Poland's Economy. Financial Markets

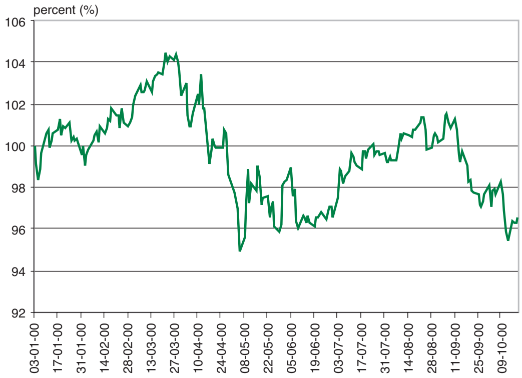
October 2000 No. 16

Major macroeconomic trends:

- September's inflation amounted to 1.0% m/m and 10.3% y/y. A rise in prices of 1.0% m/m in September was largely spurred by a rise in food prices of 1.4% m/m and a strong increase in the prices of non-food goods (roughly 1.1% m/m). Given a high base in the fourth quarter last year, annual inflation will decrease (p. 4).
- In September, industrial output prices leapt by 0.8% m/m and 8.3% y/y. This leap was prompted mainly by a rise in prices in manufacturing industry (owing to a rise in oil prices and a weakening of the zloty) and mining (p. 4).
- GDP growth decelerated in the second quarter of 2000 to 5.2% y/y chiefly on account of a statistical base effect. In the second quarter this year, economic growth was still strong despite a significant reduction in individual consumption growth. A continuing decrease in individual consumption and a curb on investment expenses, however, may slow down the pace of economic growth to below 5% per annum this and next year (p. 4).
- The current account deficit, running at USD 991m, was much above market expectations ranging between USD 700 and 800m. The current account gap grew to 7.6% of GDP from 7.4% of GDP in July. This makes the reduction in the deficit to 7% of GDP at the end of 2000 unlikely (p. 5).
- Poland's external debt grew in the second quarter this year by USD 1.1bn, triggered mainly by growth in the debt of non-government and non-banking sector (of USD 1.36bn) (p. 5).
- Since the conclusion of the TP S.A. privatisation transaction, the zloty has been weakening, seeking its equilibrium point. In the immediate future, the zloty rate is likely to be highly volatile. The euro continues weak (p. 6).
- An increase in T-bond yields given deterioration in emerging markets sentiment and fears surrounding the degree of tightness of the fiscal policy next year. T-bill yields are declining on small supply (p. 7).
- The monetary policy will be restrictive in 2001 (p. 8).
- Stable situation in foreign trade (p. 10).
- Stabilisation of industrial output in September (p. 11).
- A slights worsening of business trends in industry, deterioration of business trends in retail trade (p. 12).

Arkadiusz Krześniak

Changes in the zloty value at fixing
(3.01.2000 = 100)



Source: Reuters, own calculations

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Current economic situation

October saw a significant correction of the zloty rate and a substantial increase in T-bond yields. The yield curve increased its negative slope and shifted up by over 1 percentage point. The performance of financial markets was determined by the conclusion of the TP SA privatisation transaction on October 12, deterioration in emerging markets sentiment in relation to high oil prices, a conflict in the Middle East and a correction in US stock markets. At the same time, Poland's macroeconomic situation did not exhibit any signs of a significant improvement. The larger than excepted current account deficit in August derived from a low euro rate and high oil prices. A fall in September's inflation to 10.3% y/y was chiefly a high base effect in the fourth quarter last year. The food market will continue to be affected by inflationary pressure. Still, the annual inflation index will gradually decrease until it reaches slightly over 9% in December this year and will approach the middle of the MPC's inflation target for 2001 (approximately 7% in December 2001). Data on economic growth, although pointing to a continuing strong growth, shows a substantial fall in individual consumption and investment expenses on fixed assets. Stabilisation in industrial output in September and a potential decrease in its growth in the fourth quarter this year, coupled with weak business trends in the construction industry and potential continuing shrinkage in domestic demand, may mean that annual GDP growth this and next year will be lower than 5%. This will lead to a further increase in the unemployment rate which amounted to 14.0% in September. In 2001, oil prices are likely to stabilise at a high level while, in the fourth quarter this year, a transient rise in these prices is possible. In the near term, the euro will remain weak and, over the next 12 months, this currency may gain in value relative to the US dollar; yet, it seems unlikely to reach parity. In our opinion, in the medium term, the zloty should continue to weaken, although another strengthening of the zloty at the end of this year and in the first quarter of 2001 is also likely in relation to capital flows from privatisation and the sale of UMTS licences.

Tab. 1. Inflation indicators

	05 2000	06 2000	07 2000	08 2000	09 2000	*10 2000F*
Consumer Price Index (m/m %)	0.7	0.8	0.7	-0.3	1.0	*0.8*
Consumer Price Index (y/y %)	10.0	10.2	11.6	10.7	10.3	*9.9*
Producer Price Index (m/m %)	0.9	1.0	0.6	0.4*	0.8	*0.7*
Producer Price Index (y/y %)	7.9	8.8	9.0	8.4*	8.3	*8.1*
Average monthly FX rate (USD, y/y %)	14.3	11.6	11.3	10.3	10.1	-

Tab. 2. Activity indicators

	04 2000	05 2000	06 2000	07 2000	08 2000	09 2000
Retail Sales Index (m/m %)	2.2	-0.6	2.8	-0.7	1.4	-
Retail Sales Index[a] (y/y %)	19.9	15.1	14.8	10.3	11.2	-
Household loans (y/y %)	49.8	49.9	79.4	45.7	42.9	41.0
Industrial Output (m/m %)	-8.5	7.7	1.2	-6.9	6.1	5.0
Industrial Output (y/y %)	5.3	12.1	13.4	7.8	9.2*	5.0
Exports, current prices (in payment terms, y/y %)	-6.0	21.0	13.0	18.2*	12.7	-
Imports, current prices (in payment terms, y/y %)	-2.8	9.3	0.4	3.0*	9.8	-
Foreign Trade Balance (NBP, USD m)	-1 075	-894	-1 041	-1 042*	-1 294	-
State Budget Balance (PLN m)	-8.9	-10.0	-10.8	-11.3	-13.0	-14.0

Tab. 3. Poland's Economy

	1996	1997	1998	1999	*2000F*
Gross Domestic Product (y/y %) (fixed prices) of which:	6.0	6.8	4.8	4.1	***4.9***
Individual Consumption (y/y %)	8.3	6.9	4.9	5.1	***3.5***
Gross expenses on fixed assets (y/y %)	19.7	21.7	14.5	6.9	***5.0***
Exports, constant prices (y/y %)	9.7	13.7	9.4	2.0	***11.9***
Imports, constant prices (y/y %)	28.0	22.0	14.6	4.4	***7.0***
Inflation (average annual %)	19.9	14.9	11.8	7.3	***10.2***
Inflation (year end, y/y %)	18.5	13.2	8.6	9.8	***9.2***
Unemployment Rate (year end, y/y %)	13.2	10.3	10.4	13.0	***14.3***
Current Account Balance/GDP (%)	-1.0	-3.2	-4.2	-7.6	***-7.3***
Public Debt/GDP (%)	51.1	47.9	43.1	44.6	***43.6***

y/y - year on year   m/m - month to month   F - forecast

Sources: CSO, NBP, WBK forecasts

* corrected data, [a] in current prices

Tab. 4. Poland – medium-term forecast (average in period unless otherwise stated)

