



# MACROscope

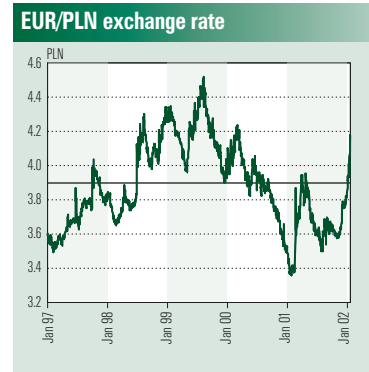
## Polish Economy and Financial Markets

July 2002

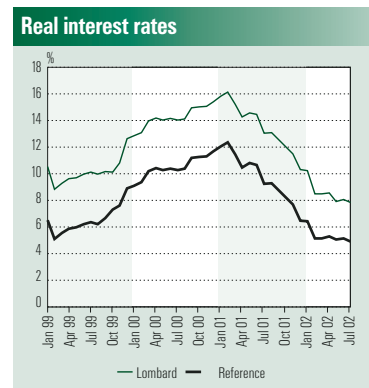
N° 36

### On the road to Euro(pe)

- Poland's EU accession negotiations are coming to an end.** During the last six months the Polish government has managed to solve many important problems, e.g. very sensitive issues of the Poles taking up jobs in the EU and the purchase of the Polish land by foreigners. Now we are entering the most difficult final stage of negotiations, in which the financial conditions of our participation in the European Community will be determined for many years. Will Polish negotiators manage to accomplish talks until the end of this year and will Poland become EU member in 2004? In this issue of Macroscopic we analyse the progress of negotiations and try to draft the most likely scenario for EU enlargement. In subsequent months we will keep monitoring this issue and with special interest we will follow the talks carried on by the government and the NBP regarding the process of EMU accession.
- Approaching date of Poland's EU accession also means that (potentially) the moment of zloty replacement by the euro gets closer.** This makes the issues regarding the process of single currency adoption (the path of exchange rate fluctuations on the road to euro, and possible date of EMU entry) the central point of interest for economists, financial markets players as well as many entrepreneurs. In this issue of Macroscopic we investigate main topics related to the process of euro adoption and describe the possible directions of changes on the Polish FX market.
- At the beginning of July, the main event was a change of Polish finance minister.** While after the first statements of new minister some uncertainties disappeared, details about next year budget and government's clear view on foreign exchange policy are still unknown. While new finance minister Grzegorz Kołodko announced a continuation of Marek Belka's policy, we still do not know whether his rule concerning central budget's expenditures growth will be binding or whether we would not see a temptation to increase spending outside the central budget. In the section Government and politics watch we try to answer key questions connected with Marek Belka's dismissal and Grzegorz Kołodko's appointment. Although the importance of the budget draft accepted by the government becomes questionable amid change on finance minister's post, we present also the short review of the draft.



Source: BZWBK



Source: BZWBK

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## The great run to a finish line or to a high hurdle?

### Has everything been already decided?

Officially, Poland started its European Union (EU) accession negotiations on 30 March 1998. In December 2000, the EU set the enlargement timetable in line with which the negotiations with the candidate countries will be completed by the end of 2002, and the enlargement could take place in early months of 2004. More than a year ago, in June 2001, Poland ranked at the bottom of the EU candidates' list in terms of the closed negotiation chapters. After the recent session of the Intergovernmental Accession Conference held in June 2002 Poland has caught up with the leaders. We have overtaken, among others, the favoured Hungary. Last month, at the Seville Summit, the „15” states confirmed the previously agreed enlargement timetable, and in addition they stated that the 10 candidate countries, including Poland, would join the EU jointly in 2004. Before that, by 31 March 2003 at the latest, they will sign the EU accession treaties. The candidates' accession to the EU in January or, say, in July 2004 will depend on the pace of work of the member states' parliament deputies on the ratification of the accession treaties. Does it mean that Poland is bound to complete the negotiations with the „15” states by the end of this year and join the EU in line with the declared date, i.e. at the beginning of 2004?

### We have cleared many hurdles so far...

The previous Government assumed a „tough” negotiation strategy and was rather slow in closing subsequent negotiation chapters and making decisions that would represent substantial concessions to the rigid approach of the European Commission. It tried negotiating in the form of „packages” – a concession in one field for a concession in the other. After the replacement of the Government as a result of the last year's elections, some „breakthrough” took place and there was an acceleration in negotiating many chapters. The Government led by the Prime Minister Leszek Miller accepted the so-called „salami slices” tactics – closing subsequent negotiation chapters or even their parts as soon as possible. Since the new Government took over, 8 negotiation chapters have been closed so far. First of all, the chapters related to the free movement of persons and capital have been closed, i.e. very sensitive issues of the Poles taking up jobs in the EU and the purchase of the Polish land by foreigners. All in all, after the last negotiation session, Poland closed negotiations in 25 chapters. The following table depicts Poland's

negotiation status after the June session compared with all candidate countries.

Accession Negotiations – State of play as at 28 June 2002

	Cyprus	Lithuania	Estonia	Slovenia	Latvia	Slovakia	Czech Republic	Poland	Hungary	Malta	Bulgaria	Rumunia
Free movement of goods	■	■	■	■	■	■	■	■	■	■	■	□
Free movement of persons	■	■	■	■	■	■	■	■	■	■	■	□
Free movement of services	■	■	■	■	■	■	■	■	■	■	■	□
Free movement of capital	■	■	■	■	■	■	■	■	■	■	■	□
Company law	■	■	■	■	■	■	■	■	■	■	■	■
Competition	■	■	■	■	□	□	□	□	□	□	□	□
Agriculture	□	□	□	□	□	□	□	□	□	□	□	□
Fisheries	■	■	■	■	■	■	■	■	■	■	■	■
Transport	■	■	■	■	■	■	■	■	■	■	□	□
Taxation	■	■	■	■	■	■	■	■	■	□	□	□
EMU	■	■	■	■	■	■	■	■	■	■	■	■
Statistics	■	■	■	■	■	■	■	■	■	■	■	■
Social Policy	■	■	■	■	■	■	■	■	■	■	■	■
Energy	■	■	□	■	■	■	■	■	■	■	□	□
Industry	■	■	■	■	■	■	■	■	■	■	■	□
SMEs	■	■	■	■	■	■	■	■	■	■	■	■
Science and research	■	■	■	■	■	■	■	■	■	■	■	■
Education and training	■	■	■	■	■	■	■	■	■	■	■	■
Telecommunication	■	■	■	■	■	■	■	■	■	■	■	□
Culture and audio-visual	■	■	■	■	■	■	■	■	□	■	■	□
Regional policy	■	■	■	□	■	□	■	□	□	□	□	□
Environment	■	■	■	■	■	■	■	■	■	□	□	□
Consumers and health protection	■	■	■	■	■	■	■	■	■	■	■	■
Justice and home affairs	■	■	■	■	■	■	■	■	□	■	□	□
Customs union	■	■	■	■	■	■	■	■	■	□	□	□
External relations	■	■	■	■	■	■	■	■	■	■	■	■
CFSP	■	■	■	■	■	■	■	■	■	■	■	■
Financial control	■	■	■	■	■	■	■	■	■	■	□	□
Financial and budgetary provisions	□	□	□	□	□	□	□	□	□	□	□	□
Institutions	■	■	■	■	■	■	■	■	■	■	■	■
<b>TOTAL</b>	<b>28</b>	<b>28</b>	<b>27</b>	<b>27</b>	<b>27</b>	<b>26</b>	<b>25</b>	<b>25</b>	<b>24</b>	<b>23</b>	<b>20</b>	<b>12</b>

Source: European Commission

In the nearest future the European Commission will send the request to the EU Council to close the negotiations with Poland in respect of „Justice and internal affairs”, which at the same time will mean that the Poland's eastern border, which will soon be the longest land border of the EU, is under control. This is the only chapter which, besides the adjustment to the European Law, consisted in earning trust of the „15” member states. If all of them agree with the stance of the European Commission, then the negotiations of this chapter will be closed at the next session on 31 July 2002. However, it is not certain. The threat is posed by the stances of the Netherlands and France which hold the most rigid approach in respect of illegal immigration control and money laundering prevention. Therefore, Poland will probably have to undertake a number of obligations to be met before 1 January 2004, i.e. before the expected EU accession date. The same issue was faced by the other 9 candidates. Nevertheless, all of them have already closed negotiations of internal affairs and justice.

Negotiations in respect of „Competition” are likely to be closed by September or October 2002. Recently there has been a breakthrough in this field. The framework has been agreed for adjusting the special economic zones to the

EU's support standards (the European Commission sees the possibility of recommending the EU's Council closing the negotiations of this chapter with Poland still in July), as well as for the developing of the steel works reengineering schemes compliant with the EU's competition principles.

Not everything may go smoothly though. Jan Truszczyński, the Polish Chief Negotiator, announced reopening of the temporarily closed "Taxation" chapter. The battle for the lower VAT on construction sector is to take place still in July. Currently, however, it seems that except for the financial covenants there are no substantial hurdles to close the negotiation process.

### **...but the worst is still ahead**

All non-financial accession issues are to be solved by the Brussels Summit on 24 and 25 October 2002. Originally, it was assumed that this would be in the course of the Brussels Summit, to which the representatives of neither Poland nor other candidate countries are to be invited, when the heads of the „15” would agree the official EU's stance on the membership financial conditions: the size of the structural funds, farmer subsidies and agricultural regions development funds as well as the premium payment principles for the new member states. Over the following 6 weeks, by the Copenhagen Summit in the mid of December, the EU countries and Poland were to make an agreement in this respect. It was emphasised that in case the EU's countries had not agreed the draft financial conditions for the Poland's EU accession before the Brussels Summit on 24 and 25 October, the closing of negotiations with Poland in December and its accession to the EU in 2004 would be seriously endangered. Being worried by this, as soon as in the mid of June at the meeting of the European Parliament, Guenter Verheugen, the EU enlargement commissioner, said: „It should be clearly advised to the Europe's citizens that the huge benefits of the EU's enlargement cannot be achieved at no expense. Of course, solidarity is expected from us. It is our best interest to show it. It goes without saying that the EU's enlargement costs should be thoroughly analysed. However, the costs of non effecting the enlargement would be analysed as well”. However, under the Berlin pressure even the Commissioner himself started to appeal for deferring the subsidies negotiations renouncing the existing stance of the European Commission.

