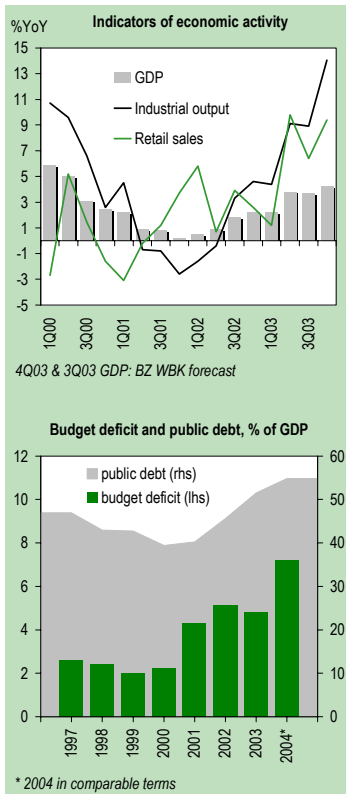




MACROscope

Polish Economy and Financial Markets

November 2003



Full throttle

■ **Macroeconomic data for September and October increased optimism as regards current and prospective situation in the Polish economy.** The arising picture is more and more unambiguous – economic recovery is gaining strength and gradually encompassing increasing number of branches. However, the improvement is still hardly noticeable in some areas of the economy. Expansion of industrial output and exports lasting for a dozen of months or so, coupled with very good dynamics of retail sales, have finally resulted in ending of deterioration on the labour market (although it is too early to claim a trend-reversal). The unemployment rate dropped to 17.4%, which means that after long five years it finally fell below level recorded in the corresponding period of previous year. Nevertheless, the jobless rate still remains high, which is a significant constraint for a demand pressure on retail prices.

■ **There is no doubt that fiscal policy (high public finance deficit leading to rising public debt) remains the main impediment for economic growth in the longer-run in Poland.** Although in recent weeks we did not receive new information as regards fiscal policy, it still remains a hot issue amid maintaining nervousness on the Polish financial market. That is why we have decided to cover fiscal policy subject in our *Special focus* section again. This time we analyse what can be effects of budget deficit reduction for the economic activity. Result of our analysis are not unambiguous. They show that non-conventional effect of fiscal adjustment is possible but it is not clear whether such effects can be obtained in transition countries, including Poland. Moreover, it is not clear what factors may trigger positive influence of fiscal policy changes on the economic activity in the short-term. There is no doubt, however, that in order to obtain positive effects of fiscal policy at least one basic condition has to be met: a credibility of the public finance reform program. The reform has to have permanent effects and it should be deep enough in order to reduce structural budget deficit and lower public debt level.

■ **Obviously, uncertainty connected with fiscal policy, leading to high volatility on the foreign exchange market and higher yields of Polish treasures, was the main argument for keeping rates on hold by the central bank.** What is important, in official statements the central bank said that strengthening signs of economic recovery did not create significant inflationary pressure, which could be dangerous from the point of view of the inflation target. However, more important than current NBP statements is a shape of new Monetary Policy Council, to be appointed at the beginning of 2004. The names of candidates may be known already in December. Taking into account both economic (no significant inflationary pressure) as well as institutional arguments (new MPC), we expect a continuation of monetary policy easing next year.

In this issue:

Special focus	2
<i>Perverse fiscal policy</i>	
Economic update	8
Central bank watch	14
Government and politics	21
EU integration watch	26
Market monitor	27
International review	30
Economic calendar	32
Statistics & forecasts	33

Maciej Reluga
Chief Economist
(+48 22) 586 8363

Piotr Bielski
(+48 22) 586 8333

Piotr Bujak
(+48 22) 586 8341

Aleksander Krzyżaniak
(+48 22) 586 8342

Email: firstname.secondname@bzwbk.pl

Financial market on 31 October 2003					
NBP deposit rate	3.75	WIBOR 3M	5.44	PLN/USD	4.0234
NBP reference rate	5.25	Yield on 52-week T-bills	5.85	PLN/EUR	4.6826
NBP lombard rate	6.75	Yield on 5-year T-bonds	6.95	EUR/USD	1.1638

This report is based on information available until 26.11.2003

Special focus

Perverse fiscal policy*

Perspectives for the fiscal policy in Poland has topped the agenda for several months now. A reduction of the budget deficit and curbing a fast growing public debt are currently the primary challenges that the domestic economy is facing. The government are attempting to reform public finances. According to economy minister Jerzy Hausner the core elements of the reform plan are the 2004 budget draft, the medium-term public finance strategy and the Programme of Public Spending Arrangement and Reduction. These documents were under our close scrutiny in the two previous editions of MACROscope. This month's edition is also devoted to the fiscal issues.

It seems that the ongoing debate on the public finances takes too little interest in the issue of an impact of the current fiscal developments, especially the planned reform on a slightly rebounding economy and growth prospects over the next couple of years (this is mentioned almost exclusively in respect of a potential weakening of the Polish zloty and growing interest rates, should the reform fail). It is however important whether and to what extent the observed upturn in business activities stems from or is attributable to the expansion of fiscal policy. It is even yet more important how the real sphere can be affected by putting a potential hold on a growing budget deficit. Below, we will try to find an answer to the latter question by briefly analysing theoretical concepts and to date experience regarding the impact of discretionary changes in fiscal policy on the real economy, both in advanced economies and in transition countries.

Conventional concept of fiscal policy

Traditional concept used to analyse the impact of fiscal policy on the scope of business activities is based on IS-LM model which envisages that expanding budget deficit by increasing expenditure or/and lowering taxes (less strict fiscal policy) contributes to a growth in aggregate demand and in effect gives boost to the economy. By analogy, curbing budget deficit by limiting expenditure and/or levying higher taxes (stricter fiscal policy) translates into a dwindling aggregate demand and in

consequence slows down the economy. At the same time it is assumed that aggregated demand reacts stronger to changes in budget expenditure than to changes in taxation. Such a conventional view on the results of a fiscal policy is called Keynesian approach.

In 1990s non-Keynesian effects of fiscal adjustment gained on popularity. This was inspired by examples of financial reforms in several countries which in a short term triggered off economic expansion. An oft mentioned example of a fiscal adjustment of such nature was a reform pursued in Ireland in the years 1986-89.

Irish reform

A necessity to undertake reforms in Ireland was a consequence of a crisis which the public finance faced in the first half of the 1980s. Public debt to GDP ratio reached almost 120% and a structural deficit was at nearly 15% of GDP (the term public deficit is explained in a table on the next page). This crowded private investments out of the market thus strangling economic growth. The reform was initiated in 1986 and continued over the years 1987 through 1989 with a focus on drastic cuts in welfare (by over 2.5% of GDP) and budget ensured salaries (with savings ca. 1.5% GDP) mainly to a substantial staff downsizing in the public administration by 10%. Except for the current expenditure, investments were also reduced by 1.5% GDP while the starting point of government financed investments was relatively high. As we can observe the changes mentioned above referred mainly to budget expenditures. The Irish reform at least in its initial phase of fiscal consolidation did not effect substantial changes in the structure and burdens of tax obligations. Other examples of effective public finance reforms show that the structure of adjustment may differ. Suffice to mention the British reform undertaken when Margaret Thatcher was in office, which similarly to the Irish reform, consisted in drastic expenditure cuts. On the other hand, fiscal adjustment adopted in the United States during Ronald Regan's presidency envisaged mainly adjustment on the taxes side.

Irish fiscal reform and the economy's performance

Item	Average growth rate in 1987-89
Structural budget deficit in % of GDP	-1.8
Consumption	3.6
Private investment	6.7
Export	11.0
GDP	3.7

Source: Giavazzi F., Pagano M., „Can Severe Fiscal Contractions Be Expansionary? Tales of Two Small European Countries”, NBER Macroeconomics Annual, 1990

* The text is a modified version of working paper "Short-run Macroeconomic Effects of Discretionary Fiscal Policy Changes" prepared by Piotr Bujak and Joanna Sivińska within the research project entitled "Strategies for Joining the European Economic and Monetary Union: a Comparative Analysis of Possible Scenarios".

Structural and cyclical budget deficits

Budget balance, i.e. the difference between revenue and expenditure is subject to cyclical fluctuations appearing as deficit during recession and as surplus during expansion. A part of the budget revenues (sometimes a very substantial one) depends on the level of business activity, e.g. revenues from indirect taxes grow when economy is performing well and decline when economy is in recession. Budget expenditure, especially welfare, show an opposite tendency (e.g. in the times of economic hardship social aid tends to increase). A deficit which arises from economic fluctuations is called a cyclical deficit. In many countries an actual deficit can be far fetched from an actual deficit. The difference between an actual deficit level and its cyclical component reflects a structural deficit, which size is permanent irrespective of the phase of an economic cycle. It shows a potential spread of the average budget deficit in the long-term (containing a complete economic cycle) and determines a long-term relation of public debt to GDP. From this perspective, a high structural deficit is the one which exceeds the long-term rate of economic growth. If a high structural deficit persists in a long run, debt is also on the rise.

The effect of consolidating public finances in Ireland yielded positive effects within the first two years since initiation. A high structural budget deficit turned into a substantial primary surplus (primary means is a difference between revenues and expenditures excluding public debt servicing costs). The rate of economic growth gained a substantial impetus and the unemployment rate remained stable. Also, private investments began to grow compensating for a shrinking budget expenditure of this nature. Moreover, the dynamics of economic growth in Ireland continued to accelerate leaving behind other developed countries within the next several years after launching the reforms (Ireland's GDP growth exceeded the growth of G7 countries by 3.8pp annually), thanks to which GDP per capita increased substantially and unemployment rate declined. Apart from a sound performance of the world economy and a growing absorption of aid funds from the EU, reasons for this favourable trend are rooted in permanence and depth of these changes. The previous attempt of public finance reform in Ireland carried out in 1982-1984 lacked such characteristics and it did not bring positive results.

Non-conventional fiscal policy theories

The Irish reform was not a stand-alone case. Non-compliant with the expectations of IS-LM model effects of fiscal consolidations undertaken in many countries in the 1980s and 1990s promoted the significance of alternative

theories explaining the impact of changes in fiscal policy on business activities in a short-term. Most of them, owing to interest in mainly short-term timescales focuses on demand. There are also other concepts which factor in supply but these apply rather to medium and long-term timescales in which the occurrence of non-Keynesian effects of a fiscal policy does not surprise.

The most popular explanation to the inconsistency of IS-LM model and a reaction of aggregate demand in economy for changes in fiscal policy is a concept called Ricardian equivalence. According to this concept, a fiscal policy cannot have any impact on aggregate demand in the economy. This concept is related to the permanent income hypothesis and the life cycle hypothesis which are based on an assumption of rational consumers' expectations, intergenerational altruism (or limitless lifespan) as well as a lack of liquidity constraints. Under such assumptions lower taxes (higher budget expenditure) now will mean higher taxes in the future. For this reason, the current value of income that they expect in the future does not change (permanent income is constant), consequently the level of consumption remains unchanged. This concept then points out why changes to the fiscal policy may not bring results envisaged by the "conventional view" of fiscal policy. It does not explain, however, why the fiscal policy may push the global demand in a direction opposite to the one assumed by IS-LM model.

There are attempts to explain perverse reactions of economic activity in response to changes in the fiscal policy by way of models which factor in, similarly to the concept of Ricardian equivalence, consumers' rational expectations (permanent income hypothesis). These however contain more realistic assumptions, e.g. referring to the consumers' lifespan (it waives Ricardian assumption that this is infinite or that there occurs intergenerational altruism). One of such models is advocated by Olivier Blanchard. It focuses on taxes taking a basic assumption that the higher the taxes the more distortions appear in economy. The model adopts a critical taxation level t^* above which economic activity begins to dwindle. In consequence, there also exists a critical level of public debt d^* in excess of which consumers expect that the level of taxes will increase in the future above level t^* thus reducing economic activity. If then consumers expect that debt will reach the level d^* , then fiscal adjustments aimed at stabilising or limiting the balance of public debt, allowing the economy to avoid exceeding the critical tax level in the future, contributes to a growth in the present value of the expected income (permanent income) thus increasing consumption and



the pace of the economic growth. This means that the growth in taxation today, not exceeding the level t^* , but allowing to avoid exceeding this critical level in the future may lead the economic expansion.

In other words, fiscal consolidation in the times of troubled public finances is good information for customers encouraging them to spend more and economic activity flourish. Blanchard also points out that in “normal fiscal times” when the economy is far from a critical level of public debt, consumers’ reaction (still bearing in mind the assumption of finite timescale of their decisions) will be as envisaged by Keynesian approach, i.e. according to the IS-LM model. All in all, the model discussed shows that the customer’s behaviour is of non-linear type – in “normal fiscal times” according to Keynesian approach and in “bad fiscal times” non-Keynesian effects can be observed.

Other models devised (e.g. the one developed by Alan Sutherland) focus not only on the level of taxation, but also on public expenditure. These models assume that at some stage due to a limited capacity to finance budget expenditure, the government will have little option but to cut excessive spending. With a low public debt balance, the likelihood of fiscal adjustment is low, hence increasing public expenditure (tax reduction) will be in line with Keynesian approach (growing consumption and aggregated demand). Nevertheless, as the public debt grows, parallel to a growing likelihood of a fiscal adjustment, a growth in the public spendings (falling taxes) will be followed by fall in consumption because consumers will be afraid that their loss on a fiscal adjustment will be greater than the value of current benefits from having a non-restrictive fiscal policy in place. This is then another assumption that the consumers’ behaviour is of no linear nature – it has Keynesian nature in “normal fiscal times” and displays non-Keynesian effects in “bad fiscal times” when the likelihood of a crisis in public finances is considered high.

Another group of models focus on the structure of fiscal adjustment. According to these models fiscal adjustment will have positive effects if it is based on spending cuts, not on tax hikes. They also assume that fiscal reform should be accompanied by agreement with social partners aimed at curbing wage claims and weakening of the domestic currency.

What does to date experience show?

Because the issue of how changes in the fiscal policy affect the economic activity has major implications for the current performance of the Polish economy (in the light

of the planned fiscal reform), we decided to analyse the effects of fiscal reforms that have been undertaken in other countries so far. We decided to check the frequency at which non-Keynesian effects of the fiscal policy occurred in the case of already implemented fiscal adjustments and what factors might trigger them. At the onset, we ran a simple statistical analysis of the effects of the fiscal reforms which were implemented in the years 1975 – 2001 in the OECD countries. Our research was limited only to the cases of fiscal expansions and consolidations which might be considered big, because our objective in this simple statistical analysis is not to assess every single case of fiscal expansion or consolidation but to select these cases which might have a strong Keynesian or non-Keynesian effect and to try to define differences which appear between them. Large fiscal expansions/adjustments are defined as cases in which a cyclically adjusted primary budget deficit in relation to a potential GDP changes by at least 1.5pp within one year.

As a measure of influence of changes in fiscal policy on the real economy we apply the concept of “adjusted growth”. An adjusted growth of a given country equals a actual growth of this country decreased by the growth rate of G7 countries and a difference between a potential growth rate of a given country and a potential growth rate in G7 countries. A conventional (Keynesian) case of fiscal expansion/consolidation is a situation in which an “adjusted growth” is lower/higher than in the previous year. A non-Keynesian case of fiscal expansion/adjustment is a situation whereby an “adjusted growth” is lower/higher than in the previous year.

Effects of fiscal policy changes in OECD countries in 1975-2001

	Number of episodes	Average change of the cyclically adjusted primary govt. balance, in % of potential GDP.	Average “adjusted growth”
Keynesian expansions	17	-2.47	1.58
Non-Keynesian expansions	23	-2.62	-1.38
Keynesian adjustments	46	2.24	-1.72
Non-Keynesian adjustments	27	2.53	1.01

Source: OECD database, own calculations

With this approach, we identified 40 cases of fiscal expansions and 73 cases of fiscal adjustments (see table above). Out of 113 selected cases of major changes to the fiscal policy, 50 were of non-Keynesian



nature. At this point we can draw the first conclusion – non-Keynesian effects of the fiscal policy are not only a theoretical concept or a sporadically occurring anomaly but quite a frequent economical phenomenon.

Next, in order to see what factors may increase the likelihood of having non-Keynesian cases of the fiscal policy, we estimated a logit type model. The results of estimation accompanied by a definition of variables can be found in the technical appendix. A dependant variable in this case is occurrence or non-occurrence of non-conventional effects of the fiscal policy. An independent variable is the size of a public debt, informing about the initial conditions prior to a reform and changes in revenue as well as budget expenditure, informing about the structure of changes in the fiscal policy. The results of the calculations did not allow to identify a factor contributing to the likelihood of occurring non-Keynesian effects of a fiscal adjustment. In the case of fiscal expansions, parameters for budget revenue and expenditure are statistically important, but the mark at the expenditure variable appeared inappropriate. Such a result with the insignificance of explanatory variables in the case of regression for fiscal adjustments, implies that the identified relationship regarding fiscal expansions is spurious. A simple estimation of the logit type model did not then allow us to draw conclusions as to whether the initial stance of public finances or the structure of a fiscal reform may be decisive for the likelihood of having non-Keynesian effects of a fiscal policy.

As both the traditional Keynesian analysis and a major part of non-conventional theories of the fiscal policy are related to demand, we decided to investigate in a further course of our research whether this channel can really be a source of non-Keynesian effects of the fiscal policy. We accept here that the best variable to explain the non-Keynesian effects of the fiscal policy is consumption. We focus then on this component of the global demand. The aim of our estimation is modest – we want to verify whether there is non-linearity in consumption induced by fiscal events as suggested by new theories.

We model consumption as a function of expected changes in disposable income and unexpected changes in the fiscal policy. We also account for the size of public debt. Specification of the equation and results of its estimation can be found in the technical appendix. Marks of parameters in a limited version of the consumption equation described above (not including a dummy variable accounting for public debt level) conform to the “conventional view” of fiscal policy.

An application of dummy variable for “bad fiscal times”, i.e. for a high level of public debt, contributes to disclosing the non-Keynesian effects in “bad fiscal times” - rising budget expenditure strangles consumption. This confirms a non-linear reaction of consumption to changes in fiscal policy assumed by theoretical concepts.

In subsequent regressions, we attempted to review whether non-linear effects of fiscal policy exist in the case of transition countries, including Poland. The results of estimation suggest that these countries also displayed non-linear behaviour of consumers in response to changes in fiscal policy. It needs to be noted, however, that in such countries, a fiscal expansion in “bad fiscal times” increased consumption, though this effect was much weaker than in “good fiscal times”. For this reason, it seems that consumers in transition countries behave in a non-linear manner, but the non-Keynesian component of their behaviour does not offset a conventional reaction, so all in all we do not observe a non-Keynesian consumers’ reaction to changes in fiscal policy.

