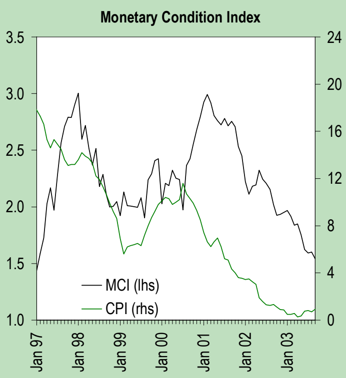
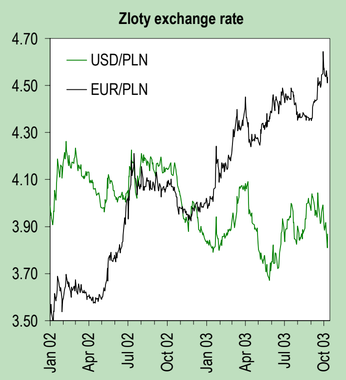
Bank Zachodni WBK

MACROscope

Polish Economy and Financial Markets

October 2003





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Postcards from the edge

■ The government accepted the medium-term fiscal strategy and the programme of spending rationalisation, which we analyse in the *Special focus* section. **The government plans quite rightly assume a reduction of social spending, but starting only from 2005. The next year fiscal plans constitutes the main risk for Polish public finances, as the government assumed the public debt to approach very closely to the second threshold level (55% of GDP).** Actually, it is assumed that only in circumstances of a favourable coincidence this threshold would not be exceeded. It is worth noticing that the consequences of this fact would be even more serious (budget surplus would be obligatory in 2006) than exceeding constitutional limit of 60% of GDP in 2005 ("only" balanced budget in 2007), unless the government decides to free up the revaluation provisions or to changes the methodology of public debt (for ESA95).

■ **While according to the government it is possible to lower the budget deficit (and public debt) in 2004 without a change of the budget draft, we think that budget amendment would be much more justifiable.** Firstly, lowering the deficit would increase a credibility of the medium-term plans, and would be positively perceived by the financial market. Secondly, without an amendment, government's promises of lowering the deficit during the year may simply not materialise – in the case of unexpected revenues shortage, possible savings would be just spent. Unfortunately, the budget amendment does not seem to be very likely, especially after the government representatives excluded such possibility. We believe this is the most serious concern as regards the public finance strategy of the government and it might be the reason for the prolonged uncertainty on the financial market in Poland.

■ **The CSO data indicated that the GDP growth in 2Q03 was surprisingly high evidencing the growing dynamics of the economic recovery.** The structure of the growth showed, however, that the improvement in investment activity is still unsatisfactory. Therefore, in the subsequent quarters the acceleration of the economic growth dynamics will be less impressive. This is indicated also by a lower than expected business climate results and the August data on industrial and construction output and retail sales. However, the very same data indicate that the current recovery is regular. What is important, it starts to translate into improvement on the labour market. August saw an annual decrease in the number of the unemployed, for the first time for many years. However, it is not accompanied by the growth in the wage pressure. As the monetary environment does not pose any substantial inflation threats, CPI is at a low level and it is expected to accelerate only moderately.

Financial market on 30 September 2003					
NBP deposit rate	3.75	WIBOR 3M	5.24	PLN/USD	3.9799
NBP reference rate	5.25	Yield on 52-week T-bills	5.13	PLN/EUR	4.6435
NBP lombard rate	6.75	Yield on 5-year T-bonds	5.67	EUR/USD	1.1667

This report is based on information available until 13.10.2003

Special focus

Men on the edge

Last month we presented the assessment of the draft budget act for 2004. Our assessment was quite negative because of a very high budget deficit and rising financing needs of the government. Although in September's issue of the MACROscope we wanted to present also an assessment of the medium-term fiscal strategy, government's delay in presenting the strategy resulted that we present our view on fiscal policy only right now. However, this was not the only consequence of the delay – the strategy was an extremely important document from the financial markets point of view, and therefore, the delay led to turmoil on both foreign exchange and fixed income market. At the end of September – in early October zloty have remained relatively weak, the yields of the Polish treasuries quite high, and this situation did not change significantly after the cabinet presented the plan. Market sentiment improved slightly after the publication of the plan of spending rationalisation, however, it was very short-lived, which should not be surprising – together with a promise of spending cuts in 2005-07 investors can read that the next year budget deficit would not be lower. This implies, in practice, that the ruling coalition did not decide to lower a risk of exceeding the 55% debt-to-GDP safety threshold, and the consequences of this fact would be even more serious (budget surplus would be obligatory in 2006) than exceeding constitutional limit of 60% of GDP in 2005 ("only" balanced budget in 2007).

Medium-term strategy as an arithmetic exercise

The medium-term strategy was supposed to add some credibility to the government's fiscal plans and was expected to prove that the budget deficit increase in 2004 would be only temporary and would not lead to a delay Poland in joining the Eurozone. However, the strategy defined only paths of necessary reduction in the budget deficit and public debt in the following years, assuming that Maastricht criteria will be met in 2007. Three different macroeconomic scenarios were presented: accelerated growth (base case), stabilised growth and unbalanced economic growth. Each path assumed that public debt in relation to GDP cannot breach the constitutional threshold level of 60% in any given year, and also simulated the effects of exceeding two lower thresholds (50% and 55%) enforced by the Polish public finance law. The budget deficit was residual in the calculations, and resulted from limitations put on the public debt level. Results of the governmental calculations are presented in the table below.

In other words, the medium-term strategy suggested a direction the government should follow in terms of reducing imbalance of public finances, however it did not show the precise ways to achieve it. That is why, financial markets were very sceptical about the strategy (especially taking into account previous strategies, which were adopted) and the general government's declarations were not enough to stabilise the market. Therefore, the plan of spending cuts becomes the most important element of the governments' strategy. It was adopted at the beginning of October. We describe it in more details below, although the fact is that in the chapter "Rationalisation of budget spending" the medium-term strategy rightly pointed out several areas on which the spending cuts / rationalisation should focus – reduction of transfers from the central budget to another public finance entities, improvement of efficiency of spending on social benefits, education, healthcare, administration etc. Additionally, the medium-term fiscal strategy assumes creating a detailed schedule of implementing specific changes in the public finances for 2004-2006, which could be monitored on an ongoing basis. This would allow the financial markets to assess the progress of a public finance reform.

Three scenarios for public finances

	2003	2004	2005	2006	2007
Scenario 1. Accelerated economic growth (base case)					
GDP growth (%YoY)	3.5	5.0	5.0	5.6	5.6
Public debt (% of GDP)	51.5	54.8	59.3	59.5	59.1
Budget balance (% of GDP)	-4.8	-5.3	-4.2	-3.3	-2.6
Scenario 2. Steady economic growth					
GDP growth (%YoY)	3.0	4.0	4.0	4.2	4.2
Public debt (% of GDP)	51.5	55.4	59.3	55.5	53.2
Budget balance (% of GDP)	-4.8	-5.3	-2.7	+1.5	0.0
Scenario 3. Unbalanced economic growth					
GDP growth (%YoY)	3.5	5.0	5.8	6.8	6.8
Public debt (% of GDP)	51.5	54.8	59.3	59.5	59.1
Budget balance (% of GDP)	-4.8	-5.3	-4.5	-4.2	-3.7

Source: Medium-term strategy for public finances

Underestimated second threshold level

The most worrisome element of the government's strategy is the fact that in the scenario of an accelerated economic growth, the government assumed that public debt would be very close to the second threshold level of 55% of GDP in 2004. Actually, it is assumed that only in circumstances of a favourable coincidence this threshold would not be exceeded. This view was repeated many times in recent days (also by the central bank's representatives), which is not surprising given the shape of the next year's budget (with high deficit and high financing needs) and its optimistic macroeconomic assumptions (high nominal GDP, high privatisation revenues, zloty appreciation), which help avoid exceeding the 55% threshold.

Last month, when we presented the assessment of the budget draft, we provocatively suggested that it would have been easier for the Ministry of Finance to prepare more restrictive budgets for the following years, if safety threshold had been reached earlier. However, it is worth noticing that consequences of exceeding the 55% public debt to GDP ratio in 2004 would be (at least) equally serious as exceeding the constitutional safety threshold of 60% (costs of such rapid fiscal adjustment would be very high – "blind" spending cut, higher taxes etc.). It seems that a risk that the public debt in 2004 would be higher than the government assumed is underestimated in recent economic discussion, as "sharp fiscal adjustment" scenario is usually presented as an equivalent to exceeding the so-called constitutional debt limit. Why the two scenarios (exceeding the second threshold of 55% in 2004 and exceeding 60% in 2005) are equivalent and require a budgetary surplus?

According to the Polish public finances law, if the public debt exceeds the level of 55% of GDP in a year" t", this implies that in a year "t+2" State Treasury debt to GDP assumed in the draft budget act (including expected payments related to the governmental guarantees) cannot exceed this ratio from a year "t". Let us analyse from this point of view the government's assumptions as well as "slightly" less optimistic alternative scenario.

Let us assume that the public debt at the end of 2004 would amount to 55.1% of GDP, and not 54.8% as assumed by the government (0.3pp represents only around PLN2.5bn), for example as a result of zloty weaker by some PLN 0.1 against the government's view. This would mean that a budget for 2006 would have to be constructed in a way to ensure that a ratio of the State Treasury debt to GDP would be lower than in 2004. As a result, the State Treasury debt would have to decrease (assuming unchanged government's scenario for 2005) by some PLN3bn in just one year, which would imply a necessity of a budget surplus. Therefore, in practice, the consequences of this fact would be even more serious (budget surplus would be necessary in 2006) than exceeding constitutional limit of 60% of GDP in 2005 ("only" balanced budget in 2007). The higher scale of exceeding 55% to GDP ratio in 2004 is (as a result of zloty depreciation or lower privatisation receipts), the higher would have to be a surplus in 2006.

Rising public debt (two scenarios)

	2003	*2004*	*2005*	*2006*
Government's base case scenario				
Public debt (% GDP)	51,5	54,8	59,3	59,5
State Treasury debt (% GDP)	48,3	50,6	55,1	55,3
Public debt (PLNbn)	414,6	472,1	549,2	596,7
State Treasury debt (PLNbn)	388,9	435,9	510,3	554,5
"Slightly" less optimistic scenario				
Public debt (% GDP)	51,5	55,1	59,6	55,0
State Treasury debt (% GDP)	48,3	51,0	55,5	50,9
Public debt (PLNbn)	414,6	474,7	551,8	551,3
State Treasury debt (PLNbn)	388,9	439,4	513,7	510,4

Source: Medium-term strategy for public finances, BZ WBK

The question is whether the government decided consciously to balance on the edge of a safety threshold, or the government just hoped to be lucky bearing in mind that a possible excess of this threshold could lead to a sharp fiscal adjustment. Or is there a "plan B" in the case of higher then assumed public debt in 2004? There are a few possible solutions. One is partial freeing up of the revaluation provisions (in agreement with the new Monetary Policy Council) and using these funds for the partial early repayment of a of the foreign debt. Other solution is that possibly, the government had already decided to change the methodology of a public debt calculation (from domestic to ESA95), that would allow to exclude the expected payments related to the governmental guarantees from the public debt, or possibly also debt towards open pension funds (OFE). This solution is more possible after the statement of Jerzy Hausner deputy Prime Minister- quoted by the Polish Press Agency: "*we should remember that according to accounting standards of the EU countries, which are likely to be adopted in Poland next year, our public debt is much lower. 60% is the threshold, but we are much further from this level than it is commonly perceived".* This would lower the public debt by several percentage points. Of course, a reduction would be artificial to a large extent, but such a methodology change would not be necessarily negatively perceived by the market if it was accompanied by the parliament's acceptance of the proposed changes in social spending, which would lead to the budget deficit reduction to below 3% of GDP in the following years. However, a credible plan of spending cuts is actually the main problem of the fiscal strategy.

No rationalisation of spending in 2004

The programme accepted by the government consists of two major parts: changes in administration and economy, and modifications in social spending. The document is consistent with information released earlier by the media and the government itself. However, it is different in one important aspect – it assumes much lower savings to be attained already in 2004. While the earlier press information and government officials' comments suggested savings of ca. PLN3.6bn already in 2004 (and it seems this was indeed Hausner's proposition presented to the government), the final version of the savings plan after the cabinet meeting included only PLN2.1bn of savings. As far as we understood comparing the document and the earlier unofficial hints, this resulted from delaying several unpopular decisions in the social policy area until 2005 (changes in rural pension system postponed by one year, lowered scale of the planned savings in 2004 in respect of funds for the disabled and the health subsidies).

The measures of social spending cuts confirmed most of the earlier information (except for the difference mentioned above). The most important areas of savings include changes in the indexation scheme for old-age and disability pensions, reduction of funds for health subsidies, reduction of early retirement pensions, levelling retirement age for men and women, sorting out disability pensions system, reorganisation of support funds for the disabled, changes in the rural pension system. The estimated savings for the budget would reach PLN12.1bn in 2007, assuming all of those proposals would be accepted and implemented. However, this seems to be a big problem, as the way from presenting those measures to their actual implementation could be very long. The government clearly does not want to make difficult decisions in such fragile area of social and economic policy on its own and announced that all those proposed changes would be the subject of broad consultations with social partners, experts and institutions. In the government's document there is an entire chapter titled "The Debate", describing a way in which the cabinet would seek a social agreement over the proposed changes. The consultations are supposed to be concluded until January 2004 to allow preparation of the relevant acts for the parliament until end-March 2004 (in a version including conclusions from the consultations). The question is whether the social debate implies that some of the proposed solutions might be scaled down or even rejected, as they clash with the interests of particular social groups. What is more, one could wonder whether in such case the total savings would be enough to curb down public expenses and reduce budget deficits in line with the government's plan.

Savings in social spending (PLNbn)

	2004	2005	2006	2007
TOTAL	**2.1**	**9.0**	**7.2**	**12.1**
out of which:				
Indexation of pensions	1.3	4.0	1.0	4.5
Health subsidies	0.3	0.4	0.5	0.5
Reduction of early retirement	0.3	0.8	1.4	2.3
Validation of disability pensions	0.2	0.5	0.9	1.1
Support for disabled	0.4	1.6	1.7	1.7
Rural pension system		1.7	1.8	1.8

Note: Figures do not sum up because the plan assumes other (also negative) savings
Source: Ministry of Economy, Labour and Social Policy

The chapter of measures in administration and economy assumes reaching annual savings of around PLN5.9bn in 2005 (and presumably not less in subsequent years), mostly by means of "rationalisation of expenditures on public administration, sorting out some public spending, and elimination of pathologies". This area of spending cuts and rationalisation included measures dependent only on the government (which did not require parliament decisions or social consultations). The list of savings includes a long series of measures like redundancies in administration, more effective use of available funds, elimination of some funds and agencies, restructuring of ailing sectors (mining and railways), a broadening tax base and the change of defence system financing. However, what is important the main savings in administration and economy are made by... increasing budget revenues rather than reduction of spending – it is at least PLN3.2-4.2bn out of total PLN5.9bn. The most important element is "further broadening of a tax base", which yields PLN2-3bn of savings per year (i.e. almost a half of the total savings in this area). The document said it was going to be attained by e.g. simplifying the tax system and improving efficiency of revenue offices, however these do not seem to be convincible arguments (especially considering a high value of those savings), as almost every government so far has assumed improvement of tax collection and broadening of a tax base, while the results were not quite impressing. The most important measure lowering the planned spending is a change of defence system financing (giving the total of PLN4.4bn cutback in 2005-2007).

Savings in administration and economy (annual savings starting from 2005 in PLNbn)

TOTAL	5.9
Out of which:	
Change of defence system financing	1.3-1.6
Broadening tax base	2-3
Restructuring mining sector	0.38
Restructuring railways	0.40
Restructuring healthcare system	0.25

Source: Ministry of Economy, Labour and Social Policy

Budget amendment is necessary

As a result of implementation of the proposed savings plan and acceleration of economic growth the government expects to reduce deficit of the public finance sector down to 2.1% GDP in 2007. This is even more significant reduction that the one outlined in a medium-term strategy for public finances, which suggests the government wants to have a broader margin of safety in the case of unforeseen events. Indeed, such spending adjustments may be significant enough and may result in reducing budget deficit, as planned in the government's medium-term fiscal strategy (if accompanied by accelerating GDP growth, which would bring about higher budget revenues). However, next year's fiscal policy remains to be the most important problem – government's plan does nothing to mitigate the risk of breaching this level next year. What is more, the planned savings for 2004 have been curbed down from PLN3.6bn to PLN2bn. It should be noticed, that public finances would be moving along the edge of the safety threshold levels for the next several years – in 2005-2007 public debt in relation to GDP would be very close to the constitutional level of 60%. And what is more important, the debt would be very close to 55% already in 2004, which is equally or even more dangerous for the public finances, as we have mentioned above.

Public finances before and after changes (% GDP)

	2003	*2004*	*2005*	*2006*	*2007*
Scenario of no fiscal consolidation					
Budget revenues	19.3	17.7	17.5	17.0	16.8
Budget spending	24.1	23.0	22.3	21.5	20.6
Budget balance	4.8	5.3	4.8	4.5	3.8
Public debt	51.5	54.8	59.9	60.7	60.3
Scenario of fiscal consolidation					
Budget revenues	19.3	17.7	17.8	17.3	17.2
Budget spending	24.1	22.7	21.3	20.6	19.3
Budget balance	-4.8	-5.0	-3.4	-3.3	-2.1
Public debt	51.5	54.5	58.6	59.4	58.7

Source: Ministry of Economy, Labour and Social Policy

The press conference after the cabinet's meeting showed the politicians realise that there is no more time for delaying necessary changes in the public finances and they cannot avoid unpopular decisions any more. Leszek Miller, PM, concluded, after the cabinet meeting, that the programme of cuts must be realised "now or never", disregarding the political situation and public support of the government. If this strong determination persists for the next couple of quarters, the risk of serious problems with the Polish public finances would be indeed lower. However, a questionable political support for the proposed changes is the only one of the reasons for concern. The most important problem is the fact that the government did not decide to change the next year budget. In our opinion, lowering budget deficit in a form of budget amendment would be much more justifiable. Firstly, lowering the deficit would increase a credibility of the medium-term plans, and would be positively perceived by the financial market. Secondly, without an amendment, government's promises of lowering the deficit during the year may simply not materialise – in the case of unexpected revenues shortage, possible savings would be just spent. Unfortunately, the budget amendment does not seem to be very likely, especially after the Prime Minister's statement, which excluded such possibility. We believe this is the most serious concern as regards the public finance strategy of the government and it might be the reason for the prolonged uncertainty on the financial market in Poland.