As a result, at the Seville Summit in June, the Presidents and Prime Ministers of the countries undertook to establish a joint EU's stance on the enlargement financial conditions only at the end of October or the beginning of November, which is related to the autumn elections in Germany. A new government in Berlin may be established after the Brussels Summit. In order to make the agreement for the

### **Doomsday scenario**

The biggest pessimists claim that the „15” will most probably be able to agree the EU enlargement financial conditions only at the December Summit in Copenhagen. On the same day, Poland and other candidate countries will have to tackle the dilemma: either you accept our offer or you are out of the group of countries, which will join the EU in 2004. As a result, deferring the discussion by the December Summit in Copenhagen would mean putting the candidates, and Poland in particular, at the wall. Frankly speaking, there would not be any time for further negotiations, as developing a new stance by the EU would take too much time. Should the contents of the treaties not be agreed by the end of 2002, in view of the time required for their ratification, the EU's enlargement in 2004 would cease to be real. It was additionally announced, in order to „threaten” the candidates, that a „new enlargement timetable” for these countries – which will not close the negotiation process by the year-end will be agreed at the Copenhagen Summit. This would mean the same enlargement calendar as for Bulgaria and Romania, which would like to join the EU in 2007 at the earliest.

Recently, Włodzimierz Cimoszewicz, Foreign Affairs Minister, has recently commented on the possibility: „There is no room for blackmailing that the train leaves at 19.10. If the train leaves at 19.30 it will not be a disaster”.

financial issues with the candidates possible (in such a short period of time) the negotiations principles will have to be changed completely. The negotiations will be held almost continuously by our chief negotiator in Brussels. He will be allocated bigger scope of authority than currently staying in regular touch with the Prime Minister. The new framework is necessary, as within a couple of weeks the decisions on big money and membership financial conditions for many years will be made. It has already been known, however, that any arrangements for 2004-2006 must meet the existing EU's budget for 2000-2006.

### **Schroeder does not want to sign the bill**

It seems that the only but very substantial obstacle for Poland's accession to the EU is represented by the enlargement financial conditions. The speculated delay in the enlargement by at least a year resulted from the very dispute on the membership financial conditions. Originally, all the EU membership financial conditions, in line with the undertaking made by the heads of the „15” within the enlargement timetable accepted in December 2000, were to be presented to the candidates by the end of June 2002. Now, we know that it did not take place. The EU has not met its undertakings for the first time. First of all, the financial conditions of integrating the agricultural sectors of the candidate countries with the EU's one were not defined. So far the

heads of the „15” have not accepted the proposal of the European Commission which consists in a gradual allocation of direct subsidies to the candidate countries. According to the Commission, the fund volumes due to the candidates were supposed to grow from 25% of the full amounts in the first year of membership up to 100% after 10 years. The lack of acceptance for the Commission’s plans resulted from the stance of Germany and the Netherlands. These countries did not want to define the amounts allocated to the candidates under the direct subsidies without a guarantee that this form of support will be gradually eliminated in the entire Union. In order to avoid a crisis in the negotiations with the candidates, however, Germany as a leader in the group of „net payers” ensured that some compromise would be achieved in respect of the subsidies. Both Edmund Stoiber, a leader of CDU/CSU, who is currently leading the research polls, and the German diplomats related with the existing Government announce their support for allocating direct subsidies proposed by the European Commission. Berlin, however, wanted to wait for the European Commission’s proposal in respect of the Common Agricultural Policy (CAP) which was presented on 10 July 2002 as well as for the result of the September elections to Bundestag. Hence, although the EU’s enlargement cost represents only a fraction of the volumes allocated to East Germany, and even the volumes previously allocated to Germany under the Marshall’s plan, it seems that Chancellor Schroeder does not want to sign the bill. The candidate countries were only assured by the member countries, that the direct subsidies represent an element of the European Law, therefore, farmers from the candidate countries are entitled to them.

It seems that the positive completion of the negotiations on the Poland’s accession to the EU will depend substantially on the „15” reaching agreement in respect of the future of the CAP. The most significant element of the Policy reform proposed by the Commission is represented by the gradual decrease in subsidies for big farms (receiving subsidies over euro 5000 p.a.) in the existing membership countries. The threat for the EU’s enlargement would be a situation when the „15” would not reach the agreement in respect of the CAP. The main battle will be fought by France and Germany against the Commission. Paris does not want the direct subsidies to be reduced (as it is their biggest beneficiary), and Berlin believes that the EU’s agricultural budget should be reduced (the Commission’s proposal does not envisage a clear cut in the expenses on agriculture, but rather a change of its structure).

A heated debate is also taking place in Poland respect of the financial conditions of Poland’s EU membership. Recently, Włodzimierz Cimoszewicz, Foreign Affairs Minister stated that the Polish Government would aim at reducing the

structural funds allocated to Poland (euro 13.8 bn in 2004-2006) in exchange for direct subsidies to agricultural production. The structural funds require co-funding from the domestic budget as well as presenting investment projects. This was confirmed by the Prime Minister Miller, although he emphasised the Polish Government had not placed an official proposal to the EU’s commission. As a response to that, however, during his latest visit to Poland the EU’s enlargement Commissioner stated that it is not possible to freely move funds within the Union’s budget. The Polish stance seems to be rational, as Poland will find it difficult to use the EU’s funds whose use will depend on effecting specific projects co-funded with the domestic budget. This is indicated by the existing problems of both Poland and other candidate countries to use the EU’s funds from the grant schemes. From the ISPA scheme (Instrument for Structural Policies for Pre-Accession aimed at the development of a large-scale transport infrastructure and environmental protection) launched in 2000 Poland has used only 7% so far. Even bigger problems will be faced in respect of using funds granted within the SAPARD scheme just launched in Poland, as it encompasses a large number of small projects. The use of the scheme in the countries, in which it has already been operational in (e.g. Lithuania, Latvia, Estonia and Czech Republic) is marginal and amounts on average 3.6%. Therefore, it is even more probable that Poland will try to negotiate larger direct subsidies in exchange for the smaller structural funds. Certainly, such a stance will be supported by PSL – one of the parties in the governing coalition. Jarosław Kalinowski – the Party’s leader, deputy PM and the Agriculture Minister, keeps on emphasising that the Polish agriculture must be guaranteed equal conditions for competition with the EU’s agriculture, which, in practice leads to the demand for granting full direct subsidies to Poland since the first day of membership.

### **Is the Irish referendum a problem?**

Apart from the problems with agreeing the enlargement financial conditions, there is yet another threat to the EU’s enlargement at the assumed date. The problem roots in the ratification of the Nice Treaty as the Irish are afraid of the Treaty’s enforcement. Their resilience evidenced by the first referendum on this issue is not related to the dislike of the enlargement itself or to the EU’s institutional reform. This results rather from the Irish dislike of the Union’s transformation into a military alliance and establishment of the European Army. In order to eliminate these concerns and ensure the victory for the Treaty ratification. Supporters in the subsequent referendum in Ireland, at the Seville Summit the heads of the „15” made a statement aimed at calming Dublin down. Should this solution be unsuccessful, then the failure of the

October ratification referendum in Ireland will mean the necessity to renegotiate the Treaty. This situation could be used as an argument to halt the enlargement negotiations. In practice, however, even the failure of the Nice Treaty should not substantially delay the EU's enlargement. As the regulations related to the participation of the new members in European institutions may be transferred from the Nice Treaty to the accession treaties, and only other stipulations of the Nice Treaty would have to be renegotiated.

### **The European Commission is positive ...**

The threat to the EU's enlargement by any of the candidate countries would be a situation when the European Commission would not request the EU's Council to close negotiations with a given country. The existing practice indicates that the positive recommendation of the European Commission is a prerequisite for the enlargement. The Commission decided to eliminate any doubts in this respect. It has been already announced that in the official report, which will be published on 16 October 2002, on the candidates' progress, the Commission will request the heads of the „15” to accept jointly the 10 candidates. The Commission's recommendation is conditional and depends on the Polish Government's „constructive and realistic” approach to the EU's offer, i.e.. the unqualified acceptance of the financial conditions proposed by the Commission.

### **...but, is the Polish society positive as well?**

Until recently the social support for Poland's accession to the EU's saw a continuous growth. However, the recent public opinion polls indicate a downward tendency (among those declaring to take part in the referendum – from 75% in April down to 69% in June 2002). According to Euro-Barometer of *Rzeczpospolita* daily, these are mainly farmers, villagers and PSL voters (the first two groups in their better part consist of the accession adversaries than its supporters), which may indicate that the fudge around the direct subsidies for the Polish farmers had an adverse impact on the Brussels picture in the Polish society. This means that if the membership financial conditions proposed by the EU to Poland are not changed, then the support for Poland's accession to the EU may see a further decrease. However, one can hardly expect it to decrease so much that it would translate in the Poles rejecting the accession treaty. Although the support for the EU's enlargement in the member countries is definitely lower, there should not be any problems with the ratification of the accession treaties. These decisions will not be made by the societies of the „15” by means of a referendum, but the decisions will be made by the parliaments of these countries (probably except for Ireland).

### **The most likely scenario**

Despite problems with the EU's enlargement related both to the Union's internal disputes and the discrepancy between Poland's expectations and the offering of the „15” countries, Poland is most likely to join the EU in July 2004. In our opinion, the enlargement timetable is likely to look as follows:

- On 16 October 2002, the European Commission will state that the membership conditions are met by the 10 candidate countries (all currently in the process of negotiations with the EU except for Bulgaria and Romania),
- On 24-25 October 2002, at the Brussels Summit the heads of the „15” will define these candidate countries which may close the negotiations this year (including Poland),
- At the beginning of November 2002, the EU's countries will reach the agreement on the financial conditions of the enlargement,
- On 12-13 December 2002, at the Copenhagen Summit the negotiations with the candidate countries will be closed (including Poland),
- The accession treaties will be officially signed by March/ April 2003,
- In July 2004 the latest, Poland will become the member of the EU (the candidate countries will be entitled to take part in the June elections to the European Parliament).

