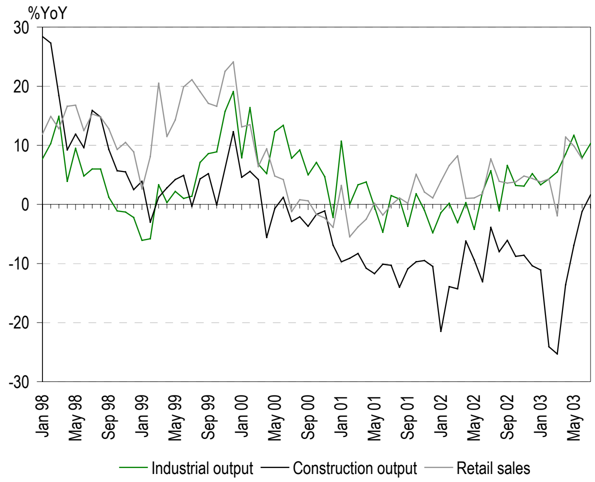
... confirmed by better financial results of Polish companies

Improvement of economic situation in Poland was also confirmed by CSO data on financial results of non-financial companies in the first half of 2003. All indices of economic and financial performance of Polish firms improved significantly and faster than in the first quarter of this year. Revenues from product sales were growing faster (11.4%YoY) than overall costs (10.2%YoY), resulting in fast improvement of companies’ profitability. Gross financial result reached PLN15bn against PLN6.4bn in a corresponding period of last year, while net financial result amounted to PLN8.8 against PLN1.5bn in 1H02. Similarly as in the first quarter of this year, the share of companies engaged in export activity was growing. And what is important, those exporting companies reported better than average financial performance.

Very good start of 3Q03...

Also economic data on real activity in July proved to be very positive, suggesting continuation of economic recovery process in the remainder of this year. Production in Polish industry proved to be stronger than expected, growing 4.9%MoM and 10.3%YoY in July after 7.9%YoY increase in June and average 6.9%YoY in the whole 1H03. The growth rate was even higher in manufacturing, where 4.8%MoM and 11.1%YoY hike was recorded. Seasonally adjusted industrial production was up 9.8%YoY. 24 out of 29 industry branches recorded increase of production, and the highest improvement (in a range of 15-40%YoY in real terms) was seen, as in previous months, in exporting industries, like manufacturing of motor vehicles, furniture, household appliances, machinery etc.

Real activity indicators



Source: CSO

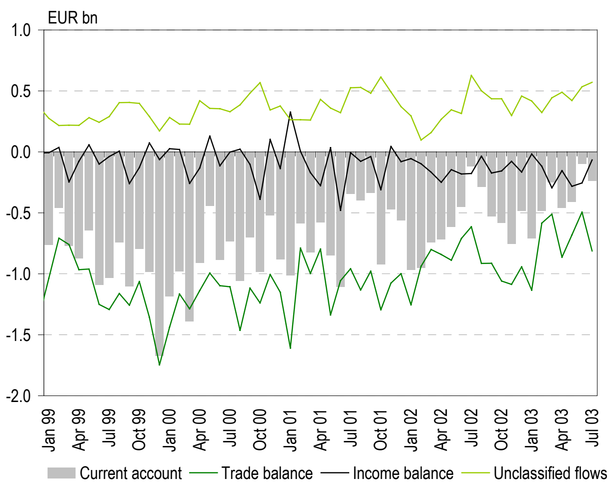
Good signal came also from construction sector, as in line with our expectations construction output recorded growth of 8.3%MoM and 1.6%YoY. Although the annual rate of growth was obviously not as much impressing as in case of industrial figures, it was a very important signal, because production in construction returned into black for the first time in more than three years (although seasonally adjusted figure was still below zero, at -4.4%YoY). The biggest increase of output (with an impressing rate of more than 100%YoY) was recorded in case of companies preparing ground for further construction works, suggesting that the improvement in this sector of economy is here to stay and we should observe the ongoing development in the quarters to come. This is good sign for fixed investments, i.e. for this component of GDP, which is the most crucial for persistent acceleration of economic growth.

Retail sales in July increased 3.8%MoM and 5.4%YoY (in nominal terms). The result, albeit a bit lower than our expectations (5.8%YoY) and market consensus forecast (6%), should not worsen the overall assessment of economic perspectives. July saw sharp downturn in sales of motor vehicles (-5%MoM, -4.5%YoY – down from +8.9%YoY in June), which resulted to some extent from very strong base effect (+6.5%MoM growth in July 2002). Nevertheless, most of other sections performed quite well, with sales in non-specialised shops growing 64.4%YoY, sales of food, drinks and tobacco 19.7%YoY, drugs and cosmetics 8.4%YoY and clothing and footwear 8.1%YoY – all figures higher than June's results. In sum, we envisage that private consumption demand would remain an important component of total GDP growth in 2H03. Although – in line with our earlier predictions – its dynamics will not be as high as in exceptional 2Q03 (when it is estimated to grow nearly 3.5%YoY).

... also in foreign trade

Balance of payments figures for July showed both current account and trade deficits higher than expected. Current account deficit reached €239m, i.e. more than most of the market forecasts. It was driven mainly by higher trade deficit, which increased to €812m from €494m recorded in June, amid sharply rising imports to €4.1bn or 8.7%YoY. Despite the fact that export also performed relatively well, imports dynamics' exceeded export's growth rate and amounted to 4.2%YoY, for the first time since September 2002. Although exports decelerated as compared with the first half of this year (average monthly growth of 5.2%), the data should be perceived as positive, if very high base effect is taken into account. Therefore, despite the fact that current account deficit was higher than expected, the data are positive, as they suggest a continuation of the economic recovery in Poland – driven by exports growth and by reviving investments demand (as shown by imports figure). According to our estimate 12M current account deficit increased to 2.8% of GDP from June's 2.7%.

Balance of payments

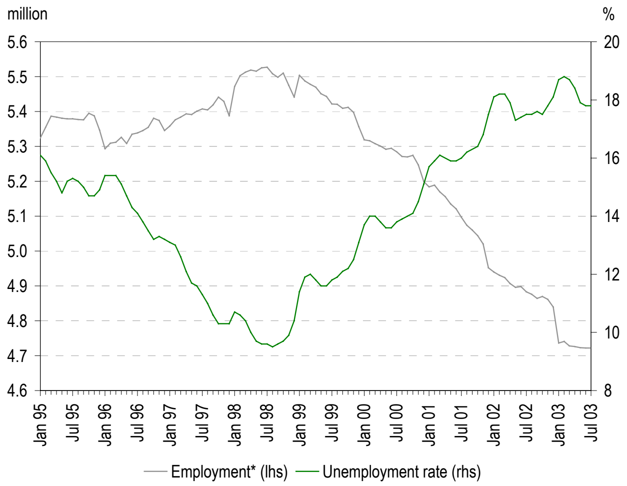


Source: NBP

... although improvement is not all over the place

Meanwhile, there is still no positive surprises on the labour market – July figures were broadly in line with expectations. Average employment in enterprise sector was stable on a monthly basis but fell again in annual terms (by 3.3% against 3.8%YoY average drop in the first half of this year). At the same time, July saw moderate growth in average wage in the enterprise sector (by 1.8%MoM and 2.4%YoY). The increase was not high enough to offset falling employment, which means that wage bill in the enterprise sector contracted again (by 1.0%YoY in nominal terms and 1.9%YoY in real terms).

Average employment and unemployment rate

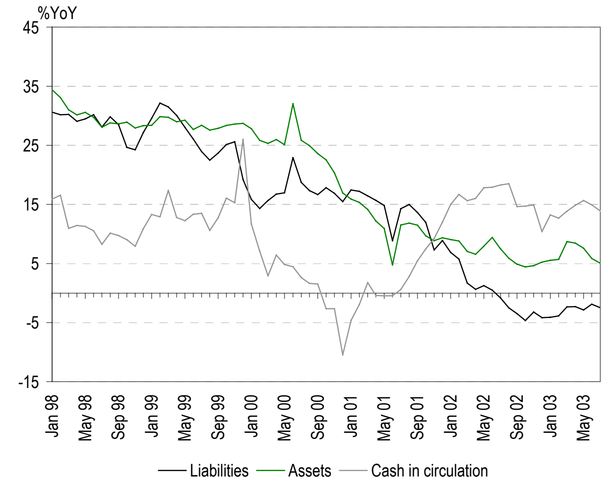


Source: CSO, BZ WBK; * adjusted for methodological changes

Officially released unemployment rate confirmed expectations, remaining at June's level 17.8%. The number of unemployed decreased by 11,600 in relation to June, but it still remained higher by 17,600 (0.6%) than in the corresponding period of last year. There is still no clear improvement of situation on the labour market, however, the facts that employment in corporate sector is not falling any more for a couple of months, and the number of new job offers in labour offices is rising in relation to previous year, signal that we could expect to see some improvement in the remainder of this year. Meanwhile, lack of increase of demand for labour despite high dynamics of industrial output and retail sales implies no wage pressure on prices as well as increase in labour productivity in the economy and thus improving international competitiveness of Polish enterprises.

Also money figures did not bring signals confirming a revitalisation of credit or deposit markets. Broad money M3 remained unchanged on a monthly basis and grew by 0.7%YoY in July. Monetary aggregates indicate inflationary pressure remains subdued. Overall deposits continued to fall (by 2.5%YoY) as a result of another decrease in households deposits (by 7.2%YoY) while corporate deposits kept growing (by 12.2%YoY in July). Similarly to previous months, despite contraction of overall deposits, growth in broad money is possible due to sharp increase in cash in circulation and other items of M3.

Monetary aggregates



Source: NBP

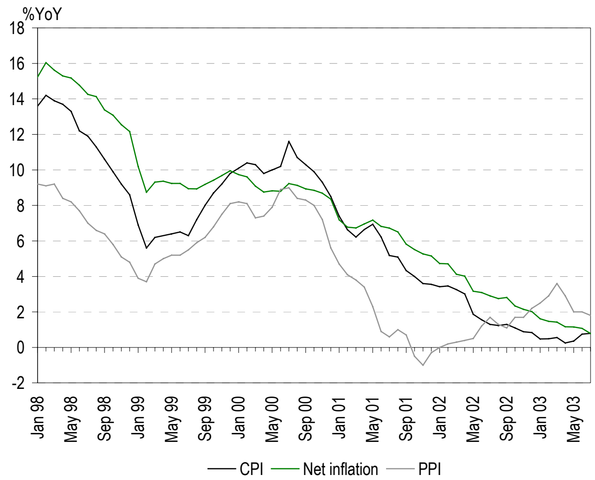
Developments on the money creation side were also similar to the previous trends. Consumer credits grew by 8.2%YoY while corporate borrowing was up 1.7%YoY in July. Current scale of lending activity in the banking sector seems to be below potential of the accelerating economy and does not pose any threat for inflation. However, we envisage that dynamics of monetary aggregates will accelerate along with further improvement in the real economy and growing financing needs of Polish firms (which will be also related to EU accession).

... and inflation does not want to rise

Consumer price index (CPI) dropped in August by 0.4%MoM and held steady at 0.8%YoY, recorded also in July. The figures were below market consensus of 0.9-1.0%YoY and our forecast of 0.9%YoY. However, we mentioned of such a possibility, as we wrote before the data release that monthly fall of food prices in CPI index might be deeper than in the preliminary figures revealed a week earlier, which was actually the case. Also, the data showed lower than expected dynamics of housing and energy prices (0.8%MoM) and in clothing and footwear (-0.4%MoM). On the other hand, transport prices and prices in recreation and culture were higher than anticipated rising by 0.3%MoM and 0.5%MoM, respectively. Other elements of CPI basket did not surprise at all and they had little impact on the overall price dynamics.

