WBK

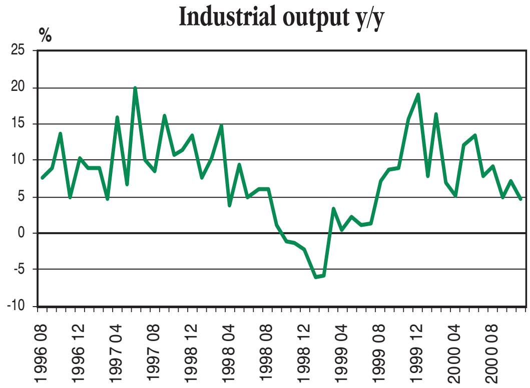
Poland's Economy
Financial Markets

December 2000 No. 18

Major economic trends

- CPI in November amounted to 0.4 m/m and 9.3 y/y, in line with market expectations. Such a moderate increase in prices in November was due chiefly to the low increase in food and services prices. (p. 4)
- Growth in producer prices was lower than market expectations and amounted to 0.1% m/m and 7.3% y/y. Such a low growth in November was due to a firming of the zloty, stabilisation in oil prices and weak internal demand. (p. 4)
- November industrial output fell by 3.3% m/m and increased by 4.6% y/y, slightly below our forecast of a 3.0% fall m/m. November data show that the fall in economic activity that resulted from high real interest rates was deeper than expected. (p. 4)
- October's current account deficit totalled USD 1.051bn, running higher than market expectations of USD 900m. The current account deficit in October grew to 7.3% of GDP after 7.2% of GDP in September. We forecast, however, that in the following months the current account deficit will stabilise at 7.0% of GDP in December this year. The trade deficit in October totalled 9.0% of GDP. (p. 5)
- In the last week of November and in December significant strengthening of the zloty against US dollar from the level of PLN 4.57 for USD (23 November) to PLN 4.30 (19 December) took place. (p. 6)
- In the last week of November the downward trend of EUR against USD reversed. After a few false signals in previous months, in December the euro passed to an upward trend reaching USD 0.90 for EUR. The period of restrictive monetary policy in the USA, and in a lesser degree in the Euro zone, has probably ended. (p. 6)
- Within the last four weeks the yield curve moved down by 135 to 195 bps given the NBP's interest rates cuts expectations, caused by the data showing that the economic growth in Poland is slowing down. (p. 7)
- The Monetary Policy Council will keep high real interest rates in 2001. (p.8)
- There was a little budget surplus in November. (p. 9)
- Core inflation does not react to changes in monetary policy (p. 10 and 11)
- The fall in investment outlays in economy in this year. (p. 12)

Industrial output y/y



Source: CSO

In this issue:

Current economic situation of Poland

At the end of November and in December further data confirming a weakening of economic growth in Poland were released. Low growth in industrial output during two consecutive months is evidence, on the one hand, of weak internal demand, but on the other hand suggests that recovery in exports is not so strong as might be expected. Weak internal demand and the end of the two most important supply shocks (stabilisation of food prices and fall in oil prices) led to faster fall in inflation in 4Q2000. This was partially due to base effect, i.e. high inflation in 4Q1999. Expectations of slowdown in economic growth triggered strong demand for the zloty and Polish treasury papers. The market expects that official interest rates have already peaked. Foreign exchange and bond markets are to a great extent immune to negative news from politics. Even the relatively high current account deficit for October did not cause the zloty to weaken. The market assessed that improvements in exports would stabilise the current account in the coming months.

Short-term prospects for the zloty are also positive – if the expectations of early cut in interest rates are sustained. In the medium-term, however, weakening of the zloty by 20 to 25% is inevitable to compensate for lower productivity of labour and restore the balance in merchandise trade.

It seems that Poland's economic situation stabilises, with significant slowdown in economic growth. There are no inflationary risks – inflation should gradually fall, remaining at single-digit level. Current account deficit will probably stabilise and will gradually fall to 6-7% of GDP in 2001.

Economic growth significantly slowed in second half of this year. Growth will be also low in the first and the second quarter of 2001. 2001 will reveal the negative consequences of the slowdown in economic growth, chiefly imbalances in the labour market, resulting in an increase in the unemployment rate.

We think that keeping high real interest rates may be destabilising for the current account in the short and medium run. High nominal interest rates encourage residents to borrow in foreign currencies, which may lead to excessive exposure to exchange rate risk. These two factors may deepen the scope of correction in the zloty exchange rate in the medium run.

Tab. 1. Inflation indicators

	07 2000	08 2000	09 2000	10 2000	11 2000	*12 2000 F*
Consumer Price Index (m/m, %)	0.7	-0.3	1.0	0.8	0.4	*0.5*
Consumer Price Index (y/y, %)	11.6	10.7	10.3	9.9	9.3	*8.8*
Producer Price Index (m/m, %)	0.6	0.4	0.8	0.6*	0.1	*0.2*
Producer Price Index (y/y, %)	9.0	8.4	8.3	8.0*	7.3	*6.8*
Average monthly FX rate (USD, y/y, %)	11.3	10.3	10.1	12.8	7.2	–

Tab. 2. Activity indicators

	06 2000	07 2000	08 2000	09 2000	10 2000	11 2000
Retail Sales Index (m/m, %)	2.8	-0.7	1.4	-0.8	1.5	–
Retail Sales Index (y/y, %)	14.8	10.3	11.2	10.4	7.2	–
Household loans (y/y, %)	79.4	45.7	42.9	40.9	38.9*	34.9
Industrial Output (m/m, %)	1.2	-6.9	6.1	5.0	2.1*	-3.3
Industrial Output (y/y, %)	13.4	7.8	9.2	5.0	7.1*	4.6
Exports, current prices (in payment terms, y/y, %)	13.0	18.2	9.3	18.6*	16.6	–
Imports, current prices (in payment terms, y/y, %)	0.4	3.0	8.6	1.3	6.8	–
Foreign Trade Balance (NBP, USD m)	-1041	-1042	-1324	-972*	-1000	–
State Budget Balance (PLN m)	-10.8	-11.3	-13.0	-14.0	-15.4	-14.9

Tab. 3. Poland's Economy

	1996	1997	1998	1999	*2000 F*
Gross Domestic Product (fixed prices, y/y, %)	6.0	6.8	4.8	4.1	***4.8***
Individual Consumption (y/y, %)	8.3	6.9	4.9	5.1	***3.4***
Gross expenses on fixed assets (y/y, %)	19.7	21.7	14.5	6.9	***4.8***
Exports, constant prices (y/y, %)	9.7	13.7	9.4	2.0	***13.1***
Imports, constant prices (y/y, %)	28.0	22.0	14.6	4.4	***9.5***
Inflation (average annual, %)	19.9	14.9	11.8	7.3	***10.1***
Inflation (year end, y/y, %)	18.5	13.2	8.6	9.8	***8.8***
Unemployment Rate (year end, %)	13.2	10.3	10.4	13.0	***14.5***
Current Account Balance/ /GDP (%)	-1.0	-3.2	-4.2	-7.6	***-7.0***
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