CATEGORY	1999	1Q 2000	2Q 2000	3Q 2000	4Q 2000	2000	2001	2002	2003	2004	2005
Interest rates											
1M	14.55	17.63	18.14	18.55	19.36	18.42	18.3	15.0	12.0	9.7	8.6
3M	14.73	17.87	18.50	19.06	19.55	18.75	18.1	15.2	12.2	9.9	8.8
6M	14.57	17.87	18.67	19.36	19.75	18.91	18.0	15.3	12.3	10.0	8.9
12M	14.77	18.07	18.86	19.51	19.90	19.09	17.8	15.5	12.4	10.1	9.0
Lombard rate	17.59	21.08	21.50	22.01	23.00	21.90	20.7	16.5	13.8	11.5	10.4
Intervention rate	13.72	17.08	17.50	18.17	19.00	17.94	16.7	14.0	11.8	9.5	8.4
Treasury bonds yields											
3L (bid)	11.89	14.60	16.28	17.04	17.00	16.23	15.9	11.9	9.5	8.5	8.0
5L (bid)	11.12	12.77	13.98	14.39	15.00	14.04	13.4	10.2	9.0	8.2	7.8
10L (bid)	9.63	10.36	11.64	12.55	12.60	11.79	10.0	9.3	8.5	8.1	7.6
T-bills yields											
13-week	13.16	16.24	16.74	17.33	17.00	16.83	15.8	13.3	11.0	8.7	7.7
52-week	13.00	16.92	17.68	18.25	18.00	17.71	16.7	13.7	11.2	8.9	7.9
Exchange rates											
USD/PLN	3.9675	4.1132	4.3762	4.3897	4.597	4.368	4.58	4.94	5.30	5.55	5.80
EUR/PLN	4.2270	4.0629	4.0872	3.9781	4.010	4.041	4.26	4.91	5.39	5.49	5.56
EUR/USD	1.0660	0.9878	0.9344	0.9062	0.872	0.927	0.93	1.00	1.02	0.99	0.96
Average depreciation (currency basket)	-	-	-	-	-	2.6%	5.2%	11.5%	8.5%	3.3%	2.8%
USD/PLN (end of period)	4.1483	4.1428	4.3907	4.5404	4.590	4.590	4.67	5.20	5.40	5.70	5.90
EUR/PLN (end of period)	4.1689	3.9650	4.2075	3.9960	4.039	4.039	4.51	5.32	5.45	5.53	5.58
EUR/USD (end of period)	1.0050	0.9571	0.9583	0.8801	0.880	0.880	0.97	1.02	1.01	0.97	0.95
Macroeconomic indicators (end of period unless otherwise stated)											
Real GDP (y/y %)	4.1	6.0	5.2	4.6	3.8	4.9	5.2	5.2	5.1	5.5	6.0
Inflation (y/y %)	9.8	10.3	10.2	10.3	9.2	9.2	6.9	5.7	4.3	3.8	3.6
Inflation (y/y %) (average)	7.3	10.3	10.1	10.8	9.5	10.2	7.9	6.3	5.0	4.1	3.7
Current account/ GDP (%)	-7.6	-7.9	-7.9	-7.4	-7.3	-7.4	-7.2	-7.0	-6.7	-6.3	-5.9
Budget deficit/GDP (%)	-2.0	-2.8	-2.3	-1.9	-1.7	-2.2	-2.0	-1.8	-1.6	-1.4	-1.2
Public debt/GDP (%)	44.6	-	-	-	-	43.6	39.9	37.6	35.6	33.4	31.1
Foreign public debt/GDP (%)	20.7	-	-	-	-	20.4	18.5	17.4	16.6	15.3	14.1
Total foreign debt/ GDP (%)	39.0	-	-	-	-	39.4	36.7	33.1	29.4	28.2	27.0

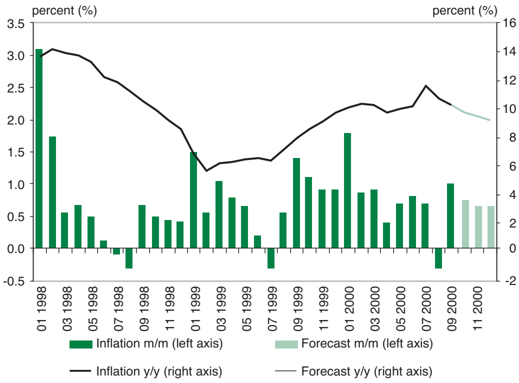
Forecast date: 20.10.2000

Notice: Forecasts based on information currently available. WBK Treasury and International Division cannot guarantee that the indicators will follow the patterns as shown above.

Inflation falls slowly

In September, inflation data were consistent with market expectations, approaching the lower limit of expectations. Annual inflation standing at 10.3% in September makes a fall in inflation to a one-digit figure in October realistic. We expect inflation to decrease to 9.9% y/y in that month and 9.2% at the end of this year. A rise in prices to 1.0% m/m in September was largely due to a rise in food prices of 1.4% m/m and a strong increase in the prices of non-food goods (roughly 1.1% m/m). Annual inflation will fall on account of a large statistical base in the fourth quarter last year. These data are positive; yet, they do not encourage a change in the MPC's tightening bias to neutral given that personal loan growth is still fairly high (3.1% m/m in September) and the food and oil market is still affected by negative supply shocks. In addition, over the past few weeks, the zloty has been weakening substantially, thereby making monetary conditions slightly less restrictive.

Inflation - consumer prices

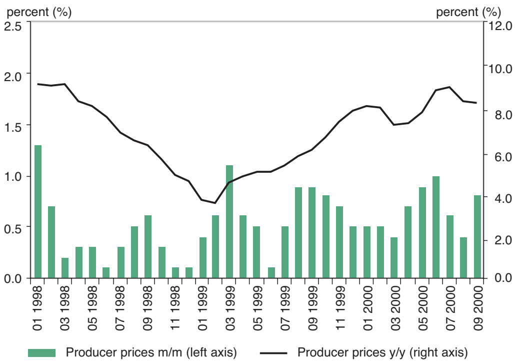


Source: CSO, own forecast

Producer prices

In September, industrial output prices rose by 0.8% m/m and 8.3% y/y, slightly more than projected. This rise was largely due to a rise in the prices of the processing industry (as a result of a rise in oil prices and a weakening of the zloty) and mining. Output and producer prices data were neutral to the market of the zloty and treasury papers, currently staying under the influence of the negative sentiment in emerging markets (fear of another rise in oil prices, conflict in the Middle East, falls on US stock markets) and a fall in the euro value.

Producer prices 1998-2000



Source: CSO

Gross Domestic Product in 1st half 2000

GDP growth decelerated in the second quarter this year to 5.2% y/y, chiefly due to a statistical base effect. In the second quarter this year, economic growth continued strong despite a significant limitation on individual consumption growth. Individual consumption was the driver of economic growth in 1999 when external demand collapsed as a result of a lagged effect of Russian crisis. In the first half of 2000, however, individual consumption decreased by 1.5 percentage points and a continuing reduction in the pace of individual consumption may be expected given a much sharper monetary and a more restrictive fiscal policy. Domestic demand is still supported by gross capital formation, in particular by growth in stocks. Growth rate of investments on fixed assets diminished to 2.9% in the second quarter of 2000 compared to 4.8% in 1999. These data indicate a prompt reaction of the real part of the economy to the tighter monetary policy in the first half of 2000. Gross value added inindustry increased by 9.8% in the first half of 2000 in comparison with only 4.6% in 1999. The banking services sector is also expanding rapidly by 5.6%. However, a slow down can be observed in construction, where higher interest rates have translated into an increase of only 2.1% in the first half of 2000. In the first half this year, the driver of the economy was recovering external demand – official exports and exports related to cross-border trade. Still, a further decrease in individual consumption growth and limitation on investment outlays may reduce the pace of economic growth to below 5% per annum this and next year.

Tab. 5. GDP growth by quarters (percent, y/y)

Period	1Q 1999	2Q 1999	3Q 1999	4Q 1999	1999	1Q 2000	2Q 1000	1H 2000
GDP growth	**1.6**	**3.1**	**5.0**	**6.2**	**4.1**	**6.0**	**5.2**	**5.6**
Total consumption	3.7	4.1	4.6	4.7	**4.3**	3.9	2.3	**3.1**
Individual consumption	4.4	4.9	5.4	5.6	**5.1**	4.6	2.6	**3.6**
Domestic demand	3.3	4.5	5.5	5.6	**6.3**	5.1	3.3	**4.2**
Gross capital formation	1.1	6.0	8.2	7.3	**6.9**	11.2	6.7	**8.6**
Investment in fixed assets	6.1	6.8	7.0	7.3	**4.8**	5.5	2.9	**4.0**
Gross value added	**1.4**	**2.8**	**4.8**	**6.0**	**3.9**	**5.8**	**5.0**	**5.4**
Industry	-2.8	1.5	7.6	11.6	**4.6**	10.1	9.4	**9.8**
Construction	2.4	3.1	3.4	5.0	**3.7**	4.0	0.8	**2.1**
Services	4.4	4.5	5.1	5.3	**4.9**	5.8	5.3	**5.6**