Producer prices' growth was a bit faster than we have anticipated and reached 0.6%MoM. It was fuelled mostly by the growth of fuel prices (3.2%MoM in this sector), growth of prices in mining (3%MoM) and rise of energy prices (1.5%MoM). Annual PPI inflation was down to 1.8%YoY from 2.0%YoY (revised) in June amid high base effect – the increase of energy prices was simply much lower than experienced in July 2002. It seems that PPI figures sill reflect lack of strong pressure on price growth, especially in manufacturing sector (PPI at 1.7%YoY), and therefore should not be perceived as a big risk factor for sharp inflation rebound.

Measures of inflation



Source: CSO, NBP

Similar conclusions are also supported by core inflation figures. In July four out of five measures increased slightly. The most important of them, 15% trimmed mean, grew to 1.0%YoY from 0.9%YoY in the previous month. As we have expected, despite some acceleration, two indicators remained below zero (inflation excluding the most volatile prices at -0.04%YoY and inflation excluding the most volatile prices and fuel prices at -0.29%YoY). Inflation excluding controlled prices recorded the highest growth to 0.7%YoY from 0.4%YoY in June. But "net inflation" – in line with our forecast – fell to 0.8%YoY from 1.1%YoY observed in June. All in all, data on core inflation confirmed that disinflation trend in the Polish economy has ended and price growth rate stabilised at very low level. The figures also reflected the fact that recent slight pick up in CPI was caused mainly by food prices (falling less than in 2002) as the only falling core inflation measure was the one excluding changes in prices of foodstuffs. Therefore, NBP data confirmed there is no demand pressure in the economy at the moment and the scale of gradual acceleration of inflation will depend on developments on the food market.

Meanwhile, data on food prices keep delivering mostly positive news recently. According to preliminary CSO data prices of food and non-alcoholic beverages fell in August by ca. 2% m/m. The decline was lower than market forecasted, which stemmed from higher than expected seasonal dip of fruits and vegetables prices (by 10.5%MoM and 18.8%MoM, respectively). Prices of other foodstuffs were broadly stable having little impact on the overall figure. Excluding fruits and vegetables, food prices in August grew 0.1%MoM. In our opinion those figures imply that CPI growth fell to from 0.8% to 0.7%YoY in August, and it should remain at similar level also in September.

In sum, all above data confirmed that inflationary pressure in Polish economy remains subdued. Now it seems that annual inflation rate could only marginally exceed 1% at the end of this year. While we forecast 1.1%YoY, the Ministry of Finance has revised its forecast for December to 1.3-1.4%YoY from previous level 1.4-1.5%YoY.

Promising sign from budget revenues in July

According to the Ministry of Finance after seven moths of this year budget deficit reached 71.5% of the annual plan, which was close to expectations influenced by earlier FinMin officials' hints. Total revenues amounted to PLN84.5bn, i.e. 54.3% of plan for the whole 2003. Although this aggregated figure was not very impressing, growing only 5.9%YoY in Jan-Jul period against 10.5%YoY in the first six months of this year, and falling as much as 14.5%YoY in July alone, this resulted mostly from the fact that this year budget received income from NBP profit already in June, whereas in 2002 it took place in July. Meanwhile, other components of budget revenues, especially tax receipts, performed well. Indirect taxes grew in July 8.4%YoY, CIT revenues hiked 12.1% and PIT were up 6.4%YoY. In nominal terms, tax revenues for each category was higher than monthly average in 1H03. Particularly promising is a sharp upturn of corporate tax growth (as compared with -55.5%YoY fall recorded in June and -14.3% in 1H03), signalling that companies' profits indeed keep growing steadily in 2003, while poor performance of CIT in previous months was caused mainly (as deputy minister Wasilewska-Trenkner hinted some time before) by the fact that they accounted for losses made in two previous years of economic stagnation. Also, accelerating flows from indirect taxes might reflect increasing business activity in the economy. We maintain our opinion that if shortfall of budget revenues takes place this year, its scale will not differ a lot from what is observed regularly every year, which will not require amendment of the budget draft.

Two well-known drawbacks were seen on the spending side, namely sharp rise of subsidies for labour fund (nearly 300%YoY in July alone and over 64%YoY in first seven moths of this year) reflecting poor situation on the labour market, and subventions for social security fund growing 21.3%YoY in Jan-Jul period, well above the whole-year target of 3.6%YoY growth. Higher-than-assumed budget spending in these areas was offset by lower than expected costs of servicing debt, amid deeper interest rates reductions, and despite the fact that privatisation revenues reached only 18.4% of the whole-year plan (PLN1.4bn).

Business climate surveys promising for the future

As expected, CSO's business climate survey for August showed quite optimistic results, consistent with economic recovery scenario. Likewise in several previous months, climate indices in industry and construction were much higher than in corresponding period of 2002, growing 12%YoY and 9%YoY, respectively. Meanwhile, business climate in retail trade was still negative and lower than a year ago, however its deterioration was slower than in the preceding month. Companies in industry sector reported considerable improvement of domestic orders portfolio, while foreign orders earned slightly negative review. Assessment of current and future output was positive, although entrepreneurs still planned to continue labour shedding. New orders in construction sector were still growing, although slower than in previous month. Also forecasts for future orders were more cautious. Production levels were similar as in July and companies predicted further layoffs, although in smaller scale than before. Retail trade companies recorded reduction of constraints for sales and expected the situation to improve in future. Big retailers (of more than 250 employees) represented positive assessment of business climate and forecasted significant rise of future sales.

Positive signals were given also by August consumer optimism survey performed by Ipsos-Demoskop institute. On monthly basis all households' optimism indicators were stable. However, the annual changes still remain in black. The overall optimism index (WOK) increased by 6.5%YoY (9.3%YoY growth in July), propensity to consume was up 1.1%YoY (3.5%YoY in July), and a general assessment of the economic climate increased most significantly with the same pace as last month of 18.6%. What is interesting, small enterprises perceived business climate as much more optimistic as compared with public enterprises' employees. This probably stems from the fact that economic recovery would be more positive for this sector of the economy. Also, a deceleration of propensity to consume (which is still driven by savings consumption rather than commercial credit) was most likely driven by fear of unemployment, which increased more than last month.

In turn, according to the NBP's cyclical report, business climate should continue improving in 3Q03, although at a slower pace than in the second quarter (which is consistent with our GDP growth forecasts). The survey recorded a growth of demand, mostly in a group of private, medium-sized, exporting companies. The inflow of new orders decelerated, however it remained high in case of exporters, which also reported an increase of their activity. Excessive inventories recorded a drop and – what is important – companies saw a significant rise in capacity utilisation in 2Q03. The central bank predicts a bit slower growth of industrial output in 3Q03, however construction production is expected to continue strong improvement. Survey results suggested also that more visible improvement on the labour market is possible in 3Q03. However, no real recovery of investment activity was recorded (except for transport and construction sectors), and also no improvement in credit demand.

Central bank watch

- **Interest rates unchanged for the second time in a row in August**
- **... we still expect another cut in September**
- **Reshuffle in the MPC already in January**

No change in interest rates level

In line with our expectations the MPC did not change interest rates at its regular monthly meeting in August, interrupting the monetary easing cycle for the second month in a row. The Lombard rate still stands at 6.75%, the discount rate at 5.75%, the reference rate at 5.25% and the deposit rate at 3.75%. The decision was in line with majority of market participants' predictions, although a quite large minority of analysts expected a reduction. Also, financial markets had priced-in a cut of 25bp. The MPC also decided not to change other parameters of monetary policy, i.e. we did not see a reduction of reserve requirements. The central bankers maintained neutral bias in monetary policy and accepted *Inflation Report* for 2Q03 (see also below).

As we expected, the main reason for keeping interest rates on hold were stronger signs of the economic recovery (high industrial output growth, the first increase of construction output since a few years, better financial situation of enterprises, warming up business climate, fast growth of export and continued increase in retail sales) as well as worsening fiscal policy stance (the MPC forecast the economic deficit to reach 5.4% of GDP this year, up from 5.1% in 2002) and high uncertainty regarding fiscal policy outlook. According to the central bank's forecasts central budget deficit would rise to 6.7% of GDP next year from 4.8% in 2003 (based on comparable methodology). The Council said in the official statement that according to NBP estimates such scale of budget gap coupled with transfers from the EU could create "a significant demand impulse" (and the importance of this impulse will be analysed again in September). Besides, among factors constraining scope for monetary easing, the MPC listed high dynamics of cash in circulation, high oil prices (although the Council said that market forecasts that average oil price in 2003 decreased to US$27.6 from US$29.4) and increase in food prices (although it is not visible in practice – see *Economic update* section).

On the other hand, the Council pointed out several factors, which are conducive to maintaining low level of inflation in future. They included low PPI dynamics, strong wages discipline, low growth of broad money supply, low credit dynamics, low inflation expectations and weak economic situation in the Eurozone and in Germany in particular. The above mentioned factors, together with persistently low level of CPI, well below the medium-term inflation target of 1.5-3.5%, suggested there is still some room for the central bank to ease monetary policy. Nevertheless, one should remember that the MPC is going to reduce reserve requirements and there will not be much scope for manoeuvre with interest rates this year. Therefore, we do not change our opinion that the reference rate will be cut only once until the end of December. We still think that September is the most likely timing. In the interview with private television TVN24, NBP president suggested that reserve requirements reduction was not likely to take place in September, as the Council would continue to analyse this issue. Therefore, in line with our earlier presumption, this decision should be expected in 4Q03. Dariusz Rosati said there was no hurry with a reserve requirement cut, suggesting it should be made until the end of this year. He also suggested that the central bank apart from lowering reserve requirement ratio could also exclude deposits with a maturity of more than two years from the reserve requirement (not necessarily this year), which would give additional boost for banking system's liquidity. Other MPC members have probably similar opinion. Wiesława Ziółkowska said that the best moment for the next interest rate cut would be September (and one should not expect interest rate cut and reserve requirement cut at the same time).

NBP critical about fiscal policy

NBP governor Leszek Balcerowicz criticised the government's 2004 budget draft. He said that it allowed public debt to grow in a way that could harm economic expansion. One could have expected such a reaction, as the budget draft actually does not show enough determination of the government to carry out fiscal consolidation next year. However, Balcerowicz added that the medium term fiscal strategy would be the key to sustaining the economic growth in Poland. In his opinion this reform package (expected to involve modest and gradual spending cuts after 2004) will determine whether Poland takes the path of fast economic growth and falling unemployment or simply has an unsustainable recovery. Well, the question is whether such statements mean that NBP chief is not going to support another monetary easing in the nearest time. In our opinion they do not. First of all, let us recall that last year Balcerowicz heavily criticised the budget draft for 2003, and later on he used to support long series of interest rate cuts. Moreover, after the last month meeting he stressed that monetary policy should not be determined solely by fiscal policy.

Inflation Report for 2Q03

At the beginning of September the NBP published *Inflation report* for the second quarter of this year. The document included economic forecasts of the central bank, which might be useful in predicting future monetary policy decisions. The table below presents NBP's inflation forecasts from August (current) and forecasts from April (previous).