Source: CSO, NBP, own calculations

* corrected data

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

Category	1999	I Q 2000	II Q 2000	III Q 2000	IV Q 2000	2000	I Q 2001	II Q 2001	III Q 2001	IV Q 2001	2001	2002	2003	2004	2005
Interest rates															
1M	14.55	17.63	18.14	18.55	19.60	18.48	19.60	18.60	18.60	17.10	18.5	15.0	12.0	9.7	8.6
3M	14.73	17.87	18.50	19.06	19.62	18.76	19.30	18.60	18.60	17.10	18.5	15.2	12.2	9.9	8.8
6M	14.57	17.87	18.67	19.36	19.78	18.92	19.30	18.50	18.50	17.00	18.4	15.3	12.3	10.0	8.9
12M	14.77	18.07	18.86	19.51	19.60	19.01	18.80	18.45	18.45	16.95	18.3	15.5	12.4	10.1	9.0
Lombard rate	17.59	21.08	21.50	22.01	23.00	21.90	23.00	22.00	22.00	20.50	21.9	16.5	13.8	11.5	10.4
Intervention rate	13.72	17.08	17.50	18.17	19.00	17.94	19.00	18.00	18.00	16.50	17.9	14.0	11.8	9.5	8.4
Treasury bonds yields															
3L (bid)	11.89	14.60	16.28	17.04	16.50	16.11	15.00	14.50	14.50	13.80	14.5	11.9	9.5	8.5	8.0
5L (bid)	11.12	12.77	13.98	14.39	14.10	13.81	12.80	12.40	12.40	11.80	12.4	10.2	9.0	8.2	7.8
10L (bid)	9.63	10.36	11.64	12.55	12.80	11.84	10.50	10.20	10.20	9.80	10.2	9.3	8.5	8.1	7.6
T-bills yields															
13-week	13.16	16.24	16.74	17.33	17.20	16.88	17.00	16.50	16.50	15.80	16.5	13.3	11.2	8.9	7.9
52-week	13.00	16.92	17.68	18.25	18.10	17.74	17.50	17.00	16.80	16.10	16.9	13.9	11.4	9.1	8.1
Exchange rates															
USD/PLN	3.9675	4.1132	4.3762	4.3897	4.525	4.350	4.33	4.38	4.43	4.48	4.41	4.85	5.30	5.55	5.80
EUR/PLN	4.2270	4.0629	4.0872	3.9781	3.920	4.018	3.94	4.08	4.19	4.29	4.13	4.82	5.39	5.49	5.56
EUR/USD	1.0660	0.9878	0.9344	0.9062	0.866	0.925	0.91	0.93	0.95	0.96	0.94	0.99	1.02	0.99	0.96
Average depreciation (currency basket)	–	–	–	–	–	2.1%	-2.0%	1.8%	1.9%	1.8%	2.1%	13.3%	10.5%	3.3%	2.8%
USD/PLN (end of period)	4.1483	4.1428	4.3907	4.5404	4.320	4.320	4.35	4.40	4.45	4.50	4.50	5.20	5.40	5.70	5.90
EUR/PLN (end of period)	4.1689	3.9650	4.2075	3.9960	3.888	3.888	4.00	4.11	4.23	4.32	4.32	5.32	5.45	5.53	5.58
EUR/USD (end of period)	1.0050	0.9571	0.9583	0.8801	0.900	0.900	0.92	0.94	0.95	0.96	0.96	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	4.4	3.6	4.8	3.6	3.9	5.0	5.8	4.6	5.1	5.2	5.5	6.0
Inflation (y/y, %)	9.8	10.3	10.2	10.3	8.8	8.8	8.3	8.0	6.8	7.0	7.0	5.7	4.3	3.8	3.6
Inflation (y/y, %) average	7.3	10.3	10.1	10.8	9.3	10.1	8.5	8.3	7.0	6.8	7.7	6.4	5.0	4.1	3.7
Current account/GDP (%)	-7.6	–	–	–	–	-7.0	–	–	–	–	-6.3	-6.7	-6.8	-6.4	-5.9
Budget deficit/ /GDP (%)	-2.0	–	–	–	–	-2.2	–	–	–	–	-2.0	-1.9	-1.6	-1.5	-1.2
Public debt/ /GDP (%)	44.6	–	–	–	–	43.5	–	–	–	–	40.1	38.5	36.7	34.4	32.1
Foreign Public debt/ /GDP (%)	20.7	–	–	–	–	20.3	–	–	–	–	17.9	17.3	16.7	15.5	14.2
Total foreign debt/ /GDP (%)	39.0	–	–	–	–	39.3	–	–	–	–	35.7	34.4	32.6	29.9	27.2

Forecast date: 19.12.2000

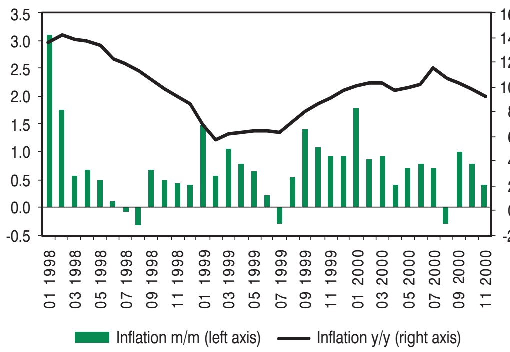
Notice: Forecasts based on information currently available. WBK Treasury and International Division cannot guarantee that the indicators will follow the patterns as shown above.

Inflation – consumer prices

CPI in November amounted to 0.4% m/m and 9.3% y/y, in line with market expectations. Such a moderate increase in prices in November was due chiefly to low increase in food and services prices. An increase in prices of non-foodstuffs was also limited. CPI in December will fall to 8.8% y/y. Due to the fall in oil prices, falling food prices and a strengthening of the zloty, inflationary pressure in coming months will alleviate.

Decrease in the y/y growth in CPI is in line with MPC expectations. As inflation will be falling and economic growth will continue to slow down, the MPC should in the near term signal the adoption of neutral stance in monetary policy. An interest rate cut, however, may be expected no sooner that the end of first quarter of 2001, if the MPC have more signals of a stabilising economy.

Inflation (%)

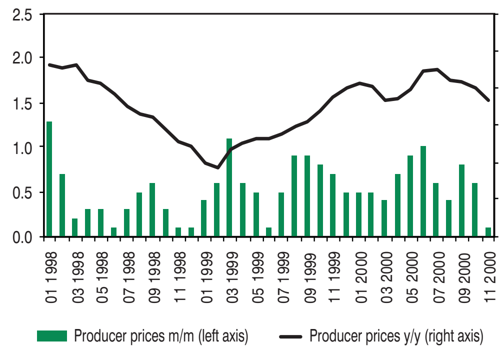


Source: CSO

Inflation – producer prices

Growth in producer prices was lower than market expectations and amounted to 0.1% m/m and 7.3% y/y. Such a low growth in November was due to a firming of the zloty, stabilisation in oil prices and weak internal demand. An effect of low demand was particularly visible in flat manufacturing prices. In the period of January to November 2000 the producer prices increased by 6.7%, compared to the same period last year. The rise in the gas price in 1Q 2001 will influence the producer price index in negative way. Next year the reduction of the difference between CPI and PPI may be expected.

Producer prices (%)



Source: CSO

Industrial output

November industrial output fell by 3.3% m/m and increased by 4.6% y/y, slightly below our forecast of a 3.0% fall m/m. In the period of January to November 2000 the industrial output increased by 8.3%, compared to the same period last year.

The main reason for this fall in industrial output was weak manufacturing output. Manufacturing output fell by 0.7% m/m after adjusting for the shorter month.

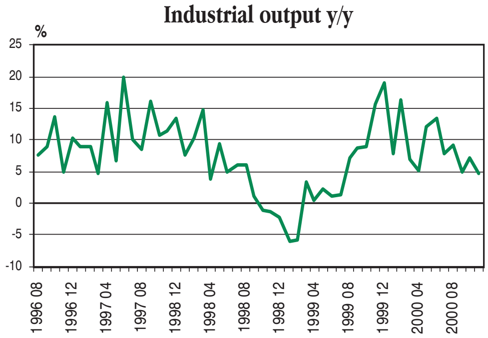
Industrial production was supported by a seasonal increase in utilities output.

November data show that the fall in economic activity that resulted from high real interest rates was deeper that one might have expected. It points also to a smaller than expected recovery in exports.

These data would probably not prompt the MPC to adopt neutral stance at its meeting on Wednesday, December 20. However, they would be an argument for cutting interest rates earlier, possibly at the end of first quarter 2001.

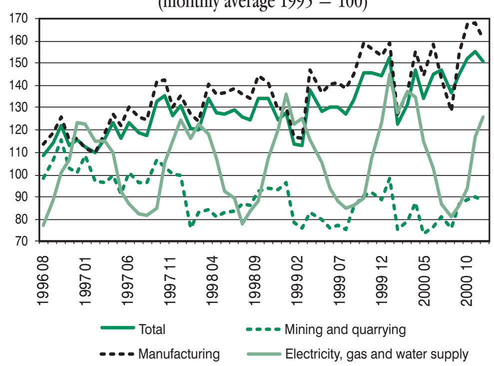
However, the MPC would be inclined to keep a high level of real interest rates, which means that the total cut in interest rates next year will not exceed 250-300 basis points.

Industrial output y/y



Source: CSO

Industrial output
(monthly average 1995 = 100)



Source: CSO

Current account deficit in October

October’s current account deficit totalled USD 1.051bn, running higher than market expectations of USD 900m. However, considering high interest payments (some USD 500m) and growth in exports, these data are quite positive.

The annual growth in exports in October stayed at 16.6% y/y whereas the annual growth in imports increased to 6.8% y/y. At the same time, there was significant increase in the positive balance of unclassified current flows to USD 485m.

The positive signal is a clear improvement on the export side, both in official trade and in cross-border trade. Growth in imports is probably related to intensified demand in the period before Christmas.

The current account deficit in October grew to 7.3% of GDP after 7.2% of GDP in September. We forecast, however, that in the coming months the current account deficit will stabilise at 7.0% of GDP in December this year. The trade deficit in October totalled 9.0% of GDP.