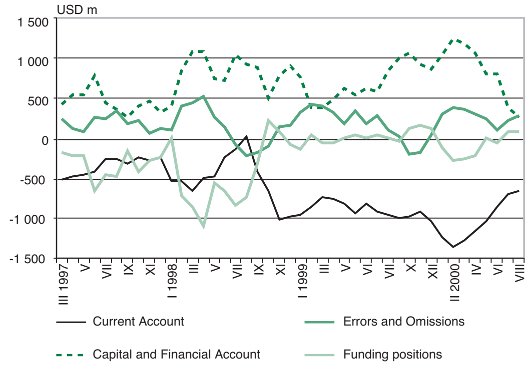
Larger than expected current account deficit in August

The current account deficit totalled USD 991m, much above market expectations ranging between USD 700-800m. The gap grew to 7.6% of GDP from 7.4% of GDP in July, making it quite unlikely that the current account gap will shrink to 7% at the end of 2000. In September, the current account deficit may reach USD 1.1bn given interest payments on Poland's external debt. Contrary to July, the structure of the gap is not positive, as in August the deficit was mainly generated by growth in the trade deficit which reached nearly USD 1.3bn compared to USD 1.041 a month before. Exports declined by 5.3% m/m whereas imports grew by 3.4% m/m, triggering an increase in the trade deficit by 24.2% m/m. From January to August 2000, exports increased by 2.9% relative to the same period last year while imports increased by 3.7%. Still, the cross-border trade balance is positive amounting to USD 350m (up 13.3% m/m). The unfavourable trade balance in August was affected by a weakening of the zloty against USD and a rise in oil prices, bringing forth an increase in import payments, while a weak euro triggered a drop in export payments, calculated in USD terms. If exports continue to shrink and imports still grow or stay at a similar level, considering weak domestic demand, domestic output may be substituted with imports, especially in relation to indirect goods. However, growth in the current account deficit does not yet pose a threat of an interest rate hike. It indicates rather that interest rates are likely to be kept at their existing level for a longer period of time and the scale of any potential cuts will be lesser than expected by the market heretofore.

Poland's external debt

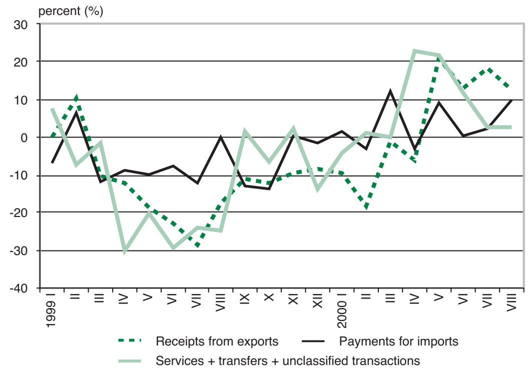
In the second quarter this year, Poland's external debt grew by USD 1.1bn, prompted largely by growth in the debt of the non-government and non-banking sector (of USD 1.36bn). There was a small decrease in the government sector debt (of USD 136m) compensating for growth of the same amount in the banking sector's debt. This large growth in the non-government and non-banking debt stemmed from an increase of USD 378m in direct investors' loans, of USD 157m in long term debt papers held by portfolio investors, of USD 120m in trade loans and of USD 674m in other loans and advances. Recently, Poland's external debt has been growing chiefly as a result of growth in the non-government and non-banking sector's debt due to the issues of debt papers and taking up of foreign loans. In the second quarter this year, the index of the share of short term debt in foreign exchange reserves slightly deteriorated – it is now standing at 37%, which is a safe level. Of the total growth in debt for the second quarter of this year, short term debt represented 14.4% while long term debt represented 85.6%.

Balance of Payments
(average for last 3 months)



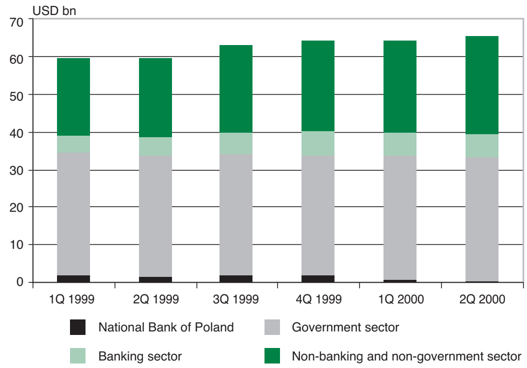
Source: NBP, own calculations

Current Account
(yearly growth of some positions)



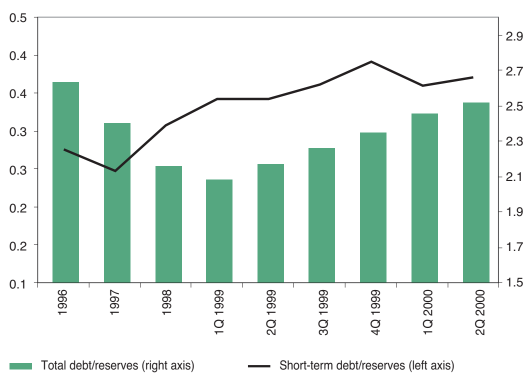
Source: NB

Poland's foreign debt



Source: NBP

Poland's debt / FX reserves



Source: NBP, own calculations

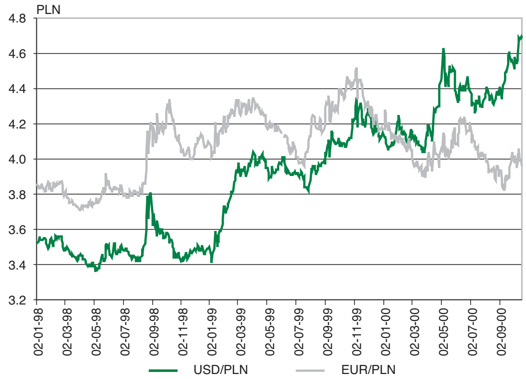
End of TP SA privatisation flows – zloty seeks a new equilibrium

The weakening of the zloty over the past two months has been chiefly caused by a disimprovement in emerging markets sentiment due to high oil prices. The currency was also affected by a further fall in the value of the euro. However, the zloty dropped to the level of PLN 4.70 against USD mainly as a result of the conclusion of TP S.A. privatisation. The expectations of inflows related to this transaction brought about artificial appreciation of the zloty, impeding the natural mechanism to restore external equilibrium through a weakening of exchange rate. The zloty ranging between PLN 4.3-4.4 against USD in the period from July to August was not consistent with a high current account deficit, running at 7.5% of GDP, and the trade deficit, standing at 10.2% of GDP. In fact, only a small portion of the expected amount of USD 1.9bn, which was to be converted to the zloty, flowed through the foreign exchange market. After a weakening at the beginning of September to the level of PLN 4.60 per USD spurred up by record high oil prices and the expected conclusion of TP S.A. flows, in the last week of September, the zloty strengthened against USD and weakened against the euro. This weakening of the zloty against the euro was related to an increase in the euro rate following a concerted intervention of G7 central banks to prop up the currency on September 22. The strengthening of the zloty against USD stemmed from the execution of a large customer order to sell USD and from the strengthening of the euro. Weaker than expected current account deficit performance in August brought forth a weakening of the zloty against the US dollar, still the zloty firmed against the euro when it turned out that the effect of the G7 intervention was short-lived. On Tuesday, October 10, the zloty weakened on account of a technical reaction associated with the squaring of long PLN positions that overlapped a strong correction in the US capital market, triggered by weak results of US companies. Emerging markets sentiment deteriorated owing to a danger of the escalation of the Israeli and Palestinian conflict. After the conclusion of the TP S.A. privatisation transaction, the zloty continued to weaken, reaching a low of PLN 4.7360 against USD on Friday, October 13. In the immediate future, the attitude towards the zloty is likely to be quite negative. Significant volatility of its rate will still be observable. At present, no positive factors that could strengthen the zloty can be seen but there are also no negative signals on the macroeconomic fundamentals side. Over the next few months, inflation should gradually decrease and the current account deficit should stabilise. In our opinion, in the medium term, the zloty should continue weakening; yet, a certain firming in its rate at the end of this year and in the first quarter 2001 is possible in relation to the flows of privatisation capital and UMTS licence sales.