NBP inflation forecast (year-end, %)

	share in basket	2003		2004	
		current	previous	current	previous
Food prices	28%	2.0	0.5	2.5	2.0
Controlled prices	25%*	2.0	3.0	2.0	3.0
Other items	47%	1.2	1.2	2.7	2.7
CPI inflation	100%	1.6	1.5	2.5	2.6

* As presented in NBP's methodology note regarding core inflation
Source: NBP

The central bank did not publish the CPI inflation forecast for 2003-04. However, it has published annual forecasts of three inflation components, and therefore it was possible to compute the exact CPI inflation forecast. It is not surprising that NBP's forecast indicates that inflation would undershoot the central bank's inflation target (2-4%) for the third year in a row. However, while the central bank continues to declare that CPI inflation will be "slightly below" 2% in December, we found that "slightly" means 0.4pp, and it was even higher three months ago (0.5pp). The change of central bank's forecasts within last three months was driven by worsening food prices outlook and lower expectations as concerned controlled prices. The two factors are offsetting each other and therefore the overall CPI inflation forecast did not change substantially. However, the NBP's inflation forecast for this year seems to be too pessimistic, as in our opinion the NBP overestimates food prices growth. Namely, to achieve 2%YoY food prices' inflation by year-end, food prices would have to grow by 1.1%MoM on average within last four months of this year. This would be the highest growth in the last four years. We predict average food prices growth of 0.6%MoM in September-December period (which is higher than in corresponding period of 2001 and 2002), which, with other items' forecasts roughly consistent with NBPs' predictions, give year-end CPI inflation of 1.1-1.2%YoY. Our forecast of average inflation in 2004 points to 1.9% growth, while the prediction for December 2004 is consistent with the central bank's forecast (with roughly the same assumptions for all components).

The question remains, whether lower-than-expected inflation in the remainder of this year will cause the MPC to continue monetary easing? Of course, the central bank's officials said many times that "one should not be too much concerned about current inflation" or that "current inflation indicators were not behind the MPC decision". However, we would like to remind one last year's important quote of the NBP president (who will actually decide about rates level this year) – "inflation at low level supports low inflation expectations". And we would like to stress that many times in the past the Polish central bank proved to be rather backward than forward-looking in its monetary policy decisions.

The central bank forecasts this year's economic growth at 2.8-3.1% and next year's at 4.1-4.6%, depending on the rate of growth of fixed investments (as world economic outlook deteriorated). Our forecasts points to the upper end of the above mentioned range, while the government is even more optimistic expecting next year's GDP growth at 5.0%. The NBP also pointed out that there would be a further increase in the economic deficit in 2004, adding that keeping a high budget deficit in the context of expectations of fast economic growth will be dangerous for macro-economic stability. However, the important fact is that *Inflation Report* explicitly said that such negative fiscal perspective is already priced-in in the central bank's inflation forecast of 2.5% in December 2004, and therefore it does not pose a risk for the next year inflation target.

The document also included full results of voting over all motions and resolutions regarding interest rates and other parameters of monetary policy in 2Q03. The most interesting were results of the meeting in April. They showed that the MPC voted over 50bps cut in April, although the proposal was not approved. What is interesting, the results also revealed that NBP governor Leszek Balcerowicz was voted down in April in the case of motion assuming 25bps cut in the reference rate and leaving remaining interest rates unchanged. However, the reference rate was cut by 25bps in April, but it was accompanied by 50bps reduction in the Lombard rate. NBP governor supported (together with four doves) that decision. Results of MPC meetings in May and June did not bring any surprises.

Four hawks to be replaced in January

Many people talk about a possible deep rate cut at the beginning of the new MPC term. However, the timing of such decision is rarely indicated precisely, while this would be important information for the financial market (money market in particular). For the time being, it seems that market analysts considered February 2004 to be the first possible month when the Monetary Policy Council in the new composition could decide about reducing interest rates more abruptly. But if we look at the calendar of MPC member mandates' expiry, it turns out that four hawks from the current MPC end their term of office already in January (please see table below).

Expiry dates of MPC members' mandates

Expiry date	MPC member	Nominated by
7 Jan 2004	Jan Czekaj Jerzy Pruski	Lower House
21 Jan 2004	Bogusław Grabowski Cezary Józefiak Wojciech Łączkowski	Upper House
5 Feb 2004	Marek Dąbrowski	Lower House
16 Feb 2004	Dariusz Rosati Grzegorz Wójtowicz Wiesława Ziółkowska	President
9 Jan 2007	Leszek Balcerowicz	

Source: NBP

In effect, already on 22 January the Council will consist of eight doves (five new nominated by the parliament, with re-elected Jan Czekaj among them, and three current presidential members), a lonely hawk Marek Dąbrowski and NBP president Leszek Balcerowicz. Of course, this is still not certain whether there would be a majority for a deep reduction already in January, as we would have five new and five old members in the Council. For current presidential members supporting such a decision would mean a complete disagreement with current Council's "small steps approach". However, it is highly possible that we might see an interest rate reduction already in the first month of 2004, before all the new members join the MPC, while deeper than usual monetary easing (of 50 bps) could not be ruled out. Of course this assumes that January meeting will not be scheduled earlier than usually, e.g. on 20-21 January.

Comments of the MPC members and central bank representatives

Last month, the opinions of the representatives of the central bank focussed on budget issues. At the beginning of the month, the press reported the warning message given by Leszek Balcerowicz, president of the National Bank of Poland, saying that Poland should brace for an Argentina-like crisis. Even though in the later part of the month, the head of NBP did not reiterate such opinions, he emphasised that the currently recorded economic revival will be neither permanent nor fast without the required reforms. The words of criticism referring to the postponement of the required changes in the budgetary policy, and the resulting delay in the entrance to the euro zone (which was called “a step backwards”) were also said by Dariusz Rosati, MPC member.

Following the August MPC meeting, the governor of the NBP said that the decisions of the Council were based on the assessment of the future inflation drivers and not on the current indices. According to Balcerowicz, the annual inflation in 2004 can reach 2.5%. When asked whether the absence of interest rate cuts in August meant the end of the interest rate trimming process, the governor of the NBP responded that such a decision was a clear signal of his own assessment of the current interest rate level from the point of view of economic growth. Such a response could suggest that he did not see any further room for interest rate reductions. When asked whether some were right to assume that there would be no more interest rate cuts this year, Balcerowicz answered that he would not be so pessimistic about it. Furthermore, during a press conference following the MPC meeting, the governor of the NBP suggested that the prospects for the fiscal policy were not the key driver of the monetary policy or the interest rate policy. This clearly shows that even a high budget deficit should not be a barrier for yet another decision to cut interest rates this year.

Bogusław Grabowski, an MPC Member, was even more “hawkish” that the NBP governor chairing the Council’s meeting and he said that the cycle of “loosening” the monetary policy was definitely coming to an end (note: he didn’t say that the cycle had come to an end), as in 1H04, the GDP would exceed the potential level and as of then, the stepping up economy would drive up the inflation. Grabowski was quoted as saying that the market expectations for the reduction of interest rates this year by further 25bp-50bp were “overshot”. It should be remembered that in the past Grabowski has been quoting similar opinions on a number of occasions and the rates were actually reduced every month. This, however, does not change the fact that there is a growing conviction among the MPC members that the cycle of reductions (during the term of office of this Council) is really coming to an end. Obviously, the stance of the five “hawks” is far more uncompromising whereas the other members clearly admit the possibility of another marginal reduction in the interest rate this year, as in the situation of stronger economic revival they do not fear a substantial inflation pressure neither this nor next year. Further moves as regards monetary policy will shift from the interest rates to the obligatory reserve rate, which the MPC wants to reduce still this year. However, most likely, as described above, the decision on the obligatory reserves will not be taken in September.

WHO. WHEN. WHERE	COMMENT
Leszek Balcerowicz, NBP governor; Financial Times, 29 Aug	I expect present members [of the Eurozone] to observe the framework […]. It should not be undermined. […] Governments need constraints. Many countries have suffered because of a lack of budget discipline. It is in the interests of new members that the essence of the pact is kept intact.
TVN24, 27 Aug	Every month we make efforts to have the best information on future inflation developments. At this meeting such a decision was taken [no rate cut]. The estimates made in the NBP show that the increased deficit of next year's public finances, coupled with additional transfers from the European Union, may create an essential demand impulse. These analyses will be repeated in September. I hope that the worries concerning fiscal policy will vanish somehow in September. At present I do not make pessimistic assumption concerning public finance. In September we will see a set of solutions for credible scenario of healing the state. At the nearest meeting the MPC would continue discussing the issue of reducing reserve requirement. The talks on this issue are conducted with the government.
PAP, 27 Aug	The current inflation indicators were nor behind the RPP decision. Roughly speaking, external forecasts comply with internal ones and show that next year's inflation would be close to the inflation goal. […] Possible inflationary pressure results from significant uncertainty concerning a scale of economic deficit of public finance sector in 2003 and – even more significant – the one concerning a shape of fiscal policy in 2004 and next years. The current interest rates do not hamper economic pick-up. If it turns out to be not persistent that is not because of the level of the rates. [no rate cut] This is a clear signal how I perceive a present level of interest rates from the point of view of economic growth. […] The decision proves that the signs of economic revival are maintaining, including investment, which also matters for inflationary pressure. On the basis of current data a level of this year's GDP growth may be over 3%. I do not want to make the impression that the monetary policy hinges on the fiscal policy.
Gazeta Wyborcza, 18 Aug	[3% GDP growth this year] There are many signals that such growth rate will be reached. […] [5% growth in 2004] This is very optimistic forecast but it is not impossible. The fact that the economy is accelerating after a period of a slowdown is natural phenomenon. It is the most important to what rate it will accelerate and how permanent the growth will be. Everybody agrees that permanent acceleration in Poland requires that a set of certain reforms will be implemented in time. […] The above-mentioned set of reforms contains reducing and rationalisation of budget expenditures. It should be done together with quite quick finishing up privatisation […]. Moreover, unfavourable regulations should be cancelled […]. Q. Is Poland threatened with bankruptcy? A. We are not in the situation like Argentina. However, already at present, tolerating excessive budget deficit depresses growth instead of reinforcing it. What’s more, we make ourselves dependent from foreign portfolio capital that flows in to buy treasury bonds. And this capital is nervous that can flow out quickly. [Poland’s entering to the Eurozone in 2007] It would be in Poland’s own interest. […] If there were no Maastricht criteria then one would have to think them out for Poland, as they are good for economic development. And if someone says that we don’t have to hurry with entering the Eurozone, in fact he says: let’s postpone indispensable reforms.
Puls Biznesu, 7 Aug	Current level of public debt is dangerous. One cannot exclude Argentinean scenario that the state will bankrupt. Tolerating high losses in mining sector, steel industry, shipbuilding industry or in state railways endanger other branches and the budget.
PAP, Reuters, 5 Aug	We did not say this would happen in July or in August [lowering reserve requirements]. We have to take into account several conditions at the same time. We are in contact with finance ministry and commercial banks. Analysis will show what is the scope for lowering reserve requirements.