### **Membership benefits**

Regardless of the fatalistic visions of the Euro-sceptics, it is generally expected that Poland's accession to the EU will automatically bring about a number of benefits which include:

- A faster growth of GDP and personal income
- A growth in the stability of the economic environment
- A decrease in the investment risk
- A growth in investments (including foreign investments)
- A development of the international trade
- An inflow of know-how and technology
- A weakening of the domestic monopolies
- A streamlined movement of the output factors
- An increase in productivity
- Financial transfers and support funds

The transfer of financial funds from Brussels may be recognised as a sole automated benefit for Poland. Even here the automatism is not full. Much depends on the fact if Poland is able to present relevant investment projects and co-fund the better part of their realisation costs (currently, it is said to be 15-25%). The leverage of the other possibilities will depend to a greater extent on the economic policy adopted by subsequent governments in Poland. The experience gained from the European integration indicates that the results may be different in different countries, despite similar entry conditions. The importance of the domestic economic policy is illustrated best by the substantial success of Ireland in the last decades and the Greek failure at the same time.

## Poland's road to Euroland: the zloty on the crossroads

Poland's EU accession negotiations are entering their final stage, the date of entry into European Union is approaching very fast. This also means that (potentially) the moment of zloty replacement by the single European currency and Poland's participation in Economic and Monetary Union (EMU) gets closer. This makes the issues regarding the process of euro adoption (the path of exchange rate fluctuations on the road to euro and possible date of EMU entry), the central point of interest for economists, financial markets players and many entrepreneurs. In this analysis we have tried to overview main topics related to the process of euro adoption and possible directions of changes on the Polish FX market.

### What FX regime for Poland?

Recently the considerations what FX strategy should Poland adopt ahead of EU and EMU entry have gained lots of attention. In May the divergence of views between the NBP and the Finance Ministry clearly emerged in this regard. Both sides initiated the discussion and established a special team with the objective to work out a common stance on FX strategy in light of the European integration. The change on finance minister's post brought additional uncertainty regarding future FX policy, especially that in his former press publications Grzegorz Kolodko opted for quite innovative solutions in this regard and he almost did not refer to those ideas after he was appointed for finance minister.

In brief, there are three main options regarding FX policy ahead of EMU entry:

- **Maintaining free floating zloty exchange rate** until EU accession and joining ERM2 (Exchange Rate Mechanism 2), then adoption of the euro as fast as possible. It was the official stance adopted by the Monetary Policy Council in May.
- **Return to managed float**, i.e. setting the parity against euro (probably weaker than current market rate of the zloty) and the bands of acceptable exchange rate fluctuations (not necessarily symmetric against central parity and possibly not known for the market) before ERM2 entry. The fluctuation bands would be defended by the NBP's FX interventions. According to unofficial information such solution has been proposed by the government to the NBP in a letter handed over by Marek Belka to Leszek Balcerowicz in May.

- **Currency board arrangement**, i.e. pegging the zloty to euro with automatic and unlimited convertibility of currency under fixed exchange rate. Such move would be preceded by one-off zloty devaluation. It is the solution proposed by Grzegorz Kolodko in press article in May. Kolodko suggested that fixed parity against euro should be set at 4.35 EUR/PLN.

Each of the above solutions implies completely different scenario for the Polish foreign exchange market in course of subsequent years, and different conclusions for investors / entrepreneurs planning any FX transactions. The government's proposals<sup>1</sup> aim at achieving two objectives: weakening domestic currency and limiting its fluctuations ahead of euro adoption, which is supposed to improve the competitiveness of Polish entrepreneurs, deliver pro-growth stimulus and neutralise or weaken huge appreciation pressure resulting from prospects for fast EU and EMU entry. On the other hand, the central bank is willing to leave exchange rate setting to the market, arguing that stopping appreciation might be very difficult if not impossible in subsequent years, and it would be very costly and risky for the economy. The only common point that seems to emerge from this discussion is the perception that Poland should adopt the single currency as soon as possible.

First, let's try to analyse which of the above-mentioned scenarios seems to be the most likely. **From today's perspective it seems that the biggest probability should be attached to the first solution, i.e. maintaining free float of the zloty until ERM2 entry.** The other strategies, though theoretically possible, appear to have little chances of implementation, and do not seem to be plausible from economic point of view.

<sup>1)</sup> It should be underscored that while there was no comments about the government's economic plans, especially regarding FX policy, since the appointment of Grzegorz Kolodko for new finance minister, it is hard to say at the moment what will be government's official stance in this regard.

EU candidate countries are free to choose FX regime in pre-accession period. Therefore one should not expect any violent protests of the European institutions to the idea of changing FX regime in Poland. However the EU's reaction would be rather calm, especially in case of currency board arrangement. Certainly, the EU would reiterate ECOFIN's official stance adopted in November 2000, which states that currency board arrangement could not be treated as a substitute for ERM2 system on the way to euro adoption, and that it is recommended for small open economies with high inflation, disciplined budget and elastic labour market (i.e. not for Poland). One should also expect the EU's disclaimer that Poland would adopt peg to euro on its own responsibility and it could not count on the ECB's support ahead EU entry, nor on the warranty that Polish currency board would be considered as ERM2-compatible after EU accession.

Nevertheless much more significant problem from the formal point of view could be the NBP's stance on FX strategy. According to current legal arrangements NBP's acceptance is necessary in order to change FX regime in Poland. In the middle of May the Monetary Policy Council unanimously agreed that the most beneficial for Polish economy would be maintaining free float of the zloty until ERM2 entry. It seems highly unlikely that the central bank's official stance would change dramatically, which seems to be confirmed by recent comments of the MPC members. So if the government was determined to change FX regime it should consider far-reaching changes of legislation, including amendment of the NBP charter and – possibly – change of the Constitution (NBP charter amendment could be ineffective, because it could be sued to the Constitutional Tribunal). This in turn would be the long and risky process. While the change of FX regime itself in a candidate country should not cause EU's serious concern, a change made against central bank's opinion and preceded by curbing central bank's independence would most likely trigger very negative reaction of the EU's institutions and would made Poland's position rather uncomfortable ahead of final round of accession negotiations. In its latest monthly bulletin the ECB underscored that passing NBP charter amendments by the parliament could make further negotiations much more difficult.

If we were to order possible FX strategies in Poland ahead of euro adoption according to the probability of their implementation, it would be as follows:

FX regime	Likelihood
Free float	70 %
Managed float	20 %
Currency board	10 %

It is worth stressing that writing this text we still do not know the official stance of the government and new finance minister on the FX policy. The co-operation of joint NBP and FinMin's committee established to work out a common solution is uncertain, especially that its co-head Andrzej Raczko left Finance Ministry. Nevertheless it seems that the field of manoeuvre for new finance minister remains very limited in this regard, mostly by present legal framework, approaching final stage of accession negotiations and relatively little time left to EU entrance.

### When to the euro?

Timetable for euro adoption in Poland depends on many factors. The most important is the timeframe determined by the U's regulations and procedures. According to those regulations new EU members will be obliged to ultimately join EMU, although there are no specific rules regarding the moment at which countries would have to apply for EMU entry. Adoption of the single currency would be possible only after fulfilling the nominal convergence criteria (set in the Maastricht Treaty, see textbox below), which constitutes some minimal time constraints that cannot be skipped.

The biggest time restrictions are determined by exchange rate stability criterion.

### Nominal convergence criteria

- **Monetary convergence** - average inflation rate should not be higher than 1.5pp above average inflation in three EMU member states with the lowest inflation.
- **Interest rates convergence** - yields on long-term treasury bonds should not exceed by more than 2pp average yields on treasuries in three member countries mentioned above.
- **Fiscal convergence** - public finance deficit should not exceed 3% of GDP.
- **Public debt criterion** - public debt to GDP ratio should not exceed 60%.
- **Exchange rate criterion** - maintaining exchange rate stability against euro for a period of at least two years; currency stability is understood as maintaining domestic currency within ERM2 system.

To estimate the minimal time requirements for Poland necessary to pass through all procedures and adopt the single currency, we should follow all the stages on the road to euro.

Assuming that accession negotiations are accomplished on time (by the end of this year) and the ratification of accession treaties by EU member states' parliaments completes quite effectively, one could assume that Poland (together with other 9 candidates) will join EU at the beginning (or at most in the middle) of 2004. Then joining ERM2 would be possible in 2H04 or at the beginning of 2005 (the country could apply for joining ERM2 only after it becomes a member state and the decision is not automatic but rather takes some time; therefore it is hard to assume that joining ERM2 would be possible immediately after EU accession). Exchange rate stability criterion implies that the time between ERM2 entry and country's application for euro adoption will take at least two years. Therefore assuming the most optimistic scenario, i.e. that the European Commission considers Poland as eligible for EMU entry just after those two year period, joining Eurozone would be possible at earliest at the beginning of 2007 (with a possible delay of half a year). It is worth noticing that joining Eurozone does not imply automatic introduction of euro notes and coins in circulation, because it is possible that there will be 1-2 years of transitory period when euro will be functioning only in non-cash settlements<sup>2</sup>.

The above-mentioned scenario, that has to be regarded as the most optimistic, can be summarised in the following table:

When	Next stage
1H 2004	Poland's EU accession, application for joining ERM2
1 January 2005	zloty entry into ERM2
2H 2006	assessment of convergence criteria fulfilment and decision on Poland's eligibility for EMU (based on data for 2005)
1 January 2007	Poland's EMU entry, introduction of euro in non-cash settlements

It is worth noticing that the pace of Poland's progress on the road to euro will depend to a large extent on the quality and direction of domestic economic policy. In the above considerations we have assumed that both the Polish government and the central bank will undergo the most probable of the earlier mentioned FX strategies, i.e. maintaining free floating zloty until ERM2 entry. Additionally we have assumed that both institutions would pursue to shorten the transitory period between EU accession and euro adoption as much as possible. So far such decla-

ration was made only by NBP. Ministry of Finance's stance on this matter could be expected in couple of months (or maybe weeks) time. It seems that introduction of currency board arrangement in Poland just before EU accession could extend the necessary period of maintaining exchange rate stability, as EC could assess that under no possible exchange rate fluctuations two years are too short to judge whether the fixed parity against euro is sustainable in the long run (besides, the parity at 4.35 EUR/PLN seems unacceptable for the EU anyway). It should be remembered that the signals from the EU's institutions, e.g. the European Central Bank, suggest rather delaying EMU entry for candidate countries.