Economic update

- **Strong acceleration of GDP growth in 2Q03**
- **... but it will be difficult to achieve much better result in subsequent quarters**
- **Finally some signs of improvement on the labour market**
- **Still no inflationary pressure**

The CSO data indicated that the GDP growth in 2Q03 was surprisingly high evidencing the growing dynamics of the economic recovery. The structure of the growth showed, however, that the improvement in investment activity is still unsatisfactory. Therefore, in the subsequent quarters the acceleration of the economic growth dynamics will be less impressive. This is indicated also by a little bit disappointing business climate results and the August data on industrial and construction output and retail sales. However, the very same data indicate that the current recovery is regular. What is important, it starts to translate into improvement on the labour market. August saw an annual decrease in the number of the unemployed, for the first time for many years. However, it is not accompanied by the growth in the wage pressure. As the monetary environment does not pose any substantial inflation threats, CPI is at a low level and it is expected to accelerate only moderately, which will result from the deterioration in the food market. Information on the Polish foreign trade remains to be a positive factor from the growth perspective. The data on the growth in the Poland's foreign debt, short-term in particular, are not so optimistic. However, its level is low enough not to talk about threats to the country solvency.

Significant GDP pick-up in the second quarter

GDP figures for the second quarter of this year, which were supposed to confirm the pace of economic recovery in Poland, proved to be very optimistic indeed, showing 3.8%YoY growth in 2Q03 against 2.2%YoY in 1Q03. The figure was much higher than market forecasts - we predicted 3.3% growth, while average forecast was at 3.2%. What is more, the numbers exactly matched earlier hints of deputy PM Jerzy Hausner, which means that for the second time in a short time prominent government official revealed classified statistical figure before its official release (last time it was deputy PM Grzegorz Kołodko in December 2002).

The strong rate of economic growth was boosted mostly by acceleration of private consumption growth (3.9%YoY) and high net exports. Meanwhile, other components affected GDP growth negatively. In particular, fixed investment growth remained in red in 2Q03 (which was the 9th consecutive quarter of its fall), although it was clearly showing an improving trend falling only by 1.7%YoY against 3.6%YoY drop in 1Q03. The structure of GDP growth in 2Q03 showed that economic recovery, although clearly visible, is still not excessively strong in Poland if we take domestic demand into account. The recorded pace of private consumption growth was to a large extent an effect of delay of some consumption spending from March to April due to later Easter in 2003, and also by earlier than last year indexation of social allowances. This effect lowered quarterly consumption figure in 1Q03 and artificially pushed it up in 2Q03. The average growth rate of private consumption for the first half of 2003 totalled "only" 2.7%YoY, which shows that there was hardly any improvement of consumption demand as compared to the previous year (when it was growing above 3%YoY on average). Also investment demand was still shrinking, as said above, although at diminishing pace, which allows for hopes that it would recover above zero in the second half of this year. The strongest area of the Polish economy remains exports, which – with relatively weak domestic demand – strongly contributed to economic development in the second quarter. Such situation makes it easy to predict that for the vast part of MPC members strong GDP figures should not necessarily create a significant argument against further monetary easing, as the economic growth is not fuelled by buoyant domestic demand, but rather by excellent performance of Polish foreign trade.

GDP growth forecasts (%YoY)

1Q03	2.2
2Q03	3.8
3Q03	3.7
4Q03	4.2
1Q04	4.6
2Q04	3.8
3Q04	4.2
4Q04	5.2
2003	3.5
2004	4.5
2005	5.0

Source: CSO, BZ WBK forecasts

The CSO vice-president Janusz Witkowski said that the GDP growth rate in the third quarter "might be similar as in 2Q03, although not necessarily better". And in fact we do not believe it could be better, because it is very hard to predict equally strong private consumption growth in 3Q03, while investment rebound would be probably still quite limited. More distinct growth acceleration (above 4%) is possible only in 4Q03, when fixed investment growth is expected to recover more significantly. We forecast GDP growth rate to reach ca. 3.5% in 2003 as a whole.

Contribution of components to GDP growth (percentage points)

	1Q02	2Q02	3Q02	4Q02	1Q03	2Q03
GDP	**0.5**	**0.9**	**1.8**	**2.2**	**2.2**	**3.8**
Total consumption	2.5	2.2	2.3	2.4	0.9	2.5
- Private consumption	2.4	1.9	2.0	2.0	1.0	2.6
- Public consumption	0.1	0.3	0.3	0.4	-0.1	-0.1
Gross accumulation	-2.6	-1.1	-1.1	-1.1	1.5	-0.5
- Fixed Investments	-2.1	-1.5	-1.1	-1.0	-0.5	-0.3
- Change in inventories	-0.5	0.4	0.0	-0.1	2.0	-0.3
Net exports	0.6	-0.3	0.6	0.9	-0.2	1.8

Source: CSO, BZ WBK

Revised GDP figures for 2002

The CSO published revised estimates of GDP and its components for 2002. The new data do not differ much from previously released figures. The overall real GDP growth remained unchanged at 1.4%, while nominal GDP was revised from PLN772.2bn to PLN771.1bn. There were some changes to growth rates of components of GDP (see table below for details). The most important change is better result in fixed investments, which indicates that this component of GDP performed slightly more optimistic than one could have thought earlier. This supports expectations for further improvement in investment activity this year. However, revision of GDP figures was not significant enough to change forecasted path of the economic growth and its breakdown.

Revised GDP growth data for 2002, %YoY

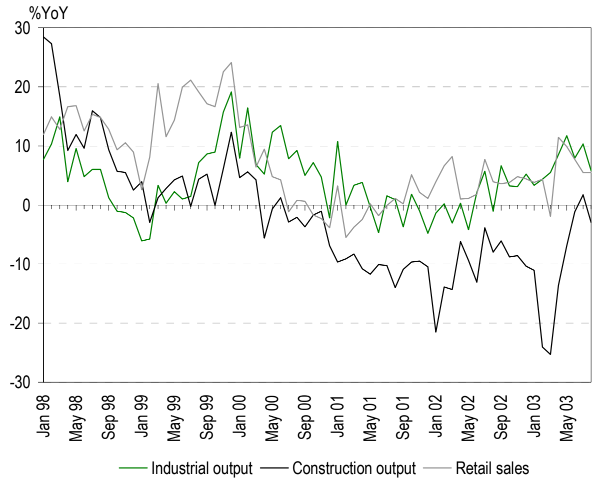
	Revised data	Previous data
GDP	**1.4**	**1.4**
Total consumption	2.8	2.8
- Individual consumption	3.3	3.3
- Public consumption	0.6	1.5*
Gross accumulation	-6.8	-6.9
- Fixed Investments	-5.8	-6.8
- Change in inventories	-206.1	-40.0*
Domestic Demand	**0.8**	**0.9**
Gross value added	**1.3**	**1.4**
Manufacturing	1.5	1.0
Construction	-8.6	-9.5

Source: CSO

Output lower than expected, but still not so bad

Sold industrial production in August proved to be lower than expected, growing 5.8%YoY against our forecast of 7.3%YoY. In relation to July output fell 5.1%. Even though the data did not meet the expectations, they still represented quite robust strength of the Polish economy, especially after we take into account seasonally adjusted series. According to the statistical office industrial output adjusted for seasonal factors (including working days effect) increased 8.6%YoY in August, which was not so much lower than 9.8% recorded in the previous month. What is more, August production figure was biased downwards by very poor performance of mining sector (output falling 8.4%YoY), energy production and water supply (only 1.6%YoY increase). Meanwhile, production in manufacturing was growing relatively fast at 7.1%YoY, confirming that economic activity in continuously expanding, driven by good exports performance, without major downturns. Of course it was lower than a record-high 11.1%YoY growth in manufacturing recorded in July, however one should not expect that double-digit dynamics of output would be persistent at this stage of economic recovery in Poland.

Real activity indicators



Source: CSO

Construction output disappointed, because it fell in red again in August (dropping -3%YoY) after it had recorded the first positive growth rate of 1.7%YoY for the last three years in July. What is more, construction output adjusted for seasonal disturbances dropped 5%YoY in August against 4.4%YoY fall in July. It did not confirm whether an improvement of situation in construction (being a leading indicator for situation in investment activity) is persistent, and we will probably have to wait a couple of months to see a confirmation of the positive trend in this sector.

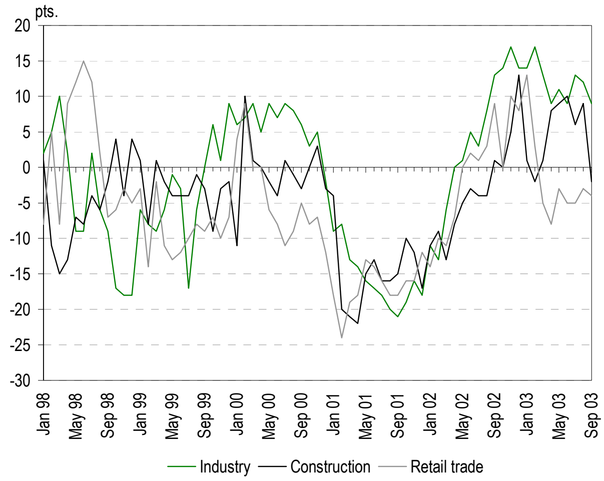
Also retail sales growth was lower than expected

Similarly as in case of industrial production, retail sales proved to be weaker than expected in August, growing 5.5%YoY (in nominal terms) against 6%YoY forecasted by the market consensus and our prediction of some 7%YoY. The growth was a bit stronger than in the previous month (5.4%) and represented continuing growth of private consumption demand. Nevertheless, it was well below average level recorded in 2Q03 (9.8%), and it seems very likely that private consumption in 3Q03 will not be as strong as in the preceding quarter – although it would remain an important component of total GDP growth. One should expect that similar pace of retail sales growth would be also continued in the following months.

Business climate a bit worse in September

In September CSO's business climate indices recorded deterioration in relation to previous month. It was not entirely caused by a seasonal effect because also corresponding year-on-year growth rates declined in all three sectors: industry, construction and retail trade. The most significant downturn took place in the construction, when business climate index was 2 pts lower than in September 2002, after a rapid annual growth in 1H03. For the first time since April the construction sector saw a reduction of new orders and a forecast of orders inflow and production for the next three months was much worse than a month ago. Expectations for employment reduction were maintained or even strengthened. Also, companies in manufacturing (where business climate index remained positive and growing) signalled a fall of new orders, caused by weak domestic market; foreign orders were strong, better than last month. The increase of output was therefore lower than in August, however forecasts remained quite optimistic. Similarly as in the construction sector, entrepreneurs in manufacturing planned a continuation of labour shedding process, even at larger scale than before. Business climate in retail trade remained in red, however companies signalled diminishing constraints in sales. Despite the fact that growing shortfall of inventories was recorded, future orders were forecasted at lower level. The scale of layoffs was also forecasted to increase. As in previous months, all but the biggest companies (more than 250 employees) in retail trade recorded negative business climate.

Business climate, YoY change



Source: CSO

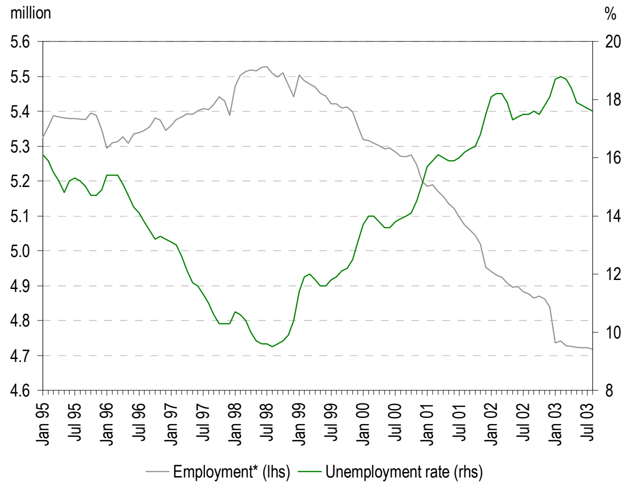
The downturn of business climate indices (especially deep in construction sector) is not positive news, however one has to wait a few more months for a confirmation whether this was a one-off phenomenon or a trend-reversal. We argue that the former was the case, however the business climate survey showed that one should not expect a significant improvement in real economy in 3Q03 as compared to 2Q03 results.

Ipsos-Demoskop published monthly results of a consumers' optimism survey. Similarly as in August, all households' optimism indicators were stable on monthly basis. However, the annual changes are still positive - the overall optimism index (WOK), propensity to consume and a general assessment of the economic climate increased by 5-6%YoY. Index of propensity to consume is the highest within last three years, while inflationary expectations are stable.

Unemployment shows some improvement... at last!

The CSO's information from the labour market in August was positive, showing a few signals that the situation on the labour market is slowly improving. Unemployment rate reached 17.6%, which was 0.1pp lower than expected and, what is more, also July figure proved to be 0.1pp lower than released before, as it has been revised downwards to 17.7%. The number of unemployed fell in relation to July (by 23,900) and for the first time in a long time it was also lower than in corresponding month of last year (by 6,500 i.e. 0.2%YoY). Also, the number of new job offers was higher than in August 2002. The fall in the number of unemployed was recorded in all Polish voivodships, which suggests that improvement is widespread process rather than a random development. Nevertheless, one should keep in mind that a possible progress will be probably quite slow and gradual.

Average employment and unemployment rate



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

Low wages and low employment

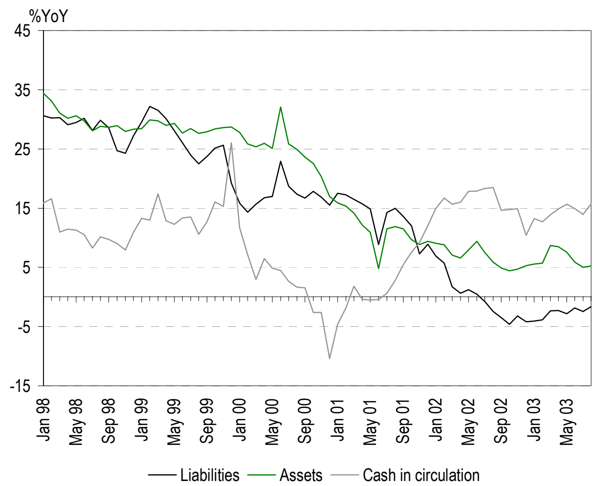
Employment in the enterprise sector eased in August by 0.1% on a monthly basis and fell by 3.2%YoY, i.e. at the same pace as in July, against average 3.8%YoY decrease in the first half of the year. This was in line with our predictions, showing that reversal of negative trend on the labour market is much slower than improvement of economic activity indicators, which is related to robust growth of labour productivity in Poland.

The CSO also said that average wages in the enterprise sector fell by 2.0%MoM and rose by 1.9%YoY. The annual growth was lower than in two previous months, confirming that it is still difficult to talk about reviving wage pressure in the economy. Low dynamics of wages coupled with continued labour shedding process led to another decrease of wage bill in the enterprise sector – both in nominal (by 1.4%YoY) and real terms (by 2.1%YoY).

Money slowly accelerated

Monetary statistics for August showed that broad money supply (aggregates M3) inched up by 0.2%MoM bringing the annual growth to 1.4%YoY (the highest annual growth since June 2002). The rise was higher than expected (market consensus pointed to 1.0%YoY increase and we predicted only 0.8%YoY growth), showing signs of picking up after slump in money supply dynamics which started in late 2001. However, one should remember that the increase stems to some degree from low base effect. As expected, the fastest growth was observed in other items of M3 and in cash in circulation (by 15.7%YoY against 13.9%YoY growth in July). The third and the largest element of money supply, i.e. overall deposits, was still falling, although the fall was lower than 2.5%YoY in July and 2.9%YoY in the first half of the year. Slightly better result in overall deposits resulted from high increase in corporate deposits (by 12.9%YoY) while households deposits dropped by 6.9%YoY against 7.2%YoY in the previous month. Along with slight acceleration in money supply growth August also saw an improvement in credit dynamics. Overall credits rose by 0.7%MoM and 5.2%YoY against 5.0%YoY growth in July. This was a result of higher growth of credit for households (by 8.8%YoY against 8.2%YoY in the previous month) while corporate borrowing dynamics remained unchanged at 1.7%YoY.