	We are seeing gradual economic recovery, but if we allow the sickness of the public finances to go on and if we do not introduce reforms this year... I do not see chances for sustainable growth. If there is no plan to reduce budget spending, we will se several excuses to postpone it again next year. From the point of view of economy it simply pays off to adopt the euro as quickly as possible, because that would mean bringing fiscal reforms earlier. As majority of our international trade is with Eurozone countries, we could have much lower rates without exchange rate risk. It is very probable that this year's inflation will stand near or slightly below the lower end [of the NBPs target]. It is very difficult to forecast long-term market interest rates, but they are rising and that has to be treated as a warning sign. Reduction of FX reserves could not threaten the stability and safety of the currency buffer. It is very likely that this year's budget will be realised in line with assumptions.
Jan Czekaj, MPC member; TVN24, 27 Aug	No threats for inflation are seen. We see acceleration of economic growth but such a growth does not inline to significant caution.
PAP, Reuters, 26 Aug	Much can be improved in co-ordination of fiscal and monetary policy, these relations are not the best. A dialogue between these institutions must be carried. The NBP law stresses it unequivocally. What is happening among the NBP and the government is characterised as conflict. […] Friendly and close relations with the government should be tried to establish. I have stated many a time that to-date monetary policy is too restrictive. Obviously, everybody would like that rates [in commercial banks] are even lower, but I am not inclined to act directly, we should leave it for market developments and shape suitable macroeconomic conditions. Interest rate policy will depend on the development of the situation in the future. There might come a time when we will rise interest rates when inflation has revived. Inflationary pressure in 2004 will be limited but if the economy accelerates rapidly it will result in natural way in stronger inflationary pressure. There is no danger of an inflation rebound as shown by many data. But on the other hand recent data require more detailed research where the growth comes from. Generally, I don't like this dividing [into hawks and doves]. I believe these labels are not good. They suggest that someone is "by genes" for cutting or rising [rates]. Interest rates policy should be dependent on economic situation development, on inflation and on growth rate. It is difficult for me to say anything today in this subject [on the date of Poland's entry to the Eurozone]. It will depend on many factors. What is more favourable must be compared to what is possible. […] We must meet Maastricht criteria. At present we do not meet all criteria, and it will be possible to cut the deficit only on the fast growth path.
Jan Czekaj, SLD's candidate for the MPC; TVN24, 11 Aug	I maintain my opinion that monetary policy has been overrestrictive since 2001. There were positive consequences such as low inflation (though falling faster than NBP expected), but this was also negative for economic climate. We have factors, which might lead to lowering interest rates (low food prices), but on the other hand we see rising fuel prices for example, which might be an opposite argument. We have no clear signs suggesting that economic recovery is persistent. GDP growth would be above 3% and it is possible it reaches 3.5%. This is still dynamics not excessively high, and not allowing for cooling down the economy. I think that we should observe a moderate zloty strengthening. Economic arguments support such a scenario in the medium-term. Of course, short-term exchange rate will be influenced by several factors, which might be observed at the moment. I am not a specialist on economic forecasting, so I would not invent my forecasts.
Reuters, 6 Aug	The MPC's main goal is to maintain stable prices and its policy indicator is the inflation target. Inflation has been so far falling much faster than the MPC's own forecasts, which implies that monetary policy had been too tight. If the inflation goal is not overshot, there is no basis to tighten policy. But there are no reasons to expect that inflation will suddenly burst out this or next year. Past monetary policy had been too restrictive and there had been more room to lower interest rates, although of course government and MPC's views on that issue are not always the same. One talk about a normal conflict of slightly different views, which is natural. There is high probability that the GDP growth will reach 3.5% this year.
Marek Dąbrowski; MPC member; Reuters, Rzeczpospolita, 9 Aug	Financial markets, which have expected a quick euro zone entry by Poland... and have ensured a significant convergence of long-term interest rates, may feel disappointed by our marco-economic prospects. As a result, capital would flow out of the country, market interest rates would increase, the zloty would weaken and inflation would increase again.
Bogusław Grabowski, MPC member; Polish Radio 1, 28 Aug	Yes, [too fast economic growth] can be dangerous. It hampers economic stability and cannot be maintained in the long run. [...] One cannot allow economic growth to continue at the expense of long-term balanced development. We have more factors, which would accelerate inflation in the following months and next year. It is food market, zloty weakening, and the worst i.e. building up public finance crisis. [...] It cannot be this way that economic growth rate rises, industrial output accelerates and we relax fiscal policy and continue with monetary easing. It would lead to a situation when this growth would be unstable in subsequent years. MPC deals with this problem [reduction of reserve requirement] and we have discussed this issue during this meeting. We will continue this discussion also in September. One has to remember one thing. Reduction of reserve requirement [...] is nothing else but a monetary easing. It is a kind of a substitute for interest rate cut, and therefore this discussion whether to cut interest rates of reserve requirement is being continued. And at the same time [there is a question] whether we can afford it at all? We will continue this discussion as every month.
PAP, Reuters, 27 Aug	The monetary policy easing cycle is definitely coming to an end. […] The scale of interest rate reductions forecast by the market amounts to 25-50 bp. Markets do overshoot. We will have to do with easing of the fiscal policy which is suppressing the monetary policy. We estimate that the short-term potential level of economic growth may be exceeded by the actual growth level in the first half of the next year. A strong depreciation of the zloty has not yet been reflected in inflation, producers have not increased margins […] but when economic recovery is back, there will begin commence a stronger transmission of the depreciation into prices.
Reuters, 1 Aug	Summer months bring the lowest deficits thanks to increased trade in food products. It is possible that in July or August we will have a current account surplus, although it will be a temporary phenomenon. In 2004 we will see stronger import dynamics on the back of economic recovery.
Cezary Józefiak, MPC member; Reuters, 20 Aug	We are at the beginning of economic recovery and at the same time we believe that inflation will rise. This means that there are no reasons for changes in monetary policy, or reduction of rates as we are going towards it. Inflation will rise to some 2.0% at the end of 2003, and it will accelerate to 2.5% at the end of 2004. At the end of this year GDP growth will stand at 3.0%.

PAP, 14 Aug	Inflation will be close to 2%, which will be driven by recent zloty weakening. Also, the trend on the food market started to reverse after a few excellent years. Fuel prices are the third factor. If someone believes that planned inflation might be achieved with an accuracy of a few decimal places of a percentage point, he is wrong. There are estimations that inflation in December 2004 would amount to 2.5%YoY. These are not conditions favouring interest rates reductions.
Dariusz Rosati, MPC member; PAP, Reuters, 22 Aug	We are very close to cuts' limit and the situation should be approached to with a great caution. […] There are prospects for cutting the obligatory reserve, which means the relaxing of the monetary policy and that, is why decisions on next cuts should be made cautiously. […] We have a successive month of production growth which cannot be ignored. We are very near to the point, beyond which we would only accelerate inflation, and not growth. We need to remember that there are few-months delays in these operations. What we are seeing now is the result of cuts made many months ago. […] We also reduced rates two, three and four months ago. The effects of these cuts may not yet be evident. […] There is no inflationary pressure yet, but we need to investigate whether it will appear next year. Rise in retail sales has been observed for over a year. It is a permanent trend which only proves that domestic consumption demand is rising slowly. However, exports are still the main vehicle of the growth. The optimistic fact is that downward trend in investment was stopped. If the government does not propose extremely irresponsible 2004 budget then certainly there should not be weakening of the zloty but contrary – the zloty should catch up for losses from the first half of the year. There is not threat from inflation side and also core inflation measures maintain at stable level or even downward trend. The whole M3 aggregate remains stable and also from monetary side no inflationary tension is rising. Inflationary impulse may come from crude oil prices, but no more from food prices. For a sixth time we will miss short-term inflationary target. But we don't worry about it, as we are watching the trend and we succeeded in lowering inflation. […] Next year, inflation will rise to some 2.0% maybe 2.5% even but it will still be low inflation. We are not in hurry to do it [lower mandatory reserves] already in August, but it would be favourable to do it by the end of the year. […] We can reduce mandatory reserve rate from 4.5% to 2%, but we can also implement fully European solution, i.e. we can free from reserve long-term deposits with above two-year maturity. […] In this case, the liquidity would increase by at least PLN7-8bn. Such a fully European solution is possible to be achieved, maybe not this year, but we will proceed to it. We don't know what will be final proposal of the government considering 2004 budget but up-to-date information point to big increase in spending and deficit resulting not only from expenditures caused by EU accession. […] Revenues rise by PLN3bn while spending by more than PLN20bn. This is not a symptom of strong will to reform public finance. Delaying Poland's entering to the Eurozone and intention to fulfil Maastricht criteria in 2007 is the step backwards. I warn that postponing the decision doesn't settle anything. Probably in 2004 negotiations on entering the Eurozone will begin and they will consider a central parity and a width of fluctuation band, which will settle some reference point for entering the euro. […] The question of fluctuation band of ±15% will be a political decision, as Polish economy cannot have the narrow fluctuation band, because it would not fulfil it. If we want that Poland meets EU requirements the band must be wider given quite shallow FX market.
PAP, 20 Aug	The CSO data are above expectations and the 10% production growth is the highest increase in quite some time. Therefore it is evident that the recovery we are talking about is gaining momentum and one can assume that GDP [growth] a year from now can reach above 3%, not just around 3% [like] in 2003. […] Already the third and fourth quarters will be much higher than the preceding ones, and GDP growth in the 3Q should be around 4%. We deal with the break in the downward trend in construction and it is a very good news indeed, because this is connected with capital investment activity which has shown negative growth rate for many months.
Grzegorz Wójtowicz MPC member PAP, 29 Aug	For the last 12 months the deficit rose to 2.9 pct of the GDP. It will remain at the similar level until the end of the year and may be slightly over 3 percent at year-end. This is not surprising. We have big imports which must be paid for at some time. Fluctuations of payment imports are big, depending on the existence of delayed payments. From time to time such import payments play such tricks. Exports and imports can fluctuate, especially in December, but there should be no big surprises. Unfortunately, there are not proofs to say that investment demand has kicked off, and this is the factor that GDP growth would depend on.
Reuters, 22 Aug	[data on output and retail sales] These are clear signals showing that the third quarter should be a breakthrough in getting to economic revival. All implies that the growth is sustainable and may last for a longer time.
PAP, 14 Aug	In August one cannot exclude deflation lower than 0.5% recorded in August 2002 and that is why 12-month inflation might go up. We should observe a moderate upward trend of inflation until 1.5-1.0% in December (closer to 1.5%). In summer months, food prices (especially fruits and vegetables) decide about inflation, but this is nothing surprising. These are only monthly indicators, which are very volatile. In the following months, we will see how prices on the food market develop after a dry weather in Poland.
Wiesława Ziółkowska MPC member Reuters, 29 Aug	The best moment in 2003 to lower interest rates will be September, because next year's budget plans will be known and inflation will still be low. It's difficult to say if further rate cuts (after a potential reduction in September) will be possible. It will depend on further development of the macroeconomic situation. We will see developments in oil prices and what will be the impact of economic recovery on inflation. Economic growth should exceed 3% this year.
PAP, 7 Aug	Inflation will be below 1%YoY in July, which obviously open room for interest rates moves. If low dynamics of credit is not maintained, one will have to wait what will happen later. In August, inflation may be higher than in July due to hike in oil prices.
Paweł Samecki, head od foreign affairs dept of NBP; Gazeta Bankowa, 25 Aug	The amount [of foreign exchange operations of EU transfers] will not be large enough to have determining influence on the market. It won't be few large operations. It will be continuos process, some payments will be coming and leaving everyday. However these issuess will be a subject of formal decision of the FinMin and the NBP. We have already similar agreements concerning pre-accession funds, though at lower scale.

Government and politics

- **Polish president's advisor predicts change in exchange rate regime**
- **Rumours about rating downgrade for Poland**
- **... seem to be exaggerated a little bit**
- **... even despite deteriorating fiscal outlook**

Change of FX regime? Rather not.

Chief economic advisor to the president of Poland, Witold Orłowski introduced a substantial turmoil on the Polish financial market, saying that in his opinion the newly elected MPC would like to abandon free float of the zloty just after the beginning of its term of office. Orłowski predicted introduction of ERM2-type managed float system with wide bands (+/-15%) and said he was convinced that the government would eagerly support such a solution. Also, in his opinion, the central bank would be then ready to start active FX interventions on the market to prevent potential zloty appreciation. Orłowski added (possibly, after noticing sharp negative FX market reaction) that it was just his personal opinion.