The theoretical and empirical literature suggest two explanations of weaker non-linearity effects in reaction of consumers in transition countries to changes in fiscal policy. They refer to a degree to which assumptions of non-conventional concepts of fiscal policy are met. Namely, it is argued that there are stronger liquidity constraints in transition economies, which stem from lower level of financial market’s development. There may be also higher proportion of myopic consumers in these countries, i.e. consumers who are not aware of the government budget constraint in a market-economy setting in the long-term.

The most important is credibility

Intention of the Polish government is that public finance reform should not harm the ongoing economic recovery, yet it should even strengthen it. New concepts of fiscal policy influence on the economic activity developed in 1990s and results of our analysis based on data covering a few dozens of public finance reforms in developed countries during the three recent decades suggest that reduction of budget deficit not only positively affects the economic growth in the long-term, but it also can have expansionary effects in the short-term. Our results also show, however, that it is not sure whether such effects can be obtained in transition countries, including Poland. Moreover, it is not clear what factors may trigger non-Keynesian effects of fiscal policy changes.



There is no doubt, however, that in order to obtain non-Keynesian effects of fiscal policy at least one basic condition has to be met: a credibility of the public finance reform program. Only due to high probability of the government's fiscal plans it is possible to observe effects of fiscal adjustment that are positive for the economic activity related to rational expectations of economic agents. They have to be convinced that public finance reform will have permanent effects and will be deep enough in order to reduce structural budget deficit and lower public debt level.

Unfortunately, it seems that this condition is not met in Poland. Credibility of the planned fiscal reform in Poland is constrained, which we have stressed several times in the past, by the fact that there are no necessary adjustments already in the 2004 budget draft. In such situation this is not surprising that that results of recent public opinion poll showed that only 3% of Poles believe in the government's ability to carry out all planned changes in public finance.

Technical appendix

At the onset, we estimated a logit type model. Such model allows for quantifying probability of occurrence of some phenomenon depending on the occurrence of given factors. In our case, we try to verify what factors affect probability of non-Keynesian effects of fiscal policy. A dependant variable in our model is occurrence or non-occurrence of non-conventional effects of the fiscal policy. An independent variable is the size of a public debt (cyclically adjusted as percentage of a potential GDP), informing about the initial conditions prior to fiscal reform and changes in revenue as well as budget expenditure (in both cases cyclically adjusted) informing about the structure of changes in the fiscal policy.

Logit estimation; probability of non-Keynesian effect of fiscal adjustment

Variable	Coefficient	z-statistic	p-value
Δ revenue	-0.137	-0.44	0.663
Δ expenditure	-0.139	-0.42	0.674
public debt	-0.005	-0.53	0.598
Pseudo R ² = 0.012		Liczba obserwacji = 64	

Note: Δ represents first difference operator; p-values is the probability of making mistake when rejecting null-hypothesis about statistical non-significance of a given coefficient.

Logit estimation; probability of non-Keynesian effect of fiscal expansion

Variable	Coefficient	z-statistic	p-value
Δ revenue	0.970	2.10	0.036
Δ expenditure	-1.013	-1.88	0.060
public debt	-0.010	-0.57	0.568
Pseudo R ² = 0.174		Liczba obserwacji = 30	

Note: Δ represents first difference operator; p-values is the probability of making mistake when rejecting null-hypothesis about statistical non-significance of a given coefficient.

Next, we model consumption as a function of expected changes in disposable income and unexpected changes in the fiscal policy. We also account for the size of public debt. In order to verify occurrence of non-linearity in consumers' behaviour in reaction to fiscal policy changes, we employ also dummy variable accounting for public debt level. We estimate the following function:

$$\Delta C_{it} = \Delta y_{it} + \Delta bal_{it} + \Delta bal_{it} * D1_{it} + e_{it}$$

where:

ΔC_{it} – consumption change,

Δy_{it} – expected change in disposable personal income,

Δbal_{it} – unexpected, cyclically adjusted fiscal impulse, defined as personal income taxes and social security contributions minus primary expenditures (excluding public debt servicing costs),

$D1_{it}$ – dummy variable that equals 1, when the government debt in a country exceeds its mean plus one standard deviation computed for the period 1970- 2001. To check the robustness of our results, we also employ a different definition of this variable and denote it as $D1_{ws}$. It equals one, when the government debt in a country exceeds the mean plus one standard deviation computed for the whole sample.



We estimate consumption equation on panel data for OECD countries (except for Poland, the Czech Republic and Hungary) for the years 1970-2001 using a simple within-effects estimator. All data comes from the OECD database. The results are summarized in the table below.

The estimation results of consumption equation for OECD countries

Variable	Estimation 1	Estimation 2	Estimation 3
Δy_{it}	0.666 (0.000)	0.656 (0.000)	0.653 (0.000)
Δbal_{it}	-0.213 (0.085)	-0.336 (0.022)	-0.437 (0.013)
$\Delta bal_{it} * D1$	-	0.428 (0.116)	-
$\Delta bal_{it} * D1ws$	-	-	0.439 (0.077)
	R ² = 0.259	R ² = 0.257	R ² = 0.261
	DW = 1.798	DW = 1.794	DW = 1.769

Note: in brackets p-values are given, i.e. the probabilities of making mistake when rejecting null-hypothesis about statistical non-significance of a given coefficient.

In the next regression we test for the presence of non-linear effect of fiscal policy in transition economies. Data availability allows us to include the following economies in our sample: Belarus, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Kazakhstan, Latvia, Lithuania, Moldova, Poland, Romania, Russia and Slovak Republic. The earliest data point is year 1990 and the latest is 2001. Since we do not have data for disposable income for majority of these countries, we proxy it by GDP. The budget balance data is for consolidated central government and is not cyclically adjusted.

Due to unavailability of a full dataset on government debt, we use budget deficits to proxy for "bad fiscal times"; thus times of fiscal distress for a given country. Dummy $D1_{it}$ is defined as the mean plus one standard deviation of the budget deficit for a given country over the relevant time period. In our estimation we employ the two-step instrumental variable estimation technique. Due to the short time period concerned and the poor quality of the data, results of estimation for transition countries should be treated with skepticism.

The estimation results of consumption equation for transition countries

Variable	Estimation 1	Estimation 2
Δgdp	0.979 (0.000)	0.975 (0.000)
Δbal_{it}	-0.307 (0.112)	-0.478 (0.058)
$\Delta bal_{it} * D1_{it}$	-	0.418 (0.267)
Instruments	Δgdp instrumented by Δbal $\Delta gdp-1$ $\Delta cons-1$	
	R ² within = 0.259	R ² within = 0.254

Note: in brackets p-values are given, i.e. the probabilities of making mistake when rejecting null-hypothesis about statistical non-significance of a given coefficient.

Economic update

- Recovery in trade and industry gains momentum
- ... but improvement still not visible in some areas
- Unemployment lower than year ago, at last
- Inflationary pressure remains under control

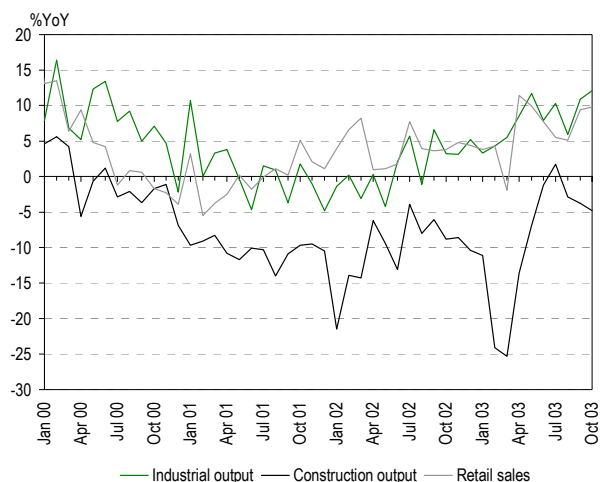
Macroeconomic data for September and October increased optimism as regards current and prospective situation in Polish economy. The arising picture is more and more unambiguous – economic recovery is gaining strength and gradually encompassing increasing number of branches. However, the improvement is still hardly noticeable in some areas of economic life. Expansion of industrial output and exports lasting for a dozen of months or so, coupled with very good dynamics of retail sales, have finally resulted in ending of deterioration on the labour market (although it is too early to claim a trend-reversal). The unemployment rate dropped to 17.4%, which means that after long five years it finally fell below level recorded in the corresponding period of previous year. Nevertheless, the jobless rate still remains high, which is a significant constraint for a demand pressure on retail prices. In effect, inflation perspectives remain favourable, despite some CPI revival in the short run amid deteriorating situation on the food market.

Excellent performance of manufacturing and trade

Real sector data for September and October proved to be very positive, better than expected. Sold industrial production increased 10.9%YoY in September and 12.1%YoY in October. According to the CSO total industrial production adjusted for seasonal factors was almost equally that strong, growing 8.3%YoY and 11.8%YoY, correspondingly. It was the highest growth of output recorded since June 2000. Such good result was mostly contributed by excellent performance of manufacturing sector, which upsurged 13.8%YoY in October after 12.4%YoY rise in September. Rise of production has been reported in large majority of industrial sectors (22 out of 29), and the most striking development took place in pro-export branches: manufacturing of motor vehicles (44.5%YoY), machinery and tools (33.1%YoY); furniture (27.6%YoY), metal elements (25.1%YoY), electrical appliance (19.1%YoY). Such information is very positive for the GDP growth prospects and strongly confirms that the Polish economy is currently on the path of revival, driven to a large extent by flourishing export sector. We can expect that foreign trade

statistics for October will show again very robust growth of Polish exports.

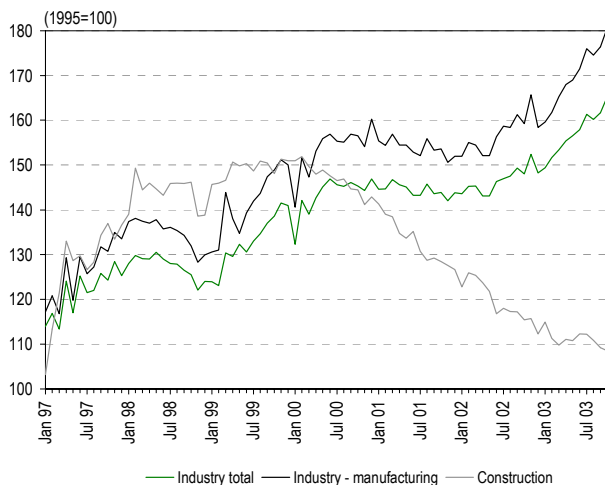
Economic activity indicators



Source: CSO, BZ WBK

Retail sales figures proved to be equally optimistic, showing 10.3%YoY hike in October after 9.7%YoY rise in September (in nominal terms). The structure of retail sales growth was very similar in both months. The highest annual growth was recorded in "the remaining retail sales in non-specialised shops" (67.5%) and in sales of food, beverages and tobacco (26.2%). Again, high growth was seen in sales of "motor vehicles" (10.5%), "textiles, clothing, shoes" (9.7%), "furniture, appliances, electronics" (7.7%), and in "cosmetics and pharmaceuticals" (6.3%). Continuously high growth of retail sales in vast majority of branches suggest that growth of households' purchases is stable, which in turn bodes well for dynamics of individual consumption. However, optimism is smothered by negative results of business climate survey in retail trade and significantly weakened consumers' confidence in the two recent months. Moreover, one should remember that retail sales data reported by the CSO do not cover the whole retail trade sector. They do not include small enterprises, which may explain pessimistic business climate in the sector despite strong retail sale figures. Therefore, although recently strong retail sales figures are positive for GDP growth outlook, it is too early to predict consumption boom in the Polish economy. One should also notice that in 3Q03 real growth of retail sales reached 6.4%YoY, which was notably below dynamics in the previous quarter (9.8%YoY). It confirms that private consumption growth in 3Q03 was most likely lower than in the preceding quarter.

Output in construction and industry (1995=100)



Source: CSO

... and disappointment in construction sector

Alas, the upswing in industrial production has been coupled with downturn in construction output, which fell 4.8%YoY in October after 3.8%YoY drop in September. The dynamics corrected for seasonal factors was even worse, showing 6%YoY decline. Such weak performance of the construction sector was disappointing, especially after sharp improvement in this area recorded the middle of this year. However, even in construction data a positive feature could be found. Although overall picture seems rather gloomy at the moment, the companies preparing ground for construction recorded again very rapid growth of nearly 100%YoY, which might suggest acceleration of construction output growth in future. Additionally, the average dynamics for 3Q03 significantly improved in comparison with previous quarters. Nevertheless, one should not expect this improvement to continue in the remaining part of the year.

Improving financial stance of industrial companies

Financial results of Polish companies (employing more than 49 people) in three quarters of this year confirmed expectations, showing continuing improvement, which was observed also in the preceding quarters. Total revenues grew much faster than in the corresponding period of 2002 and even accelerated in relation to the first half of this year. At the same time deceleration of cost increase was recorded, confirming that despite clear improvement of the business climate, companies were still attempting to improve their effectiveness. In effect net profits flourished and after three quarters of this year they were five times higher than in 2002 (PLN15.1bn against PLN3.1bn). All indicators describing financial stance of the enterprises improved and what is more, this process has been widespread

(observed in all sectors of the economy except for coal mining). Likewise in the past, the bigger progress has been recorded in case of exporting companies, which confirmed that foreign trade has been a very important driver of economic growth in recent quarters. Such positive data on firms' financial results reinforced hopes that continuing expansion of companies' activity and their growing profits would eventually allow for a recovery of investment activity.

Real activity indicators, %YoY real terms

	1Q03	2Q03	3Q03	4Q04
Industrial output	4.4	9.1	8.9	14.0*
- seasonally adjusted	4.5	8.0	8.9	10.0*
Construction output	-20.2	-7.2	-1.7	-3.1*
Retail sales	1.2	9.8	6.4	5.0*
GDP	2.2	3.8	3.7*	4.2*

Source: CSO, BZ WBK;

* BZ WBK estimate/forecast

... and investment outlays rebounded at last

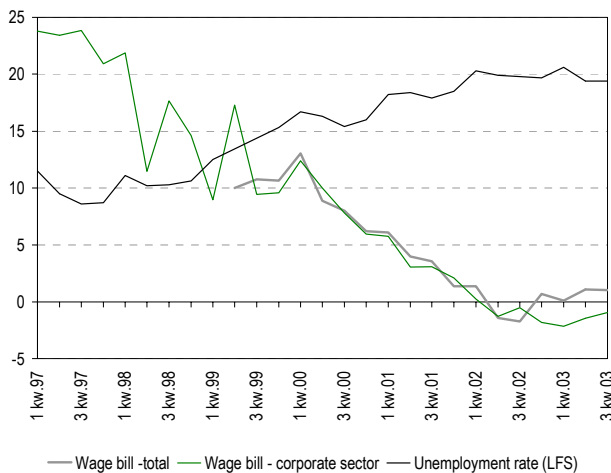
The hopes mentioned above proved justified, as according to CSO data investment outlays went up by 1.2% over the three quarters of 2003 as compared to the same period last year against 2.2% annual drop after the first half of this year. The main reason for growth in investments was significant improvement of investment activity in industrial manufacturing. In January-September period it expanded by ca. 20%YoY against 15.7% rise in the first half of the year. The number of newly started investments after three quarters of this year was 42% higher than in the corresponding period of last year while the value of newly started investment grew by 49%YoY. The data suggested that 3Q03 saw a rebound in investment activity. While reversal of negative trend in fixed investment in 3Q03 is consistent with our forecast, it seems that its growth may be even higher than 2%YoY (in real terms) predicted by us, although one has to remember that those figures concern only big companies.

... but it did not translate into recovery on the labour market

Despite more distinct recovery in growing number of industrial branches, significant improvement on the labour market is still hardly visible. Data on wages and employment in corporate sector for October showed a continuation of trends observed in previous months. Employment inched up only 0.1%MoM, and in effect its annual dynamics reached -3.2%YoY – the level roughly unchanged since July. Even though labour

shedding process was stronger in the first half of this year (average drop 3.8%YoY), last months' results prove there is still no considerable increase of demand for labour. Apparently, despite ongoing economic revival and upsurging profits, entrepreneurs are still afraid of hiring new staff. At the same time wage growth remains limited – in October the annual figure picked up to 3%YoY from 2.2%YoY in September, however it was mainly due to a low base effect, and in relation to the previous month wages fell 0.9%. Wage bill in corporate sector keeps falling in both nominal and real terms, which surely does not support expectations for faster private consumption growth in the upcoming quarters. Still difficult situation on the labour market remains a significant factor constraining potential for CPI price growth in the near term.

Wage bill (%YoY) and unemployment rate (%)



Source: CSO, BZ WBK

On the other hand, unemployment data delivered a tiny hope for a progress in the near future. The registered unemployment rate fell slightly to 17.5% in September and 17.4% in October and in both months it was 0.1pp below the analogous period of last year (which happened for the first time since late 1998, i.e. for nearly five years). Undoubtedly, this is a positive signal, but one should not overestimate it, bearing in mind two reservations, which we already mentioned a number of times. Registered unemployment rate still remains very high, being a significant factor constraining consumption demand growth. What is more, it may be affected by temporary factors e.g. graduates may do not register as unemployed because they continue education observing that current situation on the labour market is very difficult. Even if we see continuing unemployment fall in annual terms (we forecast the unemployment rate at 17.8% in December 2003 against 18% at the end of 2002), the general condition of the

labour market would remain one of the major problems bothering the Polish economy. This is confirmed by the results of latest poll concerning domestic labour market carried out by CBOS institute. The results showed that as much as 94% of Poles thinks that situation on the labour market is bad (out of which 63% said it is very bad) while none of polled persons believes it is good. Only 13% hopes the situation will improve in 12 months. Therefore, the fall of unemployment in recent months does not imply the end of problems on the labour market.