Monetary aggregates



Source: NBP

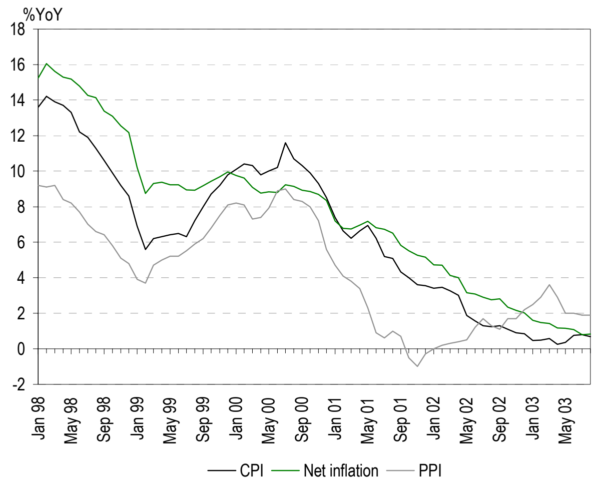
CPI lower again in August

As we have expected, the CPI fell 0.4%MoM in August, driving annual growth rate down to 0.7%YoY from 0.8%YoY recorded in July. The released figure was in line with majority of market participants' predictions, although a quite large minority of analysts expected inflation at 0.8%YoY.The positive result was contributed not only by quickly falling food prices (which plummeted 1.8%MoM), but also by declining prices of clothing and footwear (the drop of 0.7%MoM). Prices of all other major groups of products and services remained fairly stable, with a maximum monthly increase not exceeding 0.2%MoM. Only fuel prices rose by 2%MoM bringing the prices in the transport category up by 1%MoM. While summer deflation is a typical seasonal phenomenon, this year's drop of prices was even deeper than expected by some analysts and MPC members.

All in all, August inflation figures confirmed positive inflationary outlook until the end of this year. According to MPC members' forecasts, in December 2003 inflation should hit 1.5-1.6% (Ziółkowska), 1.0-1.5%

(Rosati), or 1.3%YoY (Wójtowicz). For comparison, inflation forecasts presented in the *Inflation report* for 2Q03 implied year-end CPI at 1.6%YoY. We are even more optimistic and predict it could reach 1.3%YoY at the end of this year.

Inflation measures



Source: CSO, NBP

PPI growth shows no inflationary threats

Producer prices in August increased 0.4%MoM and 1.9%YoY, which was very close to our expectations (in fact the monthly increase matched our forecast, and annual growth was a bit higher due to data revision for July). The increase of prices was fuelled mostly by the hikes in mining (1.8%MoM) and in manufacturing of fuels (3.2%MoM). Meanwhile, in most of other sectors of industry there seems to be no tendencies towards acceleration of price growth, which could create significant inflationary impulse. Most of producers' prices remain fairy stable, confirming lack of inflationary pressure in the Polish economy.

Core inflation low at stable level

Core inflation falls no more – this conclusion (suggested by NBP data already in June and July) has been confirmed also by August statistics. According to the data, four out of five core indices computed by the central bank grew faster than in the previous months. Nevertheless, the increase of growth rate was not substantial and amounted to 0.02-0.18 pct. points. The only one measure, which recorded a deceleration was CPI excluding controlled prices, showing 0.5%YoY growth against 0.7% in July. One measure remained in red - CPI excluding most volatile prices and fuels - falling by -0.15%YoY (against -0.29% last month), and only one exceeded 1%YoY (though only marginally) – i.e. 15% trimmed mean at 1.05%YoY. "Net inflation" – one of the most closely watched measures by the MPC inched up 0.05% to 0.83%YoY (or remained stable if we consider only one decimal place).

The data introduced little new information - core inflation shows no further prospects for CPI fall, but at the same time it still signals no inflationary pressure as well, as all the indices remain very low (the highest one below 1.1%YoY!) and their acceleration is very moderate.

Food prices started to grow

According to preliminary CSO data on average in September food prices grew by 1.5%MoM, i.e. much above 0.8%MoM observed in the corresponding period of 2003. The most important drivers behind price hike in September were vegetables (surging ca. 17%MoM on average), meat (up 1.2%MoM) and dairy products (1%MoM), while most of other food prices remained stable or even were slightly declining.

At the same time the CSO data showed that prices of alcohol and tobacco increased on average by 0.5-0.6%MoM in September. This was also much above last year's growth, as in September last year 0.2%MoM decline was recorded in this group of products.

The two factors surely pushed CPI growth up in September. Consequently, we estimate that consumer prices last month increased 0.5%MoM and the annual inflation rate increased up to 0.9%YoY from 0.7% recorded in August. Finance Ministry maintained its predictions and forecasts annual CPI to accelerate to 0.9-1.0%YoY in September and 1.3-1.4%YoY in December 2003.

CSO data confirmed positive trends in Poland's foreign trade

The CSO foreign trade data on a customs basis showed that Poland's trade deficit narrowed in the first seven months of this year to €7.8bn in comparison with €9.0bn in the analogous period of last year. Exports in the January-July period rose by 3.4%YoY to €25.48bn, while imports eased by 1.0%YoY to €33.27bn. In dollar terms, exports jumped by 25.8%YoY, while imports rose by 20.4%YoY. The figures confirmed NBP data for July published earlier, which showed that the economic recovery is led by export. At the same time, the data also showed improving import dynamics, which is a sign that the domestic demand was also on the rebound (NBP data on imports in August are less optimistic in this regard – see below).

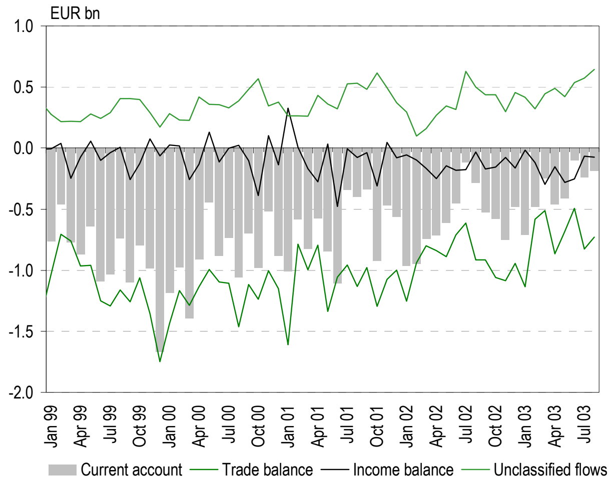
… despite NBP data on imports were disappointing

NBP published balance of payments data for August. The figures were broadly in line with expectations - current account deficit reached €188m against €239m in the previous month and €284m in the analogous period of last year. In relation to GDP, 12-month cumulative C/A deficit totalled 2.7% versus 2.8% after July. Trade gap was lower than we predicted reaching €728m (our forecast stood at €900m), down from €825m a month earlier and €915 a year ago. This resulted from maintained trend of fast growth in export and relatively low level of import. The value of export expressed in the euro grew by as much as 5.43%YoY after 3.31%YoY increase in July. One should expect a continuation of this tendency in next months, as weakening of the zloty improves profitability of export sales. Meanwhile, import value in euros recorded a 1.1%YoY drop in August after two consecutive months of growth. This suggests that rebound in investment demand is not impressive, which is consistent with earlier released data on construction output for August.

As we expected August saw very high surplus in unclassified flows. It amounted to as much as €644m against €501m in the corresponding period last year. This resulted from seasonal factors to a large extent. However, unclassified flows could have been also affected by the introduction of visas for citizens of Poland's Eastern neighbours, which is to take effect since October 1. This fact probably induced them to increase purchases in Poland in preceding months. Therefore, one may also expect high surplus in unclassified flows in September. This may be strengthened by weakening of the domestic currency, which makes selling of foreign currency by households more profitable. Other elements of current account were broadly in line expectations having relatively little impact on the deficit value.

On the financial account of the balance of payments we observed another low inflow of foreign direct investments. They amounted to only €177m in August against €284m in the previous month. Since the beginning of the year FDI inflow reached €1.99bn against €2.65bn in the corresponding period of last year. At the same time, as expected, August saw outflow of portfolio capital from Poland. As regards debt instruments investors withdrew €206m, which means that in June-August period outflow of capital from the Polish debt market amounted to €1.44bn. Although since the beginning of this year Poland attracted €1.14bn of portfolio capital, it was much less than in the analogous period of last year (€3.03bn).

Balance of payments



Source: NBP

Increase of Poland's foreign debt

The NBP released data on Poland's foreign debt (according to methodology consistent with standards of BIS, IMF, OECD and World Bank). The overall foreign debt at the end of June amounted to $91.78bn against $88.57bn at the end of the March and $80.07bn at the end of June 2002. While this represent growth of as much as 3.6%QoQ and 13.6%YoY, one should remember that this resulted to a large extent from dollar depreciation against the euro. Figures in both euro and dollar terms are presented in the table below.

Foreign debt (in billions)

	mid-2002		end-2002		mid-2003	
	USD	EUR	USD	EUR	USD	EUR
Central bank debt	0.2	0.2	0.1	0.1	0.6	0.5
Public sector debt	33.6	33.9	35.7	34.1	39.1	34.2
Banking sector debt	7.2	7.3	7.6	7.2	8.3	7.3
Other (enterprises') debt	39.1	39.4	39.9	38.1	43.7	38.2
Total foreign debt	**80.1**	**80.7**	**83.3**	**79.5**	**91.8**	**80.2**
- short-term debt	11.5	11.6	13.5	12.9	15.9	13.9
- long-term debt	68.5	69.1	69.7	66.6	75.9	66.3

Source: NBP

Using NBP data we calculated the relation of short-term debt to official reserve assets, which is regarded as the adequate measure of state's solvency (see tables below). The numbers show that this ratio increased recently, but this is still not a level indicating a risk of currency crisis in Poland. Relation of short-term debt to FX reserve in Poland is still much lower than in "crisis countries" in pre-crisis period.

Polish short-term debt to FX reserves

Date	Ratio of short term debt to official reserve assets
1Q01	35.65
2Q01	38.79
3Q01	37.44
4Q01	41.93
1Q02	40.51
2Q02	40.95
3Q02	39.60
4Q02	45.43
1Q03	47.15
2Q03	49.64

Source: NBP, BZ WBK calculations

Relation of short terms debt to FX reserves

Country	Ratio of short term debt to official reserve assets
Russia (mid-1998)	318.2
South Korea (1997)	216.6
Ecuador (1998)	131.2
Brazil (1998)	92.0
Turkey (2000)	62,0
Argentine (2001)	108,8
Poland (end-June 2003)	49.6

Source: NBP, BZ WBK calculations

Low budget revenues in August

The Ministry of Finance revealed data on budget performance after eight months of the year. While ministry's officials announced a few weeks ago that budget deficit after August may reach as much as 80-85%, which triggered a wave of comments suggesting serious problems with execution of 2003 budget act, the actual data showed that budget gap reached only 76.4% of the annual plan. Such result confirms our view that despite some problems with achieving assumed amount of revenues (deputy finance minister Halina Wasilewska-Trenkner said that budget revenues would be PLN3.7bn short of the plan, although in our opinion the gap is likely to be higher), one should not expect major problems with this year's budget execution (some spending will be cut or postponed for 2004).

Total budget revenues after August amounted to PLN96.26bn, which implies cumulative growth of 4.7%YoY and a fall of 3%YoY in August alone. Indirect taxes increased by 3%YoY cumulatively in January-August period (whole-year plan points to 7.5% growth), implying a mere 0.2%YoY increase in August (comparing with average of 3.9%YoY in the first seven months of the year). The results of direct taxes revenues were also weak in August, as CIT revenues fell by 15.8%YoY (cumulatively by 11.3% against planned drop of 4%) and PIT revenues increased by only 0.2%YoY (9.1% average monthly growth in January-July period), which means cumulative growth of 7.4%YoY against planned 13.4%. Such August results mean a significant deterioration of budgetary revenues as compared with very good data from July, when each category recorded higher than year-to-date average growth. On the other hand, cumulative spending growth amounted to 5.5%YoY in August, which is lower than 6.3%YoY increase planned for the whole year. Budget expenditures in August alone fell 0.8%YoY and amounted to PLN13.7bn, as compared with PLN16bn monthly year-to-date average. It means that the government has already started to cut some spending, but what is more important some expenditures are simply spend outside the central budget. For example, Labour Fund's whole-year subsidy was already realised after August, which means the Fund will have to finance its activity with commercial credits.

Central bank watch

- **Interest rates flat for the third consecutive month**
- **... but the MPC reduced reserve requirement ratio**
- **Monetary policy guidelines for 2004 approved**
- **Critical MPC's assessment of 2004 budget draft**

The MPC cut reserve requirements, interest rates on hold

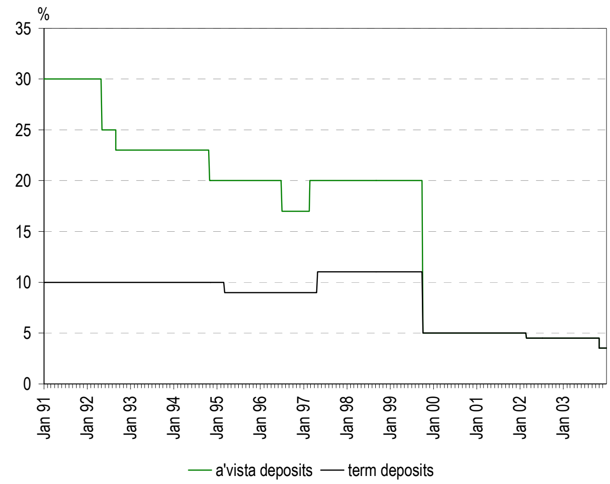
During September meeting the MPC decided, for the third consecutive month, to keep official interest rates unchanged. The reference rate, which is the most important for the Polish financial market, remained at 5.25%. At the same time, central bankers maintained neutral bias in monetary policy. The main reason for no cut was significant uncertainty regarding the shape of fiscal policy in the nearest years and recent weakening of the zloty related to that. However, the MPC did not precise whether its inflation predictions have changed as a result of those factors. According to the MPC the second reason, which spoke against the cut was continuously high dynamics of cash in circulation. However, similarly to previous months, the MPC pointed out also several factors constraining inflationary pressure in future. They included: low PPI growth rate, wage discipline in enterprises, low dynamics of credits and broad money supply, and low inflation expectations. While the MPC indicated signals of ongoing economic recovery (higher industrial production, positive business climate results, continued growth of retail sales), it said that fall of construction output in August might suggest that investment activity still remains low.

Decision about leaving interest rates unchanged was accompanied by reduction of reserve requirements ratio from 4.5% to 3.5%. The MPC's resolution on this issue applies to reserve being held since 31 October 2003. NBP governor said that the main reason for the decision was to decrease difference between the level of reserve requirements in Poland and in the European Union, in order to improve competitiveness of the Polish banking sector. One should remember that this decision also means loosening of monetary policy, as it will lead to increase in liquidity of the banking sector of some PLN3bn (higher demand for high supply of treasury papers). Not so long ago one of the officials said that a reduction of reserve requirements to 2% would be an equivalent to 50-100 bps reduction of the main interest rates. Therefore, a scale of the reserve requirements reduction (comparable to rate cut of 25-50bps) suggests that the so-called small-steps approach applies to all monetary policy parameters. We expect the second step in lowering reserve requirements at the beginning of 2004, before Poland joins the European Union.

In the reports before September MPC meeting we wrote about a possibility of reserve requirements reduction and we called it "another solution". It seems that the MPC's reasoning was as follows. Interest rate cut might have been interpreted as a confidence vote for the government, which would contrast critical assessment of fiscal situation, presented in the MPC's official statement (see below). On the other hand, no change in monetary policy parameters (which was expected by the market) might have been perceived (especially, if accompanied by strong criticism of fiscal policy) as a hint that situation in the Polish public finances is really dangerous, which could bring another wave of negative sentiment on the market. Therefore, the Council has probably decided to avoid both scenarios delivering a cut in reserve requirements, which was accompanied by negative assessment of the budget draft. Such decision leaves a room for monetary easing when the government presents a credible fiscal plan (especially referring to spending cuts).

All the government's plans are already known in October, however their assessment is not completely positive. While the medium-term plan of spending reduction earned quite positive remarks, budget for 2004 has been heavily criticised by the MPC members. However, one has to remember that most of economic data confirms lack of significant inflationary pressure. Central bank officials criticised fiscal policy many times in the past, while monetary policy was being relaxed at the same time. Therefore we do not think that critical remarks about fiscal policy rule out an interest rate cut in October – we still expect interest rate reduction by 25bps.

Reserve requirements ratio

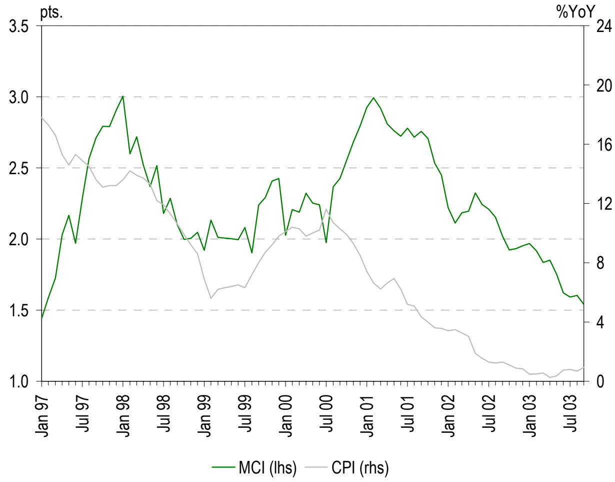


Source: NBP

... but monetary conditions are being relaxed

Despite interest rates remained unchanged in September, our estimates showed that monetary policy is being continuously relaxed. And this is not only due to reduction of reserve requirements ratio. The monetary conditions index (MCI), being a synthetic measure reflecting impact of monetary policy parameters (namely, interest rates and real exchange rates) on the economy, went down again in September, maintaining a virtually uninterrupted trend since early 2001.

Monetary Conditions Index



Source: BZ WBK, CSO

Presently, the MCI index is not only falling, but also stands at the lowest levels at least since the beginning of the MPC's term of office, which suggests that in this cycle of monetary easing, it has been relaxed to a degree, which did not happen in the last five years. A significant fall of the index this year was an effect of cumulating two simultaneous effects: a gradual reduction of interest rates and a systematic depreciation of real effective exchange rate (more than 8% since the beginning of this year). It means that the observed economic recovery should meet diminishing constraints from the monetary policy side in the upcoming quarters. At the same time it also implies that in line with accelerating growth of domestic demand, monetary policy would create smaller and smaller constraint for a potential pressure on prices in the economy. However, so far the rise of a significant inflationary pressure seems to be quite a distant perspective and despite expected acceleration of price growth, we should not be afraid that CPI would be above the mid-point of inflation target (2.5% ±1 pp) at the end of next year.