Euro continues to fall

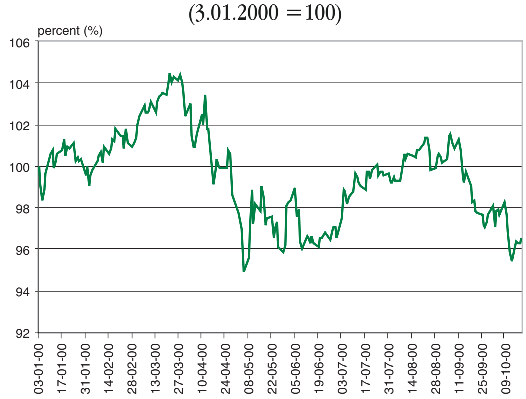
After the co-ordinated intervention by the G7 group's central banks performed on Friday, September 22, for four weeks the euro stood at over USD 0.85 for EUR. An unexpected interest rate hike of 25 basis points by the European Central Bank on October 5 led to a transitory firming of the euro rate to USD 0.8790. However, the market judged that increasing of interest rate in the euro zone might hamper economic growth in EU 11 countries. Investors' attitude to the euro is still negative although, in the assessments of the ECB and IMF, the euro is strongly undervalued against USD and JPY. We believe that in the near term, the euro may continue to weaken against USD, although in 12 months horizon, euro downward trend should be reversed.

Average exchange rate of PLN against USD and EUR (fixing)



Source: NBP, Reuters

Changes in the zloty value at fixing
(3.01.2000 = 100)



Source: Reuters, own calculations

EUR/USD

Source: Reuters

Interest rates

In the last week of September and in the first two weeks of October, WIBOR rates from 1M upwards were stable, exhibiting a small downward trend. Long term WIBOR rates increased on October 13 as the zloty weakened significantly and commentaries by MPC members appeared concerning a potential tightening of the monetary policy in the near term. 6M WIBOR hit 20.15%, 3M WIBOR 19.93% and 1M WIBOR 19.55%. However, stabilisation followed on consecutive days and, as at October 19, these rates amounted to 19.83%, 19.63% and 19.40% respectively. On the other hand, short term rates showed substantial volatility and it was noteworthy that shortage of liquidity occurred in relation to the settlement of obligatory reserves at the end of September and another strong shortage of liquidity in relation to the payment for TP S.A. stake, as a result of which O/N rates reached 24.00% on October 11.

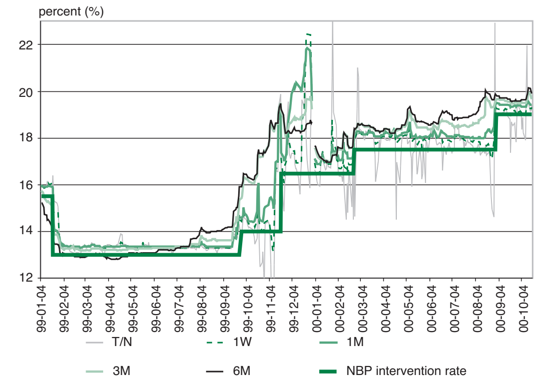
Treasury bills

In October, in the primary T-bill market, yields decreased despite an increase in market interest rates. It was related to a further limitation on 13-week T-bill supply and diminished 52-week T-bills supply. The Finance Ministry significantly reduced the issue of T-bills in October so as to minimise the costs of domestic debt service this year. Similarly, a decrease in yields occurred in the secondary market which followed the results of auctions, generating a fall in yields mainly in short terms. Compared to the previous month, as at October 18, the yield on 3-month T-bills dropped in the secondary market by 85 basis points to 16.95%, on 9-month T-bills by 40 basis points to 17.90% and on 12-month T-bills by 20 basis points to 18.10%. Yields on T-bills with short maturity will continue to fall.

Treasury bonds

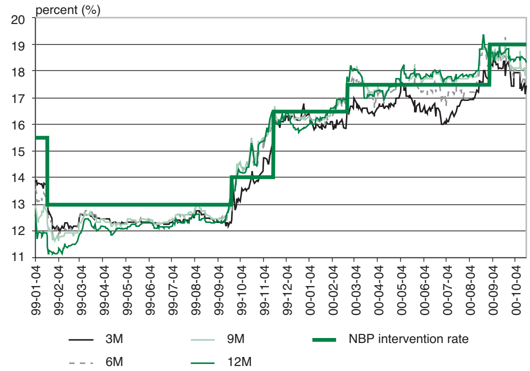
At the end of September and in the first three weeks of October, in the T-bond secondary market, a strong upward trend of yields was observable. This was particularly noticeable with respect to 5-year T-bonds. The highest T-bond yields on the secondary market were reported on October 12 and 13. The yield on 2-year T-bonds stood at 18.60%, on 5-year T-bonds 15.60% and on 10-year T-bonds 13.55%. It was prompted, among others, by a number of commentaries by MPC members indicating a tightening bias in the immediate future and a fall in emerging markets sentiment. Compared to the previous month, as at October 18, the yield on 2-year T-bonds picked up 90 basis points, hitting 18.50%, that on 5-year T-bonds gained 110 basis points, increasing to 15.40%, and the yield on 10-year T-bonds increased by 140 basis points to 13.40%. The yield curve is still shifting up and becoming steeper, staying strongly inverted. It is among others, the result of the policy of extending the average maturity of public debt and growing domestic debt. This increase in yields is also impacted by high inflation and fears of the lack of tightness of the state budget over the coming years. At present, the market is very sceptical about a potential interest rate cut in the first half of 2001, especially as this possibility has recently been questioned by MPC and central bank representatives.

WIBOR rates



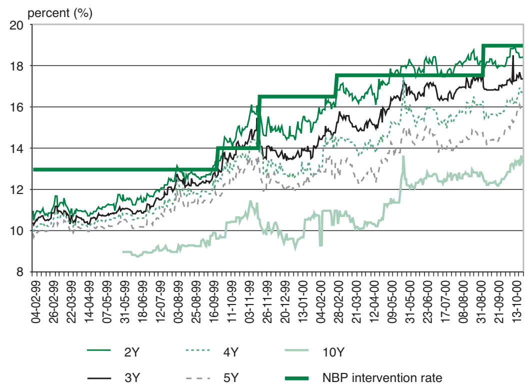
Source: NBP, WBK SA Treasury & International Division

T-Bill yield
(secondary market)



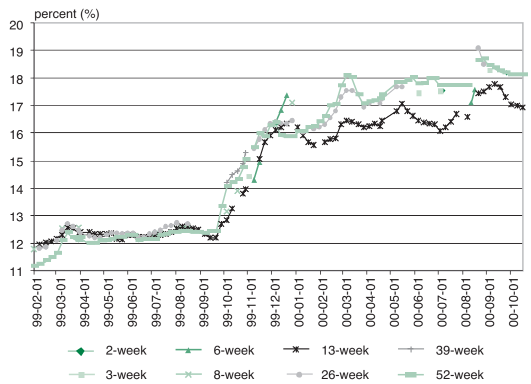
Source: NBP, WBK SA Treasury & International Division

T-Bond yield
(secondary market, bid)



Source: NBP, WBK SA Treasury & International Division

T-Bill yield (primary auctions)