### On the road to Euro

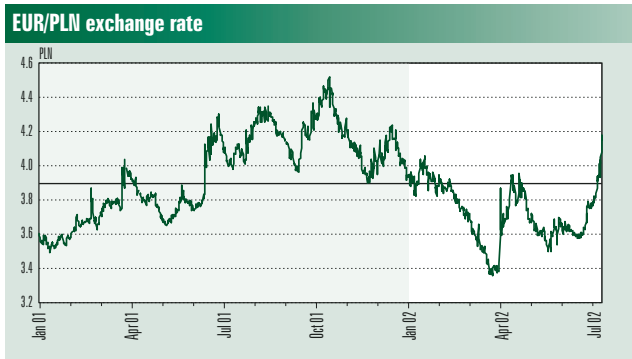
The perspective of integration with the European Union and euro adoption will be the key factors affecting the situation on the Polish foreign exchange market within next few years. One can expect that as Poland will be closer to the end of the whole process, fundamental and economic aspects will gradually lose their importance, as politicians' decision concerning the parity against euro will become the most important for the market. One has to notice, however, that there will be two parities to set up – the parities in ERM2 system and the final rate, which will hold forever.

#### *What Euro/PLN parity?*

It is difficult to conclude about a required level of the Polish currency against the euro in the long term. It is close to impossible to estimate this rate on quantitative basis – the results of such estimations are usually very sensitive on initial assumptions (about inflation rate, GDP growth etc.). However, it seems that MPC's Dariusz Rosati's argumentation from March this year may be used as a good starting point. He said that fixing exchange rate against euro might be set as an average rate from the last couple of years. Such a level may be adjusted upwards to offset the influence of big privatisation transactions or so called Harrod-Balassa-Samuelsson effect. Because within last few years no trend was observed for the zloty exchange rate against euro, two-years average could represent an equilibrium level. This would mean around 3.8-3.9 zloty per euro.

<sup>2</sup>) Krzysztof Jakubiszyn „Jak szybko do euro?” Gazeta Bankowa, 9-15 lipca 2002





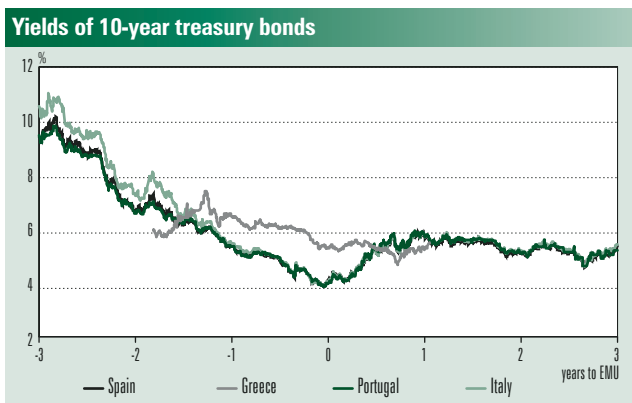
Source: BZ WBK

However, in the process of setting euro/zloty parity rate, one has also to include last two-years' development on world foreign exchange market with significant weakening of the euro against the dollar. If reversal of this trend turn out to be persistent, the final parity of the zloty against euro would amount 4.0-4.1 (around 5% weaker than stated above).

*Under appreciation pressure*

Until the zloty exchange rate will be fixed against the euro, it will fluctuate in free-floating regime and then within ERM2 system. During this period (of around five years) the market and economic factors would determine the level of the zloty. Within ERM2 mechanism, exchange rate changes will vary within currency band (standard band is defined as +/-15%, but it may be also a matter of negotiations with the EU). Please find below the most important determinants affecting the zloty appreciation during this process:

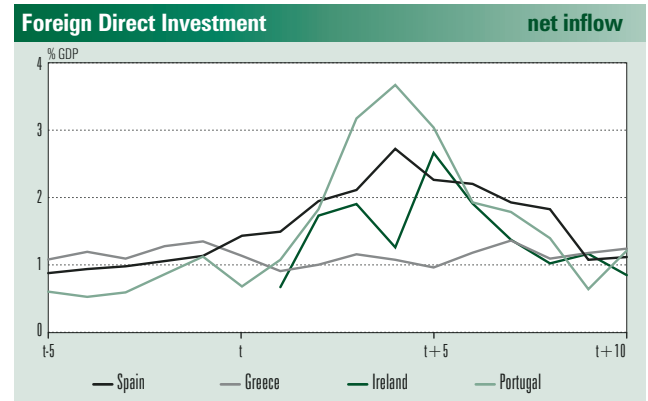
- Higher portfolio capital inflows – nominal convergence criterion requires the decrease of long-term government's bonds' yields, which should attract hot money on the Polish fixed income market. So-called convergence play may be reinforced if Poland joins the EU and euro adoption will become even more credible



Source: Datastream

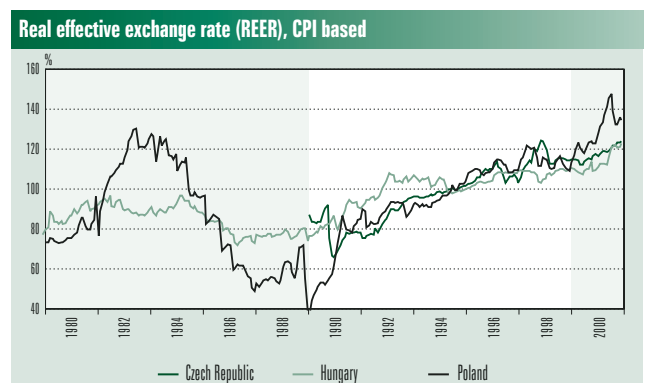
- Higher foreign direct investment inflow, which should take place after joining the EU. It is connected with so-

called real convergence play – higher attractiveness of the emerging economies amid expected higher GDP growth driven by catching up process. FDI statistics for countries, which joined the EU in 70-80s shows that such a process is relatively strong and becomes the most visible around 3-4 years after EU accession.



t - year of EU accession: 1973 Ireland, 1981 Greece, 1986 Spain and Portugal Source: IMF, BZWBK

- Structural funds and direct subsidies – Poland should be a net receiver of money flows with the EU, which means that Polish entities (both public and private) may obtain a large amount of money, which partly may go through the foreign exchange market. However, it is important to notice that large share of these funds may find its counterpart, as the government's needs for currency will increase amid a necessity to repay foreign debt.
- Harrod-Balassa-Samuelson effect – differences between productivity growth in Poland and developed countries should lead to real appreciation of the currency. Because CPI inflation has to be maintained at the level required in Maastricht criteria, such real appreciation may translate into nominal appreciation of the zloty. Real appreciation of the currencies in the region observed within last couple of years (see chart) should accelerate even further together with the strengthening of the real convergence process after EU accession.



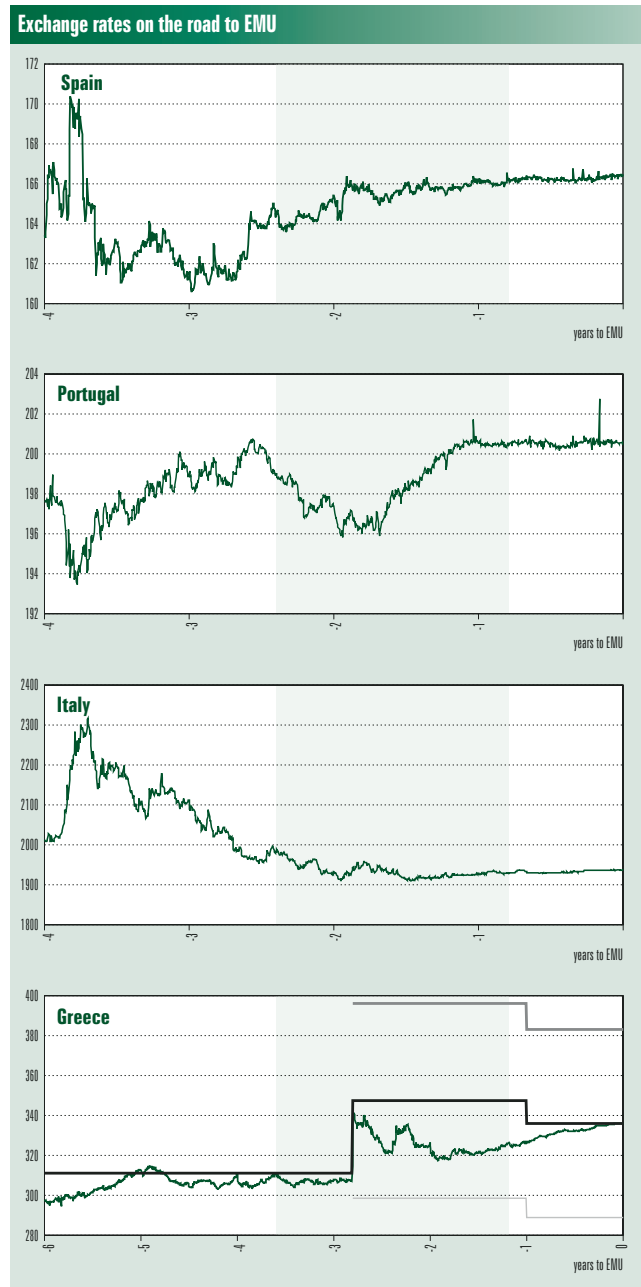
Source: IMF

Among the factors that could weaken zloty exchange rate one could list out:

- NBP's FX interventions – in case the government manages to convince central bank to do so, NBP could undertake market interventions buying foreign currencies. It has to be underscored that we see the likelihood of such scenario during the period of free floating FX regime as very limited and the possible effects as limited and short-lived, without significant influence on market trend in the long run. After joining ERM2 FX interventions would become much more likely, especially in a situation when market exchange rate would approach the band of acceptable currency fluctuations.
- Politicians efforts to weaken currency artificially – in case of lack of co-operation between NBP and government on FX interventions the government and parliament could undertake actions similar to what was observed during the first nine months of Leszek Miller cabinet's term of office. It would affect exchange rate mostly by introducing uncertainty among investors (so-called verbal interentions). The effect of such actions cannot be forecasted precisely, though one should rather not expect any persistent market reaction.
- Mistakes of domestic economic policy weakening financial markets' belief in Poland's fast EMU entry. Significant delay of euro adoption, e.g. due to inability to meet some of the convergence criteria could cause portfolio investors backing off from the Polish market causing speculative attacks against the zloty. The consequences of such event would be much deeper and far reaching than two mentioned above.