In the period of January to October this year the capital and financial account covered 79.7% of the current account deficit, compared to 67.1% last year. Foreign direct investment financed 91.0% of the current account deficit, compared to 56.4% last year. The share of Portfolio Investment in current account deficit financing increased significantly (25.9% compared to 1.2% last year). The Other Investment balance was negative in the period of January to October this year (at -37.1% of the current account deficit).

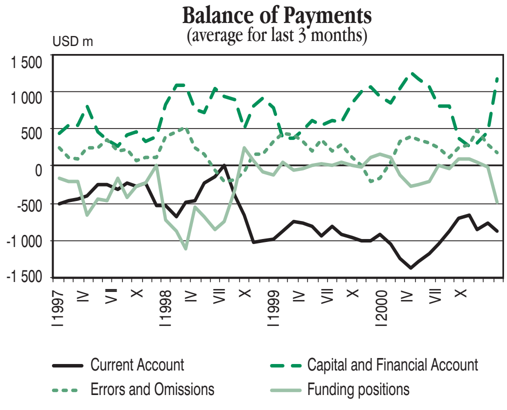
Money supply

Money supply in November increased only by 1.2% m/m after increasing by 2.4% in October. Nominal money supply increased by 14.2% y/y while real money supply increased by some 3.2% y/y.

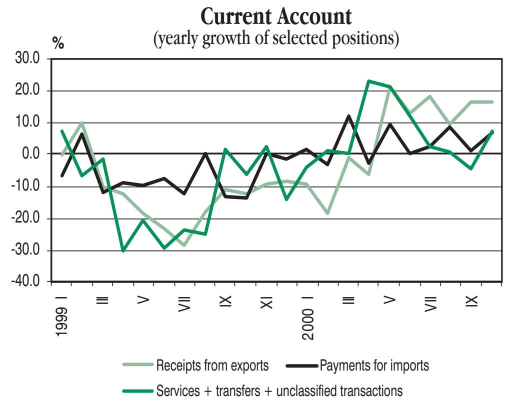
Credit to households increased by 1.2% m/m only and its yearly growth decelerated to 34.5% in November after 38.9% in October. Credit to the business sector increased only by 0.3% m/m and 13.9% y/y.

Real money supply at 3.2% y/y will be exerting downward pressure on economic growth in the coming months. Very low and decelerating growth in consumer credit combined with only 0.8% real wage growth in November will also weaken domestic demand.

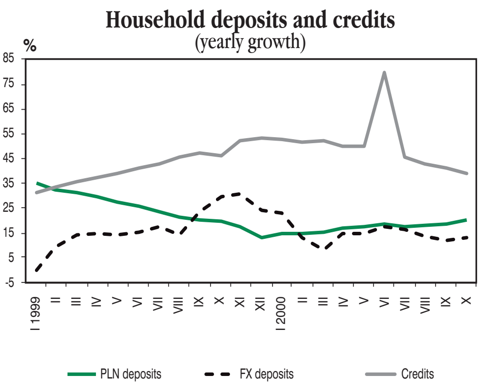
Strong zloty, falling inflation, only minor real wage growth would be arguments for easing of monetary policy in the coming months. However, we do not expect any immediate action of the MPC. We maintain our view that potential rate cut would be of limited size and may occur at the end of the first or at the beginning of the second quarter of 2001.



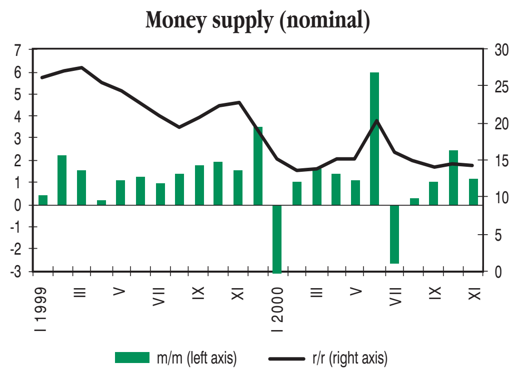
Source: NBP, own calculations



Source: NBP



Source: NBP



Source: NBP

The zloty strengthens on interest rate cut expectations

In the last week of November and in December significant strengthening of the zloty against US dollar from the level of PLN 4.57 for USD (23 November) to PLN 4.30 (19 December) took place. In this way, the zloty came back to the level of August and September this year, when the market expected flows connected with TP SA privatisation. There is a strong support about the level of PLN 4.25 for USD and the zloty should rather keep at this level even if portfolio capital continues to inflow unless there is a significant strengthening of the euro against US dollar. The firming of the zloty in the end of November and in December results from two factors. First, the weak data on industrial output in October and November and very good data on inflation in November confirmed the market view that interest rate cuts must to be introduced within the coming 3-6 months, despite the reservation of MPC concerning fiscal policy. Second, the foreign currencies from swap transactions, that allowed France Telecom to obtain zlotys to buy the share in TP SA, flowed to the market.

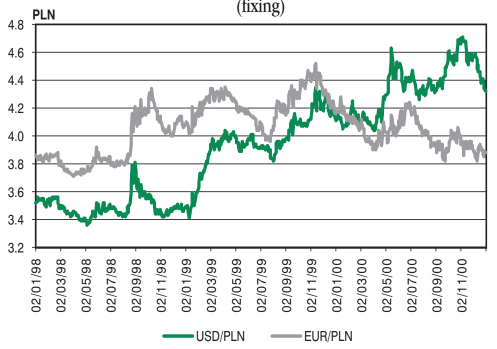
If the MPC changes its stance on monetary policy in the near term, the zloty may continue to strengthen. The present firming of the zloty will cause a faster fall in inflation and will be the factor hastening the interest rate cut.

The strong zloty may exert pressure on the current account and lead to a deterioration in Poland's trade balance. In our opinion, as Poland's foreign trade is not balanced the zloty is significantly overvalued now. This is why, in the middle term quite considerable correction of the FX rate must occur (weakening by 20-25%). However, in coming months the zloty may be still strong, supported by inflow of short-term capital invested in Polish T-bonds. We think, that maintaining high real interest rates by the MPC is improper in the current situation, as it can lead to the deterioration in the current account. It would be a good solution to decrease interest rates quite quickly but gradually. In our assessment, taking into account the uncertain public finance situation and the unwillingness of the MPC to cut interest rates quickly, two or three cuts of interest rates may be introduced in 2001, of the total amount of 2.5-3 percentage points.

The euro strengthens against US dollar

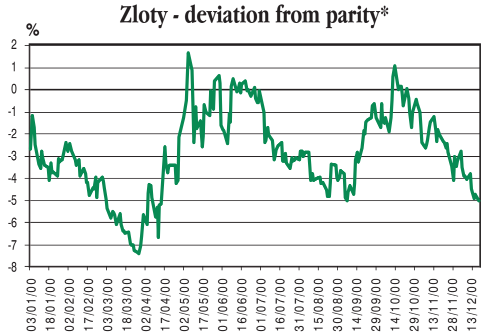
In the last week of November the downward trend of EUR against USD reversed. After a few false signals in previous months, in December the euro passed to an upward trend reaching USD 0.90 for EUR. It was the result of accumulating signals of the slowdown in the US economy together with good data from the euro zone. The business cycle in the USA precedes the business cycle in the euro zone and it will cause the difference between growth rates in USA and euro zone to decrease despite the expected growth slowdown in both the zones next year. The Federal Open Market Committee should adopt a neutral stance in the near term, which opens the way to a cut in interest rates in the USA in the beginning of next year. Given the fall in oil prices, inflationary pressure in the euro zone should decrease in the near term, which will cause the European Central Bank to close the restrictive monetary policy cycle in the near term. Before it happens, one more interest rate hike in the euro zone by 25 bps in period of 3-6 months is possible. In coming months the euro should gradually strengthen against the USD, but probably will not reach parity against USD in 2001 r.