However, finance minister Andrzej Raczko reacted to Orłowski's comment, saying that in his opinion current FX regime of free floating zloty does a good job in Poland and there is no reason to change it. He added also that a decision about pegging zloty to euro in ERM2 system could be considered not earlier than at the end of 2004 when fiscal outlook would become clearer. He also supported the widest possible bands of currency fluctuation under managed float regime. Also FinMin's spokesman and NBP representative denied any talks between the ministry and the central bank concerning the change of FX regime in Poland.

Also Deputy PM Jerzy Hausner referred to exchange rate policy. He said the government was satisfied with the current level of zloty exchange rate. Asked about possible consequences of downgrade of Poland's rating (more details below), Hausner said that in case of such a decision, the government together with the central bank would take an "immediate" action to prevent collapse of the zloty value.

Growing concerns over Poland's rating downgrade

Rumours about possible downgrade of Poland's sovereign rating, that have been sweeping the market for some time, found their peak after S&P's analyst Beatriz Merino interviewed by Reuters admitted that the rating might be reduced after the final approval of budget draft for 2004, "if the government does not take action on reform in the upcoming discussions". The fact is however, that this information should not be perceived as a big revelation. After S&P revised outlook for Poland from "stable" to "negative" in June 2003 one should have expected that the agency would closely watch Polish fiscal parameters and that more likely decision would be a cut of rating than its upgrade. The fact is also that there is a risk of deterioration of investors' sentiment towards the Polish market, which would depend heavily on the fiscal policy proposals to be presented by the government. On the other hand, however, another S&P analyst Moritz Kraemer said in the interview with PAP that he saw no pressure on changing Poland's rating, as government's policy "is in line with expectations".

... and Fitch Ratings to consider change in outlook for Poland's rating

Also Fitch Ratings announced that it would consider change in outlook for Poland's rating after the government presents details of fiscal policy in 2004. Fitch's analyst James McCormack said that possible change in outlook would depend mainly on budget spending reform, reduction of budget deficit and expected pace of public debt increase (Fitch Ratings expect debt to approach 55% of GDP next year). He added that in case of Poland domestic debt is much more important than foreign debt (which is not a problem at all). Fitch is more concerned about domestic debt and the agency would focus on that kind of borrowing when evaluating Poland's rating. McCormack said that already presented guidelines to 2004 budget are not encouraging although a bright point is the economic recovery signalled by statistical data. However, he is pessimistic as regards government's GDP growth forecast for 2004 standing at 5% and he expects that it will reach 3.5-4.0%. Such prediction is based on the assumption of loose fiscal policy and moderate interest rate cuts.

Considering a possibility of rating downgrade by the above-mentioned rating services one should remember than at the beginning of September they granted high score BBB+ for the new issue of Polish Eurobonds. Wouldn't it be strange then to change the assessment over such a short time horizon? Meanwhile, analysts from the third major ratings service Moody's haven't been commenting situation in Poland for a while. Let's hope this is not a silence before the storm.

Comments of the government members and politicians

The opinions of the representatives of the government and the other politicians recorded in August mainly referred to the fiscal issues. Jerzy Hausner, the Deputy Prime Minister and the Minister of Economy as well as Andrzej Raczko, the Minister of Finance, said they would do everything they could to reduce the budget deficit planned for 2004 below PLN45.5bn. We know now that they have not succeeded. Moreover, they stated that the economic policy had to stimulate the economic growth, but, at the same time, it had to ensure a substantial limitation of the budget deficit within the upcoming several years. The documents concerning the fiscal policy will tell whether this comes true. They are to be presented by the government in September (medium-term strategy of public finances and long-term plan of budget expenses rationalisation) and in October (proposal of comprehensive changes to the tax system). Nevertheless, it will primarily be the specific actions aimed at consolidation of public finances and not the documents presented by the government that will be decisive in this case. For the moment, however, the prospects for the long-term fiscal policy do not look too good. It has been confirmed in an interview for the Polish Press Agency by Ryszard Michalski, the Deputy Finance Minister, who said that the planned Polish road to the euro zone had grown longer recently. At the moment, 2008 is the potential earliest date of entrance to the euro zone, as defined by the government (initially it was 2007). He also said that the entrance to the ERM-2 system should not happen before 2006, assuming that spring 2008 was a realistic date of the entrance to the euro zone. So far, no decision has been taken as regards the moment when PLN should be tied to EUR rate. According to Michalski, a fixed EUR/PLN parity should not differ much from the one currently observed, assuming that the inflation remains under control (between 2%-3%) and that the EUR/USD rate remains at 1.05-1.10. In our opinion, the entrance to the euro zone can happen even later and the parity will be lower than assumed by Michalski.

Witold Orłowski, Chief Economic Advisor of the President of Poland (and one of the potential candidates to the MPC) still sees room for further reduction of interest rates. He does not agree with the voices saying that the rates should not be lowered as the economy is growing faster, because in his opinion, the rates should not stay at the current level but on the lowest possible level preventing an inflation-related threat. Orłowski concluded by saying that the new MPC could substantially adjust the level of interest rates. It is in line with our expectations as we anticipate that the reference rate will go down to 5% as at the end of 2003, and down to 4% in 2004 when the new MPC is appointed.

WHO, WHEN, WHERE	COMMENT
Jerzy Hausner, deputy PM, economy and labour minister; PAP, 29 Aug	I am not able to say if we will succeed in doing it [reducing 2004 budget deficit by PLN 2-3bn]. Today, all the ministers make efforts to convince me, as a co-ordinator of economic policy, the Prime minister and the finance minister that their expectations for increasing amounts of money are reasonable. They present their arguments we compute and calculate. I would like it but I don't know if we will succeed. But even if final deficit amounted to PLN45.5bn, which would mean the necessity of more tough fiscal policy next year, in my opinion, it would not be a bad budget.
PAP, 28 Aug	The finance minister reports he will not be possible to finance a deficit exceeding PLN45.5bn. I understand that it would be reasonable to cut VAT rate by 1 pp. because it would not result in a raise in trading and an increase in revenues. It also seems reasonable for me to cut it by 2 or 3 pp. […] However, the proposal providing for a 7 pp. cut in view of our integration with the EU and strained budget would mean that we could loose the control over public finances. This is an alarming proposal.
Reuters, Gazeta Wyborcza 7 Aug	Economic policy must stimulate economic growth and ensure a significant lowering of the budget deficit over the next few years. If I play too hard and raise the stakes too high I will not be able to do anything. If I play too cautiously then there will be no effect. Some central bank members would like to slash state spending in 2004 and enter (the euro zone) as quickly as possible. It is a dangerous extreme. I think that fiscal adjustments should take longer (...) the economy needs a demand stimulus, particularly in terms of investment.
PAP, Gazeta Wyborcza, 6 Aug	Two years ago large, single interest rate reduction would have been a strong impulse for the economy. It's all gone. Therefore, there is no sense discussing interest rates anymore. Then there was sense and I thundered because I wanted to save the day. Currently, the MPC has small steps approach and it is not a wrong policy, especially as we have economic recovery. There would be a consensus between us in terms of budget spending reduction. The most important disagreement is how fast changes should be made, as Leszek Balcerowicz would prefer to cut very fast. He thinks lowering expenses might increase total demand itself, while I think that the economy needs a demand impulse, especially on the investment side.
Andrzej Raczko, finance minister; PAP, 28 Aug	There is always room for interest rate cuts. The MPC is responsible for the interest rate policy.
PAP, 26 Aug	One should be cautious, 3.2% is within the reach or even closer. Recently released data have, of course, its influence on predictions related to GDP growth.
Gazeta Wyborcza, 22 Aug	I cannot say that depreciation of the zloty would grieve a finance minister in any particular way, especially that it contributed to economic recovery. However excessive weakening of our currency would be dangerous. Besides, next year we see little threat of it. Instead, we expect the zloty to strengthen against the euro, as the European currency will be probably weakening against the dollar. So FX rate changes will help to reduce public debt. For sure I do not feel any anxiety. The rise in yields must be seen in wider prospect. In recent two years interest rates have been lowered in Poland. In turn it caused a fall in T-bond yields. Nevertheless, further fall in interest rates will be slower. […] Bonds compete with stock market as the way of investment. As long as there was a slump on the stock market, bond yields were falling. At present stock prices are rising, which must be accompanied with a rise in bond yields. We will exceed 50% [public debt to GDP ratio] threshold, and next year we will be close to 55% of GDP. […] Increasing debt is worrying. This is one the main problems of the government, especially of the minister of finance. Within the next three years we have to reverse this tendency. […] GDP growth acceleration itself will not solve the problem. We have to concentrate not only on reviving growth, but also on lowering fiscal deficit via rationalisation of budget spending. […] Scenario of lowering debt since 2006, which I have presented, does not mean postponing public finance reform. […] Our activity towards higher discipline in public finance will show the effects lagged in time. And that is why we have to deal with the problem as soon as possible! It is impossible that budget deficit may be higher than PLN45.5bn accepted by the government. This level of deficit is very high anyway and it will result in higher debt. There is no much room for manoeuvre. The period of quick growth is the best time to take up a reparation of public finance. If we miss this time, we will stifle economic recovery and the problems will remain. My scenario for halting the growth of public debt beginning in 2006 is realistic, but it requires earlier reforms. Without them the debt will grow above 60% of GDP, and then we'll really have big problems. […] We will have to cut expenditures automatically and rise taxes. GDP growth is based on strong fundamentals - rising production and exports, higher productivity of firms. From the point of view of budget preparation, the EU accession will be connected with several costs, which are not possible to be estimated precisely. [...] Net effect of integration will be positive for the economy and for the society, but these effects will not be visible in the budget.