Labour market indicators

	1Q03	2Q03	3Q03	4Q04
Total wages** (%YoY)	2.9	3.3	2.4	2.2*
- corporate sector** (%YoY)	1.4	1.7	1.7	1.0*
Employment total (%YoY)	-3.2	-2.7	-2.0	
- corporate sector (%YoY)	-4.0	-3.6	-3.2	-3.1*
Wage bill (%YoY)	0.1	1.1	1.0	
- corporate sector (%YoY)	-2.2	-1.4	-0.9	
Registered unemployment rate*** (%)	18.6	17.7	17.5	17.8*
Unemployment rate - LFS (%)	20.6	19.4	19.4	

Source: CSO, BZ WBK; * BZ WBK estimate/forecast; ** real terms; *** end of period

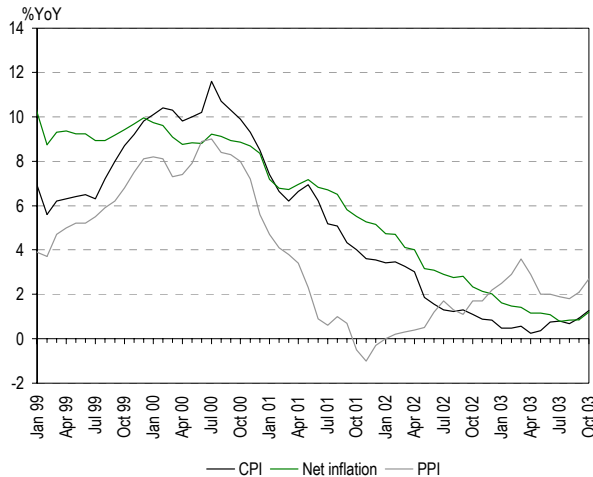
CPI slowly rising, prospects remain good

As a consequence of developments described above, there are still no demand-side pressures on consumer price growth in Poland. In September those prices increased 0.5%MoM, which pushed inflation rate up to 0.9%YoY, while in October the growth reached 0.6%MoM and 1.3%YoY respectively (the highest level since more than year). The structure of price growth indicates that the main reasons for inflation hike are supply factors. Prices of food and non-alcoholic beverages grew by 1.5%MoM in both September and October, bringing the annual growth rate of food prices up to 1.2% – the highest since April 2002. In October inflation rate was also boosted by prices of alcoholic beverages and tobacco, which resulted from low base effect related to reduction of excise tax on alcohol in October 2002 (when alcohol and tobacco prices fell by as much as 3.2%MoM). Nevertheless, the data did not show any demand-side pressure on prices. As regards clothing and footwear, which prices are more dependent on demand, we saw continuation of prices decline in annual terms: -2.9%YoY in September and -3.1%YoY in October.

In general, inflation data for September and October confirmed that currently observed gradual rebound of CPI is mainly a consequence of reversal of price trend on the food market. At the same time there are no signs

of intensified demand pressure on prices as well as consequences of recent zloty weakening on prices, which supports expectations for further monetary easing after fiscal situation stabilises somehow.

Measures of inflation



Source: CSO, NBP

Core inflation measures also confirmed that despite downward trend is already over, there are still no visible sources of strong inflationary pressure. Core measures followed CPI acceleration. Net inflation reached 1.2%YoY in October, up from 0.9%YoY in September. The second important measure i.e. 15%-trimmed mean remained unchanged at 1.2%YoY. The remaining three indicators increased but only one of them exceeded 1% in October. Average growth of all core inflation measures was lower than CPI rebound and all of them already fell below the headline measure. In general, acceleration of core inflation was moderate and it did not signal inflationary pressure to be stronger as compared to previous months.

Inflation and money, %YoY

	1Q03	2Q03	3Q03	4Q04
CPI	0.5	0.5	0.8	1.4*
PPI	3.0	2.3	1.9	3.1*
Net inflation	1.5	1.1	0.8	1.3*
Broad money supply, M3	-0.7	0.8	1.9	4.8*
Banking sector's liabilities	-3.4	-2.3	-1.4	1.4*
Banking sector's assets	6.7	7.3	5.3	7.5*

Source: CSO, NBP, BZ WBK; * BZ WBK estimate/forecast

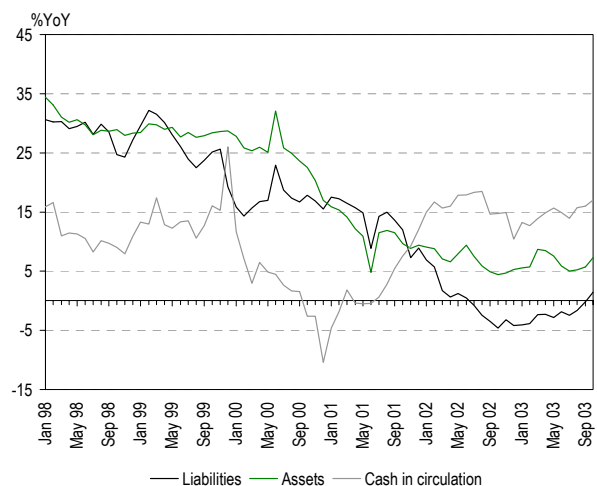
Much stronger surge was recorded in case of producer prices. PPI data for October surprised almost as much as production figures, growing 0.7%MoM and 2.7%YoY (up from 2.1%YoY in September and 1.8%YoY in August). The growth came mostly from mining industry (2%MoM and 7.3%YoY) as a result of sharply rising prices of coal and raw metals on the global market, however manufacturing sector also recorded significant

price acceleration (0.6%MoM and 2.4%YoY). One of the most important factors behind that was increase of oil prices, which contributed to price hikes in production of oil products (2.7%MoM) and chemical products (1%MoM). Another potential source of price growth was surely depreciation of the zloty, which fed into higher costs of imported raw materials and components into majority of industrial branches. While sharp acceleration of PPI growth is surely not a good news in terms of inflation perspectives, we still believe medium-term outlook is quite favourable. Sources of price rise were mostly on the supply side and should not strengthen if zloty depreciation reverses.

Money supply accelerating as well

Clear revitalisation of economic activity and trend reversal in prices contributed to acceleration of dynamics in monetary aggregates. Broad money grew 4.7%YoY in October after 3.1%YoY rise in September. The figures were much above market consensus. Overall deposits grew by 1.5%YoY in October, therefore returning into black after a period of continuous falls since mid-2002. However, households' deposits are still declining (-6.2%YoY in September and -5.1%YoY in October) amid interest rates' reductions and still poor financial stance of households. At the same time corporate deposits keep soaring (22.8%YoY in October) mirroring considerably improved financial situation and higher liquidity of Polish enterprises this year. Besides, money growth last month was pushed up by continuously high dynamics of cash in circulation, which jumped to 17.0%YoY. It seems that economic agents are continuing modifying structure of their financial holdings (from less to more liquid) adjusting it to changed macroeconomic conditions.

Assets and liabilities of the banking sector



Source: NBP



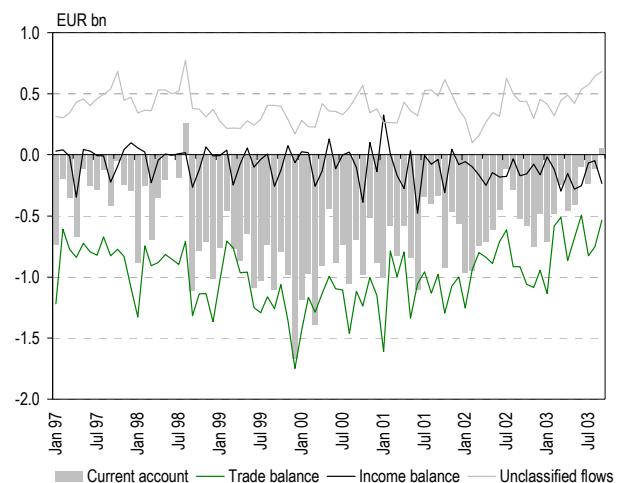
There was slight recovery in lending activity. Total credits rose by 5.7%YoY in September and 7.2%YoY in October. This stemmed mainly from acceleration of households borrowing (respectively 10.8%YoY and 12.2%YoY). Annual growth rate of corporate loans also slightly rebounded to 3.1% after a mere 1.7% average increase in the third quarter of this year. However, this was largely an effect of low base last year. Also, in the two last months, credit dynamics as well as growth rates of other monetary aggregates were positively affected by depreciation of the zloty, which increased the zloty denominated value of foreign currency assets and liabilities. All in all, rebound of money supply observed in recent months, following deep deceleration in a few previous years, reflects the ongoing recovery in the real economy and slight acceleration of price growth. At the same time, however, given low base effects and impact of exchange rate movements, acceleration of money growth does not seem to be excessive or indicating a significant threat of inflation pressure.

First current account surplus in five years

Balance of payments data for September proved to be a big surprise. Current account recorded the first surplus since August 1998 – it reached €61m compared to a revised €111m deficit a month earlier and €529m a year ago. In relation to GDP 12-month cumulative C/A deficit fell to 2.4% from 2.7% after August. Improvement on the current account stemmed from a few factors. First of all, September saw further shrinking of trade gap. It amounted to €536m (average market forecast was €768m) against €753m in the previous month and €914m in the analogous period of last year. Narrowing deficit resulted mainly from rocketing exports (by as much as 13.4%YoY in euro terms to a record high of €3.301bn, up 30.0%YoY in dollars) while imports were also moderately growing (by 0.3%YoY in euros to €3.837bn, up by 14.9%YoY in dollars). The second reason for C/A surplus in September was soaring surplus in unclassified flows. It reached €684m, which was the highest level since August 1998. As we wrote last month, this was probably a consequence of the fact that Poland's eastern neighbours rushed to complete cross-border deals ahead of the implementation of visas at the beginning of October. However, a scale of this effect is difficult to assess, as zloty weakening was probably partly contributing to high unclassified flows as well. The remaining elements of September current account were broadly in line with expectations. Services balance was at -€63m, income balance -€232m (due to

foreign debt interest payments) and transfers recorded a surplus of €208m. In the whole quarter C/A deficit reached only €289m against €971m in the previous quarter and €932m in 3Q02. At the same time, trade gap was still relatively high at €2.114bn against €2.039bn in the second quarter and €2.443bn in the corresponding period of last year. Export in July-September grew by 7.1%YoY after 5.1%YoY in the first half of the year while import advanced by 2.7%YoY following 1.5%YoY drop in the first half of the year.

Balance of payments: selected items



Source: NBP

Developments on the financial account were quite interesting as well. September saw an inflow of foreign portfolio investments in debt instruments. It amounted to €848m following three consecutive months of outflows. This is contradictory to substantial weakening of the fixed income market during that period. FDI inflow was still very low reaching only €193m against €250m on average in January-August period.

All in all, balance of payments figures for September delivered yet another sign that macroeconomic fundamentals of the Polish economy are sound and do not point to a risk of financial crisis at all. The figures showed that the recovery is still led by export (and this seems to be continued in next months on the back of recent deep depreciation of the zloty), while imports dynamics slightly improves reflecting gradual rebound of domestic demand.

Trade gap keeps narrowing also in CSO statistics

Very good condition of the Polish export sector was also confirmed by the CSO custom-based data. Those statistics showed that trade deficit in January-September period narrowed to €9.68bn from €11.2bn in the analogous period of 2002. Export increased by



6.0%YoY to €33.7bn and imports by 1.0%YoY to €43.4bn. In dollar terms, exports rose by 27.1%YoY and imports by 21.1%YoY.

Poland's foreign trade in January-September period

	EUR	USD	PLN
Exports (%YoY)	6.0 (5.7)	27.1 (27.0)	20.6 (20.2)
Imports (%YoY)	1.0 (-0.1)	21.1 (19.9)	15.0 (13.5)
Trade gap (bn)	9.68 (6.38)	10.72 (7.04)	41.72 (24.93)

Note: NBP figures in parentheses

Source: CSO, NBP

The above data show that export remained one of the main drivers of the economic growth in Poland also in the third quarter of this year. At the same time, we saw an increase (although very modest) in imports, which may suggest an improvement of investment demand dynamics. The figures also showed some changes to a structure of Poland's foreign trade. Despite a recession, Germany has still dominant share in Polish exports. However, as growth rate of exports to the largest European economy was lower than to other Poland's main trade partners from the EU (France, Italy, the Netherlands and Sweden), Germany's share in Polish export decreased slightly to 32.3% from 32.9% a year ago.

Budget deficit in 2003 restrained, leaking outside central budget

After ten months of this year budget deficit topped PLN34.8bn, i.e. 89.9% of the plan for the whole 2003. In October alone the budget gap amounted to PLN1.75bn, which was quite low level of deficit as compared to previous years (it amounted to PLN4.3bn in October 2002 and PLN2.8bn in October 2001). Even though such outcome was positive news after several months of disappointing budget figures, budget revenues saw no significant improvement in October, which was a little bit disappointing. After ten months of this year total revenues reached 79.3% of the annual plan and were 5.0% higher than in the corresponding period of last year (against 5.3%YoY increase after nine months). Tax receipts displayed only modest signs of recovery and were still performing below the plan assumed in the Budget Act for 2003. Indirect taxes increased 5.3%YoY in January-October against 4.7%YoY after September, while CIT revenues were falling 8.2%YoY compared to 10.1%YoY drop one month ago. Personal income taxes underperformed, growing 6.1%YoY against 7.1%YoY in the first nine months of 2003 and 13.4%YoY planned for the whole year.

Apparently, the reason for moderate deficit level in October was spending restraint rather than revenue

growth. Total budget expenditures advanced 4.4% during ten months of this year, however in October alone they dropped by 12.3%YoY (against 15.7% increase in September). It looks like the Ministry of Finance has begun to curb down current spending in order to adjust them to lower than planned revenues. And if we look at the structure of budget spending in October, the main sources of savings are apparent. After the subsidy for the labour fund has hit its ceiling level for this year in August, it amounted to zero in two following months. Also subsidies for pension fund and social security fund sharply decelerated in October, falling 10.5%YoY and 34%YoY respectively (against 14.6%YoY and 47%YoY increase in September), as their levels also approached top limits planned in the budget for 2003. This, matched with lower debt servicing costs, translated into much lower total expenditures, which allowed for slowdown in budget deficit growth at the beginning of the fourth quarter.

Although such data reduced a threat of budget amendment this year (revenue shortfall is being offset by spending postponement), they clearly showed that total deficit of public finances will be higher than planned this year. While cutbacks of subsidies to the labour fund, social security fund and other units, allow for keeping central budget deficit below upper limit, they obviously do not reduce financing needs of the relevant units. Fiscal deficit is just being pushed outside the central budget into the state funds and agencies, which contributes to the increase of public debt to GDP ratio.

... but the Finance Ministry faced liquidity problems

After the first three quarters of 2003 budget statistics showed extremely low level of government's deposits. They amounted to only PLN1.1bn, as compared to monthly average of above PLN9bn in January-August period. Finance Ministry's data showed that such sharp downfall was probably related to foreign debt payments. The situation triggered rumours that budget might run out of liquidity at the end of this year.

Fortunately, budget data for the next month proved that such fears were groundless. After ten months of this year liquidity on the government's accounts rose to PLN8.3bn. The inflow of funds must have come partially from the issue of Yankee bonds worth US\$1bn at the end of October, although on the other hand the government bought back Brady bonds worth some US\$0.4bn. However, given the large increase in liquidity margin, also other factors must have contributed to this result e.g. lower deficit in October



Central bank watch

- **No surprises - interest rates still on hold**
- **Agreement as regards bad loan provisions and reserve requirements**
- **Names of new MPC members to be known very soon**
- **...and MPC headcount will not change, despite such earlier SLD's plans**

Interest rates on hold until year-end

Two latest meetings of the Monetary Policy Council (in October and in November) were very similar as regards both decisions (no changes of monetary policy parameters and monetary policy bias) and statements (leaving room for further easing in the future, although the statements are not very important as MPC members will change in 2004). The reference rate still stands at 5.25%, the lombard rate at 6.75% and the deposit rate at 3.75%.

The two latest official statements of the Council seemed to be quite dovish. The list of factors that create risk for inflation was very short. It included continuously high dynamics of cash in circulation, high oil prices and the primary risk factor, i.e. uncertainty regarding current and future situation of public finance, which brought additional nervousness on the Polish financial market. The Council pointed out that liquidity problems of the budget, rising debt and unclear perspectives of fiscal reform were the main reason for increase in market interest rates and weakening of the zloty. However, the MPC said that other macroeconomic indicators (accelerating GDP growth, low inflation, low C/A deficit, high exports and low relation of short-term foreign debt to FX reserve) did not justify the weak zloty to be sustained. According to central bankers it means that fast and effective reforms of public finance would remove uncertainty, eliminating disturbance on the financial market. In line with our opinion presented many times in the past, NBP governor said the central bank was not going to intervene on the FX market ("as experience showed that hands-off policy is effective") and excluded a possibility of rate hike.

In the official statements there were several arguments suggesting a possibility of rate cut in the future, not a rate hike. The central bankers did not see a threat from monetary developments (excepting mentioned above high dynamics of cash in circulation), stressing that acceleration of broad money and credit growth rates stemmed to a large extent from exchange rate movements. The MPC also stressed other factors constraining future inflation. They included low level of

inflation measures and maintained wage discipline in the enterprise sector (although wage growth was recently higher than expected). What is important, the MPC said that strengthening signs of economic recovery (high dynamics of industrial output and retail sales, good results of business climate survey in industrial manufacturing, excellent export performance) did not create significant inflationary pressure, which could be dangerous from the point of view of the next year's inflation target of 2.5% +/-1pp.

All in all, the Council strongly suggested (stronger than in previous months) that it is not afraid of significant inflation increase (which is in line with statement of NBP deputy president Andrzej Bratkowski – see below). What is interesting, in October the NBP presented higher than previously GDP growth forecast of 3.4% for this year and 4.3-4.5% for 2004.

In recent months, MPC members evidently stated many times that in current situation (caused by uncertainty regarding public finance) another monetary easing is rather impossible this year. However, their comments and the tone of official statement indicated they could cut rates if the market was not frightened by fiscal issues. One could even say that after expected approval of fiscal plans at the beginning of 2004 we would see a continuation of interest rate cuts even if the MPC was not changed.

However, as debate over spending cuts plan is likely to be continued until the beginning of next year, we expect that the next rate cut would take place only after a change of the MPC members. Especially, as the MPC used to refrain from changes in monetary policy parameters during the last meeting of the year, as it is usually scheduled before all macroeconomic data publication (this year it will take place on 16-17 December). Additionally, the MPC will meet on 2 December to discuss central bank's accounting rules and financial plan for 2004. Changes in the central bank's accounting rules are aimed at adjusting them into line with the EU standards.

Agreement on bad loan provisions and reserve requirements

Representatives of the government, the central bank and commercial banks signed an agreement to change rules for classification of bad loans and creating bad loan provisions. Under the agreement the credits, which are not being serviced for 1-3 months are classified as credits under review, from 3 to 6 months are included into the category of sub-standard credits, from 6 to 12



months as doubtful credits and for more than 12 months as lost credits. The government also signed a deal with the banks' association to introduce interest on reserve requirements in May, when Poland enters the EU. However, the agreement assumes that the bulk of the banks' new revenue will flow into a special guarantee fund to co-finance investment projects connected with the EU accession. According to deputy PM Jerzy Hausner the guarantee fund will have at its disposal some PLN800m. In 2004 this fund would receive 80% of the interest payments (while 20% will go to commercial banks). This ratio would drop to 60% in 2005 and to 50% in 2006. Starting from 2007 all interest would go directly to commercial banks. Finance minister said that new rules for the banking sector would simplify accounting, and make general risk provisions easier, bringing tougher Polish standards closer to those prevailing in the EU. According to the banks' association estimates, ratio of bad loans to total credits, which now stands at around 21%, would fall to around 12% if EU standards were used.