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



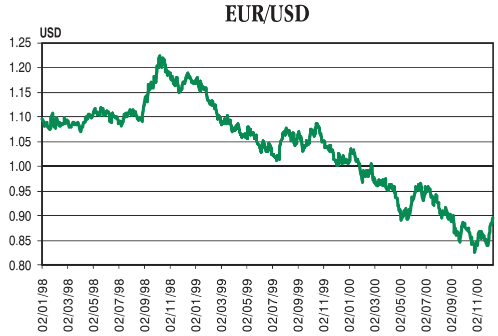
Source: NBP, Reuters

Zloty - deviation from parity*



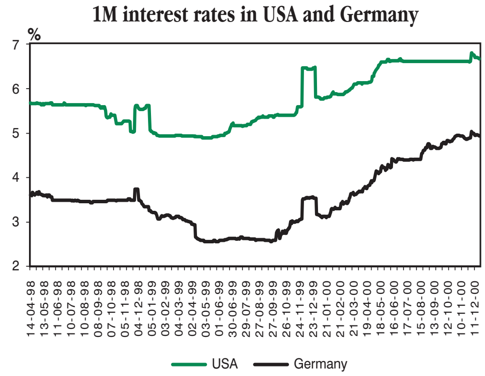
** since 12.04.2000 parity value as of 11.04.2000*
Source: NBP, Reuters, own calculations

EUR/USD



Source: NBP, Reuters

1M interest rates in USA and Germany



Source: Reuters

Interest rates

At the end of November, in connection with closing the obligatory reserve, high O/N rates fluctuations occurred. After a rise in O/N rates in November 22-24 period to 23-24%, there was a significant decrease in November 27-30. It was due to the fact that banks, which suffer from a lack of liquidity, accumulated financial resources earlier. This deepened the overliquidity, which appeared in the banking system at the end of month. On November 29, O/N rates fell to ca. 5%. At the beginning of December, the short-term money price stabilised at the level of open market operations. However, from 11 to 18 December an insignificant overliquidity appeared in the system, which resulted from reduced open market operations. On December 19, O/N rates grew in connection with incoming term of obligatory reserve settlement.

In December, WIBOR rates longer than 1M declined substantially. From November 30 to December 19, WIBOR 3M fell by 18 bp. to 19.60% and WIBOR 6M decreased by 25 bp. to 19.56%.

Treasury bills

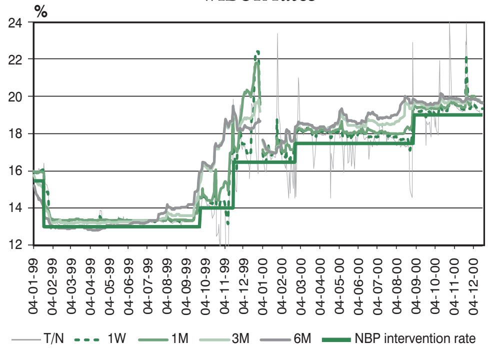
Yields on treasury bills of terms up to 9M were stable in the secondary market during the last 4 weeks. From November 24 to December 18, yields decreased slightly – by 10 basis points. Yields on 12 M T-bills fell in this period by 50 bp. to 17.60%, which means that the market is discounting an interest rate cut by about 200 bp. next year. The Finance Ministry increased in December the supply of 52-week T-bills by PLN 200m to PLN 1.3bn. However, this did not cause any yields rise, given NBP interest rates cut expectations. In the December 1-18 period, the average yield on 52-week T-bills at auctions amounted to 17.82%, which means a fall of 15 bp. comparing to November's auctions.

Treasury bonds

Since the last week of November, the pace of declining Treasury bond yields accelerated. Very low food price rises, a rapid decrease in yearly inflation and weakening internal demand caused the market to expect an interest rate cut in the near future. The macroeconomic situation stabilised and it seems probable that in the following months both inflation and the current account gap will decline. GDP growth should be small also in the first quarter of 2001, which makes interest rate cuts more possible. Yield declines were higher at the longer end of curve. Since November 24, the yield curve moved down by 135 bp. in 2Y sector, by 150 bp. in 5Y sector and by 195 bp. in 10Y sector. Of this, after much weaker industrial output in November data (December 18) the yield curve moved down by 25-75 bp. In the comming weeks, the fall in yields in the secondary market should continue.

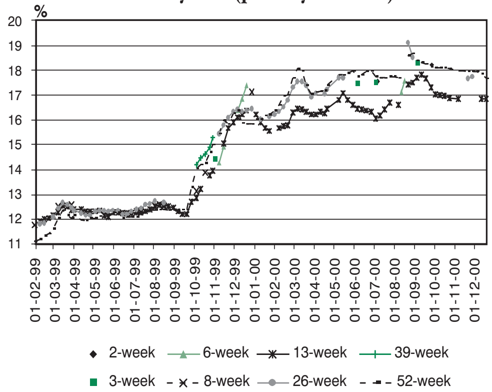
In December, supply of Treasury bonds at auctions (in nominal value) amounted to PLN 1.6 bn against PLN 1.7 bn in November. Investor bids amounted to PLN 3.9 bn and 5.0 bn respectively. In December in the primary market, the average yield on 2-year T-bonds decreased by 79 bp. and 5-year T-bonds by 76 bp.

WIBOR rates



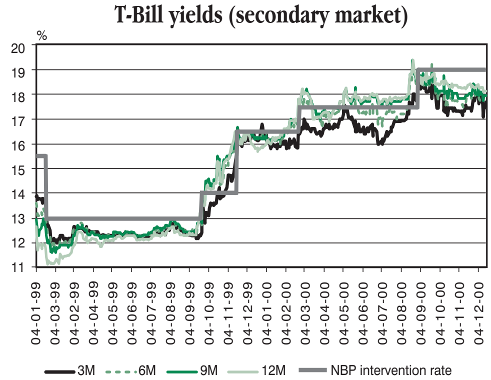
Source: NBP, WBK Treasury and International Division

T-Bill yields (primary auctions)



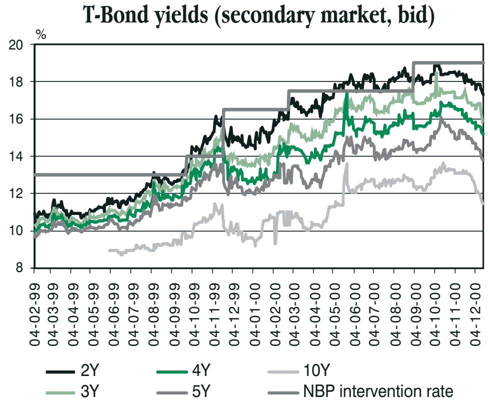
Source: NBP, WBK Treasury and International Division

T-Bill yields (secondary market)



Source: NBP, WBK Treasury and International Division

T-Bond yields (secondary market, bid)



Source: NBP, WBK Treasury and International Division

Monetary policy in 2001.

In the opinion of the MPC, there are many dangers both on the revenue and expenditure side of public finances' sector. The 2001 budget was constructed on the basis of very optimistic assumptions concerning both expenditure and revenue sides. This creates serious danger for actual performance of fiscal policy next year.

Fiscal policy next year will probably not be more restrictive than that of this year. Therefore the MPC has limited room for manoeuvre and in 2001 one may expect interest rate cut to total 250-300 basis points, despite expected deceleration of economic growth.

The MPC is aware that current policy mix is sub-optimal and causes economic growth to weaken. Despite that the MPC will be very cautious concerning an interest rate cut. A cut in interest rates is possible at the end of 1Q2001 or at the beginning of 2Q2001. Until then interest rates will probably be unchanged.

Macro-economic evidence revealing weakening of domestic demand and signals of external stabilisation of Poland's economy render another hike highly unlikely. It would be possible only in case of another serious external shock (e.g. rapid weakening of the zloty and/or unexpected increase in inflation).

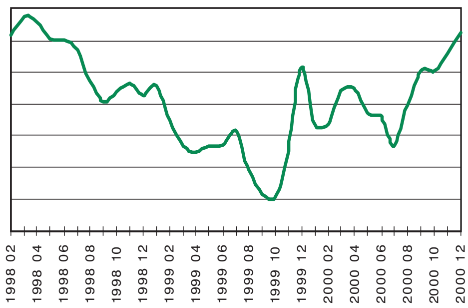
Monetary policy is currently very restrictive – at similar level as at the beginning of 1998.This can be shown by the Monetary Conditions Index (MCI) – a weighted average of real interest rate and changes in effective exchange rate. Such a high level of MCI is caused by high real interest rates that will increase in the coming months due to a fall in inflation. The other reason is a firming of the zloty that on 19 December reached a 5.3% deviation from the old parity.

The zloty may strengthen to 6-7 percent on the stronger side of old parity, but even at the current level the unit is overvalued by some 5%.

Domestic demand is weak, but the fall in inflation may compensate for an increase in the unemployment rate which revives hopes of stabilisation consumer demand (see graph aside). Growth in real wages is very low and does not allow for an increase in private consumption. An open question remains as to what would be the impact of wage compensation payments and compensations for slave work during the Second World War on domestic demand in 2001.

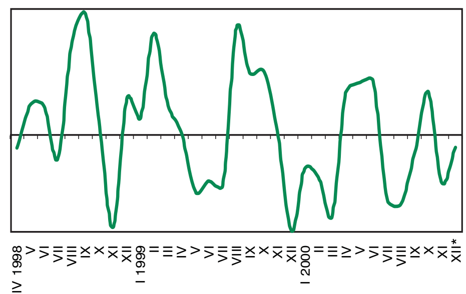
In a current macroeconomic situation interest rate cuts seem to be certain. An open question remains its timing. Any potential difficulties in reaching the planned economic deficit next year may delay a rate cut. An assessment of the budget draft by the MPC was more negative than might be expected. The main objections concerned the possibility of controlling deficit of public finances, keeping under control the deficit of Social Insurance Fund and realisation of planned amount of transfers to open pension funds. A passing of budget-related bills, that would bring to the next year budget additional PLN 3.4 bn of savings, makes next year budget draft more realistic and makes an interest rate cut less distant.