Critical assessment of 2004 budget draft

Justifying decision about no interest rates cut the MPC focused on budgetary issues. And at the same day it released the official assessment of 2004 budget draft. The document's conclusions are well in line with expectations. Central bankers stressed that they were concerned about rising expansion of fiscal policy. Evaluating the 2004 budget draft the MPC pointed out that it assumes increase in budget deficit to 6.6% of GDP (including subsidies to Social Security Fund for transfers to open pension funds), which means huge fiscal expansion despite expected continuation of the economic recovery. The MPC expressed disappointment with the fact that the government does not plan systematic measures aimed at reduction of budget spending. In MPC members' opinion there is high probability that ratio of public debt to GDP will exceed 55% (the second security threshold) next year. Therefore, the MPC said that 2004 budget draft pose threat for stable, long-term economic growth. During the press conference after the MPC meeting NBP president stressed that higher economic risk might lead to a rise in long-term interest rates and increase uncertainty regarding the zloty exchange rate. However, Balcerowicz said that there is no danger of Argentinean-like currency crisis in Poland.

Monetary policy guidelines for 2004 – nothing new

Also, the MPC approved *Monetary policy guidelines for 2004*. This document includes roughly the same elements as the medium-term strategy of monetary policy presented at the beginning of this year. Short-term annual inflation targets have been abandoned for the sake of a continuous monitoring of the medium-term goal set at 2.5% ±1 percentage point. The Council also agreed that future monetary policy should be conducted under free floating exchange rate, FX regime should not be changed until ERM-2 entry and the band of possible fluctuations of the zloty in ERM-2 system should be set to the maximum possible width. The main assumptions of inflation forecasts are consistent with those presented in *Inflation report* released recently – both food prices and controlled prices are expected to rise by 2%YoY on average in 2004, which is roughly in line with our forecast.

Comments of the MPC members and central bank representatives

The number one topic in September, appearing most frequently in economic policymakers' comments, was undoubtedly the budget draft for 2004 and perspectives of fiscal policy. Unfortunately, it was quite a difficult subject, rising mostly negative emotions, especially among the central bankers (not to mention financial market participants). A clear confirmation for that was a rising critical tone of MPC members' comments, even those who used to support deeper interest rate cuts not so long ago. Dariusz Rosati said "the government's proposals, which increase the budget deficit, reduce room for interest rate cuts, if there is such room". Grzegorz Wójtowicz was commenting monetary policy perspectives in a very similar manner, saying that the number of worrying factors for the MPC had been growing recently. Also Wiesława Ziółkowska said that expansionary fiscal policy limits the scope for monetary easing, and appraised the budget draft for 2004 as the worst budget draft since 1989. Of course the "hawks" within the MPC were much more radical. Cezary Józefiak warned that government proposals would not allow for avoiding breaching 60% of GDP threshold for public debt. In turn Bogusław Grabowski was envisaging not only looming financial crisis (which in his opinion is already there) but also a "crisis of the state" together with continuing zloty depreciation and inflation rise to ca. 2% already at the end of this year. Negative appraisal of the budget and fiscal policy perspectives undoubtedly contributed to MPC's decision about no interest rate cut in September. However it seems that it does not necessarily mean that in MPC members' opinions further interest rate reductions are not justified any more. Two of them – Wiesława Ziółkowska and Jan Czekaj – explicitly said that until the end of this year additional cuts are possible (and well justified), mostly because of still very low demand-side inflationary pressure. Interestingly enough, Czekaj said even though nominal interest rates at 2-3% level would be justified at present, there should be no deep reductions, but rather a continuation of "small steps" approach. It reduces chances for of sharp interest rate cut by 100bps or more at the beginning of new MPC term.

MPC members recognised the ongoing economic recovery, however they still did not see it as excessive. According to Cezary Józefiak industrial production was still fuelled by exports rather than investments, which was disappointing because the Polish economy needed investment demand for persistent increase of economic potential. Józefiak said also that 3.5% GDP growth was still realistic this year, however it would be fuelled mostly by consumption demand and foreign demand. In turn, in Jan Czekaj's opinion even though industrial output was lower than expected, the figures confirmed acceleration of GDP growth, which should exceed 4% in 3Q03. He believes GDP growth in Poland is still non-inflationary, which makes room for more interest rate reductions this year. A similar view belongs probably also to Dariusz Rosati, who increased his GDP forecast to 3.5%, but maintained low inflation forecasts. In general MPC members' inflation forecasts for the year-end have quite a large band: 1.5-1.6% (Ziółkowska), 1.0-1.5% (Rosati), 1.3%YoY (Wójtowicz), ca. 2% (Grabowski).

WHO. WHEN. WHERE	COMMENT
Leszek Balcerowicz, NBP president; PAP, 30 Sep	Combination of factors affecting future inflation is unchanged, and if there were any changes, they are not conducive to interest rate lowering. First of all I mean increased uncertainty on the FX market as compared to previous meeting. We mention large uncertainty concerning a shape of fiscal policy together with uncertainty on the FX market [among factors that increase inflationary pressure]. The latter is not irrelevant for analysis of future inflation. [to not exceed 55 debt threshold] We need a combination of following factors: GDP growth of 5%, zloty rate against the euro weaker and the dollar of 4.24 and 3.78, respectively, net privatisation revenues of PLN7bn, and deficit outside the central budget not higher than optimistic forecast. [to exceed 55 debt threshold] It is sufficient that: GDP growth rate is lower than 4.5%, zloty rate against the euro weaker by at least 3% than forecasted, privatisation revenues lower by PLN2bn, and total additional debt of government's funds higher than PLN2bn as compared with the budgetary plan. A probability of a combination of these factors is not very high and debt may exceed the second threshold. There is a question whether to adopt the budget, which assumes that there will be a fortunate coincidence allowing to not exceeding this level of 55% of GDP. Fast presentation of a package of solution leading to healing of Polish public finance sector would reduce an uncertainty and would make observed economic recovery sustainable. Current situation brings additional uncertainty on the foreign exchange market, but when the reasons disappear we should see a stabilisation. Since the latest MPC session the zloty has weakened by over 6% against the euro, but at the same time the euro firmed against the dollar by nearly 7%, that is the zloty edged up against the dollar. […] The zloty weakened against basket by 3%. […] Certainly, the current situation cannot be compared to countries that are usually combined with a word crisis.
PAP, 24 Sep	I want to deny a lying information, that I would conduct any talks with politicians concerning new MPC members. I do not engage and will not engage in any speculation regarding this subject. We have to count the whole deficit of the public finances sector. When the deficit is growing dramatically, then various risks grow, and uncertainty as well, including uncertainty over the shape of the price of the currency, which is of significance for inflation. We are during working talks [regarding a loan for the government for an early repayment of the foreign debt] and when we reach a decision we will present it to the public. I want to stress that this will not be a huge amount because the most important is that one should pay back as much of the debt as it is beneficial for Poland. The Ministry of Finance makes calculations and they show that the amount is not huge. It would be best for a permanent development if the 2004 budget provides for solutions aimed at spending cuts so that the budget deficit is curbed as early as from 2004 . […] But if the best scenario were not to be implemented, then it is much more important to have a reliable package of reforms implemented. At stake is the scenario that would produce effects from 2005. We have a situation of economic recovery with increasing long-term threats if no actions to restore public finances are taken. There is no doubt that we have to do with economic recovery in short term but we are interested in fast growth not only this year but also in many years in the future. It is very unlikely that at such huge issuance yields will begin to fall. They have already begun to rise. That has already started on assessments of the draft budget and projections, and against this background it is very important to offer a reliable programme of reforms that would permanently heal the public finances. […] Long-term rates are most important for the economy. […] The gap between the yield of Polish and German bonds started to widen. And from the point of view of Poland's economy is the most important thing, because on the one hand it means increased servicing costs and on the other hand it raises the cost of credits. A high budget deficit causes not only the problem of financing possibilities but also costs. If the deficit is going up, then you cannot count on keeping low yields of the treasuries. But if the costs grow, then we have additional complications in next budgets. Future debt servicing costs will become an even bigger position of the expenditures that is a delay is very costly. It is difficult not to agree with warning forecast of finance minister. (...) Against this background, it is very important to present and implement already in this year a package of measures, which would credibly signal reduction of budget deficit and holding back increase in public debt until 2005. In countries, which were reducing inflation, and this was happening in Poland, monetary policy was restrictive. Monetary easing took place after fiscal policy had become more restrictive. In Poland fiscal policy is loosened. The scale of interest rates reductions until now, comparison with countries, which were in similar situation as Poland a dozen or so years ago, the fact that the most important for the economy are long-term interest rates and that they

	are affected mainly by fiscal stance, the fact Western countries loosened monetary policy when fiscal policy was more restrictive – this is my premise of thinking about monetary policy. (...) First of all, one should remember about significant scale of interest rate reduction until now. This is the biggest accumulated scale of rate cuts in the region. Cutting the mandatory reserve rate is being considered, and it is advisable to avert an unfavourable competitive situation of banks operating in Poland. I think that a decision can be taken this year. We are holding talks on changing credit classification regulations. The proposals of the NBP and the banking supervisory commission are mostly congruent with our partners' opinions. […] We are very close to taking decisions, surely that will not be next year, but in 2003.
Financial Times, 24 Sep	Unless the government has a credible program of repairing public finance, the economy will not be able to grow in long-term. […] The reform is closely connected with the growth. If the pace of reforms slows down, the pace of economic growth will slow down very soon. [early membership in the Eurozone] It would extort fiscal stabilisation and would make it necessary to conduct reforms.
PAP, 15 Sep	Euro adoption depends on public finance reform. This is the only condition, which is not met yet. We have low inflation and therefore yields of long-tem bonds had decreased as well, as a result. There is no doubt that sick Polish public finance sector is a danger for the society and is a result of bad policy. This policy should change if the country to allow fast and permanent country's development.
PAP, 12 Sep	Bond yields are the most important for the budget. We observe a rise of the budget's borrowing costs in connection with the outlook (of the economy) which we hope will improve after the medium-term strategy is released. I stress once again the importance of the package for the future of Poland's economy.
PAP, 10 Sep	It can be said that main [budget] parameters are in line with earlier announcements from the government. The deficit will be higher than this year. Higher will be also the very fast growing public debt. Such situation cannot be reconciled with fast economic growth. Whether Poland enters the road of economic pick-up in a permanent way will depend on a packet [of fiscal reforms] the government is to present and on the way it will be conducted.
FT Deutschland, 8 Sep	We still mean an exchange rate mechanism as a broad range and not ±2,25%. […] Narrow range means almost fixed exchange rate. It could impose us unnecessary risk of exchange. […] Narrow fluctuation band increases a risk of investor's speculation against the central bank on FX transactions.
Jan Czekaj, MPC member; ISB, 25 Sep	Although it is hard to pinpoint the optimum level of the key intervention rate (now at 5.25%), it could be estimated at 2.0-3.0%, based on the situation in neighbouring countries. From the point of view of monetary policy, a weakening of the zloty exchange rate would be damaging if it translated into a higher inflation level. But this is not the case for the time being, so there is no need to worry. Also, one has to note that the first half of the year saw a further improvement in the external balance with the current-account deficit lowered by 45.8% compared with the first half of 2002. Generally, the danger connected with the currency rate is that the zloty weakening impacts the nominal value of the public debt, which is approaching constitutional thresholds. One can say that today there is no need to make monetary policy more restrictive in an effort to improve the external balance. Both the government and the NBP have instruments at their disposal which could help prevent any further depreciation of the zloty. However, one should be aware that such instruments could have should have extraordinary character while the only way to avoid the danger [high debt] in the long run is the real improvement in public finance stance. One has to remember that next year we will begin to receive foreign currencies due to Poland's joining the EU, which would naturally strengthen the zloty. After all, these resources can always come through the FX market.
Gazeta Bankowa, 22 Sep	Prospects for abrupt interest rate reduction are today more limited than one or two years ago. Today I would be afraid of a sudden 200-300bps rate cut, even though interest rates at 2-3% would be well justified. [...] I believe that after we had reached present inflation level, monetary policy could act in both directions. When we feel the business climate is overheating and inflationary pressure rises, we could hike interest rates as well. According to NBP research natural unemployment rate in Poland amounts to ca. 12-14%. [It means that] we can easily boost the economy until the unemployment rate falls below 14%. [...] In such economy like the Polish one, economic growth at 3.5% is surely not the kind of growth, which could lead to exceeding potential output. As far as unemployment rate is higher than the natural rate, potential output is not reached and there are no reasons to slow down the economy. In general, the question is: whether we should hurry for the Eurozone or not? This implies benefits as well as costs related to no possibility of using exchange rate as a tool of economic policy. The arguments for and against are not 100% unanimous. The second issue - I am not sure that they would like to invite us that fast. I am not convinced 2007 is a realistic date from the EU's point of view. [...] In my opinion benefits from EMU membership are indisputable. But it remains an open issue when we should join the Eurozone. [...] I think 2008-2009 is a realistic date. Before that we have to meet convergence criteria and negotiate a very important thing - zloty exchange rate against euro. Today we are not fulfilling fiscal criteria. And I do not think it could be attained fast without high GDP dynamics. The chances for budget deficit reduction are limited. [...] And we have pressure for tax reforms. [...] If the pressure goes in this direction, i.e. if we implement flat rate tax, then I'm afraid it would be impossible to reduce budget deficit below 3% of GDP. I do not like to talk about it [FX interventions]. I do not want to make an impression, that such measures are being considered. It all depends on circumstances. If we had a speculative attack on the zloty, resulting in negative consequences for the economy, then the NBP should consider counteracting such moves. I do not believe that the new Council [MPC] would have smaller competence than the present one. There might be different views on economic policy. But I rule out a scenario of destabilising actions.
PAP, Reuters, 17 Sep	It is difficult to formulate a unambiguous opinion as regards reasons of zloty weakening. However, the fact that the text of medium-term strategy was not published is the factor, which may lead to an increase of market uncertainty and may be reason of speculative attacks. Nothing special has happened in the economy, which could lead a permanent change of previous tendencies. Therefore, the reasons are short-term factors. The amount of budget deficit is known for several months, this is not a surprise for the market. I think that current zloty weakening is a short-term phenomenon, an appreciation pressure is likely to appear in the longer-run. Data on industrial production in August were not as good as in July, but they show that GDP growth accelerates and will exceed 4% in 3Q03. I cannot assess whether inflationary pressure will appear within next two and three quarters. Currently, we observe inflation decrease driven by low food prices. A fall of fuel prices is also possible.
Reuters, PAP, 11 Sep	We have to be cautious already because we know monetary easing possibilities will vane. But I certainly think today there is still a room to lower interest rates. It could take long months before accelerating growth starts to fuel inflation and the growth rate would probably have to exceed 5% rate expected next year to seriously threaten inflation. Low pressure on wage increase resulting from high unemployment rate will also stabilise inflation an low level in nearest time. […] We have to approach monetary policy making with humility. If there is no inflation pressure then of course interest rates should be cut, but we must carefully watch what is going on as we certainly do not want to pay the high costs of fighting inflation again. I think the new MPC will be comprised of people who will know what they are doing. […] With four more meetings of this MPC, we do not know what the starting level for the new Council will be while the economic situation will certainly require cautiousness particularly if the recovery will be permanent and I don't think any aggressive easing will be possible then.