Reserve requirements cut not unanimous

According to the Government's Monitor, in September seven members of the MPC voted in favour of reserve requirements cut from 4.5% to 3.5%, while two members opted against such decision. One member (Dariusz Rosati) was absent during the vote. Two voices against reduction belonged to Bogusław Grabowski and Jerzy Pruski. It was not very surprising, given that Grabowski strongly opposed any monetary easing decision after presentation of 2004 budget draft, and also underscored that reserve requirement cut would be an equivalent of interest rate reduction. Pruski, whose views on monetary policy are quite similar to those presented by Grabowski, apparently shared his view. However, it is worth noticing that other hawks, including the ultra-hawk Marek Dąbrowski, supported the reduction of reserve requirements ratio. The results of voting in September did not affect predictions regarding future path of interest rates, because the next monetary policy decisions will be in hands of new policymakers, who begin their term of office in January-February 2004.

MPC candidates in December, voting in January

According to speaker of the Lower House, Marek Borowski, a list of candidates for new members of the Monetary Policy Council will be drawn up in December. "Candidacies for MPC members will have to be submitted in December and the choice itself may be

moved to January", he said. Let us recall that the terms of two current MPC members picked by the Lower House (Jan Czekaj and Jerzy Pruski) runs out on January 8, while the term of the third Lower House appointee Marek Dąbrowski runs out on February 6. Three members appointed by the Senate (Wojciech Łączkowski, Bogusław Grabowski and Cezary Józefiak) will lose their mandate on January 22. Therefore, the Upper House will also have to appoint new members before January meeting of the MPC. The term of the remaining three members appointed by the president will end in February.

MPs planned reduce MPC headcount, but... they changed their view

In late October - beginning November, Polish deputies created a confusion as regards the number of new MPC members. Firstly, the parliamentary public finance committee decided to recommend reduction in the number of MPC members from ten to seven. Under the proposal, Poland's president and the two houses of parliament were expected to choose two, not three (as it is presently) members of the Council. The proposal brought a lot of comments suggesting a decreasing role of NBP president in the new council, as MPC chairman's casting vote would be important only when one of remaining members would be absent. In our opinion, one cannot say that this would significantly weaken a position of the NBP governor in the MPC, as there is no difference whether in order to press his view he would have to get a support of three members in the Council consisting of seven members or support of three members in 8-members panel. The only difference would take place if one assumes a scenario, in which the NBP chief would be supported by central bankers chosen by the president. In this case, he would have to win one more member over to his side, regardless whether the MPC would consist of seven or ten members. However, this may be more difficult when group of doves chosen by the parliament would be smaller and more disciplined (four persons) than larger (six persons) and thus probably more diverse with more discrepancies in opinions on monetary policy. However, this discussion became groundless after several weeks, as SLD deputies changed their views and they supported 10-members council (more details below in *Government and politics* section).

Comments of the MPC members and central bank representatives

MPC members quite cautiously evaluated plan of spending cuts presented by deputy PM Jerzy Hausner. The overall direction of changes was assessed as appropriate, but according to central bankers the scale of proposed spending cuts was not sufficient. They also criticised delaying deep cuts until 2005, which increased – for example in Dariusz Rosati's opinion – the risk of exceeding public debt level to GDP of 60%. Dariusz Rosati and Cezary Józefiak evidently shared our opinion that lack of amendment to 2004 budget draft seriously constrained credibility of the whole fiscal strategy. Rosati suggested that the government could decide to change the methodology of calculating public debt in Poland to ESA95 system or use a part of NBP's revaluation provisions for repayment of foreign debt. What's interesting, this suggestion was not welcomed by deputy PM Jerzy Hausner. Possibly, he did not want to play with his cards on the table before a game in the parliament. Rosati stated also that Hausner's plan was a great step forward in the right direction in terms of public finance reform. This was well in contrast with his earlier statement: "further interest rate cuts may result in forex crisis", which of course did not lead to a stabilisation of the Polish financial market (not to mention Bogusław Grabowski's statement about a crisis). Especially, as nervous atmosphere was fuelled by NBP president Leszek Balcerowicz. One day after October's meeting, in the interview with public TV, he suggested that uncertainty on the market might call for an interest rate hike. What is interesting, Balcerowicz statement was completely at odds with what he said a day earlier during the press conference after the rate-setting panel meeting. Therefore, his last comment was astonishing. It forced the central bank to issue a statement intended to clarify Balcerowicz's remarks. Namely, the central bank said: "analysis of the economic data did not argue in favour of reducing interest rates. At the same time, the Council did not examine the possibility of raising interest rates". Central bank's communication department said also that the intention and meaning of this Balcerowicz's comments were fully in line with the comments made after the MPC meeting. Well, it was extremely difficult to interpret Balcerowicz's statement this way, although we do not think it suggested that the MPC changed its monetary policy line. It was confirmed by the statement in November.

Despite high fiscal uncertainty, triggering a turbulence on the financial market, inflation expectations of central bank's representatives are still quite optimistic. Of course, there are a few hawks in the MPC (see Grabowski's comment below), but one has to note that NBP deputy president, who is closer to NBP's staff preparing forecasts, said "I don't expect the current weakening of the zloty to have any major effect on the inflation rate this and next year". However, regardless inflationary expectations, the market situation increased a predictability of MPC decisions – in October and in November MPC members strongly suggested no rate cut. The same should be expected in December.

In December we will see statements not only of current, but also of future MPC members. And these will be opinions, which should be closely watched, as they could help in understanding monetary policy decisions in 2004. Andrzej Sopoćko, former deputy finance minister, regarded as a likely candidate to the new MPC, said in an interview with PAP that there was still room for monetary easing (in his opinion rates could be reduced by additional 100bps). However, he added that level of interest rates was not the most important for the Polish economy presently. What is interesting, Jan Czekaj (new MPC member, which in line with the decision of the Constitutional Tribunal may be reappointed) said that after the appointment of the entire new MPC it would remain cautious in monetary policymaking in order to prove its credibility. Wiesława Ziółkowska said "I would not scare with the new shape of the MPC; politicians have more common sense than we imagine".

All the time we see a lot of comments as regards possible dates of ERM-2 or Eurozone entry. NBP deputy chief Jerzy Stopyra tried to convince about government's determination in reforming public finances, which in his opinion could help in strengthening the zloty. While we agree with his view on the prospective zloty appreciation, we believe that his hope for Poland's Eurozone entry in 2007 should be described as an excessive optimism. NBP's Andrzej Bratkowski said "it will be truly difficult to enter the Eurozone before 2010".

Three MPC members commented downgrade of S&P rating for Poland. Their conclusions, which helped in financial market stabilisation, were consistent with our view. Namely, they said S&P's decision should not affect investors' behaviour, as it reflected poor stance of Polish public finance, which had already been priced-in by the market. What is more, Rosati and Ziółkowska said that S&P's decision was not entirely justified, especially as its timing was concerned.

WHO. WHEN. WHERE	COMMENT
Leszek Balcerowicz, NBP President; PAP, 26 Nov	We have pointed to the factors that cause the future inflation to be limited. There are wage discipline in companies, moderate M3 money supply, low growth rate in credits for entrepreneurs and weak increase in credits for households among them. However, future rise in inflation could also result from stronger upward trend in economic growth though meeting next year's inflation target would not be endangered. The Council stands by the opinion that fiscal problems are maintaining. The fiscal situation has not changed. The government pointed to threats by itself. Apart from fiscal uncertainty, the pressure is also exerted by continuously rising cash in circulation, rising oil prices and zloty depreciation. As early as possible date of adopting euro, i.e. 2007 would be the most favourable for long-lasting economic growth. [...] Having adopted euro in Poland we will achieve benefits, we will decrease FX risk. Postponing the date would mean renouncing from certain benefits. Q. Was the rate increase not discussed? A. We may say so. I would not draw a conclusion that the same [as Germany and France] will concern applicant countries whose deficit are wider. I don't think the [Stability and Growth] Pact will be abandoned. What happened yesterday is unfortunate, may signify a weakening of the budget requirements and poses the question of the observance of treaties.
PAP, 21 Nov	It would be exposing accession countries to unnecessary risks if the EU side insisted on the narrow interpretation of the trading bands within ERM-2. I don't find an economic justification for such an interpretation. The Growth and Stability Pact prescribes certain fiscal constraints and it would be risky both for current and new member states if they were to be changed. These limits should be kept.
TVP1, 30 Oct	The analysis of factors influencing the future inflation made raises senseless. On the other hand we believed that the present nervousness on financial markets would require movements in the opposite direction. Monetary policy that comes in NBP's jurisdiction will not replace very needed economic reforms, mainly those that will result in quick repairing public finance. [...] Personally, I would not worry if the program was deeper, if there were more spending cuts and slower rise in public debt and if it was implemented sooner.
PAP, Reuters, 29 Oct	The removal of uncertainty [concerning fiscal policy] should lead to the strengthening of the zloty in comparison with the current weak level. [...] The implementation of the [Hausner's] programme would dispel the sources of the uncertainty. The proposals [to raise interest rates] were not discussed during today's meeting. We also have the intervention in our repertoire, as it is good to have a wide repertoire of instruments. We have not used this instrument while conducting free-floating rate policy. I think the experience points that it was a proper policy. We don't resign of this possibility, but the experience points it clearly that in Polish conditions sticking to free-floating rate turned to be favourable. [GDP growth] Forecasts prepared by NBP's experts have been revised upward to some 3.4% for 2003 and – as far as I remember – to 4.2-4.3% for 2004.



Reuters, 24 Oct	I maintain my view that euro adoption in 2007 would be the most favourable for the Polish economy. Focusing on such timing means reforming, which would bring GDP growth acceleration. At the moment we meet all but one Maastricht criteria. We have low inflation and public debt still below 60%. We have to lower budget deficit and to curb rising public debt, and we can do it only by lowering public spending.
Jerzy Stopyra, deputy NBP governor; PAP, 26 Nov PAP, 14 Nov	A proposal, which was accepted and assumed that central bank's financial plan should be approved by the parliament, is inconsistent with the Polish constitution (article No 227). One of financial plan's elements is connected with costs of open market operations, which is a part of monetary policy. This is the trend (zloty strengthening) which follows fundamental factors. The seasonal factors were behind the firming of the zloty. The situation is getting clear in this respect. The government shows determination to introduce the reforms it is announcing. At least in its first part. Markets, rating the fundamental factors, are valuing the zloty stronger. If the government will show determination in reducing budget deficit, the Eurozone entry in 2007 would be realistic.
Andrzej Bratkowski, deputy NBP governor PAP, 21 Nov PAP, 17 Nov	Poland should only open talks with the European Union on entering the pre-euro Exchange Rate Mechanism (ERM-2) after the passage of a package of government spending cuts. This is a minimum to launch talks (on the ERM) with the European Commission and the European Central Bank. Premature pegging of the zloty with the euro may make it difficult to pursue a coherent monetary policy and in effect delay rather than accelerate Poland's joining the Economic and Monetary Union. Poland should adopt a credible public finances reform plan that would specify the date for meeting fiscal convergence criteria as a starting point for working out new assumptions to Poland's integration with the Economic and Monetary Union. Only then will it be possible to say when a central zloty rate, a band of its fluctuations, and Poland's entry date into the ERM2 could be specified.
Reuters, 27 Oct	In my opinion, present zloty weakening is short-term, fundamentally the currency is now undervalued. I think that the situation on the market will improve in a month or so. The upcoming meeting of the MPC should help calm the situation. [...] The assessment of the macroeconomic situation has not changed since the MPC's last meeting. I don't expect the current weakening of the zloty to have any major effect on the inflation rate this and next year. [...] At the end of the year inflation is likely to be around 1.5%, certainly it will be below this year's inflationary target and I don't expect any stronger rebound next year that would threaten the 2004 inflationary target. The budget bill for the next year does not foretell an economic meltdown, but may slow down the growth. Constitutional debt threshold force some adjustment on fiscal side. However it is worth doing it as soon as possible, which means starting from next year. Hausner's plan is a step in the right direction. Of course we should consider areas where further cuts can be made. Carrying out this plan is a must. In short term it is an absolute minimum.
Reuters, 24 Oct	There is a chance to start ERM-2 negotiations in 2003, but it depends on the government's ability to reform public finance sector to lower budget deficit. At the moment we do not know about the date of ERM-2 entry, as we do not know results of government's negotiations with its political backing. Earlier we have expressed our will to enter the Eurozone as soon as possible, but the situation has become a bit more complicated. Situation will be very difficult if we do not have fiscal adjustment; Eurozone entry before 2010 would be very difficult. If we do not have a fiscal tightening, our situation will be dire. It will be truly difficult to enter the Eurozone before 2010. One cannot say we have any guarantees. Everything depends on the government, on whether it will be able to implement the necessary reforms thus preventing us from overshooting 60% of the debt-to-GDP ratio before 2006 and whether we will really be able to fulfil the Maastricht criteria in 2007 at the latest. [...] I can only say this is my hope.
Jan Czekaj, MPC member; PAP, 20 Nov PAP, 19 Nov	These good data [on industrial output] show that the economic growth strengthens and it should 3.5% growth this year seems realistic. We have waited for a long time, but it will not have significant influence on MPC decisions. (...) Along with output growth always appears inflationary pressure. However, there are still no serious threats for inflation. At the end of the year CPI will be close to the lower end of inflation target that is close to 2%. Premature pegging of the zloty with the euro within a fluctuation band would be unfavourable for Poland as it would make difficult effective policymaking. We more and more often hear warnings from ECB's representatives that we should not rush excessively, since joining [the Eurozone] is related with some costs that we will have to bear. [...] Meeting fiscal criterion must lead to limiting domestic demand and, in that way, to limiting a pace of economic growth. After joining the EU we will have to do with a necessity of adjusting prices, which means imminent acceleration in inflation. A fluctuation band of $\pm 2.25\%$ [in ERM2] and not $\pm 15\%$ is put quite clearly by that side [the European Commission]. However, if we had a $\pm 2.25\%$ band it could be very costly for monetary policy and the FX rate. Currently binding NBP law causes that the NBP is one of the most independent central banks. [...] The NBP realises this target [price stability] very well and even more than planned. [...] High NBP's credibility allows to believe that inflation will not rebound.
PAP, 5 Nov	The new MPC will be in a very difficult situation. It will be torn apart. On the one hand there are expectations for a "dovish" policy, on the other the market will fear it. Therefore, first decisions may be cautious. To be more credible the new MPC will have to take more "hawkish" decisions rather than "dovish" ones. We might be a little surprised by the first decisions. I think the date of our accession to the euro is 2009-2010. Fulfilling the Maastricht criteria will be enough. The EU will not be so eager for accession of new members too soon. This not only our problem but also EU's attitude towards new members.
Reuters, 24 Oct	We have to think about reasons of recent zloty weakening. I think these are short-term factors. Fundamentally, there is no reason for the zloty to weaken. Inflation figures are improving and so is the current account balance. Exports results are good. The factors behind the zloty fall are largely short-term, they may be of speculative nature. The MPC takes all relevant factors into consideration (deciding on interest rates), including this one.
PAP, 17 Oct	September's industrial production data should not influence MPC decision as regards interest rates. There is no inflationary pressure visible, and the data do not change this picture. I would refrain from commenting on interest cuts possibility. I see no risk for inflation, but on the other hand the situation on financial markets and on the stock exchange is very vulnerable and should be closely watched.
Bogusław Grabowski, MPC member; PAP, 26 Nov TNV24, 20 Nov	Independence of the central bank must be met not only in personal and functional terms but also in financial terms. The Parliament must not interfere in accounting rules of creating reserves to such an extent that it influences money supply. I can assure finance minister and Public Finance Committee that the MPC will change the central bank's accounting rules, adjusting them to the standards of the ECB. This will result in even more restrictive approach to revaluation provisions. This will mean that central bank profits from favourable exchange rate movements could be transferred to the budget even more rarely.