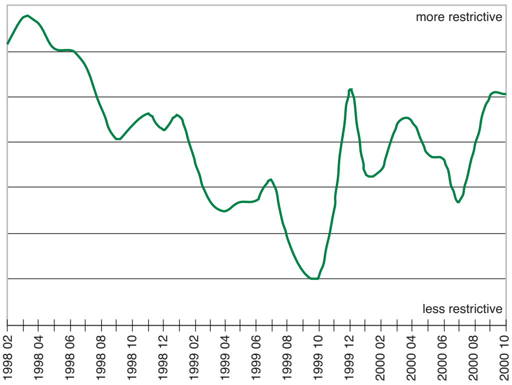


Source: NBP, WBK SA Treasury & International Division

Monetary policy in 2001

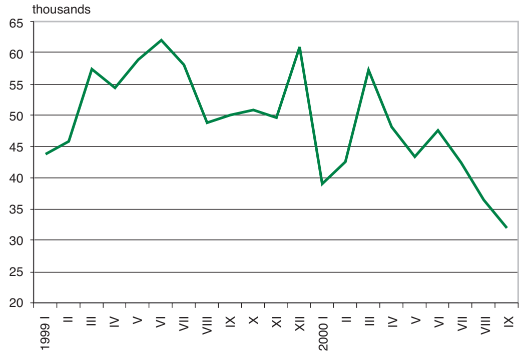
The fact that the inflation target for 1999 and 2000 was overshot twice and that two-digit inflation has been continuing this year brings the effectiveness of the pursued monetary policy into question. An analysis of inflation constituents proves that the monetary policy could have had an impact on less than 50% of inflation in the past 12 months. Core inflation, calculated as a rise in the prices of goods and services excluding energy and foodstuffs, has been stable in this period or exhibited a slight fall. Inflationary expectations, whose increase the MPC has wanted to curb over the past 12 months, have been relatively low. It is also evident in a very low rise in real wages in the business sector in the last few months. Domestic demand growth is weakening, which is particularly visible in a limitation on construction investments and a decrease in retail sales. The export sector, reviving the economy in the past few months, has come across an obstacle in the form of a weak euro and decelerating economic growth in the euro zone. In its "Monetary policy assumptions for 2001", the MPC criticises the government for reacting inappropriately to supply shocks which will continue to affect Poland's economy next year. The MPC also believes that assumed reduction in the economic deficit to 1.6% of GDP in 2001 will not be sufficient to bring about a permanent improvement in the current account deficit. In the opinion of the MPC, financing the public finance deficit from privatisation disrupts the mechanism to balance the trade deficit through exchange rate adjustments. In a situation when any growth in domestic demand, particularly consumer demand, causes imports to increase quickly, the MPC can see a further need to control its pace. The most important aim of the monetary policy will be its medium term target (4% of inflation y/y in December 2003). The MPC assumes that in 2001 economic growth will amount to 5% and the current account gap will hit 7% of GDP. An increase in money supply of between PLN 40 and 46bn is consistent with next year's wide inflation target (6% to 8% of inflation in December). At present, the MPC has no commitments with respect to exchange rate, which is full floating. However, the MPC does not rule out its intervention should exchange rate movements endanger the (upper) limit of the inflation target. We believe that over the coming two quarters interest rates will not be cut. Any change in the monetary policy's tightening bias to neutral could be expected at the end of the first quarter 2001. A cautious interest rate cut of 100 to 150 basis points is possible in the second quarter 2001. Given high yields in the secondary market, the operation to decrease the banking system's liquidity through an outright sale of converted NBP bonds, carried out since September 19, is likely to last until the end of next year. The NBP does not exclude an issue of its own securities next year. After achieving operational underliqudity, the central bank's policy will become more effective through increasing the impact of NBP interest rates on commercial banks' interest rates. The MPC expects to modify the system of open market operations. Next year, the intervention, lombard and rediscount rate will be kept. However, apart from operations to absorb liquidity, the NBP will also perform liquidity supplying operations. The NBP will introduce the central bank's deposit rate, determining the price of banks' short term deposits with the central bank.

Monetary Conditions Index



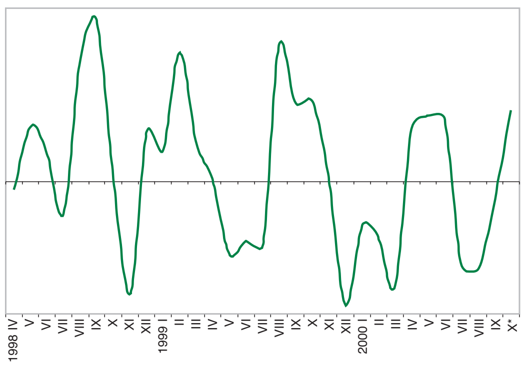
Source: NBP, CSO, own calculations

New cars sale



Source: Samar, Rzeczpospolita

Effective exchange rate

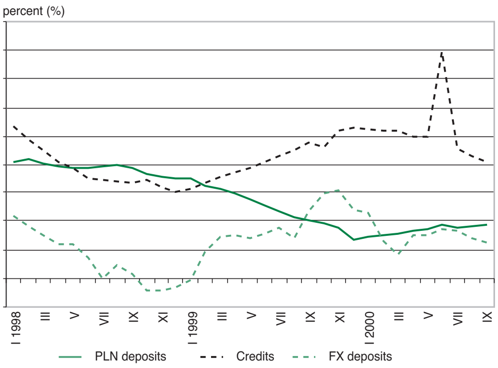


Source: NBP, CSO, own calculations
** until 19 October*

Money supply still under control

Money supply increased in September by 1.2% m/m, which means that in the last ten-day period of that month money supply accelerated substantially – money supply rose then by 0.9%. It was spurred up by large growth in corporate debt of approximately PLN 2.5bn and growth in the budget sector's debt of PLN 3.8bn. Positive personal credit and deposit trends continue. Annual PLN deposit growth is still picking up, chiefly as a result of growth in term deposits. Annual personal credit growth is experiencing quite a strong decline, which is largely due to a fall in the sales of new cars. These data confirm that the household propensity to take up loans is diminishing. Among others, it is due to a decrease in consumer purchasing power, that can be approximated by the misery index, which is the sum of the inflation rate and the unemployment rate. There is a clear correlation between growth in this index and a fall in retail sale growth.

Household deposits and credits y/y



Source: NBP, own calculations

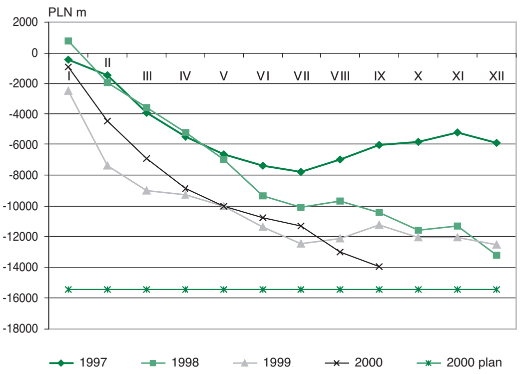
Further growth in budget deficit in September

As at the end of September, the budget deficit totalled PLN 13.98bn, representing 90.8% of the 2000 plan, compared to 84.5% after August. During the nine months of this year, revenues amounted to PLN 97.95bn, representing 69.5% of the year-long plan, relative to 61.2% a month before. Budget expenditures totalled PLN 111.93bn, equivalent to 71.6% of the plan, compared to 63.5% after August. In September, the realisation of revenues increased slightly more (by 8.3 percentage points) than that of expenditures (by 8.1% percentage points). On the revenues side, trends observable a month before continued. The corporate tax income increased significantly, standing at a high level of 80.2%. Indirect tax and personal income tax receipts, on the other hand, increased at a satisfactory pace, still their realisation to date is low – standing at 67.7% and 61.0% respectively. The planned subsidy to the Labour Fund was enlarged by PLN 100m, shifting this amount from the external debt service position. Hence, although funds were transferred from the budget to the Labour Fund in September, the extent of the realisation of these expenditures did not change. The degree of the realisation of external debt service soared 23.6 percentage points, reaching 64.8%, brought about by a decrease in the planned size of expenditures, in addition to the repayment of interest instalment on debt to the Paris Club. The costs of domestic debt service inched up, being still at a safe level of 75.4%. The realisation of subsidies to both social insurance funds does not arouse concern, either, standing at 71.8% (Social Insurance Fund) and 72.3% (Farmers Social Insurance Fund). The realisation of subsidies to local governments is high (82.2%), however. Despite much smaller growth in the budget deficit in September compared to August, low indirect tax income, representing 62.2% of planned budget proceeds, poses a risk of increase in the public finance deficit realised this year.

Household purchasing power

Source: CSO, own calculations

Budget deficit
(cumulative)



Source: Finance Ministry

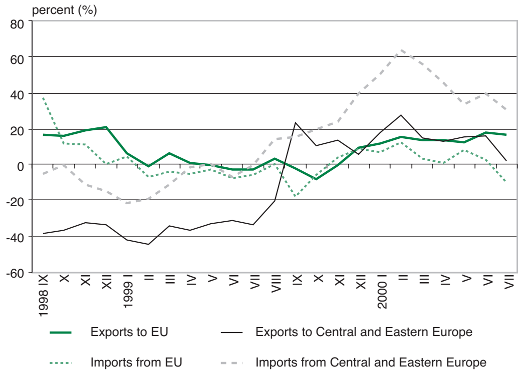
Trade turnover between Poland and European Union countries and Central and Eastern European countries

According to data corrected by the Central Statistical Office, June's exports grew by 5.8% m/m and 18.2% y/y while imports declined by 5.0% m/m and grew by 2.4% y/y. July's data show that the trade deficit with the European Union was falling for the second month in a row, reaching USD 481.2m, whereas in June it amounted to USD 664.5. These data indicate a certain weakening of trade with the European Union in July compared to June. Exports shrank by 4.4% and imports by 10.6%. In comparison with July 1999, exports grew by 16.8% and imports decreased by 10.3%, causing the trade deficit to drop by over 50%. In cumulative terms, from January to July 2000, exports to the European Union grew by 14.3% and imports by 3% relative to the same period last year. Similar changes can be seen in the latest data for the period from January to August 2000. These changes are the effect of, on the one hand, a revival in the euro zone economy, prompting growth in exports, and on the other hand, a weakening in domestic demand, which decreased the demand for imports. Similarly, trade performance with Central and Eastern European countries are slightly better after correcting data by the Central Statistical Office. After this correction, export growth stands at 4.2% m/m and 16.5% y/y, while import growth – 4.3% m/m and 39.5% y/y. In July, the scale of trade exchange and Central and Eastern European countries diminished in comparison with June. Exports shrank by 14.3% and imports by 4.8%, and as a result the deficit grew from USD 271.0m to USD 299.4m. Relative to July last year, exports grew by 1.7% and imports by 30.6%, bringing growth in the trade gap of over 100%. From January to July 2000, exports to Central and Eastern European countries grew by 15.0% and imports by 45.0% in comparison with the same period last year, where growth in trade exchange with Russia had a significant share. The upward trend of the share of these countries in trade turnover with Poland continues, which is also evident in the latest data for the period from January to August 2000.