	From the point of view of monetary policy it is quite difficult budget as it creates certain threats. I believe that the main risk connected to the budget plan is whether it will be easily financed, although right now financing of the borrowing needs remains under control. […] However, one should be aware, that a possibility of some radical and rapid cut in spending does not exist. Of course it may take place in case of some crisis, but it is not a good way to return to balance. It would be better to do that calmly in terms of fast GDP growth, which would make such changes much easier.
PAP, 4 Sep	It seems that we will be in the lower end of the inflation target. […] If the target has been set and it is not met then probably monetary policy instruments were not determined precisely. It seems that the monetary is too restrictive as compared to the target. In the ERM2 system the zloty should fluctuate in ±15% band. […] Too narrow band is unfavourable as in fact it fixes the rate and exposes the country to attacks of speculative capital. […] Real interest rates are still to low. However in recent months they have been lowered and it is accompanied with FX risk factor.
Marek Dąbrowski, MPC member; PAP, 30 Sep	This year public debt has exceeded the first safety threshold of 50%. In fact, next year's budget draft does not draw any conclusions from it, the deficit will rise next year.
Bogusław Grabowski, MPC member; PAP, 29 Sep	We will have to do with acceleration in consumer demand, as well as with increase in food and fuel prices. All supply and demand factors influencing inflation will act towards its acceleration. Therefore the inflation will rise this year and it can be close to lower end of inflationary target, i.e. 2.0%, at the year-end. […] Depreciation of the FX rate begins to influence the CPI after three months and the strongest impulse is only after eight months. However, strength of influence depends on demand-supply situation in the economy. Therefore, the depreciation in recent months is combined with an improvement of demand growth and will reflect in CPI in 2004. Lowering reserve requirements is a substitute of cutting rates. Lowering reserve rate from 4.5% to 2% would mean increasing liquidity of banking sector by PLN7.5bn that would increase money supply as a multiplier effect in long term. […] Nevertheless, the result of lowering mandatory reserve from 4.5% to 2% would be the same as of lowering revaluation provisions by PLN7.5bn. However the banking sector would benefit from it and not public finance.
Radio Zet, 29 Sep	I am extremely terrified. I believe that it [budget draft for 2004] is not only the worst budget in recent 10 years but I would say, that it is even a scandalous budget. The government is presenting the budget that disdains all the warnings and like a moth to a fire is flying towards a serious crisis. It would not be a crisis of public finances as we already have it. It would be a crisis of the state. I see no reasons for zloty appreciation that is foreseen by the government in the budgetary assumptions.
PAP, 26 Sep	Of course there is a risk of exceeding 60% limit of public debt to GDP ratio already in 2004. The weakening of the zloty means that we are faster approaching initially 55% limit and later 60% limit. Exceeding 60% limit would cause necessity of balancing the budget in the next financial year and taking into account 2003 as an example it would be a reduction of expenditure by PLN40bn. Lack of will to reform public finance, which would decrease danger of exceeding 60% level of public debt to GDP ratio cause that foreign investors lose confidence in the Polish economy. It turns out that factors, which was favourable for the zloty exchange rate so far, such as perspective of EU entry, has vanished now. The zloty will be under slight depreciation pressure. It is difficult to find appreciation factors in the nearest months and the portfolio capital will closely watch the government and parliament's actions regarding public finance. If there was no public finance reform, we could experience serious loss of investment credibility of Poland and then we could also observe outflow of capital from Poland. The zloty will weaken even if the amount of capital invested in Poland will not increase. If the amount of capital were to decrease at least slightly, the weakening of the domestic currency would be more significant. There is no doubt that in the nearest years, in the second half of the next year at the latest, we will experience tightening of monetary policy, which has to be stabiliser of the macroeconomic situation. In this context, any attempt to loose monetary policy would end very badly for the Polish economy. No economist can imagine loosening of both fiscal and monetary policy during period of economic expansion and we predict continuation of the economic growth acceleration in 2004.
Cezary Józefiak, MPC member; Gazeta Wyborcza, 19 Sep	In my opinion good strategy should assume a significant spending cuts, and budget deficit reduction, starting from 2004. It is necessary with the perspective of public debt increase, which we have. Budget spending in 2004 should be lower than assumed by the government [...]. If the government was aware of the situation and a danger which we face, expenditures reduction would not be postponed for 2005. Q: Is the strategy [...] allows to maintain public debt to GDP ratio below 60% of GDP? A: In my opinion, no. There is high probability that it exceeds this level as the government is postponing necessary decisions.
PAP, 17 Sep	I think that improvement of economic situation, which is visible is a result of business cycle. It is not GDP growth, as this may be only the case when the potential of economy is rising i.e. investments are growing. This is connected with a possibility of investment financing on the credit or capital market. [...] The problem is that high budget deficit absorb money from the market, being a barrier for growth. If the government announces the we will join the euro zone in 2008, this means that budget deficit will be lowered. Word "rationalisation" means that the government is in very difficult political situation, in which it is impossible to cut spending, because it did not do this at the beginning of the term of office, when it used to have high public support.
Dariusz Rosati, MPC member; TVN24, 23 Sep	Certainly, government's proposals, increasing the budget deficit lower room for interest rate cuts, if there is such room. All reserves on revenue side are used completely. There cannot be more revenues. [5Y T-bond auction is] worrying signal. If investors do not see a credible vision they will leave even earlier. This would mean rapid collapse of the zloty.
Parkiet, 20-22 Sep	I believe that Leszek Balcerowicz has no reason to quit. First, present situation in the MPC is very favourable for the president – distribution of opinions in the Council often allows him to decide on voting results. One cannot expect, however, that it will last forever. Second, I do not believe that a new MPC would be irresponsible. There are many candidates in Poland who would assure carrying the proper monetary policy […]. I am convinced that Leszek Balcerowicz will be able to co-work with the new Council.
PAP, 19 Sep	It is possible to increase GDP growth forecast after positive and optimistic data for 2Q03. Earlier I have been expecting GDP growth of 3-3.5%, while now I can forecast 3.5%. It is positive that fixed investments dynamics improves and it is possible we will see the first growth of investments in 3Q03.
PAP, 17 Sep	It is realistic for the deficit to be reduced every year in order to meet Maastricht criteria in 2007. But is an extremely difficult task given budget assumptions for next year and this scale of the deficit. Government's plans would be more realistic if the government did not increase the deficit in 2004. […] At present we have only a big budget for next year and very vague promises to cut spending which is a crucial issue.
PAP, 15 Sep	A month ago we expected August's inflation to be a little bit higher. It turned out that especially the monthly index lowered from July. This confirms our earlier opinion that there are no inflationary threats in the short- and medium-term. A rise in food prices will result from worse harvest this year as well as from a rise in people's revenues related to acceleration of the economy. We do expect it in a medium term prospect. This should influence inflation rate moderately. We expect that inflation rate should be between 1-1.5% at the end of the year.There is nothing special in prices, which could suggest a revision [of inflation target in 2004] . We maintain inflation forecasts for 2004. Also, there is nothing special on the supply side. Food prices and accelerating economy will be the main factors leading to CPI inflation increase.

TVN24, 8 Sep	There won't be such a pressure [to cut rates] like in the past. Firstly, the rates are already low […]. We will have a clear rise in inflation next year and maybe in successive years resulting from just from the fact that the economy is entering a period of recovery. Everybody will understand that room for cuts is not that big. Next Council will have to aim at keeping inflation at low level. I think this task will be easier. The economy is entering a period of recovery at present and inflation is very low. The thing is not to spoil the situation. It does not require as drastic measures as high interest rates any more. We have paid a certain price in shape of economic slowdown and rise in unemployment for the disinflation period. This is exceptional event. Poland have been improving its international rating systematically and at the moment we have to do with a possibility of downgrading our mark. […] I hope that the government will present a credible program of public finance restoration at tomorrow's meeting.
PAP, 4 Sep	I do not think the budget will have to be revised in 2003, if the budget realisation is in jeopardy, then spending will be cut. Next year's budget is also not in jeopardy because under Polish law, the deficit set by the Sejm is executable, the problem is the condition of public finances. […] The PLN45.5bn deficit does not sufficiently estimate the real level which may even amount to PLN60bn.
Grzegorz Wójtowicz, MPC member; PAP, 30 Sep	Current account balance is good. Current account deficit was 2.7% of the GDP for the last 12 months, while a month ago it was 2.8%. We were used to a situation, in which export is worse than imports. Now we can say that export is growing at least as fast as imports, which is not low amid economic recovery. Also, surplus of unclassified flows is rising, which might be connected with a lot of factors, which will be known after some time. Forecast are quite optimistic. Exports should be high, but imports might accelerate further if GDP growth is higher. I think that 12M C/A deficit will be below 3% until year-end. Balance of payments figures bring twofold conclusions – we see economic recovery, but we have a warning that investors are not eager to buy treasuries.
PAP, 26 Sep	If the market is not informed well enough about what is happening in the budget and may happen with it in the nearest future, investors are likely to demand higher risk premium. It is difficult to say whether this will happen already on Monday [during T-bills tender on September 29]. However, there is tendency to increase the premium. This is the information [about budget deficit after September], which – if not properly interpreted– may cause turmoil on the market. However, if there is monthly volatility, additional commentary is needed. If there is lack of it, one should not be surprised that investors are nervous. The budget is tight because GDP growth at 3.5% is the upper end of forecasts and inflation will be lower than assumed in the budget act. There have to be some tensions on revenues side in such circumstances. So far, we have only general information [about budget deficit next year].
TVP1, 25 Sep	I am an optimist but 5% is an upward limit of possible growth. A GDP growth at 4-4.5% is very likely. The Council have proved many times that we analyse the situation carefully and we will still do that. […] As rates have been lowered, the arguments for further cuts and those for keeping the rates stable have been approaching an increasing equilibrium. At the moment we have many factors that may be of concern for us. We will see which arguments prevail.
PAP, 24 Sep	The government will claim soon that the debt is growing because the zloty is weak but in my opinion the zloty is weak because the debt grows. […] A red light which is the growing public debt has been turned on. The risk of exceeding 60% limit exists indeed, as it can be influenced by FX rate changes and if we fluctuate around this limit it will be very hazardous. It is well that the document [fiscal strategy] is published but it's a pity that a bit to late, since first of all we saw a short-term prospect, i.e. next year. Long-term interest rates begin to grow on the bond market and the fiscal policy starts to shape interest rates. A few days ago we witnessed this when nobody came to buy bonds. Some deviations in long-term interest rates and fluctuations on the FX market will not change on the market in near future. I do not want to forecast that it is going to be badly but there are many factors of uncertainty and the market will take it into consideration. The market will watch budget execution and results of T-bond auctions. I think that the circumstances will force a future MPC to make very cautious decisions concerning monetary policy. […] The new Council will have narrow room for manoeuvre in these circumstances and therefore one should not expect any irresponsibility. An acceleration to certain level of the growth is possible as there is a juncture of short-term factors like it was the case in 2Q03. […] But there is a great question if the growth of 5% or more is permanent. Unfortunately, macroeconomic factors point that one should take into consideration that it will be difficult to maintain it.
PAP, 23 Sep	[as regards core inflation] It is very similarly to what was a month ago and therefore there are no signals that would allow to draw any new conclusions. All the information regarding fiscal policy will be a subject of main interest of the Council at the nearest meeting. When we receive them [NBP's forecasts of GDP for 2004], we will know, what are future demand analysis and potential future inflation like. At present we have actually the end of the year and influence of the monetary policy on this period is in fact none.
PAP, 12 Sep	There are no limits on the spending side [in budget draft], which are necessary. The deficit is high but - as various calculations show - it would be wider - had we adopted conditions comparable with those used this year […] There may be a problem with financing the deficit. I do not think that foreign investors actively offered an initiative in this respect. And financing by domestic investors signifies their departure from investments in the manufacturing sector. When you look at economic stability a level of the deficit and a rise in public debt can be worrying. The more that it can influence other indicators, too. […] From time to time we will observe a rise in long-term interest rate on the fixed income market and foreign investors can require higher risk premium. [I assess a forecast of average annual interest rate included in the budget as] optimistic in given conditions, especially with rising inflation. This forecast is questionable. The macroeconomic risk will be higher. What was revealing this year as rapid fluctuations in FX rates, next year can be appearing stronger. We will be receiving reports on budget performance and deficits will certainly be high as well as estimations of increase in public debt.
Wiesława Ziółkowska, MPC member; Gazeta Wyborcza, 30 Sep	This is the worst budget draft since 1989. The document is not transparent [...] includes contradictory assumptions. Expenditures are computed in many different ways, the deficit is too high. Budget deficit (high supply of treasuries may lead to higher market rates) will decide about interest rates level, not the MPC. Consequences of this budget will be disastrous already next year, but will be visible in the following years as well. I think that all proposals of minister Hausner are very good, but he has to convince politicians, parliament and society.
Reuters, 25 Sep	When inflation will likely rise to 1.3% at year-end, growth is driven by external demand and there is still no inflation pressure from the demand side, there is room for a reduction of rates this year. […] It is hard to say if one or two reductions are possible this year. The plans of minister Hausner sound credible, of course implementing them will be the hardest part since they concern the welfare sector. But given a situation when the growth is increasing, the necessary cuts will be easier. Obviously, it is inadmissible to allow for exceeding 60% relation of public debt to the GDP, and a change in Constitution international discredit of Poland on international markets.

PAP, 25 Sep	Fiscal policy has a negative impact on those who want interest rates to be cut or think that interest rate lowering is justified. […] However, when cutting interest rates, one takes into account many factors, not only fiscal policy, but also real phenomena, internal and external, and those from the sphere of monetary policy. It is certainly more difficult to speak about the room for interest rate cuts in a view of a more relaxed fiscal policy. And we observe just such a policy and it cannot be denied. It pushes out private investment and increases real interest rates on the market. Cuts in expenditures are necessary, as otherwise we will exceed a threshold of 60% debt against the GDP. It will be very difficult to do but there is no other way. […] If we tried to change the Constitution in case of exceeding 60% of GDP it would weaken the credibility of all Polish authorities. Economic growth and cuts in expenditures are the key to avoid the limit of 60% debt of the GDP. The problem is the way and timing of cuts, especially with worse and worse social situation.
PAP, 15 Sep	Interest rates decreases will influence economic situation in 2004, rather than in 2003. That is why maintaining of low inflationary pressure opens a room for rate cut to a larger extent. Inflation data in August shows there is no inflationary pressure from the demand side of economy, as sharp industrial production growth is driven mainly by exports. [...] Despite the fact that analysts indicated high growth of wages in the budgetary sector, this increase does not imply high demand, which could lead to higher inflationary pressure. If there are no supply shocks, year-end inflation would be low [...] much below inflation target and would amount to 1.5-1.6%. The first risk for inflation is connected with fuel prices. The second is internal political situation. The third is connected with fiscal policy programme, which is to be presented by the government [...] If this programme is strongly criticised, this could influence price development and inflationary expectations.
Andrzej Bratkowski, deputy NBP governor; Reuters, 9 Sep	It is difficult to say whether there is any room at all [to lower rates]. In making policy decisions one has to think of 2004 and 2005. […] Given expectations of faster investment growth and an accelerating economy, which will be reflected in inflation, it seems that room to lower rates this and next year is not too large. Right now, the zloty is not fundamentally overvalued and if the government proposes a credible plan for a reform, then we should see currency strengthening somewhat by the end of the year. Delaying fulfilment of fiscal criterion creates a threat of further delay of entering the Eurozone and makes it even more difficult, as with increasing policy of fiscal expansion it will be more difficult a year after year. A negative outcome of the referendum may have a negative impact on the attitude of people in EU accession states, including Poland. I hope however that it would not influence significantly a present favourable climate in Poland towards adopting the euro.
Paweł Samecki, head of foreign affairs dept. at NBP PAP, 7 Sep	There is no reason now for changing foreign exchange regime. There should not be such reasons also in 2004. It would be favourable if we could maintain free float until entering ERM2. The NBP has not considered any other possibility. I do not think that anyone consider any change. The NBP said that taking into account Poland's economic interest it would be good to join the EMU as soon as possible. This strategy has not changed. It is still binding. The problem is meeting all necessary convergence criteria. We do not know when budget deficit could be reduced below 3%. The earliest possible date of the Eurozone entry is 2007. Let us hope that the government will do everything to achieve it. It requires fiscal consolidation. 2004 is a possible date of ERM2 entry. However, there is an issue of technical negotiations and one should presume that in dozen or so months these issues will be solved, although there is no such guarantee. We can enter ERM2 system without any special formal requirements. There is no sense talking about the central parity today, because the decision will be made in a several months. There will be completely different conditions, which are not known now.

Government and politics

- **What next with public finances?**
- **Poland's sovereign ratings reaffirmed**
- **Economic freedom bill approved by the government**

Fiscal plans revealed... but uncertainty remains

In September the government approved three important documents: budget draft for 2004, medium-term strategy for public finances and programme for public spending reduction. Thus theoretically, the financial market saw everything it needed. But was it enough to calm down investors' nerves and reduce an uncertainty regarding the fiscal policy perspectives? Surely it did reduce the uncertainty, but not eliminated it, which is confirmed by persisting volatility on the Polish financial market. This month we present broader analysis of the government's fiscal plans in the *Special focus* chapter at the beginning of the MACROscope.

Moody's confirmed ratings for Poland

After series of disappointments connected with a lack of detailed fiscal plan of the government and growing concerns over uncertain perspectives of Poland's sovereign ratings, in the middle of September investors received good piece of information, which allowed for some improvement of the sentiment (at least temporarily). Moody's Investors Service confirmed its ratings for Poland at A2 (both for foreign and local currency) and maintained stable outlook. The official statement said that current rating and outlook for Poland are determined heavily by proceeding EU integration, solid growth prospects and "ongoing structural reforms". Favourable maturity structure of Polish debt and no visible threats for its servicing also contributed to positive assessment of the rating.

This has been the first strong confirmation of Poland's sovereign ratings from a major ratings service for a long time, while recently analysts of two other big agencies, S&P and Fitch Ratings, indicated a risk of rating downgrades in case the situation in public finances does not improve. For this reason, Moody's statement made a strong impulse reducing some investors' worries over possible reduction of the Polish rating.

In fact, looking at ratings of Poland, Czech Republic and Hungary in three major rating services (please see the table on the right), it seems that the risk of downgrade for Poland is not so high in the near term, as one could have expected. Poland has already the worst score (among those three countries) as regards long-term sovereign debt in foreign currency, and also has poor marks for local currency debt. Therefore it does not seem obvious (as some analysts claimed recently) that S&P or Fitch would rush to downgrade Polish ratings in foreign currencies, while for example fiscal situation in Hungary (having better score than Poland) is also very poor. The analysis of the table below suggests however, that if there was indeed a pressure for Poland's rating downgrade, it would be most likely a deterioration of outlook for local currency debt made by Fitch (rather not earlier than beginning next year) – in this area we have better mark than Czech Republic and still stable perspective.

Long-term sovereign ratings (rating/outlook)

	Foreign currency debt		
	S&P	***Fitch Ratings***	***Moody's***
Czech Republic	A–/Stable	A–/Stable	A1/Stable
Hungary	A–/Stable	A–/Negative	A1/Stable
Poland	BBB+/Negative	BBB+/Stable	A2/Stable
	Local currency debt		
	S&P	***Fitch Ratings***	***Moody's***
Czech Republic	A+/Stable	A/Stable	A1/Stable
Hungary	A/Stable	A+/Negative	A1/Stable
Poland	A/Negative	A+/Stable	A2/Stable

Source: Rating services

How to increase economic freedom

At the end of September the government approved a draft of economic freedom bill. The law prepared by the Ministry of Economy is supposed to eliminate constraints of legal and administrative nature for the entrepreneurship in Poland, as well as substantial simplification of starting and maintaining economic activity. The most important measures proposed in the package included: facilitating firms' registration procedures (e.g. by electronic channels), simplification of registry, limiting number of controls and supervision, limiting number of concessions, prevention against subjective judgement of offices and administration units. The cabinet hopes those solutions would crate a significant impulse, supporting recovery of economic activity in the coming years. Well, it is hard to disagree unless... a severe downturn in public finances will counterbalance any positive effects that could arise.