PAP, 7 Nov	Another piece of data from the food market show slight acceleration of prices. This process will surely gain its momentum in 1H04. Inflation will be accelerating, its annual growth will be rising. Food is not the only factor that will accelerate the inflation. We still have to "consume" an effect of strong zloty depreciation in recent months, higher fuel prices and very loose fiscal policy.
PAP, 10 Oct	Financial markets surprise me. Their participants think that within next few month interest rates should react on fiscal plan presented recently. Monetary policy always reacts on de facto changes in fiscal policy, not plans. Especially as in Poland we had several medium-term plans and all of them were not realised.
Cezary Józefiak, MPC member; PAP, 5 Nov	Just in short, there is still the atmosphere of uncertainty and unstability in Poland's fiscal policy and I think it is the main reason for rating downgrade. [...] I do not believe that and serious effects will result from this one event. We have already seen these effects in a shape of FX rate fluctuations. These are not the effects of rating downgrade, but rather the rating is an effect of uncertain situation.
PAP, 31 Oct	There was a good rise of exports. I hope it will continue to rise. The deficit has been recently decreasing but it is not so the case that now it will turn into a surplus. There are no reasons for such conclusions in the long-term. High exports result from higher competitiveness of Polish enterprises amid zloty weakening and lower unit labour costs. Exports is really desirable, but we need higher investments to achieve higher growth in the longer run. It seems to me that GDP growth will be around 3.5 pct for the whole year but it is connected with the utilization of production capacities.
PAP, 28 Oct	This is not a really urgent and important matter for our economy. The public finance committee should not consider whether there should be 6, 10 or 12 MPC members. [...] This way it just looks like working for publicity, planning that somebody's expenditures would be cut while there is a great problem of excessive state administration. It is important that persons representing different economic schools and ways of thinking sit on a Council and not the number of them. [...] It seems to me that attention should be paid to really crucial issues, like if the fiscal policy is proper, if the economy will be stable and if investment will increase at last and the employment together with it. In constitution and public finance act a present ruling [on NBP's aims] was accepted because of belief that the target of central bank to stabilise money power is favourable for the economy, growth, investment and employment. One can prove it is that way, indeed. [...] If the new ruling was against the main target of the NBP it would be fatal, as the main target supports the economy.
PAP, 27 Oct	As far I am concerned, I do not see such a need for now. We will see what the new Council will do about this. It is important not to introduce nervousness.
ISB, 9 Oct	This is a step in a right direction and it shows that the government sees seriousness of the situation but the proposed measures are insufficient, too weak in relation to the seriousness of the situation. (...) Propositions presented by deputy PM Hausner and accepted by the government and that what PM talked about shows something positive, namely that all worries propagated by economists were shared by at least part of the government. This is positive because warnings could have been just rejected. I am glad about that. The proposal of spending cuts does not change the fact that 2004 budget draft is based on the assumption of favourable coincidence. As a result there is a thin line before exceeding 55% level of public debt in relation to GDP. (...) Change in budget draft made by the government would show how serious is the situation. One should tell society and the parliament how dangerous is the situation, including the risk of not meeting some goal and this would be the starting point for some cuts. I call it an emergency variant, which we have to keep up ours sleeve but it has to be also showed, and then cuts would like different.
Dariusz Rosati, członek RPP; PAP, Reuters, 21 Nov	Poland, as well as other accession countries, will probably seek both an assessment on using the wide bands and a shorter mandatory stay within ERM-2. Imposing the ERM system on a free-floating currency increases the risk of speculative attacks and may erode previously seen currency stability. The very fact that wide bands will be used will discourage speculators. The most realistic option on the way to the euro is to cut the (budget) deficit to three percent (of GDP) by 2007, stay in the wide ERM-2 trading bands for two years, meaning 2007 and 2008, and then enter the euro in 2009. Borrowing needs in the first quarter of next year can be estimated at between 30 and 40 billion zlotys.
PAP, 20 Nov	Data on industrial production confirm that the recovery is in progress. They indicate that the economy is actually at the stage of accelerated growth and confirm that the growth is stable. At the moment we analyse mostly situation in public finance. Current situation on the market is caused mainly by uncertainty regarding implementation of public finance reform. Data on production cannot remove the uncertainty. [About producer prices] We have some effect of the zloty weakening, so it not a surprise and one should not be concerned about that as long as he do not have further depreciation of the zloty and I do think it will be weaker.
PAP, 14 Nov	Six is equally good as nine. (...) If such people [experts in monetary policy] will be in the new MPC, I am confident of monetary policy even if the number of MPC members was reduced to six. It is important that we should not change responsibility range of the NBP and maintain independence of the NBP as it is necessary for conducting responsible, long-range monetary policy.
Reuters, 7 Nov	I do not see any potential for further weakening of the zloty. There is potential for quite high volatility because we face a period of uncertainty. We cannot continue with privatisation at the same speed all the time. We don't have so many assets to sell. No government has attempted to make such deep cuts in social expenditure. This is a very politically sensitive issue and I think the government should be credited for that. The timing of the [rating] downgrade is unfortunate as the government is undertaking reforms. I do not expect any further downgrade.
Rzeczpospolita, 6 Nov	[FX] Intervention is one of our tools in our toolbox, but we don't see any reason to worry about it so far. I believe that what was proposed [Hausner's plan] is a great step ahead. If I said that Hausner's plan is delayed, I mean no activity in 2004, which implies more significant adjustment in the following years. This postponement of the programme means higher costs of debt servicing by some PLN2bn in 2004. I think that forecasts of a situation in public finances are based on very optimistic assumptions. Probability of meeting all these assumptions at the same time is very low. But the government has too possibilities, which were practically not mentioned. The first is a change of methodology for ESA95. The second is of course a use of NBP's revaluation provision. Possible this would be possible in cooperation with the new MPC, although I hope not the whole amount would be used. I agree that public debt threshold of 55% of GDP will be broken in 2005. Financial markets are not worried about this, as expenditures adjustment would be automatic when the thresholds are broken.
PAP, Reuters, 5 Nov	The reasons are obviously the uncertainty about public finances and the fate of Hausner's reforms, the significant borrowing plans for next year and the turbulence on the markets. This is no great surprise, it's nothing new on the market. This is the result of a situation that has been quite apparent to the market over the past few weeks and is well known.

PAP, Reuters, TVP1, 29 Oct	<p>I am not fully convinced that it [rating downgrade] is justified and therefore, I do not think the market will be affected. I think that market adjustments took place last month or six weeks though the weakening of the zloty and first of all through a rise of yields of Treasury bonds.</p> <p>The timing of the decision to downgrade the rating is a little surprising. It could have been done a month ago and not now when government's activity is increasing to find a support [for Hausner's plan].</p> <p>Due to this worries [related to public finance sphere] the trend of systematic decline in yields on Polish bonds reversed. It reversed in July or August and resulted in rating agencies' response. [...] On the one hand the government prepares a bold reform program in social security system and on the other hand they carelessly plan huge deficit for next year. This is a certain incoherency and what is more we do not know if Hausner's plan will gain the support. These are the factors of uncertainty that will not disappear in next three months.</p> <p>The fiscal situation will be determining the conditions on the markets probably in next 2-3 month's time. Even the adoption of the final version of the budget law will not remove uncertainty related to program of cuts as the schedule of actions on the Hausner's programme is longer .</p> <p>Other macroeconomic indicators are positive. Inflation is low, we have balance in payments, high reserves and therefore there are no reasons to panic.</p> <p>If the government prepares a good reform programme and adopts a pretty good budget for 2004, then the possibility might arise that rates could be further lowered.</p>
PR3, 28 Oct	<p>Interest rates in Poland can still be seen as higher than in other countries. However, on the other hand, given turmoil on the market and zloty depreciation some voices appeared that maybe we should raise the rates.</p> <p>I don't think there is a need for any type of intervention. At present the zloty is around the so called old central parity.</p> <p>I think what we are facing is a period of high volatility in rates, caused by markets' uncertainty about the government's plans concerning Mr. Hausner's program to cut budget spending and about the final shape of the budget for next year. These two very important factors will remain uncertain for another month or two, therefore we are likely to face a period of volatility and a generally weaker zloty, unless we see some developments</p>
Reuters, 24 Oct	<p>This weakening is of concern. It is too deep and there are no reasons for further weakening... I think the fall is caused by large one-off transactions. The next week's meeting of the MPC could calm the situation on the markets. I expect the statement not to include any alarming signals as the MPC has already criticised the budget and there have not been any new developments since.</p> <p>There is no reason to increase rates. What is needed is a clear signal from the government addressing fiscal concerns of investors. The weakening of the zloty is worrying but this is absolutely not a crisis. If Hausner's plan is accepted in main points, there would be no reason to tighten fiscal policy.</p>
TVN24, TVP3, PAP 17 Oct	<p>Further interest rate cuts may result in forex crisis and inflation rise. The 2004 budget deficit should be slashed by a minimum of PLN10bn, the amount close to Poland's contribution to the EU. If the deficit is not changed, it may get out of control with financial markets refusing to finance it.</p> <p>The outcome of the vote [on the budget draft] will calm financial markets.</p> <p>This idea [of new 50% tax rate] is an example of a complete economic ignorance. This would lead to outflow of money abroad, not to an increase of budget revenues. This would anti-growth policy, which would lead to a decrease of employment.</p>
Reuters, 14 Oct	<p>Hausner's plan is very positive in respect it decreases waste and mismanagement in public finances. [...] I am concerned that some changes are postponed for the next year</p> <p>I do not see a risk of crisis, but rather a risk of very difficult economic situation. [...] Crisis is possible if the market would assess that the government cannot meet assumptions, which would lead to an outflow of money. It is sufficient that the zloty weakens by 10% and debt-to-GDP ratio exceeds 60% of GDP, and such debt would be very difficult for servicing.</p>
Rzeczpospolita, 10 Oct	<p>In general, direction of changes is very good, because it decreases spending, including in the social sphere, which requires a reform since long time. This is the first government within last 13 years, which take such decisions. However, there are several doubts. Especially the fact that public spending cuts are planned started from 2005, which is election year and this decreases a credibility of the plan. Next year budget is unchanged with high budget deficit which creates a risk of exceeding constitutional safety threshold of public debt (60%). It is highly probable (which is indicated by overly optimistic assumptions) that exceeding this debt is a question of statistical error. As a result, if the constitution is not changed, public spending would have to be adjusted abruptly, which would be painful for the whole society.</p> <p>Another problem is political support. Last weeks showed that deputy PM had to surrender because of some groups' pressure, which does not bode well for this project. Also, I do not know why the government did not decide to change next year budget, as activities lowering budget deficit cannot be delayed. To avoid financial crisis and further zloty weakening, spending cuts have to be started right now. The budget amendment is necessary from this point of view, as this would add a credibility for the government's plan in economists' and investors' eyes.</p>
Grzegorz Wójtowicz, MPC member, PAP, 31 Oct	<p>The result is surprisingly good. We report a surplus for the first time in 5 years. But these are only monthly data because in year-on-year terms we still have a deficit which in my view is 2.4 pct of GDP. As far as the end of the year is concerned you may expect 2.7 pct of GDP. The deficit is lower because of two factors: high exports and high unclassified flows surplus – cross border trade was more competitive amid recent zloty weakening.</p>
PAP, 17 Oct	<p>Poland's economy will grow over 3 percent in 2003, and the economic growth in Q3 and Q4 will be similar to that in Q2. Industrial production data is only a small part of the whole economy picture. Investments growth, which in 2Q03 was still negative, is the key factor.</p> <p>There can be short-term technical problems but the budget copes well with liquidity management. It is not true that the budget is insolvent.</p> <p>The foreign exchange market is atheistic, it does not believe in miracles. This market will be reacting with more optimism to few optimistic news, and with greater pessimism to bad news that will be coming in greater numbers. This will lead to bigger swings. 2004 will be interesting, I do not expect it to be much different from what we have today. The problem is for the zloty not to move from that swing to a slide.</p> <p>Let's speak about 2008, everybody should pursue that goal. One can believe in 2007, but there is close-to-zero likelihood of that, 2008 is the question of a political will, it may be possible.</p>
Rzeczpospolita, 10 Oct	<p>We will see what will be details [of the spending cuts plan]. So far, there is no reason to say: there will be better. One can conclude from the plan that both deficit and public debt will rise. The plan alone may decrease anxiety but as yet this is only psychological action. This is how it is perceived by the market.</p> <p>These facts will matter. And often they will not be pleasant. During realisation of budget in future we will probably have nervous situations. We face long term process, during which we have to have strong nerves.</p>



Wiesława Ziółkowska, MPC member; PAP, 24 Nov	We are forecasting inflation at the end of this year in between 1.5% and 1.7%. It will be 2.5% +/- 1% in 2004 but rather over 2.5%. [...] Such a slightly higher inflation will remain at the level especially in early 2004 and the rest depends on crops and on oil prices.
PAP, 14 Nov	A good trend in exports may hold, chiefly on a large unclassified trade. We have Christmas time, a good exchange rate is maintained, our goods are relatively cheap in comparison with Czech and German goods, and the visa problem on the Eastern border is being gradually solved. We can post a surplus in unclassified trade but it's difficult to say whether it will be reflected in the whole current account.
ISB, 5 Nov	For now there no reasons to change parameters of monetary policy. Fiscal policy and developments on the domestic and international financial market does not allow for it. The situation still does not change and there are no changes, which could have influence on monetary policy and any shifts in this policy.
PAP, 30 Oct	Given current macroeconomic and fiscal situation there are no reasons for Poland's rating downgrade. There would be such reasons if the plan of public spending rationalisation failed.
Reuters, 29 Oct	I would not scare with the new shape of the MPC. Politicians have more sense than we imagine. If professionals are the members of the new Council, they would take decisions in a responsible way.
PAP, 28 Oct	Markets may calm down when the bills [Hausner's plan] will be accepted by the parliament and President will sign it.
Reuters, 14 Oct	It is the quality of MPC member's work and not their number what is the most important. The same role could be fulfilled the same well by six members. Lowering number of the members doesn't matter much. I would let it happen [assigning new aims to the MPC] if it was stated that price stability is a first-rate aim and supporting other aims remained foreground and did not harm the first target.
PAP, 8 Oct	Without an amendment [to budget draft] the chances for interest rate cuts are small, and it seems unlikely that the government will pass an amendment. September's inflation data published today show there is no inflationary pressure at the moment. The September current account deficit should be close to August's. Exports continue to be the motor of the Polish economy.
PAP, 19 Nov	PLN32bn of savings requires an effort to realise it. This would be a movement in a right direction. But on the other hand, we had several programmes like this, and we all know about their implementation.[...] We have no choice, spending must be reduced. It is amazing that the government is so natural when talking about breaking the level of public debt of 55% of GDP. It is positive that spending cuts start in 2004, but the market and the MPC will wait for details, which have to be implemented
Andrzej Sopoćko, former deputy finance minister; possible candidate for MPC member PAP, 19 Nov	There is a chance for interest rate cuts. For a year there have been a positive trend but it seems to me that the cuts should be bigger and there is a room for cutting rates by 100bps. [...] I believe that the new Council will be more inclined to cut rates, but at present the issue it looks a little different than a year ago when the question of interest rates was the most important matter in financial policy. [...] At present there are two or three more important matters, e.g. FX rate stability, decreasing restrictiveness of the policy of the central bank towards commercial banks, maybe further decreasing mandatory reserve. The zloty should strengthen since the uproar that to some extent was created by the policy, will fade. Hausner's plan is the element of balancing budget and is essential. I hope that if it is accepted the zloty will appreciate by some PLN0.15 against the euro in coming months. There is a possibility that Poland will join the Monetary Union in 2008. It is also realistic that we will enter the ERM2 system two years earlier. The fluctuation band is quite narrow. We also have some reserves to fight off short term attacks against the zloty. [...] I would support earlier, but by a few months at the most, pegging of the zloty with the euro. But we should not rush with it, let it be an open matter. For the time being a narrow fluctuation band should be maintained. [...] Interventions of the central bank would be justified only in case of speculative attacks against the zloty. If the zloty is depreciating due to political turmoil the intervention is not advisable.
Karol Smolağ from NBP's press office; Reuters, 30 Oct	The intention and meaning of this morning's comments were fully in line with the comments yesterday after the MPC meeting. [...] They were, namely: Analysis of the economic data did not argue in favour of reducing interest rates. At the same time, the Council did not examine the possibility of raising interest rates.



Government and politics

- **Social negotiations re “Hausner’s plan” continue**
- **...which implies uncertainty mood on the market**
- **Different views of rating agencies**

Nothing new in fiscal plans

After the government accepted three important documents - budget draft for 2004, medium-term strategy for public finances and programme for public spending reduction - nothing special happened on the fiscal front. In line with the schedule, changes in tax laws were accepted by the parliament. Deputy Prime Minister Jerzy Hausner continues a public debate on his (or governmental) so-called reform of public finances. However, in line with earlier announcements, conclusions will be known only at the beginning of the next year. As a result, the Polish financial market is very likely to remain nervous in the near future, which would be visible in still high yields (low prices) of treasuries and relatively weak zloty – details in *Market Monitor* section.

Different views of rating agencies

While fiscal authorities did not present new details as regards their policy perspective, three most important rating agencies released comments assessing the Polish fiscal stance. Actually, these were not only comments, but also decisions about rating (or rating perspective) change. What is interesting, assessments presented by rating agencies were quite inconsistent.

Fitch Ratings revised the outlook on the long-term foreign currency ratings to positive from stable for seven of the ten countries joining the European Union in 2004. The countries affected were Cyprus (A+), Latvia (BBB+), Lithuania (BBB), Malta (A), Poland (BBB+), Slovakia (BBB) and Slovenia (A+). Estonia's (A-) long-term foreign currency rating was placed on positive outlook a few weeks earlier. What is more, Fitch said it expected the incoming members of the EU to have sovereign credit ratings 2-3 notches above their current level when they eventually adopt the euro. What is interesting, the negative outlook on Hungary's (A-) long-term foreign currency rating and the stable outlook on the Czech Republic's (A-) long-term foreign currency rating remain unchanged, which was probably connected with fiscal problems of the two countries.

On the other hand, Standard & Poor's ratings service downgraded Poland's sovereign ratings for local currency debt. Long term rating has been cut from A to

A-, while short-term assessment from A-1 to A-2. Outlook for all ratings (both local and foreign currency) remained negative. While the rationale behind such decision was quite obvious – deteriorating condition of public finances, mounting budget deficit and public debt levels, and uncertain perspectives of public finance reforms – the timing of the operation was somewhat surprising. Standard & Poor's has reduced the outlook for Poland from stable to negative in June 2003, justifying it by the escalating debt, exceeding levels in other countries with similar credit score. Since then it was clear that a downgrade was imminent. What is more, S&P analysts have been warning for some time that the ratings might be cut if the government did nothing to mitigate upward trend of debt and deficit burden. But still, it looks unclear why the decision came in this very moment, when the final versions of both the 2004 draft budget and the medium-term reform of public spending were still unknown. Well, perhaps even the versions proposed by the cabinet have earned such negative assessment from the S&P, which triggered a shift of credit score.

While the decision was bad news for Polish financial market, being already seriously worried about the country's fiscal perspectives, market reaction was very short-lived. Right after the release of the report the zloty plummeted by some 1-2% and treasuries' yields moved up by some 10bps. However, the market made for losses very quickly, as it concluded that the decision was already priced-in.

Third of the agencies - Moody's – joined Fitch Ratings in its assessment of fiscal policy perspective. It said that Poland's local (A2) currency debt rating was under no threat and there was little danger of a debt crisis. According to the agency analyst, Jonathan Schiffer, improving fundamentals of the Polish economy and EU entry support a stable outlook of ratings and they could only be threatened by a failure to push through fiscal reforms planned by the government. However, Schiffer said that he believed in the ability of deputy PM Jerzy Hausner to push through reforms next year and prevent public debt from exceeding security thresholds, at which drastic spending cuts would be triggered. Schiffer stressed Poland had very good growth prospects, which should help meet Maastricht criteria.



Comments of the government members and politicians

In latest weeks, government's officials were concentrated on social debate as regards the reform of public finance. Prime Minister Leszek Miller and deputy PM Jerzy Hausner, who had support of President Kwaśniewski as well as Lower House speaker Marek Borowski, were convincing about their determination to carry out cuts in public spending. According to Miller proposed reforms will be implemented "regardless of circumstances (...), regardless of public opinion polls". One can be pleased with such determination of the government but political and social support for government's plan still remains a big question mark. Official opening of public debate over the public spending savings programme means that from now on almost every day we can face another series of comments from the officials regarding fiscal reform. Of course financial market participants will remain reserved and even very enthusiastic comments made by Hausner would not be sufficient to improve sentiment when fiscal policy perspective still remain very misty. Especially, as at the same we had some comments about possible PM dismissal. Well, situation is not likely to clarify earlier than at the beginning of the next year.

Government officials commented also the remarks given to Poland by international credit rating services. We saw Jerzy Hausner's reactions ranging from euphoria after Fitch Rating's announcement ("I am fulfilled") to astonishment ("this is ridiculous situation") after S&P decision.

Two another, often mentioned issues (we wrote about them also in the *Central bank watch* section) in the comment of government's representatives concerned central bank's accounting rules (i.e. possible use of revaluation provision), as well as the number of members in new Monetary Policy Council. The former problem, according to finance minister, "is open and we will be discussed". The latter subject brought a lot of comments and confusion. However, after a few weeks of useless discussion it turned out that SLD caucus changed the view and it supported 10-members Council. Does it means SLD has more applicants than previously expected?