MCI



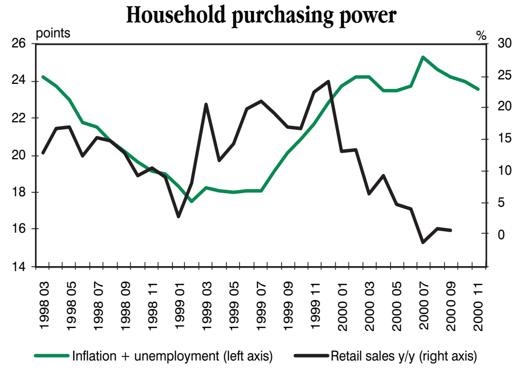
Source: NBP, CSO, own calculations

Effective exchange rate



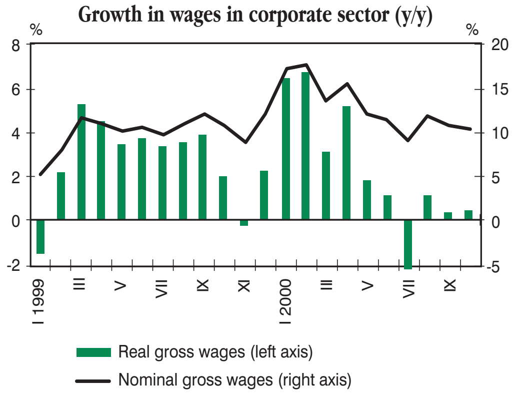
** until 18 December*
Source: NBP, CSO, own calculations

Household purchasing power



Source: CSO, own calculations

Growth in wages in corporate sector (y/y)



Source: CSO

Low budget expenditures in November

At the end of November the state budget deficit totalled PLN 14.90 bn, representing 96.8% of the plan for the whole year, compared to 100% after October. The reduction of the executed deficit after November mainly resulted from a certain slowdown in expenditure performance. It was achieved, on one hand, as the result of the determination of The Finance Ministry, but also of favourable circumstances, that allowed lower expenditure on public debt servicing and on subsidies to the social insurance system.

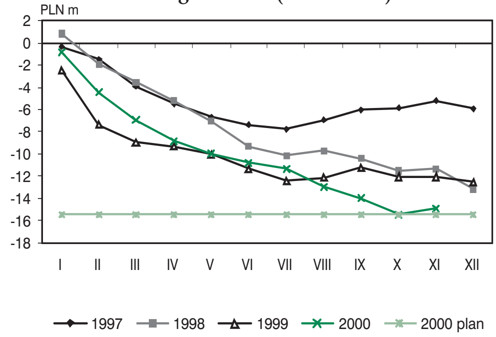
Within the eleven months of this year revenues of PLN 122.98 bn were realised, equivalent to 87.3% of the year long plan, compared to 78.4% a month earlier. Budget spending amounted to PLN 137.89 bn, or 88.2% of the whole-year plan, compared to 80.5% after October. In November only the budget revenues were for the first time in this year higher than expenditures (the difference was almost PLN 500 m), which was the result of the above mentioned low level of spending with revenues being at the usual level.

The total revenues to the budget increased in November at a rate similar to previous months. The revenues from corporate income tax rose very strongly, reaching 105.1% of the plan, which indicates that their planned execution will be exceeded significantly at the end of the year. The revenues from personal income tax increased considerably (to 80.8%) and they started to make up for previous months. However, it is too late and it is not possible for them to reach 100% of the budgeted amount in December. On the contrary, the revenues from indirect taxes increased less than from personal income tax, at a rather low rate, and certainly it is impossible to reach 100% of planned revenues. Low incomes from indirect taxes caused the total revenues to increase at a rate similar to previous months, despite the fact that the other revenues increased strongly. The indirect taxes executed below the plan will weigh on the total revenues, which will be lower than budgeted for this year.

In November budget spending increased relatively slowly. The subsidies to both social insurance funds (FUS and KRUS) rose strongest, but in fact it was quite a moderate growth by less than 8 percentage points. These expenditures are at a low level of 89.1% and 89.9% of the plan respectively. Even smaller growth occurred in servicing costs of domestic debt, which reached 95.2% of the plan and the servicing costs of foreign debt increased slightly to a very low level of 79.9%. Subsidies to local governments rose moderately to a relatively high level of 97.6%. The subsidy to the Labour Fund increased relatively slowly and its execution after November amounted to 95.0%. As stated in press information the Government plans some reductions in expenses, in order to adjust them to smaller revenues.

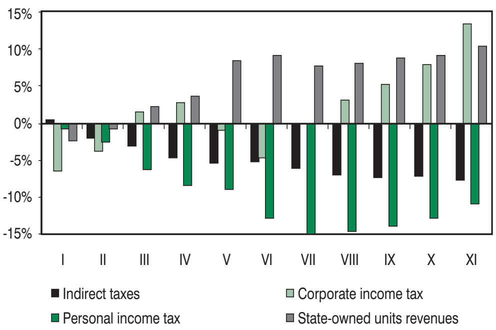
The November results of budget execution allow us to foresee that it is possible to close the budget in December with the deficit at PLN 15.4bn. PLN 500m, which remains to be used, reduces the danger that the planned deficit will be exceeded.

Budget deficit (cumulative)



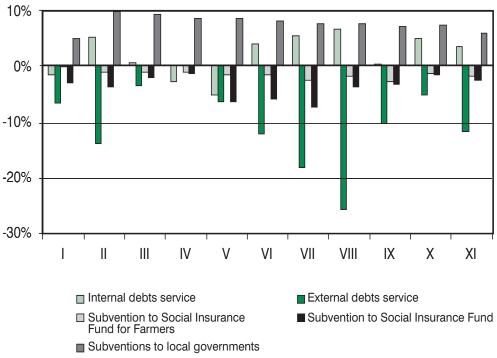
Source: Finance Ministry

Major revenues – deviation from trend*



** trend means the constant increase by 8.33% a month*
Source: Finance Ministry, own calculations

Major expenses – deviation from trend*



** trend means the constant increase by 8.33% a month*
Source: Finance Ministry, own calculations

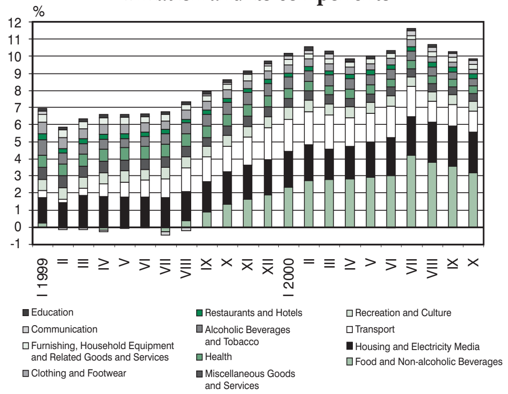
Inflation components

The Central Statistical Office calculates the inflation indicator on the base of the previous year's consumer goods basket. At the beginning of a new year, wages of this basket change in correspondence with changes in the consumption structure. In 2000, "Food and Non-alcoholic Beverages" have been given the highest weight (30.44). "Housing and Electricity Media" have also had a material impact on inflation (19.50). Out of the remaining 10 main categories, the most important has been "Transport" (7.48). As a result of a rise in the prices of these three categories, yearly inflation mounted in October this year by 3.17 percentage points (Food and Non-alcoholic Beverages), 2.38 pct. points (Housing and Electricity Media) and 1.26 pct. points (Transport) respectively. All things considered, inflation totalled 9.9% in October. The volatility of some categories' prices was substantial. Food and Non-alcoholic Beverages boosted inflation by as much as 4.2 pct. points in July this year while a year before this group contributed to decreasing inflation by 0.3 pct. points. Similarly high volatility was typical of Transport prices (largely on account of changes in fuel prices) – their impact on inflation ranged from 0.2 pct. points in February 1999 to 2.0 pct. points in March 2000. If the 12 main categories of inflation components were divided into 4 groups based on their volatility (measured with the standard deviation), then these two categories, in addition to Communication, would be in the largest volatility group. On the graph, it is clear how large an impact, particularly this year, the most volatile components have on inflation (I group) – currently, they represent half of its value whereas in the first half of last year they were just of small fraction of the inflation figure. If it had not been for such a dynamic increase in these components, inflation would be much smaller – the prices of II-IV groups' components dropped from January 1999 to October 2000 by approximately 1 pct. point.