To summarise, we expect that in a period before joining the European Union and also between entering ERM2 system and euro adoption, the zloty is likely to be under significant appreciation pressure in real, but also in nominal, terms. Within next few quarters financial markets are likely to wait for the first indicator in the process of euro parity setting – the parity in ERM2 set after the negotiations with the EU. Looking at above-mentioned arguments and zloty trends within last years, we think that the parity is likely to be established at the level of around 4.0-4.2 against the euro. However, during the two years period of ERM2, the zloty is likely to be traded on the stronger side of the parity. If appreciation pressure would be significant, it is possible that before setting the final rate of exchange, the European Union would try to convince Poland to reevaluate the parity (such scenario was observed in

Greece – see chart). Nevertheless, exchange rate against euro adopted by both sides is likely to amount 4.0-4.1.



Source: Datastream

## Economic update

- May's data consistent with expectations
- Economic revival still uncertain
- No inflationary pressure, nose-diving food prices

### GDP started to accelerate

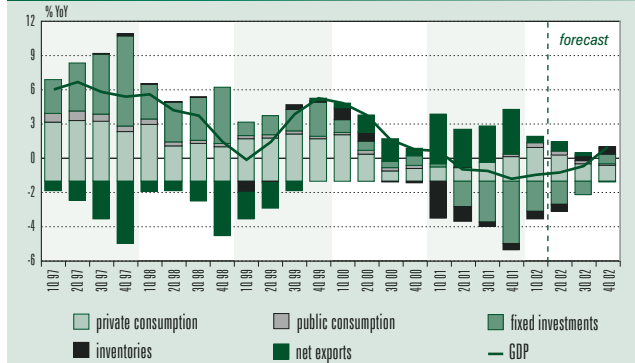
Last month the Central Statistical Office released preliminary GDP figures for 1Q02. In line with our expectations the data proved that there has been no further deterioration of economic situation at the beginning of this year, as compared to 4Q01. In fact, the overall situation improved. GDP accelerated to 0.5%YoY from 0.2% recorded in 4Q01, private and public consumption accelerated as well to 3.5% and 2.0%, respectively (from 3.3% and 1.4% in 4Q01). What is especially important, fixed investment decline has not deepened in 1Q02, reaching -13.3%YoY comparing to -13.5% recorded in 4Q01. Therefore, domestic demand remained flat in first three months of 2002, after four quarters of deterioration in 2001.

The estimated contribution of various GDP components to overall economic growth shows that the main driving force behind GDP growth was private consumption. However, if you look at retail sales figures for May delivered by CSO at the same time (retail sales decelerated to 1.8% YoY from 3.1% in April and 9.9% in March), and at the results of recent consumers' confidence survey, it becomes evident that private consumption growth is likely to decelerate later this year. Hopefully, the data show also that at the same time the performance of net external demand remained relatively good – the estimated contribution of net exports to GDP growth remained positive in 1Q02, despite the downturn of foreign trade volumes at the beginning of 2002. April data from both NBP and CSO signalled strong recovery of Polish export, and this should keep net exports contribution positive in the near term. However, we have to notice that expected acceleration of fixed investments, even if accompanied by lower growth of private consumption, should lead to higher demand for imports (intermediate and investment goods). As a result, net exports may turn negative at the end of this year.

The fact that the decline of fixed investments has not deepened in 1Q02 bodes well for the rest of the year. We expect that the annual rate of decline of investments will improve further in two subsequent quarters, and in 4Q02 there would be even moderate growth in annual terms. Some signs of improving investment climate have been already reported by companies in recent business surveys.

The reduction of interest rates that took place in recent months would be supportive, though not determinant factor here. But the perspectives for implementing parts of government's „Entrepreneurship first” package and liberalising labour code, would also have the significance (if the parliament approves these changes).

### Components of GDP growth



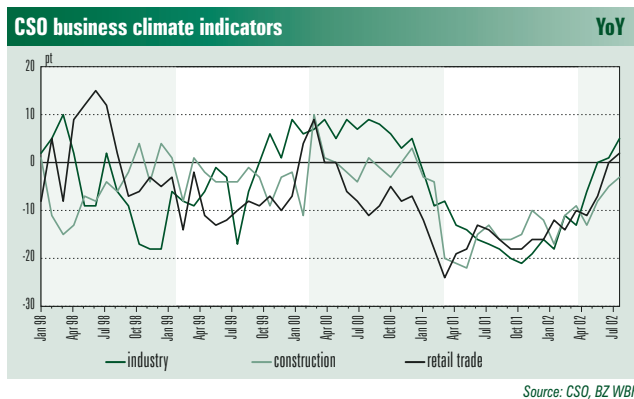
Source: CSO, BZ WBK

CSO data proved that there was no 'inventories effect' that we have mentioned many times in the past. The decline of inventories stock proved to be even slightly deeper in 1Q02 than in 1Q01, and as a result this component had negative impact on GDP growth. But on the other hand, if the de-stocking process keeps going for over a year already, then the companies should run out of their inventories completely very soon. Then they would have to rebuild the stocks, facing higher demand and revival of investment activity.

### Business climate and production stagnant

The trend of business climate indicators started in 1Q02 was not continued in June remaining at the same level as one month earlier, which may suggest that economic recovery may be more gradual than expected earlier. Results of business climate surveys showed less optimistic picture than was reported in previous months. Leading indicator of Polish economy computed by Maria Drozdowicz from the Bureau for Investments and Economic Cycles reported that new orders inflow to the companies deteriorated in May, after very dynamic growth recorded earlier this year. This signal confirmed the results of other business climate surveys released recently (made by GUS and IRG-SGH), constituting an early warning that the slight improvement of economic activity in industry that has just begun to materialise, might be quite unstable. This is especially important because at the same time the survey results suggested little chance for domestic demand recovery in the near term amid falling consumers' propensity to spend, stagnant real wages and no improvement on the labour market. The bright side is that

export performance remained relatively strong, and that companies consistently report fast improvement of their financial standing. Nevertheless, the overall message from the report was rather gloomy, which is quite a new phenomenon after several months of robust improvement of medium-term economic perspectives reflected by leading indicator growth.



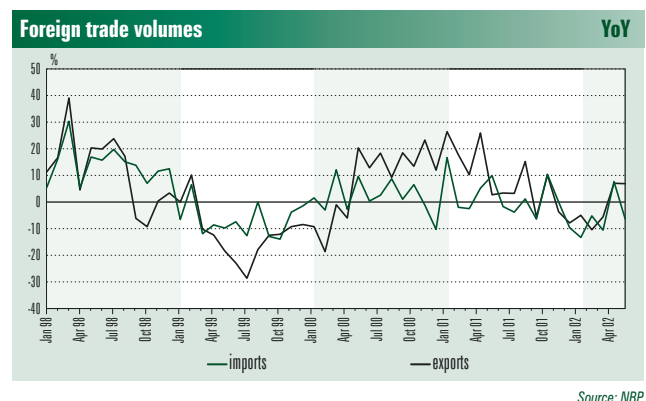
The survey among Polish households made by Ipsos-Demoskop shows rather upsetting results. The consumers' optimism index declined only slightly in June after two months of impressing growth, but survey's details were more worrying. The institute reported that the ratio of households that plan the purchase of durable goods collapsed dramatically in June, as consumers were „paralysed” by the perspective of further deterioration on the labour market. The authors say that survey proved strong dependence between employment fears and the propensity to consume, which is rather pessimistic conclusion given that job destruction process continues in the corporate sector. Survey shows that households' optimism declines rapidly amid growing conflict between the government and the central bank, which also does not bode well for the near future.

Consistently with business climate readings, industrial production fell by 1.6%MoM and 4.1%YoY in May, well below market consensus pointing to around 1.8% YoY decline. The figure was biased down, because in May the number of working days was smaller (by one) than last year. But even after adjusting for this factor the output figure shows no signs of recovery in industrial sector – the production remains stagnant since the beginning of 2001. The figure might have been additionally biased downward by the fact that few very large-scale companies from ailing sectors held the production recently because of their financial troubles (e.g. Szczecin shipyard). The latter hypothesis finds some evidence in CSO data, as the office reports that one of the biggest production collapses has been recorded in „other transport equipment” sector (-

28.7% YoY). We believe that the situation in industry should improve gradually in subsequent months. The growth rate should turn into black already in June, as the number of working days will no longer bias the results downwards and in July, more working days effect is likely to produce even around 5%YoY growth.

### Foreign trade – still positive trend

Balance of payments figures for May were not surprising. Current account deficit reached US\$484m, trade deficit US\$785m and unclassified flows surplus grew to US\$316m. At the same time NBP revised down the figures for April: C/A deficit has been lowered to US\$643m from previous US\$806m. As we expected, the data confirmed that the recovery of trade volumes that was reported for April by both NBP and CSO, was not a one-off phenomenon. Both export and import volumes remained in May well above the average levels recorded in 1Q02, although they declined somehow in relation to April. Good foreign trade figures in last two months probably reflected the revitalisation of external demand, being the consequence of gradually improving business climate in our main trading partners. Please recall that Polish companies have reported very rapid growth of export orders in business survey polls starting since the end of 1Q01. We expect that this positive trend would continue, as it would be supported not only by ongoing economic recovery in EU countries, but also by recent euro appreciation, improving our exporters' competitiveness on European markets. Nevertheless one has to remember also that in last two months Polish entrepreneurs were much less optimistic in assessing external demand growth.



The Central Statistical Office's foreign trade data for April published last month confirmed the rapid upsurge of trade volumes reported earlier by NBP, and proved to be even stronger. Export exploded in April 21.4% YoY after -7.3% YoY recorded in March and -3.8% YoY on average in 1Q02. At the same time import grew 12.4% YoY after -7.3% YoY

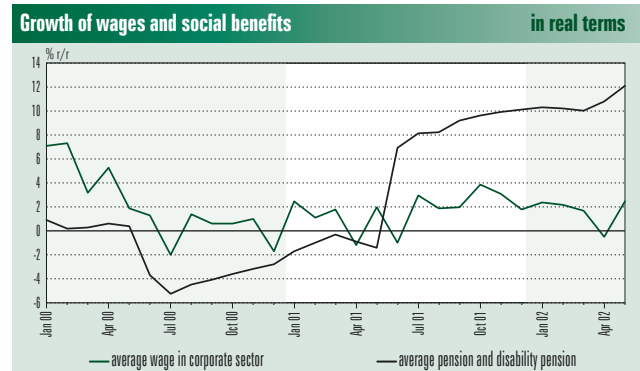
in March and -5% YoY in 1Q02. The recovery is even more pronounced than the downturn recorded at the end of 2001. If CSO data follow NBP's statistics, based on completely different methodology, it might suggest that the recovery of Polish foreign trade is becoming a real fact.