Comments of the government members and politicians

Last month government officials focused their comments on the just-approved budget bill and medium-term strategy for public finances, as well as financial markets turmoil, which in their opinion was not caused by fiscal situation. In the government's belief, the documents approved by the government constituted a notable step forward on the way towards stabilising Polish public finances. Government representatives were also eagerly trying to pass their point of view to the analysts and investors on Polish financial market, whose behaviour clearly indicated totally different assessment of government's achievements on this field. Critical opinion of MPC members and financial market economists were treated as not objective, and their authors were described as uncompetitive. Deputy finance minister unveiled motives of analysts and dealers on the financial markets, who, in his opinion, led to a negative sentiment on the market, by saying that they just wanted to take a revenge on the government.

The government officials also expressed their optimism regarding economic situation in Poland. Deputy PM Jerzy Hausner revealed GDP growth in 2Q03 one day before the official release. He also claimed that whole-year GDP growth would surely exceed 3.5%. More detailed GDP forecasts were given by Ministry of Finance official, Ludwik Kotecki, who said that the ministry predicts 3.9% GDP growth in 3Q03 and 4.1-4.2% in 4Q03.

Finance minister Andrzej Raczko was trying to improve investors' sentiment, convincing that medium-term fiscal strategy prepared by his ministry assumed deep and systematic cuts in budget expenditures, which were necessary to reduce budget deficit (even with fast growth) and meet fiscal Maastricht criteria in 2007. Raczko's comment was probably triggered by a sharp zloty depreciation that followed the government's meeting, when instead of detailed plan of healing public finances, the market saw a list of government wishes regarding reduction of budget deficit and a declaration of good intentions, together with a statement that government's focus is not on cuts, but on "rationalisation" of expenditures. Raczko tried to stop further zloty slump, by stressing that deep spending cuts were inevitable in the coming years. He also confirmed he was satisfied with present level of the zloty exchange rate – he said Polish economic fundamentals justified current strength of the zloty, which is confirmed by robust export growth. Possibly, this Raczko's reasoning is connected with the risk of breaking threshold levels of public debt in a case of further zloty depreciation (an increase of foreign debt denominated in local currency).

Surely stabilisation of market sentiment was not aided by FinMin's official comment about high budget execution after three-quarters of this year. Head of the ministry's budget department Elżbieta Suchocka-Roguska announced that budget deficit might reach as much as 85-90% of the annual plan after September. Such figure, if confirmed, would be indeed negative news about budget condition, as it would mean a very sharp increase in the deficit from August's level of 76.4% (the gap would increase PLN4-5bn in one month!). However, fortunately, the Suchocka-Roguska's hints are sometimes inaccurate, especially those given before the end of a given month – in August her early predictions were overestimated by nearly 10 pct. points. Second – even though average realisation of budget deficit in the last couple of years was lower than the range mentioned above (and was close to 80%), it happened several times that budget deficit hit 90% of the full annual figure already after nine months (not only in very bad 2000, but also in 1999). It does not necessarily mean troubles with realisation of the budget act, because budget expenditures can be cut or postponed to some extent if necessary, which allows breaching targeted deficit in case of revenue shortage not higher than several billion zloty. We maintain our view that there will be no budget amendment this year, as the Ministry of Finance seems to be keeping its grip tight on the expenditures, which are being reduced and adjusted to the revenue side. Of course to some extent it means more difficult situation of 2004 budget (because part of spending is probably postponed until the next year).

WHO, WHEN, WHERE	COMMENT
Leszek Miller, Prime Minister; Reuters, 30 Sep	Only economists, who used to be wrong, are talking about a crisis. They have received next year budget with a hysteria. If we are talking about the MPC, fortunately its term of office is coming to an end and the Council's shape will completely change next year. In the current shape, fundamentalists have a dominant position and their policy resulted in many bad things for the Polish economy.
PAP, Reuters, 28 Sep	In our opinion increase in budget deficit [in 2004] is a necessity in this case. Without it we could neither support entrepreneurship by lowering taxes nor assure full absorption of EU aid funds. We have also began works over rationalisation of public spending, as it is the best to do it during period of the economic expansion. Therefore, there is no concern that we will experience public finance crisis in the coming years. Along with budget draft we approve the medium term strategy of fiscal policy, which shows the path of budget deficit reduction and shows how to avoid increase of public debt above limits binding according to Polish law. The Argentinean crisis is only in analysts' heads. I would like to take an opportunity and say to the market that there is no such danger. It has been several times in the past that due to different reasons revenues [to the budget] were volatile. (...) I encourage to ask finance minister about these issues, not his representatives, as we experienced many misunderstandings and distortions many times.
PAP, 27 Sep	There is no concern that we will have public finance crisis in the coming years.
PAP, Reuters, 7 Sep	On Tuesday, we will hold the first round of talks on the budget project, with a deficit of PLN45.5bn. I do not think it could have any impact on Poland's rating. The markets are interested mainly in the budget deficit level and there are no changes here. The earlier proposed deficit had been confirmed. Financial markets should pay attention to the increase of the GDP. It is a big hope that this year we will top 3% and next year we will reach 5% growth rate.
PR1, 4 Sep	We strive after next year's economic growth at 5%. […] We would like to meet a formula of 6% and 7% [GDP growth] in following years [2005-06]. This solution [lowering the PIT for companies to 19%] has a negative consequence from a point of view of the central budget that results in a gap in revenues of PLN2.2bn but in the agreement reached between trade unions and employers certain solution was found giving more than PLN1bn. […] However, PLN800m remains to be found and on yesterday's government's meeting the problem was solved. […] In a draft that will be presented to the Council of Ministers on Tuesday the gap will be offset entirely. It cannot be excluded that if economy reaches higher and higher level of the growth and we reach 5% GDP [growth] a room for lowering taxes for all citizens will appear. It depends on it if we will succeed in overwhelming stagnation. It seems that we have succeeded, already.
Jerzy Hausner, deputy PM, economy and labour minister; Reuters, PAP, 30 Sep	Reasons [of zloty weakening] are not connected with real processes, as production and GDP are rising, inflation is low and unemployment increase was stopped. One of the reasons of the situation is the high level of political destabilisation. […] I have an impression that there is an impression that the government cannot deal with problems. This psychosis is reflected on the financial market, which increase the level of political risk. I think the minority government is a reason and the fact that government has to find political support of small parties. Everything, which was promised, will be realised. If someone says that the government does not take any actions, this criticism is not justified. That the mandatory reserve rate has been lowered is a positive information but I thought that the cut would be deeper. Our talks with the central bank indicated that a reduction of the rates or the mandatory rate would be favourable to the economy. I though that the reduction will be around 2 percentage points but a 1 point cut is good to the economy.

PAP, 29 Sep	From the point of view of the debt to GDP ratio, the weakening of the zloty is unfavourable if it is a permanent trend. […] For a couple of weeks we have had to do with turmoil linked most of all with various comments, of a presidential aide, an MPC member or an analyst. Up to day we have interpreted it in this way that there is lack of confidence but there may be a deeper explanation here. It has to be thoroughly analysed. There is a reason to reflect on it, maybe for some worries but no for panic. A further depreciation of the zloty would be undoubtedly unfavourable. The question is what the government can do to stop it. To answer the question the finance ministry has to submit to the government a report analysing the situation. If someone is talking about 60% of the GDP I do not disdain that, but let's remember that if we used accounting patterns accepted by the EU, that we will maybe adopt next year, our debt would be much lower. 60% of the GDP is a limit, but we are farther from it than it is generally assessed.
PAP, 26 Sep	In September last year the number of unemployed grew by 7,000. In mid-September this year we have fall of 5,000. Because the second part of the month is usually more favourable due to procedural reasons, I presume that the registered number of unemployed will fall by around 10,000 at the end of September. Optimists say even about 17.5% [the level of the unemployment rate at the end of this year] if the unemployment will decrease also in October and in November and December will not rise as sharply as last year. I do not know what will happen and I do not want to speculate.
PAP, Reuters, 24 Sep	The government approved a financial strategy that foresees high economic growth but also a need to reduce expenditures, rather than to increase tax burdens. Room for manoeuvre is on the side of cutting expenditures. PLN7bn in 2005, 6bn in 2006 and 5bn in 2007. This is the scale of necessary reductions to stay at a safe macroeconomic path. There are no moves on the side of revenues. The program of limiting public expenditures in the sphere of social transfers and putting them in order is the most important. These are disability pensions, retirement age, pre-pension benefits, valorisation and indexation of social benefits and social insurance for farmers. […] We want to submit proposed solutions for a general national debate […] and we would like it to be accepted by the 2005 budget. I believe there will be gradual [zloty] appreciation, and there is a need to conduct the monetary and economic policy in such a way so as to cause gradual appreciation, without intervention and regulation. The economic situation is stable and main threat is on financial markets, caused by high budget deficit and public debt, which translates into FX rate hike, and that means a depreciation of the zloty, higher costs of debt servicing and government paper yields. In October or November we intend to conclude an agreement with the NBP, the MPC and the Union of Polish Banks on mandatory reserves, target reserves and safety norms, that will open bank credit granting potential to entrepreneurs.
PR1, 24 Sep	At present path of development, even with high economic growth – I mean some 5% GDP growth that is expected by us already in 2004 and that we want to be maintained in successive years – so or so we will face a problem that public debt will be increasing and at certain moment – maybe already in 2005 and probably in 2006 – it will exceed the third threshold from our Constitution. This threshold is 60% of GDP. I underline, by the way, that the economic growth is very important, because in this case the GDP, i.e. denominator is higher and we can afford for more in numerator, however the economic growth is not enough. We must also limit spending.
PAP, 23 Sep	We want markets to be stable, to understand our policy. At the moment, our deficit is at its maximum level but I still believe that it is safe. The European Union and the tax cut can be the explanation. Apart from higher spending on the armed forces and the EU, no expenditures are raised. It is not the budget of giveaway benefits. […] Investors' confidence in Poland is not high. I want it to be higher but I do not see it as tragedy. The recurring turmoil on the market, can be explained with some general processes, of a global reversal from treasury papers for the benefit of shares.
Gazeta Wyborcza, 22 Sep	The financial markets will be merciless for the government and will respond in two ways: selling the zloty and bonds. […] We must accept a plan of rationalisation and reduction of public expenditures. […] Even economic growth at 5% will not preserve us from a rise in public debt to GDP relation. In 2005 a threat can appear that the public debt will exceed 60% of the GDP and therefore radical cuts must be taken up. We must cut the deficit by almost PLN7bn. It is difficult but necessary in order to avoid a collapse.
Reuters, PAP, 17 Sep	We assume that GDP growth will amount to 5.0% in 2004 and 2005 and 5.6% in 2006 and 2007. […] This is not excessively optimistic economic growth rate. I believe we will reach the higher growth but this the forecast from the Finance Ministry and the finance minister must be cautious. Since GDP growth rate amounted to 2.2% in 1Q this year then in 2Q it must have been roughly at 3.8%. In the medium-term strategy we assume budget deficit in 2005 at PLN38.8bn, in 2006 at PLN33bn and in 2007 at PLN28bn […] This is a safe path, which may be done. It guarantees that while we will break the second public debt threshold, we will not break the third one. […]This will allow Poland to meet Maastricht criteria in 2007. A decision about joining the euro zone will be taken by another government. [...] What this government has to do is presenting proposals, which would allow such decision.
PAP, 11 Sep	We will aim for public debt not to be higher than 55% of the GDP.
PAP, Reuters, 9 Sep	Next year's budget deficit is high but remains safe for financing. […] Formally there still is a room to take up such actions [lowering the deficit]. It is not very likely but one should not give up. We were looking in limiting spending and decreasing a subsidy to the Labour Fund. We want to impel an entrepreneurship in order to reach recovery of investment. The Labour Fund will need less money in case of economic recovery. The decision is based on theory of probability. We want to revive an entrepreneurship and strengthen upward trend in the economy. The faster investment rises the faster number of jobs increases. August's unemployment rate fell to 17.6% from 17.8% in July. We have not had such situation for many years for unemployment to be falling for six consecutive months. […] The [2003] budget law projected unemployment at 17.8-18.3% and I believe we should be closer to the lower than upper limit of this forecast. […] The labour minister's goal is for unemployment to be below 17%. […] There will be no new jobs without a revival in investment.
PAP, Reuters, 5 Sep	The current zloty exchange rate level is a balanced level. It is the level, which is favourable for exporters and safe for the budget. Temporary weakening of the zloty took place within a couple of previous quarters while there are no changes in recent weeks. The natural tendency is that along with approaching the EU entry date there would be appreciation pressure and it would worsen situation of exporters and competitiveness of our production at the moment of EU accession. The government is not interested in fulfilling this forecast. On the other hand, the government is not interested in weakening of the zloty. This is a good level of the exchange rate, requiring but realistic, because weakening of the exchange rate would mean significant rise in public debt servicing costs. This exchange rate is a good rate and despite the government cannot do much to influence the rate, it can do what should do, i.e. do not make mistakes in the economic policy. If there were any rating downgrades to come, that could weaken the zloty, but not necessarily. Then the government would have to take action to bolster the zloty, if we were to assess that the new levels were threatening. Immediately. We are not interested in devaluating the zloty.

PAP, 4 Sep	Chances for the lowering the deficit by PLN2-3bn next year are faint. I would like it, but it is not only my decision. A few days before accepting budget draft I believe it is possible to a certain extent, but less and less probable. The central budget is able to bear a part of the expenses of these operations [lowering banks' reserves for non-performing loans]. We want to sign the agreement within 2-3 weeks.
Andrzej Raczko, finance minister; PAP, 30 Sep	I think it is premature to link the budget with zloty moves. The assumptions of the budget were already known in July, the budget deficit in August and the outline of the whole law on September 9; in brief, the shape of the budget has been known for a couple of weeks. Linking that with what is going on with the zloty is a far-reaching simplification, you have to point out that financial markets are unstable, which translates into the emerging markets. In the program of expenditure rationalisation we wrote changes that go towards lowering the budget deficit.
PAP, 23 Sep	Why should it [5Y bond auction] not be a warning for the markets that the Finance Ministry can reject the offer if yields are unacceptable. Some money from foreign issues have flown in recently.
Reuters, 18 Sep	In our medium-term strategy it is clearly stated that this government sees the need for significant budget deficit cuts beyond 2004. […] This lowering of the deficit must not hurt economic growth, which means we do not want to increase the tax burden. So this tightening may be done by cuts in budget expenditures […] eliminating spending which is least effective and rational. […] Rationalising spending means a systematic and planned reduction of state expenditures, which will not be carried out as blind cuts but large-scale cuts in ineffective outlays. Everyone – the central bank and our ministry – declares that we want to enter the Eurozone as quickly as possible because it would be beneficial for our economy. Looking at our economic fundamentals we can say that an exchange rate which does not slow export dynamics is proper. It's clear the exchange rate which we now have is adequate for the economy, as it is accompanied by fast exports. [we rejected all offers for bonds] Simply because yields were not satisfactory. However, I don't believe that the expectations of the market and the ministry are diverging. This is a sort of search for a market consensus between the buyer and the seller. […] It's not a question of how long we can wait [and reject offers], because we can say for quite a long time. It is a question of proper co-operation with the market. If there are changes to the scale and frequency of nominal interest rate cuts, then it must be reflected in our debt yields. We see that market expectations for future rate cuts are simply smaller than before.
PAP, 16 Sep	[medium-term strategy] this is very short document. For us, the key factors are GDP growth acceleration, EU funds absorption and to create a perspective to join the Eurozone. This programme is very important – GDP growth first, but not with cost of economy destabilisation. We have adopted three scenarios based on different GDP growth path. [...] All scenarios show a required level of public deficit and public debt. [...] budget deficit is reduced in all three scenarios. I am very cautious in my statements. We are facing a very difficult year in 2004. I will return to a very serious discussion on the date [of Eurozone accession] at the end of 2004 when we will know at what stage of development and reform of the public sector we are.
PAP, 11 Sep	It is hard to say whether the public debt will exceed the threshold level of 55% of GDP in 2004 because debts are growing considerably. The level of foreign debt will differ depending on the euro and dollar rates. The other factor determining the level figure will be a nominal value of GDP. […] If we assume a possibility of a dramatic devaluation of the Polish currency, then such a real threat exists. I would like Poland to join the EMU as quickly as possible but to give a fair answer I would like to know how the economy adapts to a EU scenario in 2004. The medium-term strategy for public finance will be a document showing likely paths of economic growth, more and less optimistic. Given this background it will show what public debt and deficits could be in successive three years 2004-2006. […] Additionally, in the document we will consider what could be a maximum deficit with which we would remain on the path allowing not to exceed 60% of GDP threshold. What should be a maximum level of the deficit in successive years so that in 2006 forecasted economic growth would allow to decrease the relation of public debt to the GDP in natural way. Nominal interest rates on the Polish papers are higher than on foreign papers. The risk premium is added […]. It amounts to 60-70 bps. This means that when subtracted the risk premium from interest rate at some 5% we still have nominal rates much higher than on foreign papers. The remaining question is the FX risk. […] Assuming that the rate of the zloty does not fluctuate considerably and there is no rapid devaluation, there are reasons for investors to be satisfied from profits from Polish bonds. We have no detailed plan of next year treasuries' issuance, because we are in the middle of preparing the public debt strategy. It would be positive if we could repay a part of foreign debt, which is the most costly. Discussion with NBP on this issue s continued. If there would be a favourable solution, we will do it. The foreign exchange rate is shaped by the market. The NBP has stated that the foreign exchange regime is a floating rate, and declared that is does not intend to intervene on the FX market. The FinMin does not make any interventions on the FX market much less. If the ministry buys hard currencies at the central bank, these transactions are conducted under mutual terms […], that is we by no means intend to influence the forex rate on the market, it is shaped as the market likes. Ahead of the entry to the EU the rate will fluctuate and the appreciation trend will prevail over depreciation. The are no threats for execution of this year's budget. Tax system changes are prepared when the budget is constructed. We will try to prepare tax strategy, which will show a direction of changes in that respect. I think the preliminary shape of this strategy should be ready in October. Main changes will lead to differentiation between taxation of firms and taxation of households. What is more, we will have to deal with taxation of farmers. Estimating tax revenues in 2004 is connected with high risk, because there are some one-off elements.
PAP, 10 Sep	Monetary policy was not a growth-supporting policy but it was directed on inflation target. We have overcome the problem of inflation and tightening monetary policy, inflation should be stabilised now. If such way of thinking is adopted, one can say that the adjusting of a fiscal instrument to a neutral bias of monetary policy should result in economic growth.
PAP, TVP1, 9 Sep	When constructing the budget economic situation is particularly important. Economic growth at 3.2% is certain, and a 3.5% growth within grasp. We see it clearly there is no threat of inflation rebound. Average annual inflation will amount to 0.7-0.8% in 2003. All gives faith that the assumptions can be realised and 5% GDP growth is achievable. This budget will be a budget of keeping and accelerating growth, of entering to the EU. It will be an adjustment in central and local finances. We have to take into account additional elements of active management of public debt and that is why the deficit does not directly translate into this supply [gross supply of treasuries]. We can accelerate the economic growth acting on tax side. First step is lowering CIT rate to 19%. Second is