Import distribution

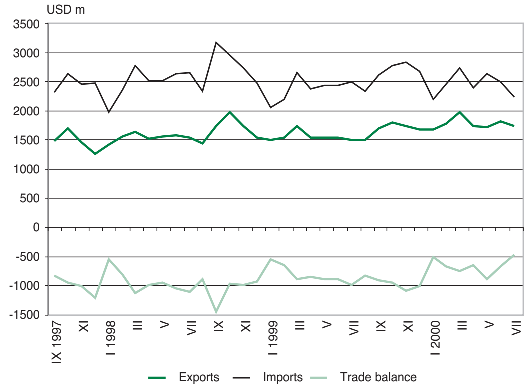
After seven months of this year, in terms of their distribution, supply imports represented 66.3% of total imports, consumer imports represented 19.2% and investment imports represented 14.3% of total imports in the import structure calculated in constant prices. In comparison with the first six months, there was an increase in supply imports from 66.0% and a fall in consumer imports from 19.5%, while the share of investment imports stayed unchanged. Since the beginning of this year, the share of consumer imports decreased substantially from 20.3% to the current 19.2%. It was the result of a drop in the prices of consumer imports of 1% with a simultaneous rise in the prices of supply imports of 11.2% and similar increases in their volumes. The drop in prices may stem from the weakening of the euro this year. Relative to the same period last year, the share of supply imports increased (from 63.9% last year) and the share of consumer and investment imports fell (from 20.6% and 15.3% respectively). These changes are the continuation of trends observable since the beginning of 1999.

Changes in foreign trade turnover compared to the same month last year



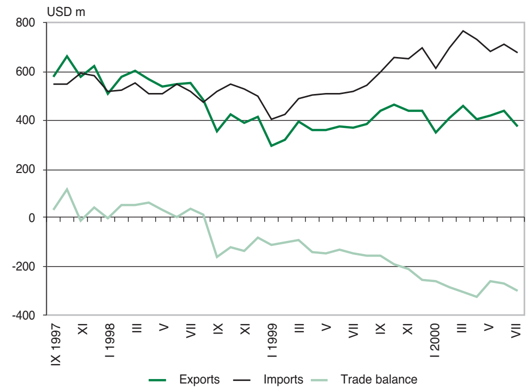
Source: CSO

Poland's foreign trade turnover with the European Union



Source: CSO

Poland's foreign trade turnover with countries of Central and Eastern Europe



Source: CSO

Industrial output growth and structure

In September 2000, sold industrial output grew by 5.0% in month-on-month terms (calculated in constant prices) and was 5.0% up on September 1999. From January to September 2000, industrial output grew by 8.9% in comparison with the same period last year. In August this year, the value of industrial output totalled PLN 38.9bn, of which 85.5% was generated in the processing industry, 8.5% in mining and quarrying and 6.0% in utilities. Within industries, the greatest growth was in: the manufacture of coke, refined petroleum products and derivatives (25.8% y/y) and the manufacture of motor vehicles, trailers and semi-trailers (21.6% y/y). The manufacture of tobacco products (-16.2% y/y) and wearing apparel and furriery (-3.1% y/y) experienced the greatest fall.

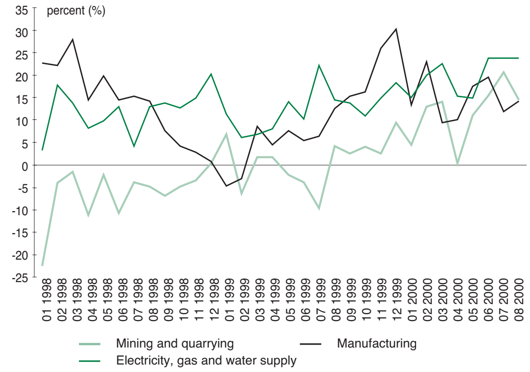
Output effectiveness

Based on an analysis of data covering the period from January 1997 to August 2000, it may be stated that the effectiveness of output in Polish enterprises is systematically increasing. Out of the three major sections of industry, the lowest productivity was in mining and quarrying (in August this year, PLN 9.8k of output per employee), but since the beginning of 1997 productivity has grown here by 55.6%. The productivity of the processing industry was largest (PLN 14.6k per employee), it increased nearly two-fold in the analysed period (up 97.2%). The productivity of utilities companies has been subject to large fluctuations related to the seasonality of output. In summer, it was low (minimum PLN 8.2k per employee in mid-1997), whereupon it surged in winter (PLN 19.4k per employee in December 1999). However, in this case as well the general trend is an increase in productivity – in August this year it was 27% up on the same month 1999. In August this year, the greatest productivity among production divisions was exhibited by the manufacturers of coke, refined petroleum products and derivatives (PLN 107.3k per employee), while the lowest productivity was exhibited by the manufacturers of wearing apparel and furriery (PLN 3.6k per employee).

Employment

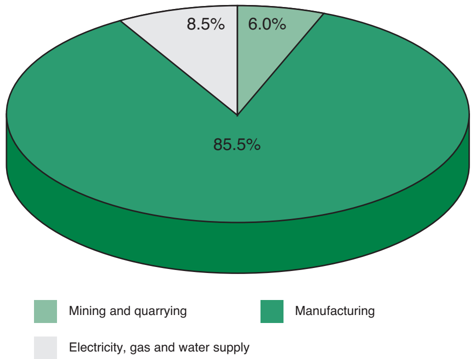
At the beginning of 1997, employment in industry amounted to 3200k. By August 2000, it had diminished by 14.5% to 2737k people. The fall in employment over this period was mild, except for the turn of 1999/2000 when employment in industry tumbled by 135k people. In the employment structure, the largest number represented the employees of food and beverage enterprises – in August this year they constituted 15.6% of all employed in industry. The share of mining and quarrying is gradually declining owing to the restructuring of this branch of industry – it fell from 10.7% in January 1997 to 8.6% in August 2000. Employment in the utilities sector covered roughly 8% of total employment (in August this year 8.4%) for all this period. Over the past year, employment has increased only in two branches of industry. These are: manufacture of coke, refined petroleum products and derivatives where in August this year there were 22.2% more employed than in August 1999 and water consumption, purification and distribution where employment increased by 4.5% in comparison with last year. Industries where the number of employees reduced most drastically were the manufacture of metals (down 19.5%) and the manufacture of leather products (-14.3%).

Yearly growth in industrial output
(current prices)



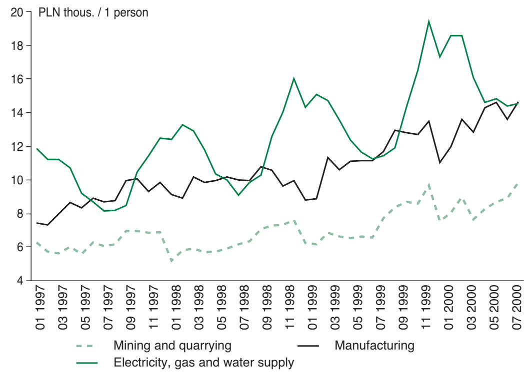
Source: CSO

Industrial output structure in August 2000



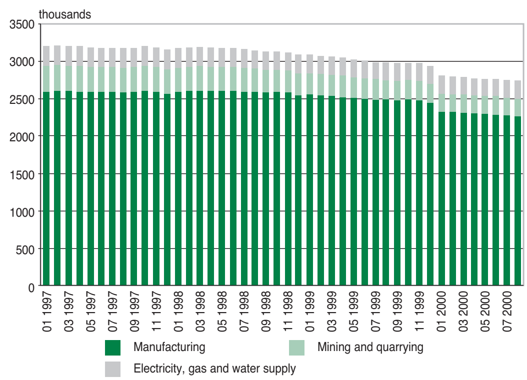
Source: CSO

Industrial productivity



Source: CSO

Employment in industry – greatness and structure



Source: CSO

In September, the business trend climate in Poland's economy experienced slight deterioration. Yet, most entrepreneurs continued to assess business trends for their products positively. The situation was best in the building industry and worst in retail trade.