### Inflation – closer and closer to the bottom

Polish inflation rate collapsed in May to 1.9%YoY from 3% recorded in April. As usual in recent months, the main factor behind such deep inflation fall was deflation of food prices, reaching -0.9%MoM and -0.4%YoY. Nevertheless it has to be noticed that prices in other CPI components also exhibited very limited growth, e.g. prices of clothing and footwear remained flat, as well as prices of housing and energy. Fuels dropped only marginally by 0.2% MoM. Food deflation in May happened for the first time in history of the Polish market economy, and additionally it was very deep. The timing and the size of this price decline signal two factors: on the one hand the scale of oversupply on the food market this year is indeed enormous, on the other hand the demand remains relatively low. This increases the probability that food prices will keep falling at least until the end of July, and even afterwards the increase would not be excessive, bringing down the whole forecasted inflation path. Nevertheless it is worth to notice that there appeared some opinions from food market experts, that the whole rumour about the abundance of food this year is somehow exaggerated in which case the trends could turn less optimistic later this summer. The truth is, however, that there are even more factors lowering forecasted inflation for the rest of year. The supply side shock resulting from introduction of excise tax on electricity would be probably weaker than expected, as the energy market regulator said that average electricity price growth for final consumers would amount to ca. 5.7% (instead of 10%). The Polish railways announced the hike of ticket prices since 1 July of 6-14%, but the share of railway tickets in CPI basket is so small that it will not have significant impact on projected inflation path.

Labour market data also do not suggest that we may observe an increasing pressure on retail prices from the demand side of economy. In May wages in corporate sector increased 4.2%YoY, while the employment declined by 4.6%YoY. This is broadly in line with the trends observed in previous months. The wage deceleration in April to 2.3%YoY proved to be one-off factor. The most worrying thing is that there is hardly any improvement in job destruction rate, which ranges in 4-5%YoY for a couple of quarters. Nominal wage bill declined by 0.6%YoY in May, implying around 2.6%YoY decline of real wage bill. We reiterate that no improvement on the labour market might

jeopardise the private consumption growth later this year, as it cannot be financed permanently by savings de-stocking.



Source: CSO

All these factors call for another close look at forecasted inflation path. In our base scenario we expect that during most of the summer CPI growth would remain below 2% YoY, falling to even 1.5% in July. The inflation should rebound somehow in 2H02, though it seems rather unlikely that it exceed significantly 3% by the end of year.

### Funny money: figures hard to interpret again

We have written many times before that money supply data should be interpreted with care because of the possible measurement errors. And in May it proved again that these data may be far from reliable. Look at the table below to see how NBP has changed the data for April in relation to the preliminary figures released last month. The adjustment for headline M3 in April amounts to PLN1.4bn.

What could be said about monetary trends when data are subject to such substantial adjustments? Not much. One cannot even be sure what is the annual money growth rate, as we do not know whether the NBP has revised only April's figures or the whole time series since December 1996, as was the case one month earlier. Given large amount of good will and the assumption that both current and historical data are correct, it could be noticed that the deceleration of deposit growth continues after five months of 2002, while there are some first signs of recovery on the credit market. The increasing divergence between deposits and credits growth rate might be a serious problem for the central bank, especially if economic recovery gets stronger and loans growth would accelerate significantly.

**Broad money M3 and its counterparts**

PLN m	as of 30 Apr		as of 31 May
	Preliminary	Revised	Preliminary
<b>MONEY SUPPLY</b>	<b>319 320.9</b>	<b>317 935.3</b>	<b>322 685.2</b>
Cash in circulation	40 014.2	40 005.0	39 832.4
Deposits and other liabilities	278 894.6	277 556.1	282 154.9
Households	205 951.7	205 333.2	206 493.5
Non-financial corporations	47 104.3	46 604.0	50 100.5
Social security funds	1 785.5	1 971.4	1 774.4
Other components of M3	412.1	374.2	698.0
<b>NET FOREIGN ASSETS</b>	<b>137 807.0</b>	<b>135 848.9</b>	<b>138 711.1</b>
(USD m)	34 623.1	34 131.2	34 410.2
<b>NET DOMESTIC ASSETS</b>	<b>181 513.9</b>	<b>182 086.4</b>	<b>183 974.1</b>
Credit	230 466.5	230 791.6	234 031.9
Households	85 144.1	85 845.9	86 185.0
Non-financial corporations	125 099.1	124 448.8	126 055.0
Social security funds	1 189.1	1 189.6	2 046.2
Credit to central govt., net	63 787.5	63 727.1	63 819.4
Other items, net	-112 740.2	-112 432.3	-113 877.1

Source: NBP

There is another very interesting feature of monetary statistics. We are not able to say what was the actual growth rate for M1 aggregate, as we found two different data sets in two different files on the NBP website! Nevertheless the released data show several important and worrisome trends, that put a question mark over the stability of economic recovery perspective. First of all they confirm robust and sustainable growth of narrow money and cash in circulation (the upward trend is apparent, and it approaches 20%YoY very fast). What is more, the upsetting trend in personal deposits seem to deepen – term deposits die off while current deposits accelerate vigorously, which signal diminishing propensity to save among the households. The risks are moderated somehow by the fact that credits remain stagnant for a while. Nevertheless monetary data need to be traced down very closely in the subsequent months, because they signal that when first signs of faster economic growth emerge the inflationary impulse might appear from the monetary fundamentals.

**Budget deficit – it could be better**

Preliminary budget results after five months showed that the deficit reached PLN22.96bn i.e. 57.4% of whole-year plan. Although the deficit figure looks good, the revenue side proved to be weaker than expected, especially after rather optimistic comments made by minister Marek Belka. The annual growth rates for major revenue sources declined substantially in May, although they remained at relatively good level in the cumulative terms (see the tables below). Inflows from indirect taxes and CIT proved to be especially weak, contrary to expectations. It is difficult to explain at the moment, while it stands in odds with economic news from 1Q02, suggesting ongoing consumption demand and improving companies' financial

standing. While we still remain rather optimistic about perspectives for meeting this year's budget plan, it has to be noticed that there is one significant risk factor in the second half of this year. The conditional construction of this year's budget implies that full expenditures will be realised if indirect tax inflows prove to be good until July.

**Budget revenues and expenditures, %YoY, cumulative**

	Dec-01	Jan-02	Feb-02	Mar-02	Apr-02	May-02	PLAN 2002
<b>Revenues</b>	<b>3,4</b>	<b>-10,7</b>	<b>0,0</b>	<b>-1,0</b>	<b>2,2</b>	<b>1,8</b>	<b>3,4</b>
Indirect taxes	3,3	-3,2	3,9	6,0	9,7	7,4	10,9
CIT	-20,9	-40,8	6,3	13,7	14,1	11,3	4,2
PIT	1,7	-5,0	-0,8	1,9	-0,5	-1,4	13,5
Budget entities incomes	21,4	-47,3	-24,2	-43,4	-35,6	-29,0	-31,4
Import tariffs	-19,6	-14,0	-8,9	-8,8	-9,4	-10,4	-14,9
<b>Expenditures</b>	<b>14,5</b>	<b>3,1</b>	<b>5,3</b>	<b>2,3</b>	<b>4,1</b>	<b>4,8</b>	<b>7,1</b>

Source: BZ WBK calculations

**Budget revenues and expenditures, %YoY, in single month**

	Dec-01	Jan-02	Feb-02	Mar-02	Apr-02	May-02
<b>Revenues</b>	<b>-1,4</b>	<b>-10,7</b>	<b>13,3</b>	<b>-3,0</b>	<b>11,3</b>	<b>0,3</b>
Indirect taxes	11,3	-3,2	13,0	10,6	21,2	-0,6
CIT	-13,6	-40,8	16,9	22,4	15,3	-6,4
PIT	0,5	-5,0	4,8	10,8	-5,8	-5,4
Budget entities incomes	-26,4	-47,3	44,0	-63,7	-4,4	29,8
Import tariffs	-16,5	-14,0	-4,2	-8,6	-10,8	-14,2
<b>Expenditures</b>	<b>32,1</b>	<b>3,1</b>	<b>7,6</b>	<b>-5,0</b>	<b>9,9</b>	<b>8,6</b>

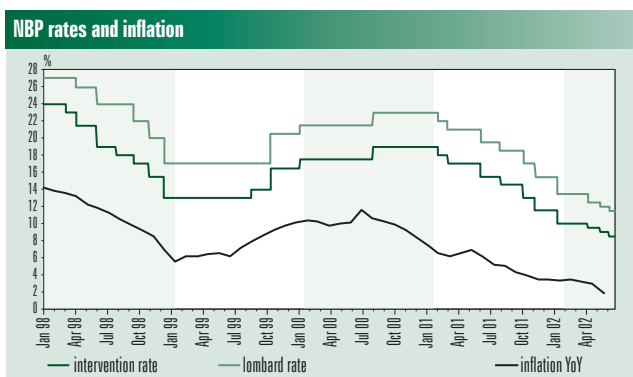
Source: BZ WBK calculations

## Central bank watch

- Intervention rate at 8.5%
- Inflation target at 3% (+/- 1%) in 2002-03

### Rates down again in June

During the Monetary Policy Council's meeting held on 25-26 June all main interest rates were cut by 50bps and neutral bias in monetary policy was maintained. The decision was justified by recent economic data signalling that economic activity, and especially domestic demand recovery might be weaker than earlier anticipated, and inflationary perspectives for this and next year improved significantly. What is important, among factors limiting rates' reduction the MPC mentioned government's budgetary assumptions for the next year. The MPC criticism relating to budget proposal after the conference was interesting from earlier MPC members statements' point of view. In the past we had three members from dovish faction (Krzyżewski, Rosati, Ziółkowska) saying that budget deficit of PLN40bn should be perceived as positive. MPC official statement and Leszek Balcerowicz's speech during press conference suggested that NBP president joined hawks, as the statement said explicitly 'such budget proposal, which shows further loosening of fiscal policy, limits significantly further reduction of interest rates'. This suggests that FinMin and government's decision concerning budgetary plans will be very closely watched by the MPC and will affect monetary authorities' decision in the remainder of this year. We think, however, that continuation of low inflation and low economic activity within next few months may trigger another 50bps cut even despite around PLN40bn budget deficit. We expect inflation to remain below 2% for the next two months and production to grow moderately and rates are likely to be cut again in August-September.