	implementing an option for entrepreneurs, who pay personal tax, consisting in uniform tax rate at 19%. These changes result on revenue side and we have offset them on spending side. We do not refuse public finance reform. We have accepted budget draft, afterwards we will prepare medium-term strategy. The third element is constructed by Mr. Hausner and will consist in rationalising expenditures.
Halina Wasilewska-Trenkner, deputy finance minister; PAP, 12 Sep PAP, 9 Sep	The share of fixed spending in the next year budget will be lower by some PLN4bn as compared with 2003. This is connected with new rules of financing spending of local governments entities as well as with a lack of some spending indexation. [...] We estimate revenues lower by PLN2.2bn as a result of flat tax rate for enterprises [of 19%]. It is partly offset by flat tax-free income level. In next year's budget funs for pre-financing and co-financing amount to some PLN8bn. In 2004, domestic debt servicing costs will be at PLN21.044bn and foreign debt servicing costs at PLN5.94bn.
Ryszard Michalski, deputy finance minister; PAP, Reuters, 16 Sep	Budget deficit is planned to amount to 2.6% of GDP in 2007. This path was presented in the Pre-accession Economic Programme and it is realistic, in my opinion. I hope we will never exceed 60% of GDP level of public debt, as measured with ESA95. Today it is at 47% and I do not think we will exceed 55 even in the most pessimistic scenario. This Maastricht criterion will be met for long time ,possibly forever. The Finance Ministry, in its medium-term fiscal strategy, proposes a path for curbing the budget deficit from 5.3 % of GDP in 2004 to 2.6% in 2007. Eurozone accession will be possible in 2008 with the help of political decisions by the EU and the ECB.
Elżbieta Suchocka-Roguska, head of budget dept. in FinMin; PAP, 26 Sep	Budget deficit after September may near 90% of the whole year plan. I estimate initially that it will reach 85-90%. One should not be afraid of budget performance after September, as the government will make a decision to adjust [cut] spending side of the budget to lower revenues.
Arkadiusz Kamiński, head of debt dept. in FinMin; PAP, 9 Sep	A timetable of next year's issue will be probably announced in October or November following our talks with treasury market dealers. […] For the time being we have defined a global amount of financial needs and afterwards we will try to adjust the timetable to it. It will probably coincide with dates and bond types that have been this week.
Jacek Krzyślak, head of FinMin's research dept.; PAP, 26 Sep	We estimate September prices to rise 0.5 percent against August which will translate into an annual inflation rate at 0.9-1.0 percent in September. Higher than expected growth in food prices was a result of increase in prices of vegetables and citrus fruits. However, this usually happens in September.
Ludwik Kotecki, deputy head of research dept. in FinMin; Reuters, 16 Sep Reuters, 4 Sep	We are counting on economic growth to accelerate due to continued export growth and increased investments. It seems that already in 2Q03 data recovery in consumption demand will be observed. We forecast an economic growth at 4.2% in 3Q03 and 4.1-4.2% in 4Q. Given July's data on the output we estimate that GDP growth amounted to 3.6% in 2Q03. […] We think that GDP increased by 2.9-3.0% in the whole first year-half.
Jarosław Neneman, finance minister's advisor; PAP, 3 Sep	Effective tax rate in the lowest income bracket amounts to around 13%, i.e. much smaller than proposed 19%. In the second bracket effective tax rate stands at 17%, so these taxpayers may also lose. The only group, which will benefit, are taxpayers from the highest income bracket as effective tax rate for them is at around 30%.
Anonymous FinMin's representative; Reuters, 25 Sep	If we marginally miss out on keeping public debt below 55% in 2004, then we will effectively paralyse public finances two years later. A one-pp. difference in the EURPLN rate could determine if the threshold is breached in 2004, which would have fatal consequences.
Wojciech Olejniczak, agriculture minister; Reuters, 3 Sep	There are PLN2.3-2.4bn guaranteed for the subsidies, thanks to which Polish farmers will be able to get 55%. […] There will also have to be money in the budget for pre-financing of the subsidies, which is some PLN3.7bn. But it is up to the finance ministry to decide how to get and how to book those funds.
Witold Orłowski, chief President's economic advisor; PAP, 11 Sep Reuters, 5 Sep PAP, 5 Sep	I am waiting for a strategy, since the budget – like in previous years – goes towards worse and worse budget with larger deficit. Medium term-strategy can be a hint that something will change starting from next year. […] The strategy should contain a path of deficit reduction, information on the ways of deficit financing, particularly on privatisation. Most probably the new MPC will seek to adopt a managed float quickly after starting its new term. This probable policy switch will be accompanied by the start of market interventions aimed at keeping the zloty from strengthening. Such changes of course need government approval, but this government is nearly certain to want to change the currency regime. I don't expect to be too much tinkering with setting the parity rate, which should be near market levels, but everything depends on the makeup of the new MPC. I believe that we could lower interest rates without inflationary risk at present, within the nearest months. Monetary easing is not necessary for starting up revival as business climate improves at present. If one may cut rates without any risk then one can do that. I think the reduction could total 25-50 bps. The [budget] deficit [at PLN45.5bn] is too high but it is not the deficit that could lead to collapse of the zloty.

Market monitor

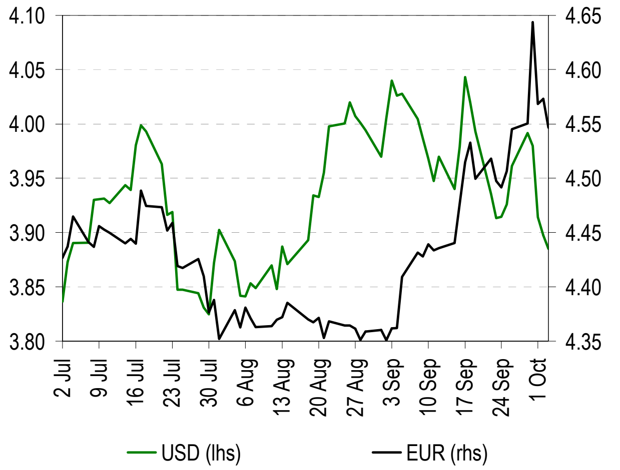
- **Zloty has seen its historical low against euro**
- **Higher risk premium on bond market**

The zloty slumps amid the fiscal uncertainty

After the lazy summer holiday months September was a month of much more significant turmoil on the FX market. The market was particularly turbulent in the second half of the month due to the increased uncertainty related to the fiscal policy. Zloty slumped over 3.5% against the basket over a month. The situation globally – i.e. a fast surge of €/$ rate – resulted in the substantial depreciation of PLN (almost 7%) against euro and the marginal appreciation against dollar.

In September, according to NBP's fixing rates the dollar ranged from PLN3.9135 (23 Sep) to PLN4.0431 (17 Sep) with the average rate of PLN3.9792 (against PLN3.9186 in August). The euro ranged from PLN4.3508 (2 Sep) to PLN 4.6435 (30 Sep) with the average of PLN4.4649 (PLN4.3665 in August). Looking back at our projections from the previous MACROscope (4.05 and 4.45, respectively) a noticeable difference was observed in the case of the dollar which resulted primarily from the larger depreciation of the US currency on the international market than expected.

Zloty FX rate in recent 3 months

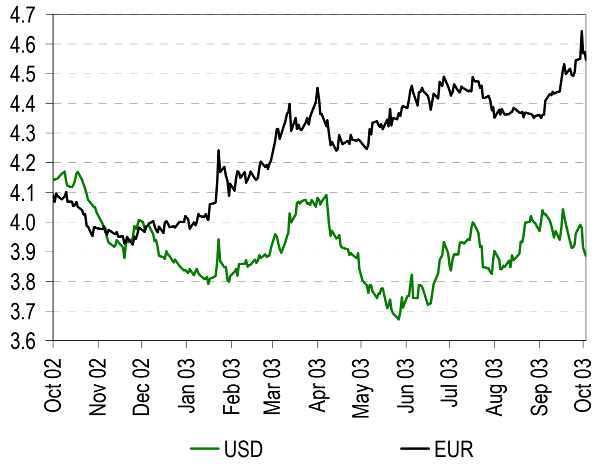


Source: NBP

A temporary but deep depreciation of the zloty was seen already in the first week of September in response to rumours on possible downgrade of Poland's rating and politicians' comments on waiving a floating FX regime. Soon afterwards the draft budget was presented, which did not have any impact on prices. The market became nervous in the middle of the month as despite its previous announcements the government did not present its fiscal strategy. After two days of selling the zloty recorded its three-year historical low. Over the next couple of days losses were partially recovered amid the information on maintaining the stable rating outlook and strong GDP data.

The last days of September were very nervous. The lack of information on the future fiscal policy was accompanied by concerns related to the performance against the 2003 budget after the statement from the MF representative. This resulted in further substantial depreciation of the zloty against the dollar-euro basket down to the weakest rate since May 2000. At the same time €/$ rate saw a robust surge which brought about the historical euro rate at 4.65.

Zloty FX rate in recent 12 months



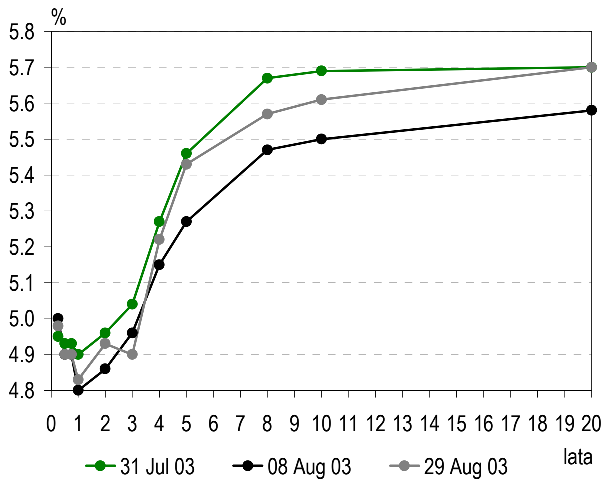
Source: NBP

Early October the market tranquillised and the trend reversed for a while. Investors were buying record cheap zloty that was supported by statements from the NBP head after the MPC meeting.

.... the same applies to the T-bond market

In September, negative sentiments dominated in the treasuries' market as well. As at the month-start, yields at the longer end of the curve increased due to speculations related to the downgrade in Poland's rating. As a result, a risk premium for the Polish bonds (the difference between the expected 5Y interest rate in Poland and Europe in five years time) rose by 20bp. By the month-end, the market was impacted by the fiscal news and the risk premium surged the further 10bp. The mere draft budget was not reflected in prices but estimates of financing needs weakened the longer end of the curve. The delayed publishing of the fiscal strategy had a similar effect. Besides, when the MinFin increased the supply of T-bills in the primary market in the second half of the month, the bond prices went down on the shorter end of the yield curve.

Yield curve

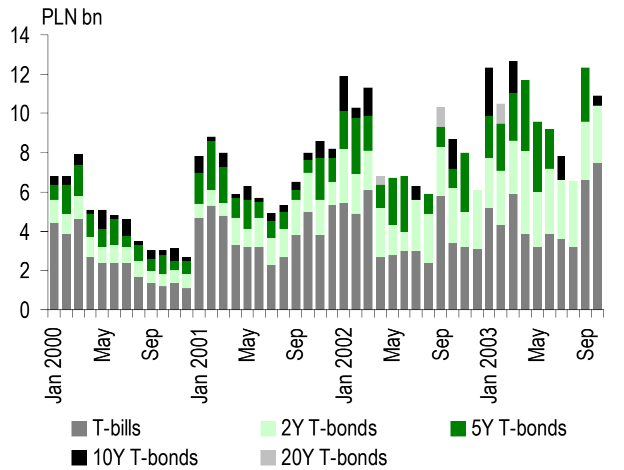


Source: BZ WBK

At the turn of September the market weakened as a result of decreasing expectations for the interest rate cut and after the MPC meeting it stabilised and started to strengthen after the US market.

On 17 September, a week after the cancelling the 20-year bond auction (described last month), the auction of 5-year papers was held but it was not a success of the ministry amid the fiscal uncertainty. No bonds were sold. Not only was the demand lower than supply but investors offered low prices as well and all their offers were rejected. On 1 October a 2-year benchmark tender was held. Given the unsuccessful bond auctions it turned out be rather successful. Many bonds were offered, a relatively high demand was recorded (PLN6.2bn) and the entire offer was sold. An average yield matched current market quotations and was 5.246% against 4.982% in September. A bond supplementary tender was not held a day after. However, the closely watched, additional T-bill auction was held and the entire offer was sold with the demand substantially higher than supply. Yields were higher than the current quotations but it should be noticed that this curve sector is not very liquid.

Supply of Treasuries



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

On 8 October a relatively low offer of 10-year bonds was met with a moderate demand (PLN950m). All the bonds were sold and the average yield was 5.968% against 5.169% recorded in the course of the previous auction of these papers in July and was higher than the current market level.

In the course of the first October auctions the MinFin did not have substantial problems with selling treasuries, although it should be pointed that supply was very low and the yields high.

Treasury bill auctions (PLN m)

	OFFER / SALE			
Date of auction	*13-week*	*26-week*	*52-week*	*Total*
01.09.2003	-	-	900 / 900	900 / 900
08.09.2003	400 / 400	-	800 / 800	1,200 / 1,200
15.09.2003	400 / 400	-	800 / 800	1,200 / 1,200
22.09.2003	-	200 / 200	900 / 1,094.2	1,100 / 1,294.2
29.09.2003	-	700 / 355.5	1,500 / 1,849.1	2,200 / 2,204.6
September total	**800 / 800**	**900 / 555.5**	**4,900 / 5,443.3**	**6,600 / 6,798.8**
Date of auction	*10-week*	*13-week*	*52-week*	*Total*
02.10.2003*	3,500 / 3,500	-	-	3,500 / 3,500
06.10.2003	-	100	900	1,000
13.10.2003	-	100	900	1,000
20.10.2003	-	-	1,000	1,000
27.10.2003	-	-	1,000	1,000
October total	**3,500 / 3,500**	**200**	**3,800**	**7,500**

Source: Finance Ministry * additional auction

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	2,700	0
October	01.10	OK0805	2,900	2,900	08.10	DS1013	500	500	15.10	5Y	800 - 1,800	-
November	05.11	OK0805	-	-	19.11	5Y	-	-	-	-	-	-
December	03.12	OK1205	-	-	-	-	-	-	-	-	-	-

Source: Finance Ministry * with supplementary auction

International review

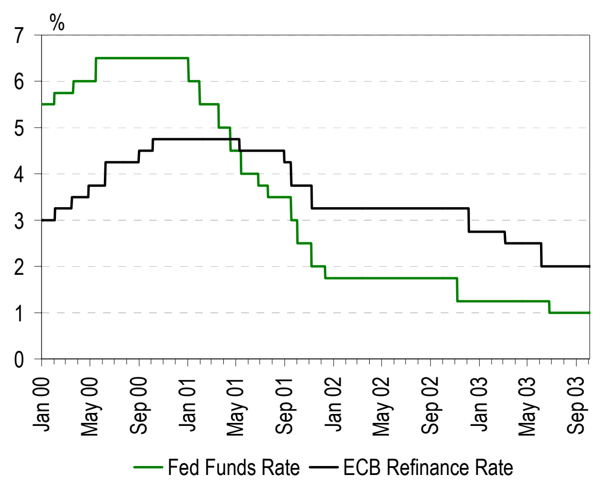
- **No changes in interest rates, will it be continued?**
- **Slight increase in inflation**
- **Expected recovery is closer in the Eurozone**

Interest rates still unchanged

In line with analysts' expectations, at the meeting on 2 October the Council of the European Central Bank did not change interest rates. The main Eurozone's rate – refinance rate – stands at 2.0%, after it was lowered by 50bps on 5 June. This is the lowest level since introducing the euro and the beginning of conducting monetary policy by the ECB. During the press conference, the ECB president Wim Duisenberg (it was his last meeting as the president) stated that the outlook for recovery in the European economy was positive and recent data were in line with the scenario of gradual revival in the second year-half. In his opinion, short-term threats for the economy are balanced. According to more and more market participants, the main Eurozone's interest rate would remain unchanged till the year-end.

At a meeting on 16 September Federal Open Market Committee left interest rates unchanged, in line with market expectations. Federal fund rate remained at 1.0%, the lowest level since 1958. In the statement Fed pointed at very weak performance of the labour market and assessed that the risk of very low inflation was a reason of worries concerning the future performance of the economy. They believe that the monetary policy and rising productivity are strong support for economic activity. Next meeting of the Federal Open Market Committee is planed for 28 October.