Industry

The general business climate index in manufacturing was slightly lower in September than in the previous month, but it was still judged positive and better than in the same months of two previous years. It stood at +5 points – out of surveyed companies, 22% assessed business trends positively and 17% negatively. Other companies considered their situation to be the same. The deterioration of business trends was the consequence of much tighter than a month before expectations of companies for the next two months. Business trends were viewed as much better in the private sector than in the public sector. In September, manufacturers experienced a slight improvement in demand, especially external demand, expanding their current output. The projections of future demand, albeit tighter and tighter every month, are likely to remain optimistic. The financial situation of enterprises was still judged negative, but it should improve in the near term. In the coming quarter, continuing dismissals of employees should be expected and the prices of industrial products ought to rise at a much slower pace than forecast last month.

Construction

In September, the business trend climate in the building industry was regarded as positive (the index stood at +18 points), although it was a little lower than a month before and lower than in the same months of previous six years. The positive assessments of current economic activity (similar to those of last month) and the assessments of future economic activity, characteristic of that time of the year, slightly worse than last month (but still positive), will have an impact on the assessment of business trends in the construction industry. The general business trend climate in the private sector was viewed a bit better than in the public sector. Over the coming three months, growth in construction and assembly output is projected. Prices should rise slower than forecast last month. As a consequence of the expected slow down in output and order portfolio growth, construction and assembly companies expect employment to fall faster than forecast in August.

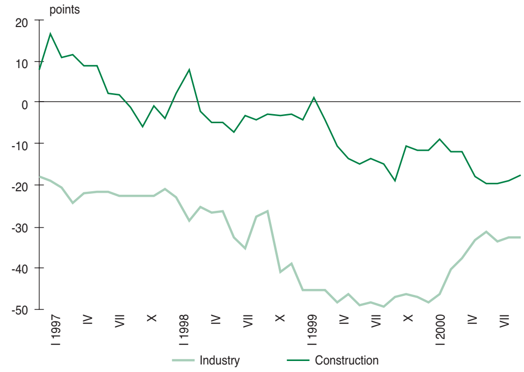
Retail trade

In September, the general business trend climate worsened compared to the previous month and the relevant index was negative (-5 points). This situation was due to a clearly worse economic situation of companies both in current and future terms, determined by their sales and financial situation. The pace of the expected increase in sales decelerated substantially. The future financial situation was also assessed less positively than a month before. In effect, the scale of employee dismissals may increase. Business trends were judged best by those trading in furniture and radio and TV appliances and household goods (+28 points) and worst by the sellers of fibre, wearing apparel and footwear (-24).

Business trends in Poland
(seasonally adjusted)

Source: CSO

Employment forecasts

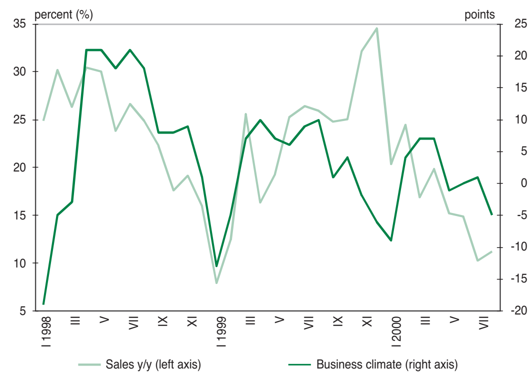


Source: CSO

Price expectations

Source: CSO

Retail trade - sales and business climate



Source: CSO

Economic Release Calendar October/November 2000

Monday	Tuesday	Wednesday	Thursday	Friday
23 October POL: Food prices (I half of X)	**24**	**25** POL: Monetary Policy Council meeting	**26**	**27** *USA: Durable goods orders (IX)* *USA: Consumer sentiment (X)*
30	**31** *CZ: Money supply (IX)*	**1 November** **All Saints Day** *CZ: State budget (X)*	**2** *EUR: ECB meeting* POL: Balance of payments (IX) POL: Foreign trade on a cash basis (IX)	**3** POL: Food prices (II half of X) *USA: Factory orders (IX)* *USA: Employment (X)*
6	**7** POL: Balance sheet of NBP (X) POL: Official reserve assets (X) POL: Economic trends in industry, construction and retail trade (X)	**8** *CZ: Inflation (X)* *CZ: Unemployment (X)* *CZ: Industrial output (IX)*	**9** *USA: Producer prices (X)* *CZ: Construction output (IX)*	**10**
13 *CZ: Producer prices (X)*	**14** POL: Money supply (X) *USA: Retail sales (X)* *CZ: Retail sales (IX)*	**15** POL: Employment and wages in corporate sector (X) POL: Inflation (X) POL: State budget (IX) *USA: Industrial output (X)* *USA: FED meeting*	**16** *EUR: ECB meeting* *USA: Inflation (X)* *USA: Money supply (X)*	**17** POL: Industrial output (X) POL: Producer price index in industry and construction (X)
20 POL: Unemployment (X)	**21** *USA: Foreign trade (IX)* *CZ: Foreign trade (X)*	**22** *USA: Consumer sentiment (XI)*	**23** POL: Food prices (I half of XI)	**24**
27	**28** *USA: Durable goods orders (X)*	**29**	**30** *EUR: ECB meeting* *CZ: Money supply (X)*	**1 December** POL: Balance of payments (X) POL: Foreign trade on a cash basis (X)