During June's press conference Leszek Balcerowicz expressed also the MPC's view about exchange rate

mechanism, while this was not included in the official statement. He reiterated that zloty exchange rate against euro, which has recently weakened substantially in both nominal and real terms, should be more closely watched by the government than against US\$, as it affect two-thirds of Polish trade. Balcerowicz said also that foreign and domestic economic activity is much more important for exporters than exchange rate level.

### Inflation target revised downwards

The MPC has also taken another decision lowering inflation target for the end of this year to 3% ( $\pm 1\%$ ), down from previous 5% ( $\pm 1\%$ ), and set the short-term inflation target for 2003 also at 3% ( $\pm 1\%$ ). Lowering inflation target for 2002 was explained by the need to maintain transparency of monetary policy and clarity of its priorities and objectives. It was the consequence of more optimistic inflation path for this year and lower the MPC's inflation forecasts – the statement said explicitly that CPI growth would be significantly below 4% YoY in 2H02. the MPC also wanted to send strong signal to the market participants, reducing the expectations for the scope of future interest rate cuts. It is worth to remind that it was the second time that the MPC has lowered its short-term inflation target in the middle of year. The former case was in March 1999 when after the period of sharp inflation decline followed by significant monetary easing the MPC changed inflation target for the end of year from 8-8.5% to 6.6-7.8%. But it is also worth to remember that the actual inflation rate at the end of 1999 was 9.8%, overshooting both of the target bands. While we do not believe that the same story would repeat also this time, the lesson from history should cool down the expectations for further significant monetary easing later this year (though we still expect 50bps rate cut in 3Q02).

While lowering inflation target for 2002 was to some extent surprising, the target for 2003 was set in line with expectations. The range 3% ( $\pm 1\%$ ) is consistent with earlier medium-term inflation target defined as „inflation below 4% at the end of 2003“. It is also consistent with government's budget assumption of average inflation at 3% in 2003. Such inflation goal would require stabilising inflation at present level rather than continuation of disinflation process. Nevertheless while fiscal policy next year is expected to remain very loose, and the economic recovery would start to exert pressure on the price growth, the scope for interest rates reduction next year would remain very limited.

The MPC announced also that in 2H02 it would release new medium-term guidelines for monetary policy with new medium-term inflation target. The draft should base

on the agreement with the government over the strategy of Poland's entry to Eurozone. We expect that new medium-term target should be compliant with Maastricht criteria regarding price growth, and could aim at achieving inflation not higher than 2% by the end of 2005.

### The usual alliance within MPC has broken in April

For predicting future MPC's decisions it is always useful to follow the pattern of MPC members' voting during past meetings. The results published last month in the government's Monitor (see the table below) were quite surprising, as first of all they have shown that the April rate cut have been passed through mainly because of the support of hawkish MPC members. What is more, the hawks' faction within the MPC has broken down in April, as Jerzy Pruski was against 50 bps rate cut. While it is easy to explain the voting pattern of other members (Marek Dąbrowski is always against monetary easing, Wiesława Ziółkowska and Grzegorz Wójtowicz surely wanted to cut more than 50bps), the rationale behind Pruski's decision is hard to guess. One possibility is that he has also supported deeper rate cut at the time. Mind that it was in April when Leszek Balcerowicz announced the MPC's „small steps approach” in further monetary easing, which was quite surprising for the market, as most of analysts expected 100bps and market priced in such deeper cut. The other option is that he was against any rate cut at all. Nevertheless, it is worth to bear in mind for the future that the usual alliance does not have to hold forever.

**MPC VOTING FOR THE 50bps RATE CUT IN APRIL**

Leszek Balcerowicz	+
Marek Dąbrowski	-
Bogusław Grabowski	+
Cezary Józefiak	+
Janusz Krzyżewski	+
Paweł Łączkowski	+
Jerzy Pruski	-
Dariusz Rosati	absent
Grzegorz Wójtowicz	-
Wiesława Ziółkowska	-

Source: Reuters



## Comments of the MPC members

In June the discussion between the government and the MPC regarding foreign exchange policy was continued in the media. The MPC members' comments have concentrated on the fact that appreciating pressure on the zloty is unavoidable as it is connected with the perspective of EU enlargement (real and nominal convergence). Leszek Balcerowicz confirmed this view during the press conference saying that the best solution is free float and that the central bank may discuss with the government possible scenarios of euro adoption.

Wiesława Ziolkowska reiterated again that she supports much deeper interest rates reduction, which would be better for the Polish economy than 50-100 cuts. The NBP's president stated, as usual, that rates are much lower than 18 months ago and that the NBP has to wait for the effects of the cuts made so far. From the point of view of required level of interest rates, Bogusław Grabowski's comment was quite interesting, as he said that nobody knows what level of nominal or real interest rates would be necessary for the Polish economy right now.

What is interesting, it seems that the first time since several quarters, the central bank is more sceptical about economic recovery than government's forecasters. Bank's chief economist Adam Czyżewski said that GDP growth in 2Q02 is likely to amount only 0.2-0.3%YoY comparing to 0.5% in 1Q02. At the same time he hopes that recovery will come around 3Q-4Q and whole year growth would amount some 1%.

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### WHO? WHERE? WHEN? QUOTE

Dariusz Rosati, MPC member;

Gazeta Wyborcza, 5 Jun „The conclusion is clear – if market is convinced that the currency will remain strong, the capital will keep flowing in and no intervention could reverse the appreciation trend.”

„In the long term the most efficient intervention is lowering public finance deficit and such monetary policy that prevents creating expectations for further rate cuts.”

PAP, 10 Jun

„Out of three uncertainties that we faced when determining monetary policy, i.e. inflationary pressure from food prices, oil prices, and budget uncertainty, there is no serious threat related to food prices anymore.”

„One should expect inflation to rise not earlier than in September, and it would not be a rapid upturn. Inflation should be below 4% at the end of year.”

Rzeczpospolita, 14 June

„GDP in the first quarter of this year amounted to 0.5%, which, does not, however, represent any recovery. [...] There was no movement in the first quarter. I expect improvement in the second quarter, fuelled by interest rate cuts.”

PAP, Reuters, 21 June

„In general the number of factors that could accelerate inflation in second half of the year and in next year declines.”

„Inflation measures show lack of inflationary pressure and very deep stagnation in economy's real sector.”

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Wiesława Ziolkowska, MPC member;

PAP, 4 Jun

„I'm an enthusiast of deeper interest rate cuts, which would be more beneficial for the economy than the reductions by 50 or 100 bps. It would be better to make several much more pronounced rate cuts.”

„There is still a scope for interest cut, though it is not very wide.”

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Leszek Balcerowicz, NBP governor;

PR3, 5 Jun

„Interest rates have been reduced very substantially. And why we can't take the risk of further reduction? Because we have to care for savings, that keep decelerating sharply, and we can't allow for jeopardising low inflation, which is the most important for the people.”

„Budget deficit next year has to be much lower. It's the general recommendation from all distinguished institutions. [...] We have budget for 2003 ahead and it is very important what would it be.”

PAP, 18 June

„I can only say that decisions [on interest rates] will be made exclusively on the basis of economic arguments and analysis, it's our constitutional responsibility.”

„As regards exchange rate mechanism, MPC still believes that present regime is better than other systems proposed, but it's ready for the discussion over the future development in context of EU and EMU entry.”

„We suggest the discussion over such manners of purchasing foreign currencies needed for foreign debt repayment that would allow for lessening the appreciation pressure. If the proceeds for this purpose would be attained mainly from offshore bond issues, and part of those currencies would flow into Polish market, it would strengthen the zloty. It is all about minimising this phenomenon and purchasing foreign currencies on Polish market.”

„Low inflation rate is mostly the result of transitory factors and one cannot assume that it would be persistent [...] but some forecasts might materialise, saying that inflation would be lower than 4% at the end of year.”

„The change of inflation target for this year dismisses the uncertainty about monetary policy shape in subsequent months.”

PAP, Reuters, 26 Jun

„Such [small steps] policy is consistent with the experience of well established central banks, where at the end of easing cycle rate cuts were much lower than at the beginning of the cycle.”

„At the present stage more likely are smaller rate cuts than higher.”

„One can say that we're facing the perspective of inflation stabilisation at present level.”

„We don't have the final version [of budget draft for 2003] but one can say that even if the deficit amounted to PLN40bn [...], even if economic deficit was at this year's level, it would imply the deterioration of public finance condition, while growth acceleration is assumed at the same time.”

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Janusz Krzyżewski, MPC member;

PAP, 7 June

„At this stage we've consumed inflation fall in May. MPC was aware cutting the rates in May what will happen [to inflation] in May. We knew during our last meeting that May inflation rate would be very low.”

„It should not be that way that if there is a decline in May then in June there will be cut as well. It should not be taken into consideration, because we've consumed May inflation decline last month. [...] The most important is not to create the impression that if we have excellent information about inflation then we will have to cut in June. It's not what it's all about.”

„Inflation decline driven by food price collapse is not very constructive, because every monotonous feature in this area is worrisome. When [food prices] start to grow, they can threaten the inflation target. [...] Inflation fall driven by one group of products calls for caution.”

PAP, 24 Jun

„I am aware that the budget is difficult. In my opinion budget assumptions are cautious. I welcome this caution with delight. The assumptions allow for considering further monetary policy easing. This is the issue that we will discuss with certainty.”