Interest rates in the USA and Eurozone



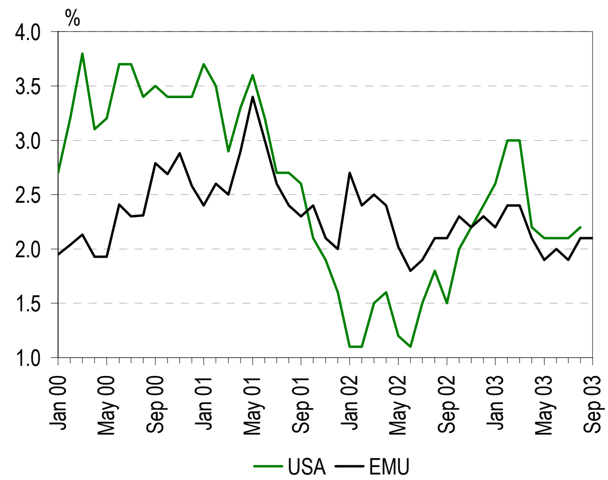
Source: Reuters

Eurozone consumer inflation rises to above 2%

According to final calculations, in August consumer prices in the Eurozone increased by 0.2%MoM. As a result annual inflation rate increased to 2.1% from 1.9% recorded in July, which exactly matched preliminary estimations and analysts' expectations. Moreover, according to preliminary estimations, inflation in the Eurozone reached 2.1%YoY in September, i.e. 0.1 pct. point higher than market consensus forecast. It was the second month in a row when Eurozone's inflation slightly exceeded 2% level, being the ceiling of ECB's inflation target. In August data on producer prices exactly matched analysts' forecasts. The prices increased by 0.2%MoM and annual growth rate amounted to 1.4%, the same as in July.

Eurozone's M3 money supply growth rate amounted to 8.2%YoY in August decelerating from 8.6% recorded in July and revised from 8.5%. Meanwhile analysts expected a slowdown in a rate of M3 growth to 8.3%.

Consumer inflation YoY



Source: Reuters

Data from the US on inflation roughly matched analysts' forecasts. In August consumer prices increased by 0.3%MoM, while 0.4% was expected. The figure translated into a rise in annual rate to 2.2% from 2.1% recorded in July. Annual core inflation rate fell to 1.3%, which is the lowest level since 1966. Figures of producer prices roughly matched market forecasts. In August the prices increased by 0.4%MoM, while expectations stood at 0.3%. Annual rate of producer inflation recorded acceleration to 3.4% in August from 3.0% in July.

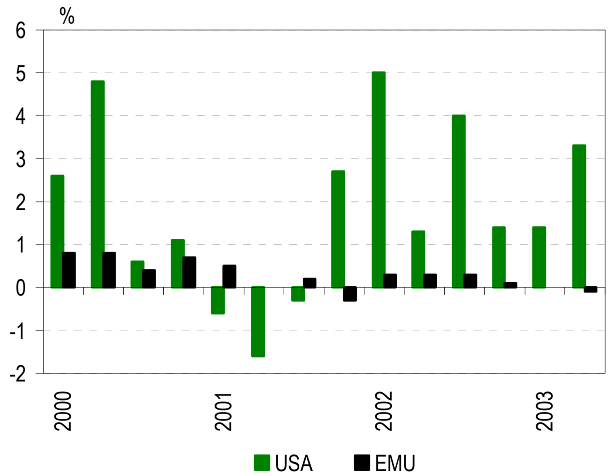
In the US the growth revised upward

According to final data on economic growth in the United States, in the second quarter this year the GDP increased by 3.3%QoQ compared to 1.4% recorded in the first quarter. It was slightly faster rate than the one released a month ago in preliminary information, when the growth was estimated at 3.1%. The revised data were also stronger than analysts' forecasts as they expected confirmation of preliminary estimations.

Data from the United States on industrial production were quite close to expectations. In August the output rose by 0.1%MoM, while 0.2% was forecasted. July's figure was revised upward to 0.7% from 0.5% released previously. On the contrary, retail sales recorded a weaker than expected growth. In August the sales increased by 0.6%MoM, compared to expectations at 1.4%, while in July it rose by 1.3% (revised from 1.4%). The main reason of such a weak figure was a fall in sales of clothes.

The unemployment rate decreased to 6.1% in September from 6.2% recorded in August, while stable rate was expected. It was the third consecutive fall in the rate. What's more, for the first time in eight months the number of jobs in economy increased. In September it rose by 57,000, while analysts expected a fall of 30.000.

GDP growth QoQ



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

… and no changes in the Eurozone – still in red

Data on Eurozone's economic growth in the second quarter this year were confirmed in the second release. According to latest estimates, Eurozone's GDP decreased by 0.1%QoQ and recorded a rise of 0.2%YoY in this period. The data exactly matched analysts' expectations. Moreover, the European Commission confirmed growth forecasts for 3Q03 and 4Q03 at the level of 0.0-0.4%QoQ and 0.2-0.6%QoQ, respectively.

According to bi-annual economic report prepared by the European Commission, Eurozone is going to experience an acceleration of GDP growth in the second half of 2003 and there are clear signs this would be the beginning of a new trend, even despite strong euro, which might constraint export growth. According to the Commission, both monetary and fiscal policies are supporting economic revival, which is going to unveil in the coming quarters.

Better climate indicators in Europe

Major business climate indicator for the German economy – index of entrepreneurs' sentiment IFO – recorded a fifth consecutive rise, reaching 91.9 pts in September versus 90.8 pts in August, while forecasts pointed to the increase to 92.0 pts. Head of the IFO institute stated that the assessment of present situation is like a year ago but expectations for future improved significantly.

In September economic activity in the Eurozone's industry was rising for the first month since February this year while analysts expected slower pace of a decline. Reuters PMI index increased to 50.1 pts from 49.1 pts in August, while 49.7 pts was forecasted, so it exceeded the level of 50 pts, i.e. a limit between improvement and deterioration in activity. Meanwhile, in the United States economic activity in the industry recorded a slow down in activity while analysts expected slight acceleration. The ISM index reached 53.7 pts in September against 54.7 pts in August and 55.0 pts forecasted.

… but actual data do not point to recovery

Data on industrial output were weaker than forecasted. In July production increased by 0.6%MoM and annual growth rate amounted to -0.3%, compared to -1.6% recorded in June. Forecasts stood at 0.9% and -0.5%, respectively. Eurozone's retail sales figures were slightly stronger than market expectations. In July, the sales increased by 0.1%MoM and remained unchanged on annual basis, compared to forecasts at -0.2% and 0.1%, respectively.

The unemployment rate amounted to 8.8% in August, unchanged from revised July's data. Analysts expected the rate to remain at 8.9% released previously for July.

What's hot this month

Monday	Tuesday	Wednesday	Thursday	Friday
29 September POL: MPC meeting (1st day) POL: T-bill auction *ITA: Inflation preliminary (Sep)*	**30** POL: MPC meeting (decision) POL: Balance of payment (Aug) *FRA: GDP (2Q)* *EMU: Inflation preliminary (Sep)* *EMU: Economic sentiment; Business climate (Aug & Sep)*	**1 October** POL: T-bond auction OK0805 *EMU: PMI (Sep)* *EMU: Unemployment (Aug)* *USA: ISM (Sep)*	**2** POL: Additional T-bill auction *EMU: ECB meeting* *EMU: Producer prices (Aug)* *USA: Factory orders (Aug)*	**3** *USA: Unemployment (Sep)*
6 POL: T-bill auction *EMU: Retail sales (Jul)*	**7** POL: Food prices (2H Sep)	**8** POL: T-bond auction DS1013	**9** *GER: Unemployment (Sep)* *GER: Industrial output (Aug)* *EMU: GDP (2Q)*	**10** *FRA: Inflation preliminary (Sep* *FRA: Industrial output (Aug))* *USA: Producer prices (Sep)* *USA: Foreign trade (Aug)*
13 POL: T-bill auction *ITA: Industrial output (Aug)*	**14** POL: Inflation (Sep) POL: Money supply (Sep) POL: Wages & employment (Sep) *ITA: Inflation final (Sep)*	**15** POL: T-bond auction PS0608 *USA: Retail sales (Sep)*	**16** *EMU: Inflation final (Sep)* *USA: Inflation (Sep)* *USA: Industrial output (Sep)*	**17** POL: Industrial output (Sep) POL: Producer prices (Sep) *EMU: Industrial output (Aug)*
20 POL: T-bill auction *EMU: Foreign trade (Aug)*	**21** POL: Retail sales (Sep) POL: Unemployment (Sep)	**22** POL: Core inflation (Sep) POL: Business climate (Oct)	**23**	**24** *EMU: Balance of payment (Aug)*
27 POL: Food prices (1H Oct) POL: T-bill auction	**28** POL: MPC meeting (1st day) *GER: IFO (Oct)* *EMU: Money supply (Sep)* *USA: Fed meeting*	**29** POL: MPC meeting (decision)	**30** *ITA: Inflation preliminary (Oct)*	**31** POL: Balance of payment (Sep) *EMU: Inflation preliminary (Oct)* *EMU: Economic sentiment; Business climate (Oct)*
3 November POL: T-bill auction *EMU: PMI (Oct)* *USA: ISM (Oct)*	**4** *EMU: Producer prices (Sep)* *EMU: Unemployment (Sep)*	**5** POL: T-bond auction OK0805 *EMU: Retail sales (Aug)*	**6** *EMU: ECB meeting* *EMU: GDP (2Q)*	**7** POL: Food prices (2H Oct)

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	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

		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	Oct 03
Industrial production	%YoY	6.6	3.2	3.1	5.2	3.3	4.3	5.5	8.5	11.7	7.9	10.3	5.8	12.9	9.2
Retail sales ***	%YoY	4.7	5.1	5.9	4.9	4.1	4.2	-1.7	11.0	9.7	8.1	5.4	5.5	5.4	5.1
Unemployment rate	%	17.6	17.5	17.8	18.1	18.7	18.8	18.7	18.4	17.9	17.8	17.7	17.6	17.5	17.4
Gross wages ** ***	%YoY	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	2.0
Export (acc. to NBP)	EURm	2.912	3.182	3.004	3.223	2.761	2.635	2.957	2.969	3.015	3.018	3.282	2.875	3.040	3.300
Import (acc. to NBP)	EURm	3.826	4.241	4.090	4.166	3.895	3.219	3.467	3.833	3.696	3.512	4.107	3.603	3.900	4.250
Trade balance (acc.to NBP)	EURm	-914	-1.059	-1.086	-943	-1.134	-584	-510	-864	-681	-494	-825	-728	-860	-950
Current account balance	EURm	-529	-580	-753	-484	-711	-483	-248	-460	-411	-100	-239	-188	-430	-620
Budget deficit (cumulative)	PLNbn	-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	-34.9
Budget deficit (cumulative)	% annual plan	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	90.0
CPI	%YoY	1.3	1.1	0.9	0.8	0.5	0.5	0.6	0.3	0.4	0.8	0.8	0.7	0.9	1.0
PPI	%YoY	1.1	1.7	1.7	2.2	2.5	2.9	3.6	2.9	2.0	2.0	1.9	1.9	1.8	1.8
Broad money (M3)	%YoY	-1.5	-2.5	-1.0	-2.0	-1.4	-1.2	0.5	0.8	0.3	1.3	0.7	1.7	2.5	2.0
Deposits	%YoY	-3.5	-4.6	-3.2	-4.2	-4.1	-3.8	-2.3	-2.3	-2.9	-1.9	-2.5	-1.7	-1.2	-1.7
Credits	%YoY	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	6.2
USD/PLN	PLN	4.15	4.12	3.95	3.91	3.84	3.87	4.01	3.96	3.74	3.80	3.90	3.92	3.98	3.91
EUR/PLN	PLN	4.07	4.04	3.96	3.99	4.08	4.17	4.33	4.30	4.33	4.44	4.44	4.37	4.46	4.50
Reference rate *	%	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	5.00
WIBOR 3M	%	8.07	7.45	6.81	6.82	6.56	6.37	6.17	5.90	5.53	5.38	5.26	5.16	5.17	5.15
Lombard rate *	%	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	6.50
Yield on 52-week T-bills	%	7.25	6.77	5.88	5.78	5.74	5.83	5.67	5.43	4.75	4.66	4.85	4.82	4.93	5.05
Yield on 2-year T-bonds	%	7.16	6.62	5.78	5.75	5.55	5.66	5.52	5.16	4.78	4.79	4.89	4.86	5.02	5.20
Yield on 5-year T-bonds	%	7.07	6.57	5.91	5.67	5.57	5.58	5.36	5.15	4.88	4.90	5.17	5.38	5.60	5.60
Yield on 10-year T-bonds	%	6.79	6.22	5.89	5.69	5.62	5.67	5.52	5.41	5.13	5.03	5.37	5.60	5.94	6.00

Source: CSO, NBP, BZ WBK

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

Quarterly and annual economic indicators

		2001	2002	2003	2004	1Q02	2Q02	3Q02	4Q02	1Q03	2Q03	3Q03	4Q03
GDP	PLNbn	750.8	772.2	805.9	865.4	178.6	189.5	191.2	213.0	184.5	198.2	200.1	223.1
GDP	%YoY	1.0	1.4	3.5	4.5	0.5	0.9	1.8	2.2	2.2	3.8	3.7	4.2
Total consumption	%YoY	1.8	2.9	2.3	2.8	2.8	2.6	2.8	3.2	1.0	2.9	2.6	2.7
- Private consumption	%YoY	2.1	3.3	2.8	3.2	3.5	2.9	3.1	3.5	1.4	3.9	3.0	3.0
Fixed investments	%YoY	-10.2	-6.7	1.4	9.9	-12.8	-7.9	-5.9	-3.6	-3.6	-1.7	2.0	5.0
Industrial production	%YoY	0.6	1.5	8.5	5.5	-1.6	-0.4	3.3	4.6	4.4	9.1	9.6	11.1
Retail sales (real terms)	%YoY	0.2	3.3	5.4	5.0	5.8	0.7	3.9	2.6	1.2	9.8	5.4	5.0
Unemployment rate *	%	17.5	18.1	17.8	18.0	18.2	17.4	17.6	18.1	18.7	17.8	17.5	17.8
Gross wages (real terms)	%YoY	1.6	1.5	1.3	1.4	1.9	1.4	2.3	0.3	1.4	2.0	1.1	0.6
Export (acc. to NBP)	EURm	33.823	34.746	36.252	39.152	7.853	8.668	8.816	9.409	8.353	9.002	9.197	9.700
Import (acc. to NBP)	EURm	46.848	45.712	46.232	50.393	10.847	11.109	11.259	12.497	10.581	11.041	11.610	13.000
Trade balance (acc.to NBP)	EURm	-13.025	-10.966	-9.980	-11.241	-2.994	-2.441	-2.443	-3.088	-2.228	-2.039	-2.413	-3.300
Current account balance	EURm	-7.992	-7.188	-5.184	-8.000	-2.659	-1.780	-932	-1.817	-1.442	-971	-857	-1.914
Current account balance	% GDP	-3.9	-3.6	-2.8	-4.0	-3.9	-3.6	-3.6	-3.6	-3.1	-2.7	-2.7	-2.8
Budget deficit (cumulative)*	PLNbn	-32.6	-39.4	-38.7	-45.5	-16.4	-25.0	-29.8	-39.4	-15.5	-23.8	-32.9	-38.7
Budget deficit (cumulative)*	% GDP	-4.3	-5.1	-4.8	-5.3	-9.2	-4.5	-2.5	-4.5	-8.4	-4.2	-4.6	-2.6
CPI	%YoY	5.5	1.9	0.7	2.1	3.4	2.1	1.3	0.9	0.5	0.5	0.8	1.2
CPI*	%YoY	3.6	0.8	1.3	2.5	3.3	1.6	1.3	0.8	0.6	0.8	0.9	1.3
PPI	%YoY	1.6	1.0	2.4	2.2	0.2	0.7	1.4	1.9	3.0	2.3	1.9	2.3
Broad money (M3)	%YoY	9.2	-2.1	2.8	5.8	3.2	2.5	-1.5	-2.1	0.5	1.3	2.5	2.8
Deposits	%YoY	8.9	-4.3	-0.6	6.6	1.7	0.5	-3.5	-4.3	-2.3	-1.9	-1.2	-0.6
Credits	%YoY	9.3	5.3	6.7	11.9	7.1	9.4	4.9	5.3	8.7	5.9	5.1	6.7
USD/PLN	PLN	4.09	4.08	3.90	3.89	4.13	4.04	4.15	3.99	3.90	3.83	3.93	3.93
EUR/PLN	PLN	3.67	3.85	4.36	4.36	3.62	3.72	4.08	4.00	4.19	4.36	4.42	4.48
Reference rate *	%	11.50	6.75	5.00	4.00	10.00	8.50	7.50	6.75	6.00	5.25	5.25	5.00
WIBOR 3M	%	16.10	9.09	5.59	4.34	11.02	9.80	8.50	7.03	6.37	5.60	5.20	5.18
Lombard rate *	%	15.50	8.75	6.50	6.50	13.50	11.50	10.00	8.75	7.75	6.75	6.75	6.50
Yield on 52-week T-bills	%	14.77	8.18	5.06	4.20	9.64	9.11	7.82	6.14	5.75	4.94	4.87	4.70
Yield on 2-year T-bonds	%	13.97	7.94	5.08	4.50	9.27	8.84	7.63	6.05	5.58	4.91	4.92	4.90
Yield on 5-year T-bonds	%	12.59	7.86	5.35	5.80	9.09	8.69	7.60	6.05	5.50	4.98	5.38	5.55
Yield on 10-year T-bonds	%	10.74	7.34	5.57	6.10	8.28	7.92	7.24	5.93	5.60	5.19	5.64	5.85

Source: GUS, NBP, BZ WBK

* at the end of period

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