WHO, WHEN, WHERE	COMMENT
Aleksander Kwaśniewski, President; PR3, 19 Nov	If SLD's National Council does not support Hausner's plan the Prime Minister should resign. [...] We should know what is the stake and if the PM is convinced that the plan is right he must go all the way. In my opinion this is honest.
Marek Borowski, speaker of the Lower House; Reuters, 14 Nov Gazeta Wyborcza, 7 Nov	I am positive the new central bank bill will be passed by the Sejm this year. Hausner's plan will be good for Poland and lethal for the SLD if the party does not implement it . Some people say that the central bank should take out a bowl with punch while guests have a good time, so they should hike interest rates when the economy recovers. Therefore, even a "dovish" MPC can get ready to take out the bowl next year with rising budget deficit, accelerating economic growth and increasing inflation. This means that the central bank will not necessarily want to lower real and even nominal interest rates as it is planned in the budget.
PAP, 17 Oct	I do not share the view that spending cuts plan means political end for SLD. I think the opposite, SLD, this would be the SLD's end if it does not accept this programme, because it could survive one year, but not until 2005. It is impossible to wait this programme acceptance, and this view will be spread out. If this political formation would not be able to support the government in this crucial issues, this would mean that this parliamentary group lost its ability to rule the country. [50% PIT rate] This is a proposal, which have to be think over.
Leszek Miller, Primie Minister; Reuters, 17 Nov	If the (SLD's) National Council would reject this plan [Hausner's program of spending cuts], it would have far reaching consequences. The cabinet would not be able to carry out its work in a situation where one of its most important plans is rejected. [Asked if that meant he would resign, Miller said:] Well no, I don't want to forejudge anything since I don't want this to sound like a kind of threat.
PAP, 13 Nov	I am glad that we have such good result [no-confidence vote against Hausner], because it bodes well for program of spending rationalisation. (...) If a person associated with the program receives such support, one can logically assume that the program will also get such support. It would be very good because the program is difficult. Bills, which will make up the program are likely to trigger many controversies and it would be good if the whole program could count on such support as today.
PAP, Reuters, 6 Nov	I confirm the determination. The government will be executing the Hausner's program and the government count on the support for it also from the opposition. One day well-known agency upgrades Poland's rating and on the other day another agency does something opposite. It seems to me there is significant turmoil in this matter. It would be good if experts could determine some common point of view.
Puls Biznesu daily, 28 Oct	The treasury minister has received clear instructions. We cannot be happy that this year's privatisation plan will not be met. The treasury minister was obliged to considerably speed up privatisation in every possible area. Much can be changed in the budget draft though it rather concerns flows of some amounts and not deficit level. Q. And what if Hausner's plan will fail? A. If we do not make work, then in 2005 we will have to cut spending much deeper and without any rational plan, just because we may be reaching constitutional debt threshold of 60% of GDP. And this would be very unpleasant. So if somebody thinks that we could delay or dilute this plan, they should first answer this question: 'What will happen in two year's time, if we do so?' Majority of proposals from Mr. Hausner's plan will be implemented not in 2004, but in 2005. In 2004 we will mainly focus on legislation so that the act were in force on proper time. Besides, a part o them will get in force still in 2004. Anyway, on 1 January 2005 all government's intentions should be a law and not a plan.
Jerzy Hausner, deputy PM, economy and labour minister; PAP, 21 Nov	I have an impression that IMF report presented in Warsaw on Thursday has too dramatic tone. I did not read that document, I know it only from newspapers. If the IMF says that chance for improvement of the Poland's economic situation depends on implementation of the governments' plan of spending cuts, then I agree with it. The most difficult privatisations are ahead of us. However, they will not be carried out under some pressure but in line with our economic interest.
PAP, 20 Nov	The data [on industrial output] mean that our economy is still on a path of recovery. It is a good news. (...) However, I will be more confident about the recovery if investment rebounds. It seems it have not happened so far. Investment outlays grew for sure, but we still do not have investment boom. I wait for more significant investment growth, which will give more reasons for optimism.
PAP, 19 Nov	Tax strategy, which was unofficially discussed by the government on Tuesday, includes changes, which will allow to create target shape of Polish tax system until the end of this decade. We want to establish some level of tax burden on the economy and not to increase it. The level of this burden in 2004 will be the maximum.



PAP, 17 Nov	The linking of the zloty rate to the euro seems to be justified from the economical and technical point of view and in a sense it will bring us closer to the euro in Poland. Time is ripe for considering this proposal. [...] This should be considered, it cannot be lightly treated in view of the fact that our trade exchange that is mostly realised in euro. Inflation was planned at 1% to 1.3%. I think we are closer to the upper limit. It is neither surprising or a reason for concern. [...] I want to stress that inflation was very low in the second half of last year. In this connection inflation in the second half of this year is slightly higher than it was in the second part of 2002 which has not come as a surprise for anybody. It is difficult to imagine further food price falls given the fact that they lasted for a long time in Poland and had a structural character.
PAP, 13 Nov	If the unemployment will grow after we joined the EU I declare, taking responsibility for my words, that I will resign from the post.
Reuters, 12 Nov	Finance minister set a different exchange rate (from in the guidelines) for financing public debt, at an average annual exchange rate of 4.6. So in debt servicing cost calculations he has a buffer above the 4.35 rate [assumed for the whole budget].
PAP, 6 Nov	[S&P's decision] This is a bad signal, one cannot be pleased with it. What is ridiculous is that one day one agency raises a rating outlook and on the other another agency downgrades it. There is too much confusion in these matters. This situation is ridiculous, that one agency foresees a positive outlook for Poland a day earlier and another one sees that the matters go in opposite direction. What Fitch did is convincing and what S&P did is questionable. I hope that positive facts will prevail and as a result S&P will change their note. I see no reasons to assume now that the government will not conduct reforms. The government will officially examine and adopt a tax strategy on December 2 and appropriate draft laws will be sent to the Parliament by the end of March 2004. [...] The government will unofficially discuss the document on December 18 that will be sent to caucuses afterwards so that we are sure that it will be supported. The tax strategy does not speak about concrete solutions. It only speaks of dilemmas of choices. The document presents goals we want to achieve. [...] The tax system must support economic growth by limiting fiscalism and ensure stable and proper budget incomes. It must be accepted by Poles and it has to be clear, simple and cheap. Tomorrow I will ask Sejm speaker to bring special parliamentary committee into existence for the drafts related with the program of public spending rationalisation. [...] I intend to prepare all the drafts till the end of the quarter, so that they were accepted by the present parliament, regardless when they will come into effect. I expect a fall in the number of unemployed by 10,000, or 0.1 pp. in October. At the end of October the unemployment rate will amount to 17.4%. At the end of the year it will be probably lower than in 2002.
Rzeczpospolita, 6 Nov	[...] I don't want to use the possibilities mentioned by prof. Rosati [ESA system and revaluation provisions] in order to make the situation easier for myself [...].
PAP, 4 Nov	[after upgrade in Poland's rating outlook by Fitch] I am happy. At last, those who should notice government's efforts for economic growth and rescue of public finance did notice there is a chance.
PAP, 31 Oct	There is no need to amend a 2003 budget law. Budget revenues are lower than expected and we analyse why it happens. There are higher than planned costs of debt servicing because of current market situation. Zloty depreciation also means higher costs, although it is not significant - a few dozen of zloty millions. If level of spending is to be adjusted, the situation should be analysed together with other ministers to find out what kind of spending would be reduced.
PAP, 29 Oct	[MPC's decision] This is not a decision harmful to the economy. Some say its high time to speak about raising not cutting the interest rates. The MPC's decision may be perceived as good enough. I think that the MPC could cut rates but the decision did not belong to me. I believe that in the first half of 2004 interest rates will be cut, that it will be possible and justified.
Rzeczpospolita, 29 Oct	I present risk factors. I present what exceeding of the constitutional safety threshold mean. [...] If we would not respect this limit, financial markets would make us aware of it by stopping to finance the deficit. It is not enough to remove thermometer to avoid a fever. There was no such a discussion [to increase constitutional debt limit of 60% of GDP]. This is a Stalin-like approach to the constitution.
PAP, 9 Oct	We do not face such a danger [exceeding 60% of GDP] in 2003 or 2004, that's absolutely certain. I believe there is no such a threat in 2005 if reasonable policy is conducted, although we cannot be so sure here. Such a threat appears in 2006 at the earliest and we cannot say we are not interested in that because our term ends in 2005. We say that we feel responsible for that. We undertake some actions now so as the next government, whatever it will be, would not have to face the situation when drastic spending cuts and tax hikes would be needed. If political opposition think seriously about governing in the future, it has to take into account that blockade of this program may mean that the next government, also opposition government, will face such necessity. We cannot give it up and opposition cannot block our actions if we think rationally about our state. I seems to me that October's unemployment rate will fall to 17.4%. [...] If one observes the same pattern as in last months of 2003 then at the year-end it should not be worse than 17.9% and it should be even lower.
Andrzej Raczko, finance minister; PAP, Reuters, 21 Nov	The long-term equilibrium rate not short-term levels should be used. Our forex market is not that deep and the exchange rate fluctuates. Meeting Maastricht criteria is equal to promoting stable economic growth. For that reason Poland should meet the criteria as soon as possible. The criteria are not only the pass to the Eurozone, but also a standard, which allows for achieving fast economic growth. Hausner's program is the key instrument, which can enable to meeting Maastricht criteria. From my point of view aspiration for the earlier possible entry to the Eurozone is equivalent to consistent implementation of public finance reform. If we will look at our entry to the EU from the point of view of savings and investments, the integration process gives us positive impulses. I mean, above all, creation of good conditions for investment inflow, both FDI's and portfolio capital. First of all, there will be considerable lowering of risk perceived by investors. However, favourable conditions for investors will not depend only on the EU entry but also on our economic policy.
PAP, Reuters, 20 Nov	Market confidence should return after the Hausner's plan has been put in operation. The market was mainly reacting to bad political news. Most important will be to show we have the political ability to pass the Hausner plan -- this we will do, knocking off the milestones needed to regain markets' trust. I understand the markets, that they wanted facts and not a plan, which was unable to be achieved at once. Either one believes the government once again or the assumption is negated, which undoubtedly has an effect on the market. I would note the clear difference between investors' on foreign debt markets evaluation of our situation...and that of those who invest locally. Risk is entirely differently viewed on the domestic market. We are entering the EU and our system will only become more stable over the coming years. I understand that markets would have liked more specifics and not just the Hausner plan outline, but this was simply not possible at the moment.

	<p>The condition of the economy seems to be good. There are projections of 3.5% growth in 2003. Current account deficit is also under control. Inflation is low, projected at below 1% at the end of this year. Economic acceleration in 2H03 is visible as is the halt of unemployment, or even its slight fall. The only cause for concern is high budget deficit and fast growing debt. But against foreign standards its level is not alarming, being at 50% pct of the GDP at present. A strategic direction as regards deficit lowering is our commitment not deal with the deficit by increasing fiscalism as this would not be good for the economy.</p> <p>We can't count on miraculous solutions such as untying the central bank's reserves. We have to think in terms of sustainable trimming of the deficit. We are aware of how critical the Hausner plan is.</p>
Reuters, PAP, 19 Nov	<p>There are no legal foundations to use revaluation provisions in face of accounting rules applied by the NBP and the current MPC does not want to change these rules. (...) I will ask the new MPC whether it is going to maintain current accounting rules [regarding revaluation provisions]. I understand that this problem is open and we will be discussed. I do not see other way of discussing this problem from the simple reason – I am not going to suggest that I try to violate the central bank independence.</p> <p>Constructing budget for 2004 I asked whether this amount [revenues for the budget from freeing up of revaluation provisions], which was assumed by my predecessor can be achieved and at the same time whether the MPC is going to change its stance on this issue. I was answered that no and if yes, the adjustments would be aimed at meeting EU standards with this regard. I think, however, that the issue of accounting rules will be decided by the new MPC, which can confirm current rules or change them. I as a finance minister should know what is an opinion of the new MPC on this issue, which does not mean that I want to suggest anything.</p> <p>We assumed that improvement in tax collection will amount to around PLN2bn. This assumption was made basing on estimates of effects of changes in tax administration. It is unrealistic to think that tax collection could be better than we assumed. (...) Tax revenues are forecasted based on assumption that GDP growth will reach 5%. Given this optimistic assumption, risk of overestimating next year's budget revenues is much higher than in previous years.</p> <p>Pegging the zloty with the euro in a fixed currency exchange rate mechanism before ERM2 is utterly unnecessary. [...] The position of the ministry is that the current floating currency exchange rate is right. The issue of any pegging our exchange rate and rigidity in relation with the euro may be only a solution from the point of view of our entry of the ERM2.</p> <p>At present a plan of issues for both domestic and foreign markets in 1Q04 is built. We are considering various options of both financing on domestic market as well as serious financing on foreign markets. The scale of the budget's borrowing needs will be significantly higher than in 1Q03.</p> <p>We will be certainly acting on the zloty and the FX markets to conduct conversion [of the debt] in order to minimise the costs of public debt servicing. [...] The ministry will use all instruments, including five and ten-year bonds although there are much more dearer than one-year instruments. Because of the risk and safety of the budget we have to apply the instruments, and change the key profile so that if - touch wood! - we reach the level of some 60% debt, there will be no liquidity threat.</p>
PAP, 31 Oct	<p>We will not be doing anything as far as issuance on foreign markets is concerned.</p> <p>I do not know about such a proposal [for early repayment of Poland's debt towards the Paris Club]. There are no talks with the central bank about using FX reserves for early debt repayment. We are not talking about that, as there is no need.</p> <p>If [fusion of PKO BP with PZU] were to halt PKO BP privatisation, the opinion of the finance minister who is waiting for privatisation revenues is unambiguous.</p> <p>We want the draft of a new tax system to be ready in spring 2004. Basically the line of the strategy is like the line of the government economic policy. The tax system will promote entrepreneurship.</p>
Bloomberg, 27 Oct	<p>I can see no reason whatsoever for increasing interest rates as Polish real interest rates are still high. We have inflation at European levels, while our official key rates clearly are much higher than the European level. The introduction of Hauser's plan will lead to lowering public debt-to-GDP ratio, bringing more room for lower rates. [...] We have to start thinking about interest rates next year regardless of the current situation. [...] The new MPC will have a bit of a different role than the current one, which set lowering inflation as its priority target. Now, amid lack of inflation pressure, the new council will no longer have to fight for lower inflation and it rather will have to protect it at current levels, giving the new council more space for manoeuvring.</p> <p>We have a free floating zloty. The market sets the price. Neither the central bank nor the Finance Minister should intervene. I surely have no such plans. [...] The government neither has any instrument to influence the zloty level nor plans to put any pressure on the market by buying or selling currencies. The government though may declare and is doing it that it intends discipline the state's finances</p> <p>Two-thirds of our financing comes from the domestic market. It is time to start thinking about changing the proportion a bit as a part of our management with liquidity. [...] We sold bonds in dollars, pounds, yen and euros. [...] But we have been analysing the possibilities of selling bonds in different currencies. The Swiss franc is another currency to think about. Also longer maturity than 10 years can be analysed. It's possible to test the even longer-maturing debt, but this can be done after the date of euro adoption is known.</p> <p>There is a basic difference between investors who buy Poland's long-term securities considering its economic fundamentals and between traders, who look for quick profits. Their points of view is different. Foreign investors buying amounts to be held for a long time don't analyse in detail the current political turmoil but are more forward looking.</p> <p>There will be no revision of this year's budget.</p> <p>The government is aware that the 2004 budget is not restrictive enough. [...] We do want to reduce the budget deficit and we will implement all solutions aimed at trimming spending that won't require a time-consuming legislature already in 2004.</p>
PR1, 27 Oct	<p>The FX rate is influenced by two elements. One of them is of long-term nature and is based on economy. From this point of view premises are good in view of quick pace of economic growth, high exports dynamics and low inflation. The second element is a short-term one and it is our evaluation of fiscal adjustments, as I would put it.</p>
Reuters, 13 Oct	<p>We want to start negotiations on the entry of ERM2 as quickly as possible. It depends on progress in work of joint team of the NBP and MinFin.</p>
Financial Times, 1 Oct	<p>The foundations are strong.</p> <p>Let the miners strike, we're going to do it [close the mines].</p> <p>Reductions have to be done in a planned and gradual way so that they do not harm the economy.</p>
PAP, 1 Oct	<p>Quick adoption of the euro will allow Poland to consume all additional benefits coming from the country's presence in the European Union.</p> <p>We have to see how the Polish economy is adapting to the European Union in 2004, and in December 2004 we could think about specifying the date of our entry of the Eurozone.</p>



Piotr Czyżewski, treasury minister; Radio PiN, 13 Nov	We think that PLN4.5bn can be achieved [privatisation revenues this year]. I estimate that we are short of around PLN0.8bn. [PLN9bn of privatisation revenues in 2004] There is huge effort needed to achieve it. However, we decided that we should to have such target for a few reasons.
Halina Wasilewska-Trenkner, PAP, 20 Nov	It is difficult to comment this research [showing that revenues shortage in this year's budget will reach PLN5.6bn] while I do not know its methodology. For the time being, we are basing on the budget draft for 2004 and it assumes that revenue shortage will reach PLN3.6bn this year. The situation in November is better than we forecasted but it is difficult to talk about precise numbers because, for instance, we have the first day of this month's PIT payments today.
Jacek Krzyślak, Head of FinMin's research department; PAP, Reuters, 20 Nov	The headline figure was better than forecast, but growth in the construction sector was lower than what we had expected and that is why we are not changing our forecasts for GDP growth. The output figures confirm that reaching a target of some five-percent growth next year is realistic.
Marek Dyduch, SLD general secretary; PAP, 16 Oct	This [PM change] was one of variants discussed recently, and not a concrete proposal. We have to be ready for any possibility.
Jerzy Jaskiernia, head of SLD caucus; PAP, 17 Nov PAP, 16 Oct	Our conclusion is that lowering of MPC headcount would not be favourable for a choice of competent persons. It is more rational to have 10 persons in the Council, as there is a need for different types of specialisation during MPC meetings. Possibly, we would like to listen PSL view as regards candidates. PSL is in the opposition, but it has its own opinion. We have already a few good candidates. The government won the confidence vote, we have economic recovery and high chances to accept next year budget. I find no reason, which could justify such rumours [about PM dismissal]
Stanisław Stec SLD deputy Reuters, 17 Nov	We will most likely support 10-members Monetary Policy Council, as we do not want to introduce many changes in NBP bill. SLD caucus supports 10-members Council.
Witold Orłowski, President's chief economic advisor; PAP, 25 Nov	To tell the truth, if the rates were lower today, I would ask myself if the MPC should not think about raising them. As the MPC refrained from lowering the rates, then it will probably do nothing. At present announcing the date of Poland's entry to the ERM2 is premature. [...] Any pegging with the euro is related with a danger of speculation. One should not do that until we are sure that we will meet all convergence criteria and be ready to adopt the euro. As far as ERM2 entrance is concerned I am not sure whether we should do it when we do not know what a fiscal policy will be in a few coming years. [...] This is not the best moment to determine the parity as the economy is in 'strange' condition. There is no recession nor permanent growth. We do not know what a medium term equilibrium rate should be.