Core inflation

The exclusion from inflation of the highest volatility factors is intended to calculate the so-called net inflation, which may be treated as core inflation, showing permanent trends of price movements. One of the methods followed by the National Bank of Poland in calculating core inflation is the calculation of net inflation through the exclusion from inflation of food and fuel prices. From January 1999 to October 2000 the inflation indicator calculated excluding Fuels from the goods basket, ran similarly to the total inflation indicator with the exception that it was lower during most months. Only from January to March 1999, was inflation excluding Fuels slightly higher. Over the next months the situation reversed and the difference between these two indicators began to rise – it was highest in March 2000, amounting to 1.3 pct. points. The difference decreased in April and following months to ca. 1 pct. point and also stood at this number in July, at the maximum inflation indicator. Since August, inflation excluding fuel prices is lower than total inflation indicator by about 0.5 pct. points. After excluding the Food and Non-alcoholic Beverages from the goods basket, such calculated inflation is during most months higher than total inflation and also more stable. At the beginning of 1999, the difference between these two indicators amounted to slightly below 2.9 pct. points and grew to a maximum 3.3 pct. points in July 1999. Then the indicator declined and in June 2000 it was insignificantly higher than total inflation. However in July, at inflation's maximum, it was lower than inflation by as much as 1 pct. point. During the following months the difference decreased.

Inflation and its components



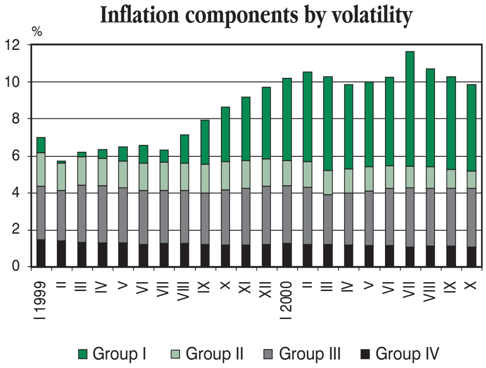
Source: CSO, own calculations

Tab. 5.

Main inflation categories according to volatility	standard deviation*
GROUP I	
Transport	7.15
Communication	5.76
Food and Non-alcoholic Beverages	4.96
GROUP II	
Health	2.68
Education	2.26
Alcoholic beverages and Tobacco	1.65
GROUP III	
Clothing and Footwear	1.30
Housing and Electricity Media	1.19
Miscellaneous Goods and Services	1.09
GROUP IV	
Furnishing, Household Equipment and Related Goods and Services	1.08
Restaurants and Hotels	0.85
Recreation and Culture	0.79

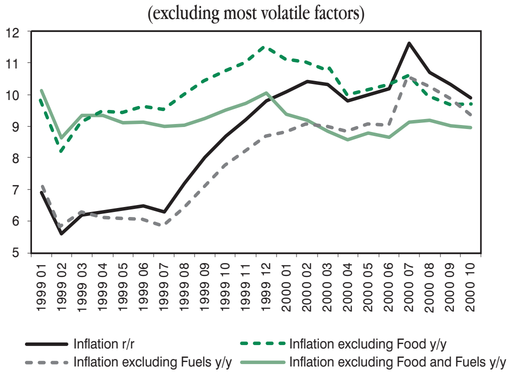
** Jan. 1999 - Oct. 2000*
Source: CSO, own calculations

Inflation components by volatility



Source: CSO, own calculations

Net inflation
(excluding most volatile factors)



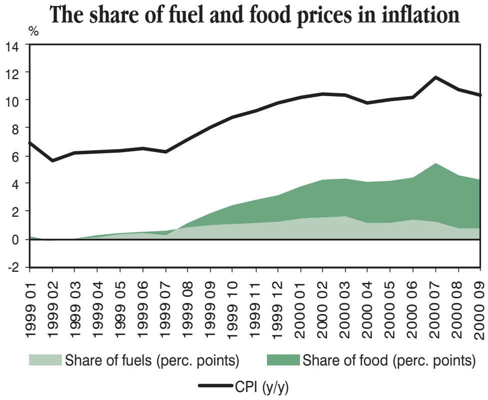
Source: CSO, own calculations

Fuel price changes contributed to the inflation increase especially from April 1999 to March 2000. Afterwards the influence of this factor weakened and the importance of food prices growth increased. Between 1999 and 2000, the net inflation indicator, calculated through the exclusion of both food and fuel prices stayed stable, demonstrating even a slight downward trend (from 10.1% at the beginning of 1999 to 9.0% in October 2000). As the ordinary inflation indicator increased, the core (net) inflation indicator in 1999 was higher and in 2000 – lower than the ordinary figure. Assuming that Fuel and Food remain in the inflation basket, but their prices are constant, then inflation would oscillate around 6% in the analysed period, with a downward trend. This trend grows in strength if assume a zero-level of Electricity prices growth therein.

Another method of calculating core inflation (also used by NBP) is the 15% trimmed average. It consists of smoothing out the series through eliminating from inflation the components with the 15% of smallest and 15% of largest price movements. This indicator ran similarly to the inflation indicator with the exception that, as it was initially at a higher level, it reported a stronger fall, and then, its increase was slightly milder. While analysing inflation-related phenomena, the median (dividing the whole class into two halves) may also prove helpful. From January to August 1999, it declined from 8.85% to 5.3% and, after a gradual increase, it reached 7.8% in October this year. Given that currently the median is much lower than the inflation indicator, it seems that inflation is hiked by a number of groups, which have a large impact on it (Food, Fuel, Electricity). In March this year, the rise in Fuel prices totalled 57% y/y, translating into an increase in inflation of 1.6 pct. points, Food rose by 13.8% y/y in July this year, boosting inflation by as much as 4.2 pct. points, whereas Electricity became more expensive in September this year by 10.9% y/y, as a result of which inflation increased by 1.2 pct. points.

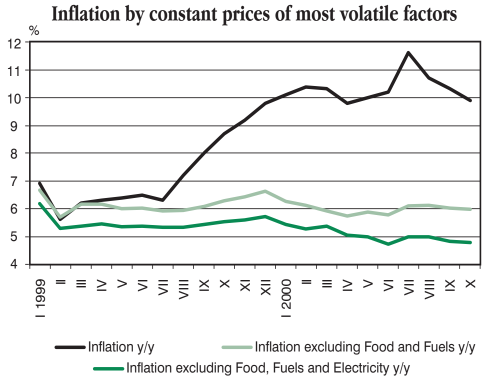
This analysis leads to the conclusion that, for fighting inflation effectively in the Polish conditions, it is necessary to pursue a policy that would stabilise the markets of factors with the largest impact on generating inflationary impulses. Supply shocks that influenced the food and fuel markets during last two years are beyond the control of the monetary authorities. Both in the food and fuel markets, the scrapping of trading barriers in international trade have a significant effect. However, it encounters strong resistance from domestic manufacturers. Regarding food prices, the negative influence they had on the government's pro-cyclic agricultural policy, deepening the prices' fluctuations instead of stabilising them. The specific nature of the fuel market in Poland, monopolised to a large extent, has additionally heightened the rise in fuel prices that has taken place world-wide. Deregulation and demonopolisation of this market seems necessary. Some steps to offset the excessive rise in prices in these areas have been taken. As a result of this and thanks to favourable external conditions – reversal of the upward trend of fuel prices on the world's exchange markets – inflation has begun to fall in recent months. The main reasons for this should be sought for in the stability of food prices and a fall in fuel prices. Provided these trends maintain, a continuing decrease in inflation seems possible in the near term. Core inflation in the analysed period remained quite stable. Influence of changes in monetary policy on core inflation seems to be very restricted.