PAP, 8 Aug	I would like to limit the budget deficit as much as possible. I believe that the sums we are talking about - two to three billion - are realistic. Ministry of Treasury sent us new privatisation agenda, which shows that expected revenues from privatisation in 2003-04 would amount to PLN14bn on top of what is already realised this year. Our financing needs on the international markets depend on our foreign debt structure. The European market will be the most important one, although we will also issue on the American market. We are also more active on the Japanese market. Next year financing on the international market would amount to €3-4bn.
Wojciech Olejniczak; agriculture minister; PAP, 7 Aug	I support an introduction of tax for farmers. In difficult circumstances (as this year's) they would not pay, they would pay only if they have incomes
Krzysztof Pater; deputy minister of economy; Reuters, 7 Aug	In 2H04 we will have to start a discussion on increasing investment limit abroad [for pension funds]. There is a consensus within the government that it should be increased, but there might be problems in the parliament. For example, Law and Justice deputies wanted to put a stop to foreign investments at all. Civic Platform is unpredictable as well. But next year reality will change, we will be in the European Union, and it is unquestionable that the limit should be increased. I understand that the government would prefer to leave the money in Poland, to finance infrastructure projects, but the problem is that there were no such projects within last two years, and we see a risk of stocks overvaluation and speculation bubble.
Ryszard Michalski, deputy finance minister; PAP, 19 Aug	[next year's domestic issue of treasuries] It is a big amount, as it results from exchange and repurchase operations, as well as with hew issues. […]. The amount of issue is not finally decided since it will depend on the budget. […] We assume higher revenues from privatisation but it is not decided yet. At present we consider PLN14bn from privatisation in this and next year. It would improve a situation new issues would have to amount to PLN30bn and more than that for deficit and borrowing needs of the budget. We are working on a strategy of public debt management in which questions of domestic and foreign financing are decided. Domestic one will prevail in one to ten relation. It casts some light on the scale of next year's operations. Assuming that inflation will be under control, which is quite likely, only little depreciation of the zloty would be necessary [when determining the parity against the euro], though every depreciation supports the economy. […] If the eurodollar cross maintained at 1.1 with downward trend (eurodollar purchase power is estimated at 1.05) the dollar would strengthened against the euro to the level of 1.05 within next 2-3 years. In this case, with inflation at 2-3% a year it would mean that the central FX rate would differ slightly. If we assume that spring 2008 is a realistic date of Poland's entering to the Eurozone we would have to enter the ERM2 mechanism two years earlier. It would mean that we should do it at the beginning of 2006. The process of joining the Eurozone is slowing down by a year. Before we were talking about 2007, now we are talking about spring 2008. […] We will see what next year will look like. It is very important and then, at the beginning of 2005 we will take a decision how to work on further.
Reuters, 7 Aug	We would like to start with an offer of €300m. We hope for demand of Polish investors as well and signals suggest the demand might be very high. It is possible to increase offer to €500-600m.
Halina Wasilewska-Trenkner deputy finance minister Reuters, 31 Aug	Putting budgets together, particularly the one for the next year where there are so many variables, is like a jigsaw puzzle where some elements seem not to fit at all. It will be very difficult to finance a deficit of PLN45.5bn. It's a lot of money, and it's a limit that cannot be breached. It would be great if we could narrow it, but at this point we do not know if we will manage to do so. This year, while revenues are short of plan, there is no danger of having to revise this year's headline deficit, as there is room to cut discretionary spending. We can't close our eyes and just wait for the end of the year, but there will not be an upward revision of the headline deficit. That would be suicide. I have to honestly say that we do not know how much in privatisation revenue to expect this year, and it does give us a headache. But I do hope the seven billion zlotys that we will put in the budget next year is feasible. What is also very optimistic is the recovery in what had long been Poland's Achilles' heel. More construction is more output, but also more building materials and furniture, and that means more taxes for the budget.
Jacek Krzyślak, head of research dept. of FinMin; PAP, Reuters, 27 Aug	We forecast that [in August] prices were 0.4% lower than in July, which translates into an annual index at 0.7%. […] In our opinion the fall in inflation is still caused by food. We believe that in a second half of the month food prices will not be falling. Starting from September inflation will begin to rise to 1.3-1.4% at the year-end.
Gazeta Wyborcza, 22 Aug	It can't be excluded that minister Grzegorz Kołodko was right as 3.5% of GSP [this year] assumed in the budget is very likely. […] By this time we stayed at 3.2% economic growth in 2Q and 3.4% in 3Q. Now we know that it will be better, even 4% is possible in last three months of the year. Financial results of companies are very good, which is in fair way for investment.
PAP, 20 Aug	Data [on industrial production] are extremely good, we have not expected such a good data and certainly we will have to revise upwards our forecasts.
Elżbieta Suchocka-Roguska, head of budget dept. FinMin; Reuters, 27 Aug	I estimate preliminarily that the budget gap after August will exceed 80% of the plan, but will be below 85%. There are no stresses on the budget, the schedule is performed in line with the plan. It is likely that state revenues will continue to be somewhat lower than the plan, which will force adjustments on the spending side
Edmund Cichowski head of FinMin's excise tax dept. PAP, 13 Aug	We will considerably cut the excise tax [on beer and wine] as of January 1. We will monitor the market and another such a move is feasible after Poland joins the EU. We will continue to talk about this issue and nothing is certain. The excise tax may be cut by a total of 20-30 percent. Next year budget calculations will take into account the effect of lower excise tax. As for now, the management of the Ministry of Finance did not oppose our departments' proposal.
Witold Orłowski, president's chief economic advisor; PAP, 25 Aug	Polish economy can in fact reach a GDP growth rate of no more than 5%. In short term it can deviate upwards but at cost of increasing economic imbalance. I reiterate that with present scale of implementation of structural reforms the economy will rise at limited rate even within recovery period. […] If there is still time to implement structural reforms, especially in public sector […], Polish economy could grow at 8, 9, 10%. It is always this way that with great spare capacity, with huge output gap (and we have such situation at the moment) there is non-inflationary growth. But we have to make a distinction between inflation fluctuations because of supply-side factors and "overheating". [....] We can count on many quarters, at least one year of growth without "overheating" economy. We could talk about it only if fast growth persists for one or two years. There is still room for interest rate cuts. One, two or three quarters ago interest rates should have been lower than they used to be. At the moment one argument gets stronger and stronger – why cut if the economy is beginning to grow? The answer is: because interest rates should not be at the level met but at the lowest possible level, which would not threaten with inflation growth. [...] There is a chance, and it would be teh last opportunity in the next couple of quarters because of large output gap, of interest rate reduction. [...] I believe the new MPC could decide for quite substantial interest rate reduction. The later it is made, the more risky such decision would be.

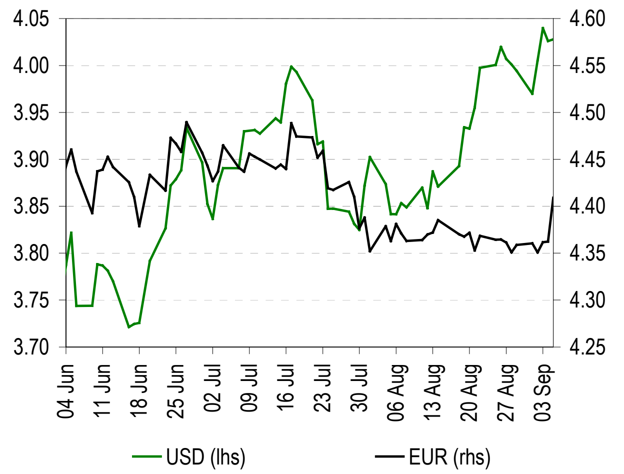
Market monitor

- **Zloty exceptionally stable against the euro**
- **Bonds – risk premium has grown**

August saw continuation of quiet holidays

August saw holiday peace on the Polish currency market. After a relatively peaceful July (while over the two last years the first holiday month was rather nervous) August was pretty dull. Turnover and daily rate fluctuations were marginal. August witnessed a very stable EURPLN rate, which fluctuated within a very narrow range (see below). As this was the case, the USDPLN rate demonstrated a higher volatility, which was driven by changes on the international market. As at the end of August, zloty was by some 1% weaker against the currency basket as compared to late June. The change was primarily driven by zloty depreciation against dollar following the appreciation of the American currency against the European one in the world.

Zloty FX rate in recent 3 months

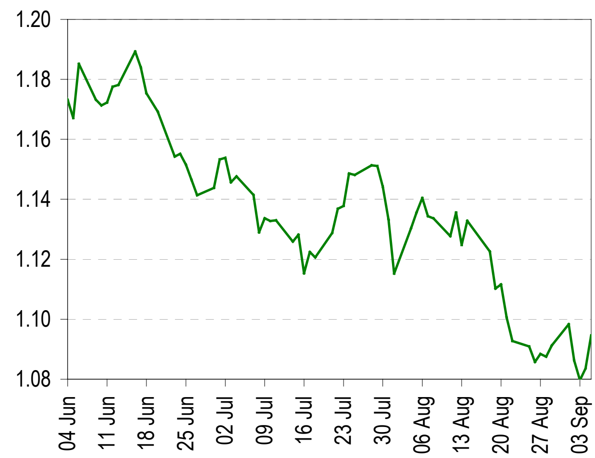


Source: NBP

According to NBP's fixing rates, in August dollar bought between PLN3.8414 (6 Aug) and PLN4.0198 (26 Aug) and it gave an average of PLN3.9186 (against PLN3.9036 in July). At the same time, the euro was valued from PLN4.3510 (28 Aug) to PLN4.3852 (14 Aug) and at PLN4.3665 on average (PLN4.4398 in July). Average rates of the euro and the dollar were a bit higher than assumed in our projections presented in the previous MACROscope (4.35 and 3.85, respectively). A bigger difference was recorded in the case of the dollar that was primarily triggered by USD appreciation, which was higher than expected.

The exceptionally stable EURPLN rate in August is worth highlighting. While looking for reasons behind this phenomenon, it cannot be forgotten that it cropped up in the holiday time when markets are more stable due to a quieter environment. Still, one cannot fail to notice that the euro stabilised around the level of 4.35 which would be referred to as "Kołodko level", as the finance minister of that time referred to the level as favourable for the economy and as a parity at which the zloty will be converted into the euro (in our opinion the parity is likely to be lower). Moreover, with this stable the euro rate, the currencies key for the Polish market swapped their roles, as to date the dollar rate had been more stable and responded primarily to domestic events while the euro rate had also reflected the changes on the international markets.

EUR/USD FX rate



Source: NBP, BZ WBK

The first week of September saw revival on the market. The holiday was over and so was the peace in the market environment. Rumours about the possibility of downgrading Poland's rating and the statement by Witold Orłowski about possible departure from floating rate regime, as well as uncertainty regarding fiscal policy, triggered a rapid zloty depreciation against the two currencies and the EURPLN rate moved closer to 4.45 which had not been recorded since mid-July.

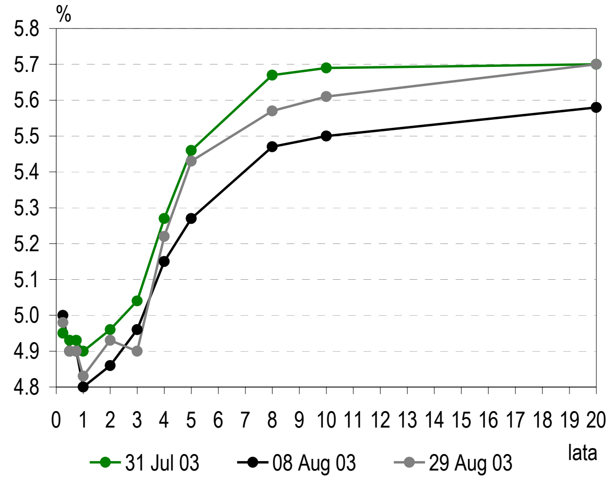
Bond market still following global trend

While a substantial growth in bond yields was recorded in July, in the first week of August, the situation reversed and the market strengthened considerably. Just like in the case of the July's weakening, prices were still impacted by an international market sentiment which was positive at this time after a series of successful auctions. The optimistic expectations with regard to the domestic bond tender, its good outcome and information on food prices also helped the market.

In the reminder of August, the market was again overwhelmed by the downward trend on the world's markets and its impact was reversed for short periods only or further strengthened by domestic developments, e.g. favourable inflation data or the statement from the MPC meeting that was perceived negatively. However, owing to a considerable fall early in the month, the curve moved slightly down in August. Yield differences between the Polish and European market stayed comparable reflecting no increase in the risk premium.

However, at the beginning of September, the long end of the yield curve rapidly grew following rumours about the possible downgrade of Poland's rating, which was followed by the information that S&P can really consider doing so. Following these incidents and with high uncertainty as regards fiscal policy in the medium term, the risk premium for Polish treasuries measured with the difference between the expected 5-year interest rate in Poland and in Europe in the next 5 years increased to 100bps. If one compares it to the level of early July, the difference increased by nearly 90bps.

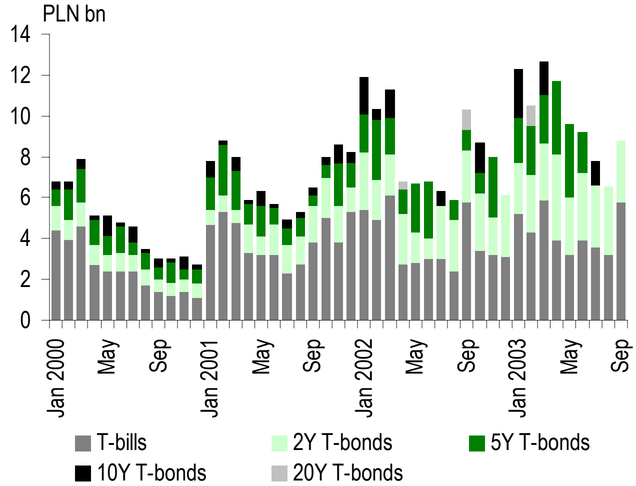
Yield curve



Source: BZ WBK

On 3 September the second auction of a 2-year benchmark (OK0805) was held. Bonds totalling PLN2.5bn (in nominal terms) were offered and a high demand was recorded (PLN6.2bn), two and half times as high as the supply. Obviously, all the offered bonds were sold but the offered low prices resulted in a rise in average yield to 4.982% from 4.894% at the auction in August, being slightly above expectations but in line with current market level.