EU integration watch

- Commission's report critical in respect to Poland
- Commission published forecasts for accession countries

Last report on accession countries critical about Poland

At the beginning of November the European Commission released the report on the progress of ten candidate countries on their way to EU accession. This was the last document of this kind before the enlargement of the European Union, which will take place in May 2004. The report was quite critical in respect to Poland, pointing out many delays in a preparation to European standards. Poland is the country with the biggest number of slacks in preparations, since as much as nine areas of common policies raised concerns of the Commission. Of course the most important was a necessity to significantly cut public spending and reduce fiscal imbalance to avoid public debt increase, although the fact is that the report noticed an improvement of economic situation in Poland. Also, the Commission said the government must respect the independence of the Polish central bank and it must solve problems in getting ready to participate in the EU's Common Agricultural Policy. Problems in meeting EU standards were most visible in food, veterinary controls and fisheries controls.

After report was published, Poland's president Aleksander Kwaśniewski called a Cabinet Council meeting to reconcile its conclusions. Polish officials said they realised the problems, which were pointed out by the Commission, and were going to cope with them in the remaining time before the EU accession. We will know about these statements' effectiveness within the next six months.

The Commission published forecasts for the accession countries

The European Commission published its macroeconomic forecasts for the 10 countries joining the EU in May next year. The economic growth is forecasted to accelerate on average in all countries to 3.8% next year and 4.2% in 2005 from 3.1% this year. Inflation is predicted for all states to amount on average to 2.4% this year, 3.5% in 2004 and 3.1% in 2005. General government balance is expected to reach on average 5% in 2003 and 2004 and then decline to 4.1% in 2005. The European Commission's forecasts for Poland are presented in the table below (in comparison with Polish government's predictions included in the Pre-accession Economic Program sent earlier to the EC). What is important, the Commission said that its figures for Poland did not include spending cuts recently announced by the government, which should significantly curb the deficit from 2005 (as assumed in PEP). On the other hand, the report assumes (similarly as PEP) that Poland will receive a favourable ruling from Eurostat over the treatment of open pension funds (OFE), while its classification is still to be decided (and it is expected at the beginning of 2004). If this factor was excluded, the deficit could be higher by around 1.5 pp of GDP every year. What is worth noticing, the Commission estimates general government debt at around 50% of GDP in the following years (assuming OFE treated as public sector), which means that if Hausner's plans effects were included, it would be lower than 50% of GDP i.e. the first safety threshold in the Polish public finances law. Of course, public finance law defines public debt according to the Polish methodology, which means that the government would have to change the Polish law to avoid prudential measure.

Forecasts of basic macroeconomic indicators for Poland

	European Commission			Pre-accession Economic Programme		
	2003	2004	2005	2003	2004	2005
GDP growth	3.3	4.2	4.8	3.0	5.0	5.0
Average inflation (HICP)	0.8	1.9	2.7	0.8	2.2	2.8
General government balance (% of GDP)	-4.3	-5.9	-4.9	-4.1	-5.0	-4.0
General government debt (% of GDP)	45.1	49.2	51.5	44.3	46.9	49.2

Source: Pre-accession Economic Program, European Commission

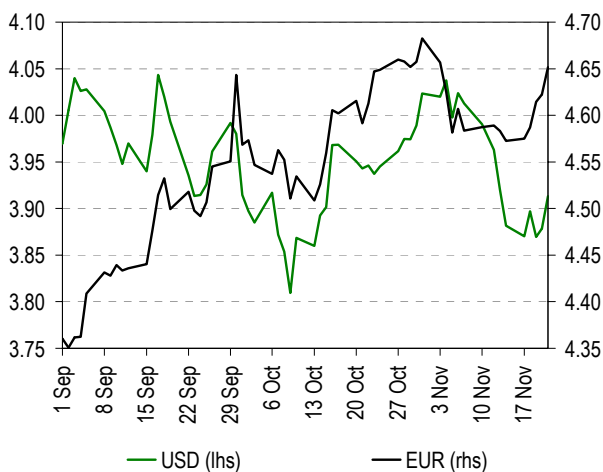
Market monitor

- Zloty's historical low against euro again
- ... and further rise in the risk premium on T-bonds
- ... while very short-lasting response to rating downgrade

Fears of the rates increase have weakened the zloty

After much nervousness in September, and in particular towards the month-end, the first half of October saw a calmer trade on the FX market. However, the uncertainty returned in the latter part of the month with regard to the future fiscal policy which translated into, groundless in our opinion, fears of the increase in rates, which again triggered the zloty depreciation. At October-end, the zloty was weaker by some 1% both against the dollar and the euro on September-end. Again, in early November, sentiment improved and did not deteriorate even after lowering the rating for Polish debt by S&P. However, in the second half of November the zloty weakened at less active trade in response to some negative information from the domestic and foreign environment.

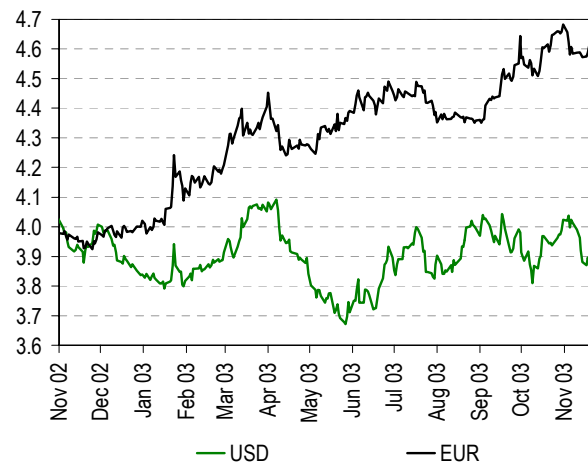
Zloty FX rate in recent 3 months



Source: NBP

In October, according to the NBP fixings, the dollar ranged from PLN3.8096 (on 9 Oct) to PLN4.0234 (31 Oct) with the average at PLN3.9240 (against PLN3.9792 in September). The euro ranged from PLN4.5084 (13 Oct) to PLN4.6826 (31 Oct) with the average of PLN4.5918 (PLN4.4649 in September). In comparison to our projections in previous MACROscope (3.91 and 4.50, respectively), a clear difference can be noted in the case of the euro, which stemmed essentially from appreciation of this currency on the international markets.

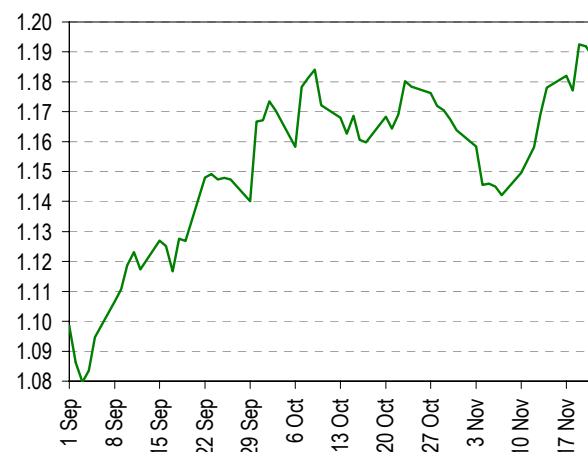
Zloty FX rate in recent 12 months



Source: NBP

In early October, the zloty was making up for the loss after the 2.5% depreciation at the end of September, supported by the MPC decision and statement of the NPB governor. As mentioned before, in 1H of the month, the trade was calmer, however rates were relatively unstable which stemmed from high fluctuations of EURUSD rate over that period and the rising uncertainty while awaiting the release of the plan on cuts in the public spending. Around 15 October, the market experienced nervousness again, which was directly driven by the information about the significant drop in the budget liquidity reserve at September-end and rumor about the change of the Prime Minister.

EUR/USD FX rate



Source: NBP, BZ WBK

In the second half of October, market sentiment was very negative. Once again it was dominated by the uncertainty as regards the fiscal policy, which this time started to translate into fears of the increase in interest rates (groundless from the fundamental point of view). The situation got even worse on news of changing the number of the MPC members, statements of the rating

agencies' representatives (in particular from S&P) and the forint depreciation. Over this period, the zloty hit its historical low several times, last time on 31 X it was 4.72 against the euro and represented the weakest level against the dollar-euro basket since November 1999.

In early November, the sentiment fully reversed. Positive sentiment prevailed during the whole first week, which was prompted by strong current account data. Then the market was further boosted by the information about raising the outlook of the rating for Poland's foreign currency debt by Fitch Ratings and on the increase in the budget liquidity reserve. Downgrading the domestic debt rating by S&P caused merely a temporary weakening of the zloty, which indicates that such a decision of the agency had already been priced-in.

The long weekend prior to the Independence Day significantly reduced the market activity and such a situation lasted for two weeks. Initially, the zloty was strong and its appreciation was supported by changes in the EURUSD rate. However, the middle of the month saw the deterioration in sentiments again. It started with domestic affairs: unsuccessful T-bond auction and Minister Raczko's statement on large borrowing requirements of the budget in 1Q04. In addition, the negative sentiment on all markets was reinforced by terrorist attacks in the Middle East.

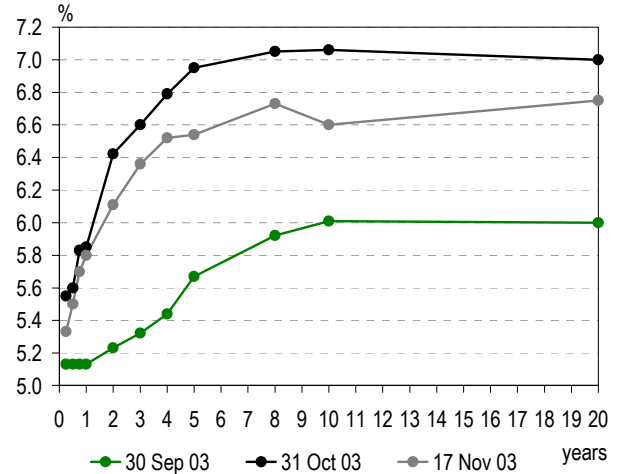
... and the market of Treasury bonds

Similarly, the first two weeks of October were also calmer on the fixed income market, which facilitated the drop in the risk premium for Polish securities (the difference between the expected 5Y interest rate in Poland and in the Eurozone in five years) by some 10 basis points. However, upon the announcement of Hausner's plan the negative sentiments prevailed. The upcoming news, e.g. about the drop in the budget liquidity reserve and the possibility of rejecting the next year's budget in the Parliament already in the first reading, increased the premium by 30bps. However, even deeper weakening (by further 40bps) occurred when fears of rates increase emerged. In addition, the market became illiquid, as the spread between bid and ask prices deepened significantly.

In early November, market sentiment was positive and the yield curve was moving downward. The reaction to the rating downgrade was very short-lasting because on the day of its announcement the yield at closing was much lower than at the opening. In the first week of

November, the risk premium for Polish treasuries decreased by 40bps and with the lower trade activity it stabilized for around a week after the Independence Day.

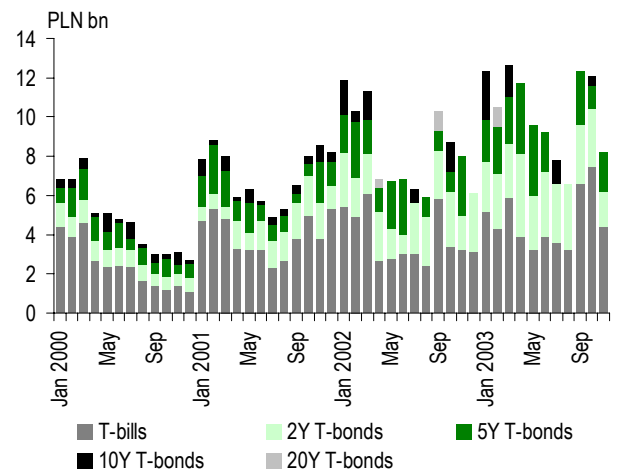
Yield curve



Source: BZ WBK

In the middle of the month, with the little trade activity, sentiments deteriorated after the unsuccessful auction, announcement of high supply of securities in 1Q2004 and a series of terrorist attacks. As a result, the risk premium for Polish bonds went up by 30bps.

Supply of Treasuries



Source: Finance Ministry, BZ WBK

On Wednesday, 15 October, an auction for 5-year PS0608 bonds was held. A relatively low supply (PLN1bn) met a high demand on the part of investors (PLN2.7bn). All the treasuries were sold, however low prices were offered and as a result the average yield was as much as 5.805% against 4.851% at the previous successful auction in June and it was higher than the current market level. At the supplementary auction no demand was declared.

On 5 November an auction was held for 2-year OK0805 benchmark. Again, a moderate bid (PLN1.5bn) met a relatively high demand (PLN3.7bn) and all the bonds were sold. The average yield totaled 6.237% and was much higher than a month before (5.246%). This time, however, it was compliant with current market quotations and at the supplementary auction a very high demand was recorded (PLN1.8bn) and of course the Ministry of Finance sold all offered securities.

The next auction of 5-year bonds held on 19 November was a failure. This time the offer of DS0509 treasuries was relatively high (PLN2bn), whereas the reported demand was lower than the supply (PLN1.8bn) and hardly 75% of the offered bonds were sold. The average yield was higher by nearly 90bps than at the previous auction and higher than the current market level. In view of the negative market sentiments, the supplementary auction was not held.

At October-end, the Ministry of Finance made an announcement on the planned issue of treasury securities by the year-end. Information in this respect is presented in the tables.

Short-term outlook for the Polish financial market is still not very optimistic. The significant uncertainty can be felt in the air as regards the fiscal policy outlook. Therefore, one cannot rule out sharp movements in the yields or weakening of the zloty in the upcoming weeks. Only passing the 2004 budget bill and the acts introducing the Hausner's plan can bring a more solid improvement in market sentiments.

Treasury bill auctions (PLN m)

Date of auction	OFFER / SALE		
	13-week	52-week	Total
02.10.2003*	3,500 / 3,500 *	-	3,500 / 3,500 *
06.10.2003	100 / 100	900 / 900	1,000 / 1,000
13.10.2003	100 / 100	900 / 900	1,000 / 1,000
20.10.2003	-	1,000 / 1,000	1,000 / 1,000
27.10.2003	-	1,000 / 1,000	1,000 / 1,000
October total	3 700 / 3 700	3,800 / 3,800	7,500 / 7,500
03.11.2003	-	1,400 / 1,400	1,400 / 1,400
07.11.2003	-	1,000 / 1,000	1,000 / 1,000
17.11.2003	-	1,000 / 1,000	1,000 / 1,000
24.11.2003	-	1,000 / 1,000	1,000 / 1,000
November total	-	4,400 / 4,400	4,400 / 4,400
01.12.2003	-	1,000	1,000
08.12.2003	-	1,000	1,000
15.12.2003	100	1,400	1,500
22.12.2003	-	0 - 1,500	0 - 1,500
December total	100	3,400 - 4,900	3,500 - 5,000

* additional auction, 10-week bills
Source: Ministry of Finance

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*	PS0608	1,200	1,000
November	05.11*	OK0805	1,800	1,800	19.11	DS0509	2 000	1 485,5	-	-	-	-
December	03.12	OK0406	1,500 - 2,500	-	-	-	-	-	-	-	-	-

Source: Ministry of Finance

* with supplementary auction

International review

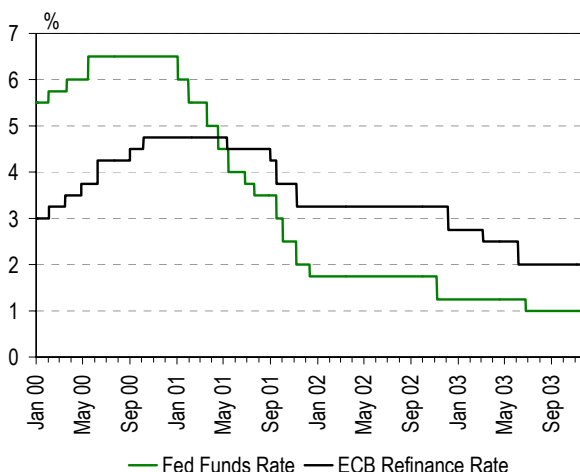
- Interest rates unchanged
- Clear falls in inflation rates
- Expected Eurozone's recovery around the corner
- Stability and Growth Pact violated

Interest rates will remain unchanged for the moment

In line with analysts' expectations, the Governing Council of the European Central Bank did not change interest rates at the meeting on 6 November. The main Eurozone's rate – refinancing rate – stands at 2.0%, i.e. the lowest level in the history of ECB's monetary policy. It is expected to remain at this level till mid-2004 (another meeting of the council is planned for 4 December). During the press conference the new ECB president Jean-Claude Trichet (it was his first meeting as the president) stated that economic recovery can be noticed but its signs are still weak. On the contrary, in the United Kingdom the MPC decided to raise interest rates by 25bps in order to cool increase in prices on property market and to limit consumer's borrowing. Starting from today, the main interest rate stands at 3.75%.

Also, Federal Open Market Committee left interest rates unchanged at the meeting on 28 October, which matched market expectations. Federal fund rate remained at 1.0%, i.e. the lowest level since 1958. In the statement Fed pointed to a risk of a fall in inflation to undesirably low level, which suggests one should not expect a rate hike soon. On the other hand, Fed said that a situation on the labour market was stabilising. Next Fed's meeting is planned for 9 December and no change in interest rate is expected.

Interest rates in the USA and Eurozone



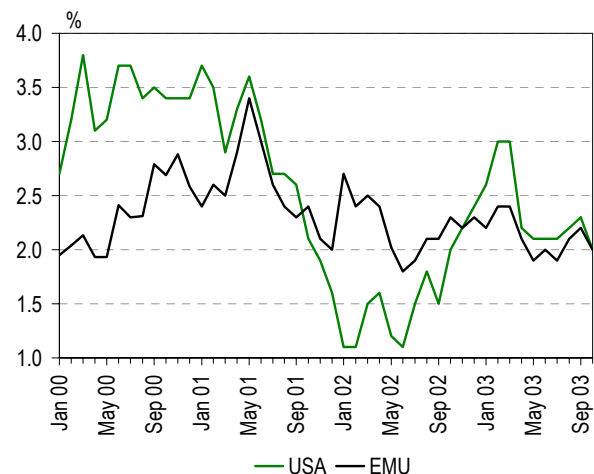
Source: Reuters

Consumer inflation at 2%

According to final calculations, in October consumer prices in the Eurozone increased by 0.1%MoM. As a result annual inflation rate declined to 2.0% from 2.2% recorded in September and revised upward from 2.1%. This means that inflation in October was exactly at the level of the ceiling of ECB's inflation target. Analysts expected an increase in prices of 0.3%MoM and confirmation of preliminary estimation at 2.1%YoY. In September producer prices remained unchanged in monthly terms and annual growth rate declined to 1.1% from 1.4% recorded in August and July.