The share of fuel and food prices in inflation



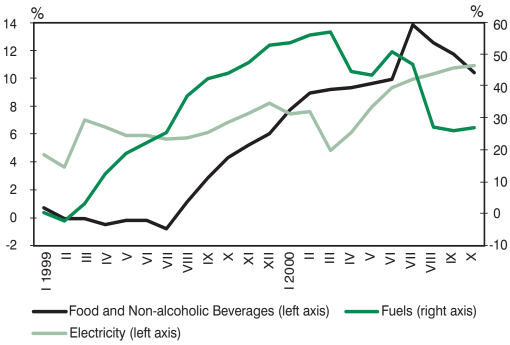
Source: CSO, own calculations

Inflation by constant prices of most volatile factors



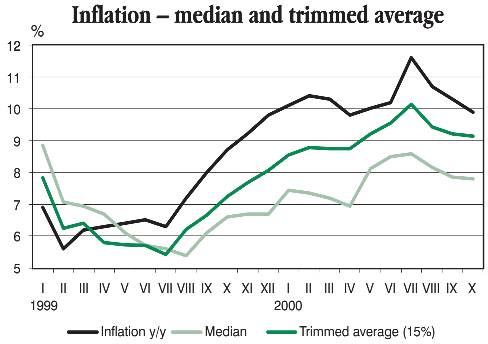
Source: CSO, own calculations

Price changes indicators of categories with a big influence on inflation y/y



Source: CSO, own calculations

Inflation – median and trimmed average



Source: CSO, own calculations

Investment outlays

The total investment outlays (calculated in current prices) in Poland's economy decreased by 7.5% in first three quarters of 2000, compared to the same period last year. For two years the yearly growth of investment outlays decreases. To compare, in 1999 it amounted to +11.7% and in 1998 +29.3%

Out of four sections of the national economy, the largest decrease in investment outlays occurred in construction – by 31.6%. In 1998 the yearly growth of investment outlays in construction was the highest and amounted to +61.5%, which indicates that construction is the most sensitive to favourable or unfavourable conditions for investment. Less sensitive, but still proving strong fluctuations are trade and repair, for which the outlays growth totalled -18.0% in the period of January-September this year, and in 1998 +44.7%. Much larger volatility characterises the amount of investment in industry. This year the investment outlays in this section decreased by 7.7%, while in 1998 they rose by 21.6%. On the contrary, in section transport, storage and communication the investment outlays increased by 1.6%, proving the least sensitivity to high interest rates and unfavourable business trends.

This year the highest increase in investment outlays, out of all industry divisions, occurred in manufacture of other transport equipment (by 79.1%), manufacture of leather and leather products (by 65.1%) and manufacture of rubber and plastic products (by 34.9%). The highest decreases occurred in manufacture of basic metals (by 49.4%), manufacture of pulp and paper (by 46.5%) and in manufacture of coke, refined petroleum products and derivatives (by 37.3%).

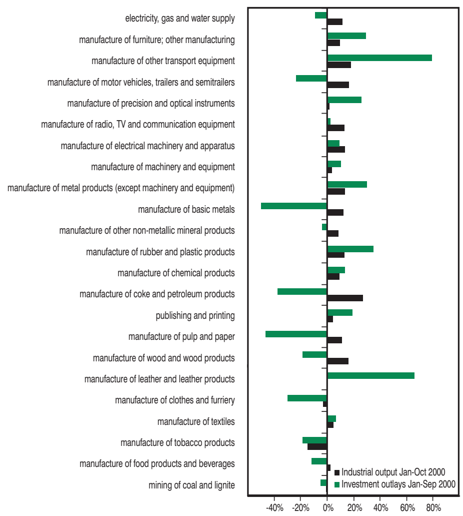
Meanwhile in the period of January to October this year the industrial output proved the highest growth in the sector manufacturing coke, refined petroleum products and derivatives (by 27.2%) and in the sector producing other transport equipment (by 17.6%). The decreases in sold industrial output occurred in manufacture of tobacco products (by 14.8%) and in manufacture of clothes and furriery (by 3.0%).

Dwellings

During the last three years the number of dwellings under construction increased by over 100,000 reaching in the end of October this year 713,100. The growth was stable, only in winters there was a certain seasonal slowdown resulting from the character of the construction sector. The rate of yearly growth increased quickly in 1999 and reached in December 8.6%, by 6 percentage points more than a year before. It resulted from the announcement of cancellation of housing tax reduction – the people wanted to benefit from it and they started to build. In the second half of this year the growth rate decreased to 7.2% in October.

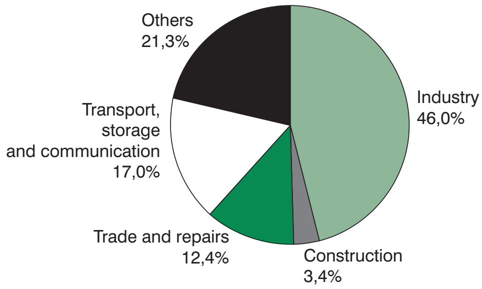
Significantly most dwellings are completed in the end of the year – in December 1999 15,878 dwellings were completed, while during the year about 6,000 a month. The growth rate of the number of completed dwellings rose strong in 1999. In 2000 slight decrease occurred.

Yearly growth of output and investment outlays in industry



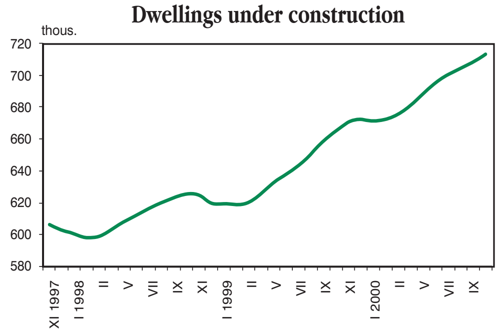
Source: CSO, own calculations

Structure of investment outlays Jan-Oct 2000



Source: CSO, own calculations

Dwellings under construction



Source: CSO, own calculations

Economic Release Calendar December 2000 / January 2001

Monday	Tuesday	Wednesday	Thursday	Friday
18 December 2000 POL: Industrial output (XI) POL: Producer price index in industry and construction (XI)	**19** *USA: Foreign trade (X)* *USA: FED meeting*	**20** POL: Monetary Policy Council meeting	**21** POL: Unemployment (XI) POL: GDP (III kw.) *CZ: Foreign trade (XI)* *GER: Producer prices (XI)*	**22** *USA: Durable goods orders (XI)* *USA: Consumer sentiments (XII)*
25 **Christmas**	**26** **Christmas**	**27** POL: Food prices (I half of XII)	**28**	**29** *CZ: Money supply (XI)*
1 January 2001 **New Year's Day**	**2** POL: Balance of payments (XI) POL: Foreign trade on a cash basis (XI) *CZ: State budget (XII)*	**3** POL: Food prices (II half of XII)	**4** POL: Economic trends in industry, construction and retail trade (XII) *EUR: ECB meeting* *USA: Factory orders (XI)*	**5** *GER: factory orders (XI)* *USA: Unemployment*
8 POL: Balance of NBP (XII) POL: Official reserve assets (XII) *GER: Industrial output (XI)*	**9** *GER: Unemployment (XII)* *CZ: Inflation (XII)* *CZ: Unemployment (XII)*	**10** *GER: Balance of payments (XI)*	**11**	**12** *CZ: Producer prices (XII)* *CZ: Industrial output (XI)* *CZ: Construction output (XI)* *USA: Retail sales (XII)* *USA: Producer prices (XII)*
15 POL: Inflation (XII) POL: State budget (XII) POL: Employment and wages in corporate sector (XII) POL: Money supply (XII)	**16**	**17** *USA: Inflation (XII)* *CZ: Retail sales (XI)*	**18** POL: Industrial output (XII) POL: Producer price index in industry and construction (XII) *EUR: ECB meeting*	**19** *USA: Foreign trade (XI)*
22 POL: Unemployment (XII) *CZ: Foreign trade (XII)*	**23** POL: Food prices (I half of I)	**24** POL: Monetary Policy Council meeting	**25**	**26** *USA: Durable goods orders (XI)*
29 *CZ: Money supply*	**30** *USA: FED meeting*	**31** *USA: FED meeting*	**1 February** POL: Balance of payments (XII) POL: Foreign trade on a cash basis (XII) *EUR: ECB meeting*	**2**