Supply of Treasuries



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

Two days before the planned for 10 September auction of 20-year bonds the Finance Ministry cancelled it due to unfavourable market conditions. The ministry announced that at the auction on 17 September the supply of 5-year PS0608 bonds would range in between PLN1.8-2.8bn.

Treasury bill auctions (PLN m)

	OFFER / SALE			
Date of auction	*13-week*		*52-week*	*Total*
04.08.2003	-	-	700 / 700	700 / 700
11.08.2003	-	-	600 / 600	600 / 600
18.08.2003	-	-	900 / 900	900 / 900
25.08.2003	-	-	1,000 / 1,000	1,000 / 1,000
August total	**-**	**-**	**3,200 (3,200)**	**3,200 (3,200)**
01.09.2003	-	-	900	900
08.09.2003	400	-	800	1,200
15.09.2003	400	-	800	1,200
22.09.2003	-	200	900	1,100
29.09.2003	-	400	1,000	1,400
September total	**300**	**600**	**4,400**	**5,800**

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	3,600	3,555	-	-	-	-
June	04.06*	OK0405	3,300	2,852,2	18.06	PS0608	2,000	2,000	-	-	-	-
July	02.07*	OK0405	3,000	2,836.0	9.07*	DS1013	1,200	1,200	-	-	-	-
August	06.08*	OK0805	3,360	3,360	-	-	-	-	-	-	-	-
September	03.09*	OK0805	3,000	2,501	10.09	WS0922	cancelled		17.09	PS0608	-	-
October	01.10	OK0805	-	-	08.10	DS1013	-	-	15.10	5Y	-	-
November	05.11	OK0805	-	-	19.11	5Y	-	-	-	-	-	-
December	03.12	OK1205	-	-	-	-	-	-	-	-	-	-

Source: Finance Ministry * with supplementary auction

International review

- **No changes in interest rates**
- **Relatively stable inflation**
- **Is recovery in the Eurozone closer?**

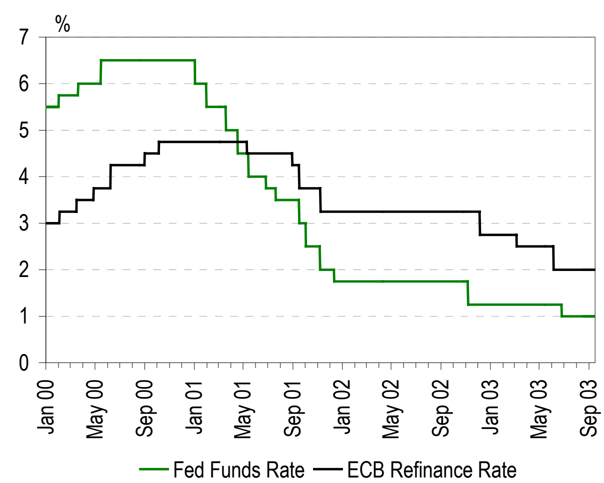
In September interest rates unchanged

In line with analysts' expectations, the Council of the European Central Bank did not change interest rates at the meeting on 4 September. The main Eurozone's interest rate – refinance rate – stands at 2.0%, after it was lowered by 50bps on 5 June. During the press conference the deputy ECB president Lucas Papademos said that the Council expected economic recovery to begin in the 2H03 and to speed up next year. He added that threat for this scenario had decreased recently, but they had not vanished, yet.

The ECB stated in its monthly bulletin that the present shape of monetary policy was proper and record low interest rates supported economic activity. The opinion was reiterated that the recovery in the European economy would occur in 2H this year. High crude oil prices were mentioned as a threat for inflation, however the ECB forecasts annual inflation rate to fluctuate around 2% till year-end and to fall below this level next year.

In the United States next meeting of the Federal Open Market Committee is planned for 16 September. Since June federal fund rate has remained at 1.00%, the lowest level since 1958. At the moment majority of analysts forecast no changes in interest rates during the next meeting.

Interest rates in the USA and Eurozone



Source: Reuters

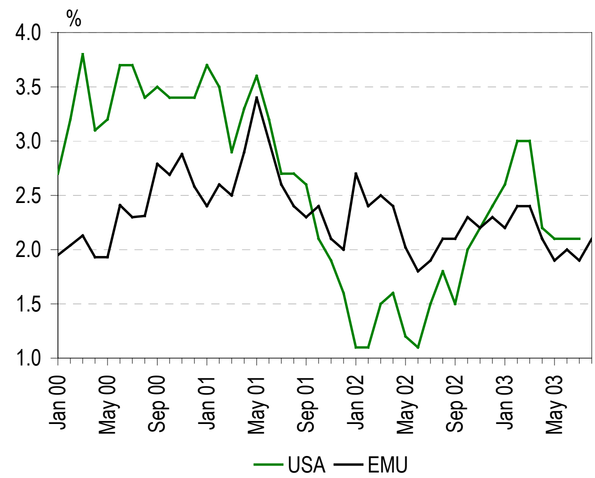
Consumer inflation still around 2%

According to final calculations, in July consumer prices in the Eurozone decreased by 0.2%MoM and as a result annual inflation rate fell to 1.9% from 2.0% recorded in June, which exactly matched preliminary estimations but was lower than analysts' forecast at -0.1%MoM and 2.0%YoY. Moreover, according to preliminary estimations, in August Eurozone's annual inflation rate increased to 2.1% reaching the highest level for four months and exceeding the target ceiling imposed by the ECB, as an indicator of mid-term price stability. Meanwhile, analysts forecasted acceleration in the price growth rate to the level of the limit i.e. 2.0%. In July, producer prices in the Eurozone were lower than forecasted by analysts. PPI remained unchanged as compared to June and annual growth rate of the prices slowed down to 1.3% from 1.4% a month earlier. The forecasts stood at 0.2%MoM and 1.5%YoY.

According to the European Central Bank, Eurozone's M3 money supply growth rate amounted to 8.5%YoY in July accelerating from 8.4% recorded in June and revised from 8.3%. Meanwhile analysts expected a slowdown in a rate of growth to 8.1%.

Data from the United States on inflation were in line with analysts' forecasts. In July consumer prices increased by 0.2%MoM, which translated into unchanged level of annual inflation rate at June's level of 2.1%. Overall producer prices increased by 0.1%MoM in July, which was a little below expected 0.2%. As a result the annual growth rate rose to 3.0% from 2.9% recorded in June.

Inflation YoY



Source: Reuters

American economy is accelerating

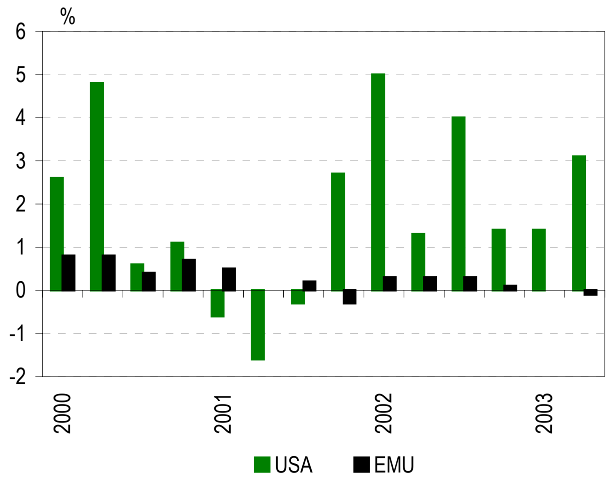
According to preliminary information on economic growth in the United States, US GDP increased by 3.1%QoQ in 2Q03, which was higher than the figure released a month ago in advanced information, when the growth rate was estimated at 2.4% only. What is more, the revised data were close to analysts' expectations at 3.0% and significantly better than 1Q03 figure of 1.4%.

In the United States industrial output was stronger than expected as it rose by 0.5%MoM in July, compared to 0.1% in June. Data on industrial production were very close to forecasts. US retail sales increased more than expected in July, which boosted market hopes for economic recovery. In relation to June retail sales were up 1.4% while analysts forecasted 0.9%MoM growth on average. Also June and May figures have been revised up sharply (in June to 0.9%MoM from 0.5% released previously). The result was heavily contributed by car sales.

… while the Eurozone's economy still stagnant

Data on the economic growth in the Eurozone in the 2nd quarter this year turned out to be in line with analysts' forecasts but weaker than in flash estimate. Eurozone's GDP declined by 0.1%QoQ and it rose by 0.2% on annual basis decelerating from 0.8%YoY recorded in the 1st quarter and revised from 0.9%. Analysts expected GDP growth rate at -0.1%QoQ and 0.4%YoY while its flash estimate was at the level of 0.0% and 0.4%, respectively. Eurozone's GDP fell for the first time since 4Q01, which resulted from negative growth rates in all major economies of the EMU.

GDP growth QoQ



Note: growth rates for the USA are annualised
Source: Reuters

The European Commission revised downward its forecast of economic growth for the Eurozone due to low GDP growth rate in the first year-half. According to the latest estimations GDP should rise by 0.5% in the whole 2003 compared to 0.7% forecasted previously. At the same time the Commission said that Eurozone's economy would revive in the last quarter this year mainly as a result of improvement in sentiment of consumers and in retail trading and better international business climate.

Data on industrial output were clearly weaker than forecasts. In June the production in the Eurozone declined by 0.1%MoM and annual growth rate slowed down to -1.6% from -1.4% recorded in May and revised from 1.3% released earlier. Forecasts stood at 0.2% and -0.7%, respectively. Also, retail sales figures were clearly weaker than market expectations. In June, the sales remained unchanged on monthly basis and increased by 0.7%YoY, compared to forecasts at 0.5% and 1.1%, respectively.

Indicators point to recovery in Europe

Major business climate indicator for the German economy – index of entrepreneurs' sentiment IFO recorded a rise stronger than expected by analysts, reaching 90.8 pts in August versus 89.3 pts in July, while forecasts pointed to its increase to 90.0 pts. Head of the IFO institute stated that the data were in line with the expectations of economic revival in 2H03.

In August economic activity in the Eurozone's industry was falling at slower pace than in July, which roughly matched analysts' expectations. Reuters PMI index increased to 49.1 pts from 48.0 pts in July, while 49.0 pts was forecasted. The activity in the American industry was rising at significantly faster pace than in July and faster than expected by analysts. In August the ISM index increased to 54.7 pts from 51.8 pts in July, while 53.8 pts was forecasted. The index remained above 50 pts, i.e. the limit between improvement and deterioration in activity, while Eurozone's PMI is still below it.