Basic Macroeconomic Data

CATEGORY	unit	1999			2000								
		October	November	December	January	February	March	April	May	June	July	August	September
PRICES													
Consumer price index (y/y)	%	8.7	9.2	9.8	10.1	10.4	10.3	9.8	10.0	10.2	11.6	10.7	10.3
Consumer price index (m/m)	%	1.1	0.9	0.9	1.8	0.9	0.9	0.4	0.7	0.8	0.7	-0.3	1.0
Production price index (y/y)	%	6.8	7.5	8.0	8.2	8.1	7.3	7.4	7.9	8.9	9.0	8.4*	8.3
Production price index (m/m)	%	0.8	0.7	0.5	0.5	0.5	0.4	0.7	0.9	1.0	0.6	0.4*	0.8
Price index of assembly and construction production (y/y)	%	8.3	8.8	9.1	7.7	7.5	7.7	8.3	8.4	8.8	9.1	8.7*	8.2
Price index of assembly and construction production (m/m)	%	0.7	0.8	0.5	0.6	0.6	0.9	1.1	0.7	0.7	0.4	0.5*	0.3
Exchange rate USD/PLN (y/y)	%	17.6	23.3	19.6	15.9	9.0	3.7	5.8	14.3	11.6	11.3	10.3	10.1
Exchange rate USD/PLN (m/m)	%	0.7	3.5	-2.0	-1.6	0.8	-1.1	3.5	6.2	-2.2	-1.7	0.8	3.0
Exchange rate EUR/PLN (y/y)	%	-	-	-	1.3	-3.9	-7.9	-6.6	-2.6	1.9	1.3	-5.9	-8.7
Exchange rate EUR/PLN (m/m)	%	2.7	-0.1	-4.0	-1.4	-1.8	-3.3	1.3	1.8	2.4	-2.5	-2.9	-0.8
Real gross wages in enterprise sector (y/y)	%	1.9	-0.3	2.3	6.5	6.8	3.1	5.2	1.8	1.3	-2.2	1.1	0.4
ACTIVITY INDICATORS													
Gross domestic product (y/y)	%	-	-	6.2	-	-	6.0	-	-	5.2	-	-	-
Industrial output (y/y)	%	8.9	15.9	19.1	7.9	16.4	6.8	5.3	12.1	13.4	7.8	9.2*	5.0
Industrial output (m/m)	%	0.1	-0.9	5.7	-19.0	7.3	11.6	-8.4	7.7	1.2	-6.9	6.1	5.0
Construction and assembly production (y/y)	%	-0.1	5.9	12.3	4.6	5.6	4.2	-5.6	-0.6	1.2	-2.9	-2.1*	-3.8
Construction and assembly production (m/m)	%	4.6	-2.3	23.2	-32.1	5.0	17.2	2.2	-0.6	2.8	-0.7	1.4	-
Retail sales of goods (y/y) [a]	%	15.3	29.3	27.0	31.8*	35.4	15.8*	20.9*	23.8*	33.0*	26.2	-	-
Retail sales of goods (m/m) [a]	%	7.0	-0.5	-4.4	-7.7*	13.9*	5.4*	-6.9*	4.3*	3.8*	-8.0	-	-
Exports on a customs basis (y/y)	%	15.3	29.3	27.0	31.8*	35.4	15.8*	20.9*	23.8*	33.0*	26.2	-	-
Exports on a customs basis (m/m)	%	7.0	-0.5	-4.4	-7.7*	13.9*	5.4*	-6.9*	4.3*	3.8*	-8.0	-	-
Imports on a customs basis (y/y)	%	15.1	30.4	34.7	31.2	34.6	11.9	13.4*	31.5*	20.7*	3.1	-	-
Imports on a customs basis (m/m)	%	6.2	4.1	-2.9	-19.4	13.3*	9.2	-7.9*	16.5*	-8.6*	-13.7	-	-
LABOUR MARKET													
Number of unemployed	thous. persons	2 187	2 257	2 350	2 478	2 528	2 534	2 490	2 446	2 437	2 478	2 496	2 529
Unemployment rate	%	12.2	12.5	13.0	13.6	13.9	13.9	13.7	13.5	13.5	13.7	13.9*	14.0
Average employment in corporate sector	thous. persons	5 738	5 723	5 679	5 319	5 316	5 308	5 301	5 292	5 295	5 284	5 271	5 269
Average monthly gross wages in corporate sector	PLN	1 881	1 946	2 186	1 882	1 926	1 992	2 067	1 988	2 049	2 036	2 051	2 088
Nominal increase in wages (y/y)	%	10.9	9.0	12.3	17.2	17.9	13.7	15.5	12.0	11.5	9.2	11.9	10.7
STATE BUDGET													
Budget revenues	PLN bn	100.6	112.5	125.9	11.0	20.3	31.0	40.9	51.8	64.2	74.8	86.2	98.0
Budget expenditures	PLN bn	112.6	124.6	138.5	11.8	24.8	38.0	49.8	61.8	75.0	86.1	99.2	111.9
State budget deficit	PLN bn	-12.1	-12.1	-12.6	-0.9	-4.5	-6.9	-8.9	-10.0	-10.8	-11.3	-13.0	-14.0
Domestic government debt	PLN bn	-	-	134.7	-	-	141.9	-	-	143.7	-	-	-
Foreign government debt	PLN bn	-	-	129.7	-	-	128.2	-	-	135.8	-	-	-

Basic Macroeconomic Data

CATEGORY	unit	1999 October	November	December	2000 January	February	March	April	May	June	July	August	September
BALANCE OF PAYMENTS													
Current account	USD bn	-849	-1 178	-1 683	-1 207	-954	-1 344	-850	-401	-860	-701*	-991	-
Trade balance	USD bn	-1139	-1 561	-1 765	-1 458	-1 140	-1 241	-1 075	-894	-1 041	-1 042*	-1 294	-
Exports	USD bn	2 221	2 151	2 470	1 922	2 038	2 371	2 032	2 407	2 397	2 473*	2 341	-
Imports	USD bn	3 360	3 712	4 235	3 380	3 178	3 612	3 107	3 301	3 438	3 515*	3 635	-
Services: net	USD bn	-128	-140	-208	-174	-171	-202	-177	-105	-159	-131*	-130	-
Unclassified transactions: net	USD bn	426	299	174	286	225	218	398	324	337	309	350	-
Capital and financial account	USD bn	863	834	1 405	1 485	647	1 074	672	653	-165	343*	561	-
Direct investments	USD bn	363	789	744	763	354	430	449	310	363	488*	157	-
Portfolio investments	USD bn	451	809	256	244	587	1 598	131	20	90	232*	-436	-
MONEY SUPPLY													
Money supply	PLN bn	251	255	263	255	258	262	266	269	285	277	278	281
Money supply (y/y)	%	22.4	22.9	19.3	15.1	13.7	13.8	15.2	15.2	20.6	16.2	14.9*	14.3
Money supply (m/m)	%	1.9	1.5	3.5	-3.1	1.0	1.6	1.5	1.1	5.9	-2.7	0.3*	1.2
Total deposits (y/y)	%	23.5	24.2	18.3	15.7	14.7	15.5	16.6	16.8	23.3	18.5	17.1*	16.4
Total deposits (m/m)	%	1.8	2.1	2.4	-1.6	1.3	1.9	0.9	1.6	6.4	-3.1	0.5*	1.3
Household loans (y/y)	%	46.0	52.2	53.0	52.5	51.8	52.1	49.8	49.9	79.4	45.7	42.9	41.0
Household loans (m/m)	%	3.7	4.3	4.5	0.6	1.2	3.4	1.6	3.8	25.2	-15.0	2.5	3.1
Corporate loans (y/y)	%	24.5	23.7	21.6	20.8	18.8	18.1	19.1	17.9	19.7	18.8	18.2*	17.3
Corporate loans (m/m)	%	2.5	2.2	-1.5	2.5	1.0	0.9	2.0	0.6	2.2	0.1	1.4*	2.2
FINANCIAL INDICATORS													
Average deviation from the central parity [b]	%	0.8	2.0	-1.3	-3.0	-3.7	-6.2	-5.1	-	-	-	-	-
Average exchange rate USD [c]	PLN	4.1092	4.2527	4.1696	4.1036	4.1353	4.0902	4.2347	4.4988	4.3994	4.3229	4.3593	4.4900
Average exchange rate EUR [c]	PLN	4.4031	4.3974	4.2200	4.1608	4.0850	3.9507	4.0033	4.0758	4.1740	4.0684	3.9486	3.9152
Average exchange rate DEM [c]	PLN	2.2513	2.2484	2.1577	2.1274	2.0886	2.0200	2.0469	2.0839	2.1341	2.0801	2.0189	2.0018
Average WIBOR T/N [c]	%	13.82	15.51	17.69	17.50	16.29	17.92	17.64	17.33	17.73	17.87	17.31	18.84
WIBOR 1M [c]	%	14.70	16.77	20.45	17.26	17.44	18.17	18.15	18.13	18.13	18.05	18.24	19.39
WIBOR 3M [c]	%	16.64	18.53	19.03	17.30	17.85	18.44	18.34	18.60	18.55	18.51	19.12	19.55
Average 3M T-bill yield [c]	%	13.68	15.35	16.28	16.03	16.13	16.56	16.72	17.01	16.49	16.48	17.38	18.17
Average 12M T-bill yield [c]	%	14.58	15.95	15.99	16.18	17.00	17.57	17.31	17.86	17.85	17.76	18.34	18.65
Average 2Y T-bond yield [c]	%	14.56	15.39	14.78	15.10	16.17	16.56	16.85	17.78	18.02	17.77	18.27	18.11
Average 10Y T-bond yield [c]	%	10.40	10.63	9.81	10.13	10.55	10.42	10.56	11.89	12.46	12.53	12.72	12.40
MONETARY POLICY INSTRUMENTS													
Intervention rate	%	14.0	16.5	16.5	16.5	17.5	17.5	17.5	17.5	17.5	17.5	19.0	19.0
Rediscount rate	%	15.5	19.0	19.0	19.0	20.0	20.0	20.0	20.0	20.0	20.0	21.5	21.5
Lombard rate	%	17.0	20.5	20.5	20.5	21.5	21.5	21.5	21.5	21.5	21.5	23.0	23.0
Monthly devaluation rate [b]	%	0.3	0.3	0.3	0.3	0.3	0.3	0.3	-	-	-	-	-

** data officialy corrected, [a] in current prices, [b] up to April 11 2000, [c] average including non-working days, Sources: CSO, NBP, Finance Ministry, Reuters, own estimations*

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The following sources were used in preparing this bulletin: Cetral Statistical Office, National Bank of Poland, Finance Ministry, Reuters.