Basic Macroeconomic Data

Category	unit	December	January	February	March	April	May	June	July	August	September	October	November
PRICES													
Consumer price index (y/y)	%	9.8	10.1	10.4	10.3	9.8	10.0	10.2	11.6	10.7	10.3	9.9	9.3
Consumer price index (m/m)	%	0.9	1.8	0.9	0.9	0.4	0.7	0.8	0.7	-0.3	1.0	0.8	0.4
Production price index (y/y)	%	8.0	8.2	8.1	7.3	7.4	7.9	8.9	9.0	8.4	8.3	8.0*	7.3
Production price index (m/m)	%	0.5	0.5	0.5	0.4	0.7	0.9	1.0	0.6	0.4	0.8	0.6*	0.1
Price index of assembly and construction production (y/y)	%	9.1	7.7	7.5	7.7	8.3	8.4	8.8	9.1	8.7	8.1	7.8*	7.8
Price index of assembly and construction production (m/m)	%	0.5	0.6	0.6	0.9	1.1	0.7	0.7	0.4	0.5	0.2	0.5	0.6
Exchange rate USD/PLN (y/y)	%	19.6	15.9	9.0	3.7	5.8	14.3	11.6	11.3	10.3	10.1	12.8	7.2
Exchange rate USD/PLN (m/m)	%	-2.0	-1.6	0.8	-1.1	3.5	6.2	-2.2	-1.7	0.8	3.0	3.3	-1.6
Exchange rate EUR/PLN (y/y)	%	–	1.3	-3.9	-7.9	-6.6	-2.6	1.9	1.3	-5.9	-8.7	-9.8	-11.2
Exchange rate EUR/PLN (m/m)	%	-4.0	-1.4	-1.8	-3.3	1.3	1.8	2.4	-2.5	-2.9	-0.8	1.4	-1.7
Real gross wages in enterprise sector (y/y)	%	2.3	6.5	6.8	3.1	5.2	1.8	1.3	-2.2	1.1	0.4	0.5	0.8
ACTIVITY INDICATORS													
Gross domestic product (y/y)	%	6.2	–	–	6.0	–	–	5.2	–	–	–	–	–
Industrial output (y/y)	%	19.1	7.9	16.4	6.8	5.3	12.1	13.4	7.8	9.2	5.0	7.1*	4.6
Industrial output (m/m)	%	5.7	-19.0	7.3	11.6	-8.4	7.7	1.2	-6.9	6.1	5.0	2.1*	-3.3
Construction and assembly production (y/y)	%	12.3	4.6	5.6	4.2	-5.6	-0.6	1.2	-2.9	-2.1	-3.7	-1.7	-1.3
Construction and assembly production (m/m)	%	49.3	-57.7	6.6	17.5	-0.1	16.8	11.6	-4.6	7.2	7.0	6.6*	-17.8
Retail sales of goods [a] (y/y)	%	34.6	20.3	25.4	16.9	19.9	15.1	14.8	10.3	11.2	10.4	7.2	–
Retail sales of goods [a] (m/m)	%	23.2	-32.1	5.0	17.2	2.2	-0.6	2.8	-0.7	1.4	-0.8	1.5	–
Exports on a customs basis (y/y)	%	27.0	31.8	35.5*	15.9*	21.0*	23.9	34.4*	38.8*	27.9*	21.7	–	–
Exports on a customs basis (m/m)	%	-4.4	-7.7	13.9	5.5*	-6.9	4.3	4.8*	-0.2*	-3.3*	9.3	–	–
Imports on a customs basis (y/y)	%	34.7	31.2	34.7	12.2	13.5	31.7*	24.1*	21.1*	15.5*	5.6	–	–
Imports on a customs basis (m/m)	%	-2.9	-19.4	13.2*	9.4	-8.1	16.6	-6.2*	-1.4*	-6.2*	6.0	–	–
LABOUR MARKET													
Number of unemployed	thous.	2 350	2 478	2 528	2 534	2 490	2 446	2 437	2 478	2 496	2 529	2 548	2 613
Unemployment rate	%	13.1	13.7	14.0	14.0	13.8	13.6	13.6	13.8	13.9	14.0	14.1	14.5
Average employment in corporate sector	thous.	5 679	5 319	5 316	5 308	5 301	5 292	5 295	5 284	5 271	5 269	5 274	5 247
Average monthly gross wages in corporate sector	PLN	2 186	1 882	1 926	1 992	2 067	1 988	2 049	2 036	2 051	2 088	2 089	2 160
Nominal increase in wages (y/y)	%	12.3	17.2	17.9	13.7	15.5	12.0	11.5	9.2	11.9	10.7	10.4	10.2
STATE BUDGET													
Budget revenues	PLN bn	125.9	11.0	20.3	31.0	40.9	51.8	64.2	74.8	86.2	98.0	110.5	123.0
Budget expenditures	PLN bn	138.5	11.8	24.8	38.0	49.8	61.8	75.0	86.1	99.2	111.9	125.9	137.9
State budget deficit	PLN bn	-12.6	-0.9	-4.5	-6.9	-8.9	-10.0	-10.8	-11.3	-13.0	-14.0	-15.4	-14.9
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	December	January	February	March	April	May	June	July	August	September	October	November
BALANCE OF PAYMENTS													
Current account	USD m	-1 683	-1 207	-954	-1 344	-850	-401	-860	-701	-961	-592*	-1 051	–
Trade balance	USD m	-1 765	-1 458	-1 140	-1 241	-1 075	-894	-1 041	-1 042	-1 324	-972*	-1 000	–
Exports	USD m	2 470	1 922	2 038	2 371	2 032	2 407	2 397	2 473	2 271	2 424*	2 590	–
Imports	USD m	4 235	3 380	3 178	3 612	3 107	3 301	3 438	3 515	3 595	3 396*	3 590	–
Services: net	USD m	-208	-174	-171	-202	-177	-105	-159	-131	-119	-90*	-100	–
Unclassified transactions: net	USD m	174	286	225	218	398	324	337	309	350	420	485	–
Capital and financial account	USD m	1 405	1 485	647	1 074	672	653	-165	343	725	357*	2 442	–
Direct investments	USD m	744	763	354	430	449	310	363	488	169	242*	4 557	–
Portfolio investments	USD m	256	244	587	1 598	131	20	90	232	-234	-72*	-262	–
MONEY SUPPLY													
Money supply	PLN bn	263	255	258	262	266	269	285	277	278	281	287	291
Money supply (y/y)	%	19.3	15.1	13.7	13.8	15.2	15.2	20.6	16.2	14.9	14.1	14.6	14.2
Money supply (m/m)	%	3.5	-3.1	1.0	1.6	1.5	1.1	5.9	-2.7	0.3	1.0	2.4	1.2
Total deposits (y/y)	%	18.3	15.7	14.7	15.5	16.6	16.8	23.3	18.5	17.1	16.1	17.4	16.9
Total deposits (m/m)	%	2.4	-1.6	1.3	1.9	0.9	1.6	6.4	-3.1	0.5	1.1	3.0	1.6
Household loans (y/y)	%	53.0	52.5	51.8	52.1	49.8	49.9	79.4	45.7	42.9	40.9	38.9*	34.9
Household loans (m/m)	%	4.5	0.6	1.2	3.4	1.6	3.8	25.2	-15.0	2.5	3.0	2.3*	1.2
Corporate loans (y/y)	%	21.6	20.8	18.8	18.1	19.1	17.9	19.7	18.8	18.2	17.4	16.1*	13.9
Corporate loans (m/m)	%	-1.5	2.5	1.0	0.9	2.0	0.6	2.2	0.1	1.4	2.3	1.4*	0.3
FINANCIAL INDICATORS													
Average deviation from the central parity [b]	%	-1.3	-3.0	-3.7	-6.2	-5.1	–	–	–	–	–	–	–
Average exchange rate USD [c]	PLN	4.1696	4.1036	4.1353	4.0902	4.2347	4.4988	4.3994	4.3229	4.3593	4.4900	4.6369	4.5606
Average exchange rate EUR [c]	PLN	4.2200	4.1608	4.0850	3.9507	4.0033	4.0758	4.1740	4.0684	3.9486	3.9152	3.9696	3.9035
Average exchange rate DEM [c]	PLN	2.1577	2.1274	2.0886	2.0200	2.0469	2.0839	2.1341	2.0801	2.0189	2.0018	2.0296	1.9958
Average WIBOR T/N[c]	%	17.69	17.50	16.29	17.92	17.64	17.33	17.73	17.87	17.31	18.84	19.74	20.07
WIBOR 1M[c]	%	20.45	17.26	17.44	18.17	18.15	18.13	18.13	18.05	18.24	19.39	19.47	19.65
WIBOR 3M[c]	%	19.03	17.30	17.85	18.44	18.34	18.60	18.55	18.51	19.12	19.55	19.68	19.75
Average 3M T-bill yield[c]	%	16.28	16.03	16.13	16.56	16.72	17.01	16.49	16.48	17.38	18.17	17.53	17.44
Average 12M T-bill yield[c]	%	15.99	16.18	17.00	17.57	17.31	17.86	17.85	17.76	18.34	18.65	18.41	18.31
Average 2Y T-bond yield[c]	%	14.78	15.10	16.17	16.56	16.85	17.78	18.02	17.77	18.27	18.11	18.54	18.23
Average 10Y T-bond yield[c]	%	9.81	10.13	10.55	10.42	10.56	11.89	12.46	12.53	12.72	12.40	13.24	13.06
MONETARY POLICY INSTRUMENTS													
Intervention rate	%	16.5	16.5	17.5	17.5	17.5	17.5	17.5	17.5	19.0	19.0	19.0	19.0
Rediscount rate	%	19.0	19.0	20.0	20.0	20.0	20.0	20.0	20.0	21.5	21.5	21.5	21.5
Lombard rate	%	20.5	20.5	21.5	21.5	21.5	21.5	21.5	21.5	23.0	23.0	23.0	23.0
Monthly devaluation rate [b]	%	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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