According to the ECB, Eurozone's M3 money supply growth rate amounted to 7.4%YoY in September decelerating from 8.2% recorded in August. Meanwhile analysts expected a slowdown in a rate of growth to 7.8%.

Consumer inflation YoY



Source: Reuters

Data from the United States on inflation roughly matched analysts' forecasts. In October consumer prices remained unchanged on monthly basis, while 0.1% rise was expected by economists. This figure translated into a fall in annual inflation rate to 2.0% from 2.3% recorded in September. Producer prices were rising significantly faster than forecasted in October. They increased by 0.8%MoM, while expectations stood at 0.2%. Annual rate of producer inflation remained unchanged at September's level of 3.4%.

In the US the growth revised upward

According to preliminary information on economic growth in the United States, US GDP increased by 8.2%QoQ in 3Q03, which was stronger than the figure released a month ago in advanced information, when the growth rate was estimated at 7.2%. It was the

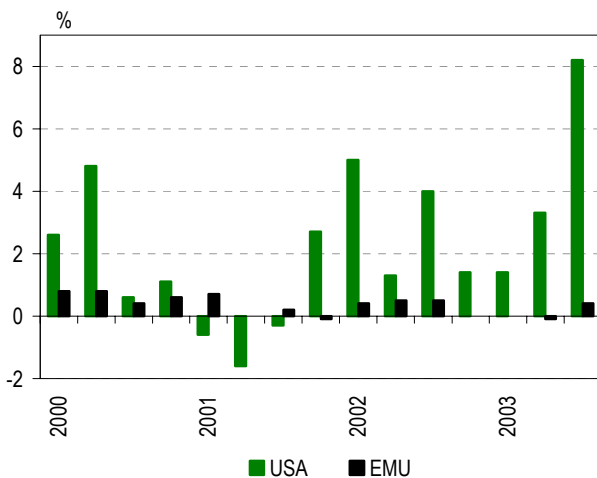


highest pace of economic growth in almost twenty years. The revised data were also better than economists' expectations at 7.8% and significantly better than 2Q03 figure of 3.3%. Analysts expect that in 4Q03 GDP growth will decelerate, but it will be still relatively high at some 4%.

In the United States data on industrial production and retail sales roughly matched the expectations. In October the output rose by 0.2%MoM, while 0.3% was forecasted. September's figure was revised upward to 0.5% from 0.4% released previously. The sales decreased by 0.3%MoM, compared to expectations at -0.2% and data for September were revised to -0.4%MoM from -0.2% released previously.

In the United States the unemployment rate decreased to 6.0% in October from 6.1% recorded in September, while stable rate was expected. What is more, the number of jobs in economy increased by 126,000, while analysts expected a rise of 58,000. It was the third consecutive rise, which means that high economic growth influences the labour market in positive way.

GDP growth QoQ



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

... and in the Eurozone in black at last

In November flash estimations of economic growth in 3Q03 have been released for the Eurozone and its main economies. According to it, in 3Q German GDP increased by 0.2%QoQ after it had shrunk by 0.2% in 2Q03. In annual terms the German economy shrunk by 0.2% in 3Q03. The data were exactly in line with market forecast.

Major business climate indicator for the German economy – index of entrepreneurs' sentiment IFO – recorded a seventh consecutive rise, amounting to

95.7pts in November versus 94.3pts in October, while forecasts pointed to the increase only to 95.0pts. The index reached the highest level in almost last three years. Both the expectations for future and the assessment of present situation improved.

In France the GDP increased by 0.4%QoQ in 3Q following 0.3% fall recorded in 2Q03. Analysts expected the growth rate at 0.3%. Besides, in Italy the GDP rose by as much as 0.5%QoQ in 3Q after a fall of 0.1% in 2Q while a rise of 0.3% was expected. Also the data for the whole Eurozone were better than forecasts, as in 3Q03 the GDP growth of 0.4%QoQ was recorded, compared to forecasts at 0.3%. In annual terms, Eurozone's GDP recorded a rise of 0.3%, accelerating from 0.2%YoY in 2Q. All the data suggest that last quarter the European economy entered the path of economic recovery. At the same time, the European Commission confirmed growth forecast for 4Q03 at the level of 0.2%-0.6% and released the forecast for 1Q04 at 0.3-0.7%.

Data on industrial output in the Eurozone were weaker than forecasted. In September the production declined by 0.6%MoM and annual growth rate amounted to -1.8%, compared to -0.5% recorded in August and revised from 0.1%. Meanwhile forecasts for September stood at -0.5% and -0.6%, respectively. Eurozone's retail sales decreased by 0.1%MoM and 0.9%YoY, compared to forecasts at -0.3% and -0.7%, respectively.

The unemployment rate in the Eurozone amounted to 8.8% in September, unchanged from August's level, which matched analysts' expectations. The highest unemployment was recorded in Spain, France and Germany.

Bad signal from the European Union

Finance ministers of EU countries decided against proceeding with disciplinary procedure versus Germany and France despite their deficits are set to exceed limits agreed in the Stability and Growth Pact for the third successive year in 2004. They merely asked them for a political commitment to reduce deficits. The compromise deal is a bad signal for current and future EU members, because it shows a possibility to avoid the most restrictive clauses.



What's hot this month

Monday	Tuesday	Wednesday	Thursday	Friday
3 November POL: T-bill auction EMU: PMI (Oct) USA: ISM (Oct)	4	5 POL: T-bond auction OK0805 EMU: Unemployment (Sep) EMU: Retail sales (Aug) USA: Factory orders (Sep)	6 GER: Unemployment (Oct) EMU: ECB meeting	7 POL: Food prices (2H Oct) POL: T-bill auction USA: Unemployment (Oct)
10	11 Independence Day ITA: Industrial output (Sep)	12 FRA: Industrial output (Sep)	13 GER: GDP (3Q) FRA: GDP (3Q) FRA: Inflation preliminary (Oct) ITA: Inflation final (Oct) USA: Foreign trade (Sep)	14 POL: Inflation (Oct) POL: Money supply (Oct) ITA: GDP (3Q) EMU: GDP (3Q) USA: Producer prices (Oct) USA: Industrial output (Oct) USA: Retail sales (Oct)
17 POL: T-bill auction EMU: Industrial output (Sep)	18 POL: Wages & employment (Oct) EMU: Inflation final (Oct) USA: Inflation (Oct)	19 POL: T-bond auction DS0509 FRA: Inflation final (Oct) EMU: Foreign trade (Sep)	20 POL: Industrial output (Oct) POL: Producer prices (Oct) GER: GDP (3Q) FRA: GDP (3Q)	21 POL: Business climate (Nov)
24 POL: Core inflation (Oct) POL: Retail sales (Oct) POL: Unemployment (Oct) POL: T-bill auction	25 POL: MPC meeting (1 st day) GER: IFO (Nov) USA: GDP (3Q)	26 POL: MPC meeting (decision) EMU: Balance of payment (Sep)	27 POL: Food prices (1H Nov) EMU: Money supply (Oct)	28 POL: Balance of payment (Oct) ITA: Inflation preliminary (Nov) EMU: Inflation preliminary (Nov) EMU: Economic sentiment; Business climate (Nov)
1 December POL: T-bill auction EMU: PMI (Nov) USA: ISM (Nov)	2 EMU: Producer prices (Oct) EMU: Unemployment (Oct)	3 POL: T-bond auction OK0406 EMU: GDP (3Q)	4 GER: Unemployment (Nov) EMU: ECB meeting EMU: Retail sales (Sep)	5 POL: Food prices (2H Nov) USA: Unemployment (Nov) USA: Factory orders (Ocy)
8 POL: T-bill auction	9	10 ITA: GDP (3Q)	11 FRA: Inflation preliminary (Nov)	12 POL: Money supply (Nov) POL: Wages & employment (Nov) ITA: Industrial output (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	16-17
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

		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	Nov 03
Industrial production	%YoY	3.2	3.1	5.2	3.3	4.3	5.5	8.5	11.7	7.9	10.3	5.9	10.9	12.1	12.0
Retail sales ***	%YoY	5.1	5.9	4.9	4.1	4.2	-1.7	11.0	9.7	8.1	5.4	5.5	9.7	10.3	10.6
Unemployment rate	%	17.5	17.8	18.0	18.6	18.7	18.6	18.3	17.9	17.7	17.7	17.6	17.5	17.4	17.6
Gross wages ** ***	%YoY	0.5	1.8	2.4	2.7	2.1	0.7	4.2	0.0	3.1	2.4	1.9	2.2	3.0	2.5
Export (acc. to NBP)	EURm	-3.2	-2.3	-4.1	-3.9	-4.0	-3.7	-3.5	-3.6	-3.2	-3.2	-3.1	-3.2	-3.2	-3.2
Import (acc. to NBP)	EURm	3 182	3 004	3 223	2 761	2 635	2 957	2 969	3 015	3 018	3 282	2 862	3 301	3 450	3 312
Trade balance (acc.to NBP)	EURm	4 241	4 090	4 166	3 895	3 219	3 467	3 833	3 696	3 512	4 107	3 615	3 837	4 250	4 144
Current account balance	EURm	-1 059	-1 086	-943	-1 134	-584	-510	-864	-681	-494	-825	-753	-536	-800	-832
Budget deficit (cumulative)	PLNbn	-580	-753	-484	-711	-483	-248	-460	-411	-100	-239	-111	61	-620	-282
Budget deficit (cumulative)	% annual plan	-34.0	-37.1	-39.4	-4.1	-11.7	-15.5	-18.0	-23.2	-23.8	-27.7	-29.6	-33.1	-34.8	-36.8
CPI	%YoY	86.4	94.0	100.0	10.6	30.2	40.0	46.6	60.0	61.5	71.5	76.4	85.4	89.9	95.0
PPI	%YoY	1.1	0.9	0.8	0.5	0.5	0.6	0.3	0.4	0.8	0.8	0.7	0.9	1.3	1.6
Broad money (M3)	%YoY	1.7	1.7	2.2	2.5	2.9	3.6	2.9	2.0	2.0	1.9	1.8	2.1	2.7	3.3
Deposits	%YoY	-2.5	-1.0	-2.0	-1.4	-1.2	0.5	0.8	0.3	1.3	0.7	1.7	3.1	4.7	5.2
Credits	%YoY	-4.6	-3.2	-4.2	-4.1	-3.8	-2.3	-2.3	-2.9	-1.9	-2.5	-1.7	-0.2	1.5	1.7
USD/PLN	PLN	4.4	4.6	5.3	5.5	5.7	8.7	8.5	7.6	5.9	5.0	5.2	5.7	7.2	8.0
EUR/PLN	PLN	4.12	3.95	3.91	3.84	3.87	4.01	3.96	3.74	3.80	3.90	3.92	3.98	3.92	3.94
Reference rate *	%	4.04	3.96	3.99	4.08	4.17	4.33	4.30	4.33	4.44	4.44	4.37	4.46	4.59	4.62
WIBOR 3M	%	7.00	6.75	6.75	6.50	6.25	6.00	5.75	5.50	5.25	5.25	5.25	5.25	5.25	5.25
Lombard rate *	%	7.45	6.81	6.82	6.56	6.37	6.17	5.90	5.53	5.38	5.26	5.16	5.17	5.42	5.40
Yield on 52-week T-bills	%	9.00	8.75	8.75	8.50	8.00	7.75	7.25	7.00	6.75	6.75	6.75	6.75	6.75	6.75
Yield on 2-year T-bonds	%	6.77	5.88	5.78	5.74	5.83	5.67	5.43	4.75	4.66	4.85	4.82	4.91	5.30	5.95
Yield on 5-year T-bonds	%	6.62	5.78	5.75	5.55	5.66	5.52	5.16	4.78	4.79	4.89	4.86	5.02	5.53	6.31
Yield on 10-year T-bonds	%	6.57	5.91	5.67	5.57	5.58	5.36	5.15	4.88	4.90	5.17	5.38	5.60	6.04	6.86

Source: CSO, NBP, BZ WBK

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


Quarterly and annual economic indicators

		2001	2002	2003	1Q02	2Q02	3Q02	4Q02	1Q03	2Q03	3Q03	4Q03
GDP	PLNbn	750.8	772.2	690.4	178.6	189.5	191.2	213.0	184.5	198.2	200.6	225.3
GDP	%YoY	1.0	1.4	3.5	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	2.6	2.8	3.2	1.0	2.9	2.6	2.7
- Private consumption	%YoY	2.1	3.3	2.8	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	-12.8	-7.9	-5.9	-3.6	-3.6	-1.7	2.0	5.0
Industrial production	%YoY	0.6	1.5	9.1	-1.6	-0.4	3.3	4.6	4.4	9.1	8.9	14.0
Retail sales (real terms)	%YoY	0.2	3.3	6.7	5.8	0.7	3.9	2.6	1.2	9.8	6.4	9.4
Unemployment rate *	%	17.5	18.0	17.8	18.2	17.4	17.6	18.0	18.6	17.7	17.5	17.8
Gross wages (real terms)	%YoY	1.6	1.5	1.5	1.9	1.4	2.3	0.3	1.4	1.7	1.7	1.1
Export (acc. to NBP)	EURm	33 823	34 746	37 122	7 853	8 668	8 816	9 409	8 353	9 002	9 445	10 322
Import (acc. to NBP)	EURm	46 848	45 712	45 864	10 847	11 109	11 259	12 497	10 581	11 041	11 559	12 683
Trade balance (acc.to NBP)	EURm	-13 025	-10 966	-8 741	-2 994	-2 441	-2 443	-3 088	-2 228	-2 039	-2 114	-2 360
Current account balance	EURm	-7 992	-7 188	-3 922	-2 659	-1 780	-932	-1 817	-1 442	-971	-289	-1 220
Current account balance	% GDP	-3.9	-3.6	-2.5	-3.9	-3.6	-3.6	-3.6	-3.1	-2.7	-2.4	-1.5
Budget deficit (cumulative)*	PLNbn	-32.6	-39.4	-38.7	-16.4	-25.0	-29.8	-39.4	-15.5	-23.8	-33.1	-38.7
Budget deficit (cumulative)*	% GDP	-4.3	-5.1	-5.6	-9.2	-4.5	-2.5	-4.5	-8.4	-4.2	-4.6	-2.5
CPI	%YoY	5.5	1.9	0.8	3.4	2.1	1.3	0.9	0.5	0.5	0.8	1.5
CPI*	%YoY	3.6	0.8	1.7	3.3	1.6	1.3	0.8	0.6	0.8	0.9	1.7
PPI	%YoY	1.6	1.0	2.6	0.2	0.7	1.4	1.9	3.0	2.3	1.9	3.1
Broad money (M3)	%YoY	9.2	-2.1	5.0	3.2	2.5	-1.5	-2.1	0.5	1.3	3.1	5.0
Deposits	%YoY	8.9	-4.3	1.5	1.7	0.5	-3.5	-4.3	-2.3	-1.9	-0.2	1.5
Credits	%YoY	9.3	5.3	8.3	7.1	9.4	4.9	5.3	8.7	5.9	5.7	8.3
USD/PLN	PLN	4.09	4.08	3.90	4.13	4.04	4.15	3.99	3.90	3.83	3.93	3.93
EUR/PLN	PLN	3.67	3.85	4.39	3.62	3.72	4.08	4.00	4.19	4.36	4.42	4.60
Reference rate *	%	11.50	6.75	5.25	10.00	8.50	7.50	6.75	6.00	5.25	5.25	5.25
WIBOR 3M	%	16.10	9.09	5.64	11.02	9.80	8.50	7.03	6.37	5.60	5.20	5.41
Lombard rate *	%	15.50	8.75	6.75	13.50	11.50	10.00	8.75	7.75	6.75	6.75	6.75
Yield on 52-week T-bills	%	14.77	8.18	5.33	9.64	9.11	7.82	6.14	5.75	4.94	4.86	5.75
Yield on 2-year T-bonds	%	13.97	7.94	5.38	9.27	8.84	7.63	6.05	5.58	4.91	4.92	6.11
Yield on 5-year T-bonds	%	12.59	7.86	5.67	9.09	8.69	7.60	6.05	5.50	4.98	5.38	6.80
Yield on 10-year T-bonds	%	10.74	7.34	5.81	8.28	7.92	7.24	5.93	5.60	5.19	5.63	6.83

Source: GUS, NBP, BZ WBK

* at the end of period



Bank Zachodni WBK S.A.

TREASURY DIVISION

plac Gen. Władysława Andersa 5, 61-894 Poznań
secretary tel. (+48 61) 856 58 35, fax (+48 61) 856 55 65

This analysis is based on information available until 26.11.2003 has been prepared by:

ECONOMIC ANALYSIS UNIT

ul. Marszałkowska 142, 00-061 Warszawa. fax (+48 22) 586 83 40
Email: ekonomia@bzwbk.pl Web site (incl. Economic Service page): <http://www.bzwbk.pl>

Maciej Reluga – Chief Economist

Phone (+48 22) 586 83 63, Email: maciej.reluga@bzwbk.pl

Piotr Bielski (+48 22) 586 83 33

Piotr Bujak (+48 22) 586 83 41

Aleksander Krzyżaniak (+48 22) 586 83 42

TREASURY SERVICES DEPARTMENT

Poznań

pl. Gen. W. Andersa 5
61-894 Poznań

tel. (+48 61) 856 58 14, (+48 61) 856 58 25

fax (+48 61) 856 55 65

Wrocław

ul. Rynek 9/11
50-950 Wrocław

tel. (+48 71) 370 25 87

fax (+48 71) 370 26 22

Warszawa

ul. Marszałkowska 142
00-061 Warszawa

tel. (+48 22) 586 83 20

fax (+48 22) 586 83 40

This publication has been prepared by Bank Zachodni WBK S.A. (a member of AIB Group) for information purposes only. It is not an offer or solicitation for the purchase or sale of any financial instrument. All reasonable care has been taken to ensure that the information contained herein is not untrue or misleading. But no representation is made as to its accuracy or completeness. No reliance should be placed on it and no liability is accepted for any loss arising from reliance on it. Bank Zachodni WBK S.A., its affiliates and any of its or their officers may be interested in any transactions, securities or commodities referred to herein. Bank Zachodni WBK S.A. or its affiliates may perform services for or solicit business from any company referred to herein. This publication is not intended for the use of private investors. Clients should contact analysts at and execute transactions through a Bank Zachodni WBK S.A. entity or an AIB Group entity in their home jurisdiction unless governing law permits otherwise. Copyright and database rights protection exists in this publication.



Bank Zachodni WBK is a member of Allied Irish Banks Group