What's hot this month

Monday	Tuesday	Wednesday	Thursday	Friday
1 September POL: T-bill auction *EMU: PMI (Aug)*	**2** *EMU: Unemployment (Jul)* *EMU: Producer prices (Jul)* *USA: ISM (Aug)*	**3** POL: T-bond auction OK0805 *EMU: Retail sales (Jun)*	**4** *GER: Unemployment (Aug)* *EMU: ECB meeting* *USA: Factory orders (Jul)*	**5** POL: Food prices (2H Aug) *GER: Industrial output (Jul)* *USA: Unemployment (Aug)*
8 POL: T-bill auction	**9** *EMU: GDP (2Q)*	**10** POL: ~~T-bond auction WS0922~~	**11** *FRA: Inflation preliminary (Aug)* *USA: Foreign trade (Jul)*	**12** POL: Money supply (Aug) POL: Wages & employment (Aug) *FRA: Industrial output (Jul)* *USA: Producer prices (Aug)* *USA: Retail sales (Aug)*
15 POL: Inflation (Aug) POL: T-bill auction *ITA: Inflation final (Aug)* *USA: Industrial output (Aug)*	**16** *EMU: Industrial output (Jul)* *USA: Inflation (Aug)* *USA: Fed meeting*	**17** POL: T-bond auction PS0608 POL: Industrial output (Aug) POL: Producer prices (Aug) *EMU: Inflation final (Aug)*	**18** *EMU: Foreign trade (Jul)*	**19** POL: GDP (2Q) POL: Retail sales (Aug) POL: Unemployment (Aug) *ITA: Industrial output (Jul)*
22 POL: T-bill auction POL: Business climate (Sep)	**23** POL: Core inflation (Aug) *FRA: Inflation final (Aug)*	**24** *EMU: Balance of payment (Jul)*	**25** *GER: IFO (Sep)*	**26** POL: Food prices (1H Sep)
29 POL: MPC meeting (first day) POL: T-bill auction *ITA: Inflation preliminary (Sep)* *EMU: Money supply (Aug)*	**30** POL: Balance of payment (Aug) POL: MPC meeting (decision) *EMU: Inflation preliminary (Sep)* *EMU: Economic sentiment (Aug & Sep)* *EMU: Business climate (Aug & Sep)*	**1 October** POL: T-bond auction OK0805 *EMU: PMI (Sep)* *EMU: Unemployment (Aug)* *USA: ISM (Sep)* *USA: Unemployment (Sep)*	**2** *EMU: ECB meeting* *EMU: Producer prices (Aug)*	**3**
6 POL: T-bill auction *EMU: Retail sales (Jul)*	**7** POL: Food prices (2H Sep) *GER: Unemployment (Sep)*	**8** POL: T-bond auction DS1013	**9** *GER: Industrial output (Aug)* *EMU: GDP (2Q)*	**10** *FRA: Inflation preliminary (Sep)* *USA: Producer prices (Sep)*

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	17-18	26-27	29-30	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	30	31	28	30
Money supply	14	14	14	14	14	13	14	14	12	14	14	12
NBP balance sheet	7	7	7	7	7	6	7	7	5	7	7	5
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

		Aug 02	Sep 02	Oct 02	Nov 02	Dec 02	Jan 03	Feb 03	Mar 03	Apr 03	May 03	Jun 03	Jul 03	Aug 03	Sep 03
Industrial production	%YoY	-1.1	6.6	3.2	3.1	5.2	3.3	4.3	5.5	8.5	11.7	7.9	10.3	7.3	9.2
Retail sales ***	%YoY	5.1	4.7	5.1	5.9	4.9	4.1	4.2	-1.7	11.0	9.7	8.1	5.4	7.1	6.8
Unemployment rate	%	17.5	17.6	17.5	17.8	18.1	18.7	18.8	18.7	18.4	17.9	17.8	17.8	17.7	17.7
Gross wages ** ***	%YoY	2.8	3.8	0.5	1.8	2.4	2.7	2.1	0.7	4.2	0.0	3.1	2.4	1.9	1.4
Export (acc. to NBP)	EURm	2 727	2 912	3 182	3 004	3 223	2 761	2 635	2 957	2 969	3 015	3 018	3 309	2 850	3 040
Import (acc. to NBP)	EURm	3 642	3 826	4 241	4 090	4 166	3 895	3 219	3 467	3 833	3 696	3 512	4 121	3 750	3 900
Trade balance (acc.to NBP)	EURm	-915	-914	-1 059	-1 086	-943	-1 134	-584	-510	-864	-681	-494	-812	-900	-860
Current account balance	EURm	-284	-529	-580	-753	-484	-711	-483	-248	-460	-411	-100	-239	-200	-330
Budget deficit (cumulative)	PLNbn	-27.3	-29.8	-34.0	-37.1	-39.4	-4.1	-11.7	-15.5	-18.0	-23.2	-23.8	-27.7	-29.6	-32.9
Budget deficit (cumulative)	% annual plan	69.3	75.5	86.4	94.0	100.0	10.6	30.2	40.0	46.6	60.0	61.5	71.5	76.4	85.0
CPI	%YoY	1.2	1.3	1.1	0.9	0.8	0.5	0.5	0.6	0.3	0.4	0.8	0.8	0.7	0.7
PPI	%YoY	1.3	1.1	1.7	1.7	2.2	2.5	2.9	3.6	2.9	2.0	2.0	1.8	1.8	1.7
Broad money (M3)	%YoY	-0.2	-1.5	-2.5	-1.0	-2.0	-1.4	-1.2	0.5	0.8	0.3	1.3	0.7	1.4	1.6
Deposits	%YoY	-2.5	-3.5	-4.6	-3.2	-4.2	-4.1	-3.8	-2.3	-2.3	-2.9	-1.9	-2.5	-2.0	-2.0
Credits	%YoY	5.9	4.9	4.4	4.6	5.3	5.5	5.7	8.7	8.5	7.6	5.9	5.0	5.2	5.1
USD/PLN	PLN	4.18	4.15	4.12	3.95	3.91	3.84	3.87	4.01	3.96	3.74	3.80	3.90	3.92	4.05
EUR/PLN	PLN	4.08	4.07	4.04	3.96	3.99	4.08	4.17	4.33	4.30	4.33	4.44	4.44	4.37	4.45
Reference rate *	%	8.00	7.50	7.00	6.75	6.75	6.50	6.25	6.00	5.75	5.50	5.25	5.25	5.25	5.25
WIBOR 3M	%	8.55	8.07	7.45	6.81	6.82	6.56	6.37	6.17	5.90	5.53	5.38	5.26	5.17	5.15
Lombard rate *	%	10.50	10.00	9.00	8.75	8.75	8.50	8.00	7.75	7.25	7.00	6.75	6.75	6.75	6.75
Yield on 52-week T-bills	%	7.86	7.25	6.77	5.88	5.78	5.74	5.83	5.67	5.43	4.75	4.66	4.85	4.82	4.85
Yield on 2-year T-bonds	%	7.60	7.16	6.62	5.78	5.75	5.55	5.66	5.52	5.16	4.78	4.79	4.89	4.86	4.95
Yield on 5-year T-bonds	%	7.62	7.07	6.57	5.91	5.67	5.57	5.58	5.36	5.15	4.88	4.90	5.17	5.38	5.55
Yield on 10-year T-bonds	%	7.29	6.79	6.22	5.89	5.69	5.62	5.67	5.52	5.41	5.13	5.03	5.37	5.60	5.85

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	750.8	772.2	803.7	178.6	189.5	191.2	213.0	184.5	197.8	199.1	222.3
GDP	%YoY	4.0	1.0	1.4	3.1	0.5	0.9	1.8	2.2	2.2	3.3	3.1	3.9
Total consumption	%YoY	2.4	1.8	2.9	2.3	2.8	2.6	2.8	3.2	1.0	2.9	2.6	2.6
- Private consumption	%YoY	2.6	2.1	3.3	2.6	3.5	2.9	3.1	3.5	1.4	3.4	2.8	2.8
Fixed investments	%YoY	2.7	-10.2	-6.7	3.5	-12.8	-7.9	-5.9	-3.6	-3.6	1.6	5.0	7.0
Industrial production	%YoY	6.7	0.6	1.5	7.9	-1.6	-0.4	3.3	4.6	4.4	9.0	8.9	9.3
Retail sales (real terms)	%YoY	1.0	0.2	3.3	5.6	5.8	0.7	3.9	2.6	1.2	9.8	6.4	5.0
Unemployment rate *	%	15.1	17.5	18.1	18.2	18.2	17.4	17.6	18.1	18.7	17.8	17.7	18.2
Gross wages (real terms)	%YoY	1.3	1.6	1.5	1.3	1.9	1.4	2.3	0.3	1.4	2.0	1.1	0.8
Export (acc. to NBP)	EURm	30 768	33 823	34 746	36 254	7 853	8 668	8 816	9 409	8 353	9 002	9 199	9 700
Import (acc. to NBP)	EURm	44 970	46 848	45 712	46 393	10 847	11 109	11 259	12 497	10 581	11 041	11 771	13 000
Trade balance (acc.to NBP)	EURm	-14 202	-13 025	-10 966	-10 139	-2 994	-2 441	-2 443	-3 088	-2 228	-2 039	-2 572	-3 300
Current account balance	EURm	-10 672	-7 992	-7 188	-5 096	-2 659	-1 780	-932	-1 817	-1 442	-971	-769	-1 914
Current account balance	% GDP	-6.0	-3.9	-3.6	-2.7	-3.9	-3.6	-3.6	-3.6	-3.1	-2.7	-2.7	-2.7
Budget deficit (cumulative)*	PLNbn	-15.4	-32.6	-39.4	-38.7	-16.4	-25.0	-29.8	-39.4	-15.5	-23.8	-31.0	-38.7
Budget deficit (cumulative)*	% GDP	-2.2	-4.3	-5.1	-4.8	-9.2	-13.2	-2.5	-4.5	-4.9	-4.9	-5.1	-4.8
CPI	%YoY	10.1	5.5	1.9	0.7	3.4	2.1	1.3	0.9	0.5	0.5	0.7	0.9
CPI*	%YoY	8.5	3.6	0.8	1.1	3.3	1.6	1.3	0.8	0.6	0.8	0.7	1.1
PPI	%YoY	7.8	1.6	1.0	2.3	0.2	0.7	1.4	1.9	3.0	2.3	1.8	2.2
Broad money (M3)	%YoY	11.9	9.2	-2.1	2.8	3.2	2.5	-1.5	-2.1	0.5	1.3	1.6	2.8
Deposits	%YoY	15.5	8.9	-4.3	-0.6	1.7	0.5	-3.5	-4.3	-2.3	-1.9	-2.0	-0.6
Credits	%YoY	16.9	9.3	5.3	6.7	7.1	9.4	4.9	5.3	8.7	5.9	5.1	6.7
USD/PLN	PLN	4.35	4.09	4.08	3.91	4.13	4.04	4.15	3.99	3.90	3.83	3.95	3.97
EUR/PLN	PLN	4.01	3.67	3.85	4.33	3.62	3.72	4.08	4.00	4.19	4.36	4.42	4.37
Reference rate *	%	19.00	11.50	6.75	5.00	10.00	8.50	7.50	6.75	6.00	5.25	5.25	5.00
WIBOR 3M	%	18.48	16.10	9.09	5.58	11.02	9.80	8.50	7.03	6.37	5.60	5.23	5.10
Lombard rate *	%	23.00	15.50	8.75	6.50	13.50	11.50	10.00	8.75	7.75	6.75	6.50	6.50
Yield on 52-week T-bills	%	17.77	14.77	8.18	5.06	9.64	9.11	7.82	6.14	5.75	4.94	4.84	4.70
Yield on 2-year T-bonds	%	17.37	13.97	7.94	5.07	9.27	8.84	7.63	6.05	5.58	4.91	4.90	4.90
Yield on 5-year T-bonds	%	14.00	12.59	7.86	5.35	9.09	8.69	7.60	6.05	5.50	4.98	5.37	5.55
Yield on 10-year T-bonds	%	11.79	10.74	7.34	5.56	8.28	7.92	7.24	5.93	5.60	5.19	5.61	5.85

Source: GUS, NBP, BZ WBK

* at the end of period

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