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Boguslaw Grabowski, MPC member;	
PAP, 7 June	„Monetary policy should not react to supply shocks, unless they cause second-round inflationary effect by fuelling inflationary expectations. It could react to supply shocks if they fuel inflation.” „In a classical situation monetary policy should not react to fast inflation decline driven mostly by supply-side factors.” „What MPC will watch closely now is not low level of inflation, while this is caused mainly by supply-side factors. MPC will focus on demand-side factors and inflationary expectations.”
PAP, 24 Jun	„Under the government assumption of growth acceleration to 3.1% next year from 1-1.2% this year overall economic deficit should be below 4% in 2003, in order to achieve tightening of fiscal policy.” „Under such economic growth economic deficit at 4.3% would imply maintaining present tightness of fiscal policy.” „Economic deficit exceeding 4% of GDP would imply increasing the inflationary pressure that could result in tightening monetary policy and could jeopardise GDP growth perspective by 3.1% next year.” „Average inflation at 3% is consistent with MPC’s medium-term inflation target assuming decline of inflation rate below 4% in 2003.”
PAP, 28 Jun	„We do not know exactly what is the required level of interest rates (nominal and real) in a current macroeconomic situation – this is the first slowdown of the Polish economy.” „Saying that unemployment rate depends on current level of interest rates is misunderstanding.”
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Andrzej Bratkowski, deputy NBP governor;	
PAP, 17 June	„It seems that in subsequent months more important will be data regarding real sphere and trends. Whether inflation would be slightly higher or lower during next 2-3 months would not have any significant impact on interest rate decisions.” „All the rime we’re looking at next year, at how past interest rate cuts influence the economy and how they would influence in future.”
PAP, 27 Jun	„There was no such case that after period of disinflation accompanied by significant decrease of official interest rates, GDP growth accelerated without fiscal tightening. In Polish circumstances we need lower budget deficit, because loose fiscal policy creates a risk for economic growth.” „We cannot exclude a possibility that CPI inflation falls further in June, all depends on food prices. If they fall, inflation falls as well.” „From the point of view of economic growth, the second quarter does not look much better than 1Q02, I hope the third quarter will be better.”
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Cezary Jozefiak, MPC member;	
PAP, Reuters, 19 June	„Economic recovery comes behind schedule, and more pronounced signs of recovery should be expected not earlier than on the turn of 3rd and 4th quarter.” „We still don’t have signs of recovery. I.e. there is one or two phenomenon that keeps up the hopes. I mean the improvement of companies financial results and relatively strong export figures. I hope that improving financial results of companies will finally translate into investment demand growth, that’s the key point for me.” „Industrial production could rebound in third or fourth quarter. Industrial production figures have no significant impact [on MPC decision next week], but they will be considered.”
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Grzegorz Wojtowicz, MPC member;	
PAP, 28 Jun	„I would not exclude a possibility that CA may be closer to 4% than 4.5% if euro maintains its strength. However, growth recovery expected in 2H02 may increase imports and offset the effect of weak euro.”
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Adam Czyzewski, head of macroeconomic research at NBP;	
Rzeczpospolita, 29 Jun	„GDP growth in 2Q02 would amount to 0.2-0.3% compared to 0.5% in 1Q02. Economic recovery should appear on the turn of third and fourth quarters. In 2002 GDP growth would reach ca. 1%.”

# INFORMATION ON THE MEETING OF THE MONETARY POLICY COUNCIL

## ON JUNE 25-26, 2002

The Monetary Policy Council held its meeting on June 25-26, 2002. The Council was submitted the materials prepared by the Management Board and departments of the NBP as well as information and analytical materials prepared by the Ministry of Finance, banks and research institutes. On this basis the Council discussed the external conditions of the Polish economy, the situation in the real sector of the economy and tendencies in the area of wages and social benefits, in public finance sector, money supply, lending and interest rates and the formation of prices and inflation expectations.

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1. The Monetary Policy Council decided to set the inflation target for the year 2003 at the level 3% (with tolerance at +/- 1 percentage point). It is the specification of the medium-term monetary policy target set in September 1998: lowering inflation to the level below 4% in 2003. It is also the level that is coherent with the inflation index accepted by the Government in Guidelines of the state budget draft for the year 2003.
2. Moreover, the Monetary Policy Council informs that in the second half of this year the guidelines of the medium-term strategy of the monetary policy will be published within the framework of which the next medium-term inflation target will be defined. The Monetary Policy Council assumes that the basis for these guidelines will be the strategy of Poland's accession of the Economic and Monetary Union prepared in consultation with the Government.
3. The conditions for the accomplishment of the inflation target in 2002 appeared to be considerably more favorable for the inflation reduction than it was forecasted at the moment of its setting in August 2001. Unexpectedly positive were the supply-driven factors, especially in relation to foodstuff and fuel prices. Smaller than forecasted will be the growth of prices subject to administrative regulation. The domestic demand dynamics has been established at a lower level.
4. Due to the above mentioned, it is possible to expect that inflation – if there is no unexpected and unfavorable supply shocks in the second half of this year – will the most likely be clearly lower than 4% what constitutes the bottom limit of the range of the inflation target announced in August 2001. This will be the case despite the cutting of interest rates of the NBP since August 2001 to May this year by 6.5 percentage points in total.
5. Considering these circumstances and aiming at the primary target of the monetary policy that is the stabilization of inflation on a low level and also considering the need to preserve transparency about the priorities of the carried out monetary policy, the Monetary Policy Council decided to lower the level of the inflation target for the year 2002 to 3% with a permissible fluctuation range +/- 1 percentage point.

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The Monetary Policy Council discussed and approved the Balance of payments of the Republic of Poland for the 1st quarter 2002 and Inflation Report in the 1st quarter 2002 and was submitted The Evaluation of the Economic Situation of Banks in 2001 and The Evaluation of the Impact of Monetary, Tax and Supervisory Policies on Banks Development in 2001 prepared by the Commission for Banking Supervision.

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### I. External conditions.

Since the last meeting of the Monetary Policy Council signals indicating that the external conditions should support a gradual economic boom in Poland have been maintained.

- The economic growth in the United States is still expected.
- Visible are the signs of the economic situation improvement in the eurozone economy where the economic growth at the moment is assessed at 1.3% (1.2% a month before). In Germany, similarly to the situation in May this year, this indicator is assessed at 0.9%.

### II. Production, economic growth.

1. A general evaluation of the economic situation indicates that the growth pace of the economic activity will probably be a little slower than it was indicated by the earlier macroeconomic data. In the 1st quarter this year, Gross Domestic Product increased in real terms by 0.5% as compared to the same period last year and as compared to 0.2% in the 4th quarter 2001. The domestic demand was maintained at the level noted a year before while in the 4th quarter 2001 it dropped by 2.8%. Individual consumption increased by 3.5% as compared to the increase by 3.3% in the 4th quarter last year, and gross investments in fixed assets lowered by 13.3% as compared to the drop by 13.5% in the 4th quarter of the previous year.
2. The economic situation should begin to improve gradually in the 2nd half this year. It may be indicated – besides a favorable impact of external conditions – by:
  - An improvement of earnings of enterprises in the 1st quarter this year that is favourable for the increase of investment activity.
  - A higher than forecasted by the NBP increase of income from employment and income at disposal of households in the 1st quarter of this year. The NBP assessment of the nominal growth of income at disposal of households in 2002 has been increased from 3.3% to 4.3%.
  - In May this year, the economic situation indicator set by the Institute of Economic Development of SGH increased by 3 points. May was the fourth month in a row where the economic situation in processing industry improved. Enterprises expect a further improvement of the economic situation.
  - In May this year – for the first time since the beginning of the economic situation survey by the Gdansk Institute for Market Economics (January 2001) – the entrepreneurs positively evaluated the economic situation. The entrepreneurs expect a further improvement of economic situation.
3. The information indicating the coming boom is accompanied, however, by the data indicating that its pace will be very moderate within the next couple of months:
  - The growth pace of retail sales lowered from 3.1% in April to 1.8% in May this year.
  - Results of the economic situation survey by GUS, in general proving the possibility of the economic situation improvement, indicate the worse than a month before evaluations of the current situation and less optimistic forecasts concerning future demand and production in industry. In construction, a general atmosphere of the economic situation is evaluated at the level close to the situation observed a month before and a year before. The evaluations of the atmosphere of the economic situation in retail sales maintained at the level noted in May this year and they are better than a year before, however, the forecasts for the next couple of months worsened.
  - Despite the decrease of final goods inventories in the 1st quarter this year, the entrepreneurs covered by the economic situation survey by GUS still assess that the level of inventories in industry is excessive and in retail sales – sufficient.
  - A recessive trend of industrial production has been maintained. In May this year, the industrial output was by 4.1% lower, and after eliminating seasonal factors (one business day less than in May 2001) by approximately 2% lower than a year before.
  - In May this year, the drop of construction output as compared to the same month of 2001 was bigger than in April (9.4% as compared to 6.2%), but the trend indicators confirm the observed a month before tendency to slow down the drop of construction and assembling production.

### III. Wages, social benefits.

The latest data confirm a moderate although stable increase of income of households. As compared to the situation a month before, the assessment of a nominal growth of income at disposal of households in 2002 has been increased from 3.3% to 4.3%.

- A moderate level of nominal growth of average wages in enterprises has been maintained. Within the period January-May 2002, this growth in real terms amounted to 1.6% and was higher than a year before. A low level of economic activity does not enable forecasting of an essential acceleration of wage growth in the next couple of months.
- The drop pace of employment in enterprises insignificantly decreased. The average employment was lower by 0.2% as compared to April and by 4.6% than a year before. The unemployment rate dropped from 17.8% to 17.2%.
- In the 1st quarter this year, the drop of employment in the national economy was smaller than in the enterprise sector and a nominal growth of average wages was faster. Very high was also the growth of unemployment benefits and pre-retirement benefits.

#### IV. Situation in public finance sector.

1. The data on the state budget accomplishment indicate that there are no visible bigger threats to the accomplishment of the Act on the State Budget for the year 2002. However, there is a threat that the economic deficit will be higher due to the situation of earmarked funds: low revenues from social insurance contributions, delays in transferring due contributions to Open Pension Funds, growing expenses of the Labour Fund and a possibility to borrow by the Wage Guarantee Fund.
2. In the situation of a high economic deficit, especially dangerous is the decreasing transparency of public finance due to the increase of public expenses that, according to the currently applied by the Government principles of calculating revenues and expenses of the public sector, are not reflected in the earnings of this sector. For example, the Agency for Agricultural Market that has already borrowed approximately PLN 1.5 billion intends to finance the additional intervention on the market using the resources coming from loans the repayment of which is guaranteed by the State Treasury. Such kind of debt increase should be treated as a form of increasing the deficit of the public finance sector.
3. The economic deficit of the public finance sector will be maintained in 2002 on a very high level (approximately 5% GDP), adversely affecting the economic growth perspectives. A big supply of treasury securities that is necessary to finance the borrowing needs of the budget, limits the possibilities to finance the development of enterprises and it may result in the appreciation of the exchange rate of the zloty without strengthening at the same time – as opposed to direct foreign investments the competitiveness of the economy.
4. The Ministry of Finance presented Guidelines of the state budget draft for the year 2003 according to which the economic deficit of the public finance sector would amount to PLN 38.8 billion, i.e. 4.9% GDP, and the budget deficit is to remain at the high level of 2002. In the situation of a forecasted acceleration of the economic growth, it means a further loosening of fiscal policy. Therefore, there will be maintained the above mentioned negative impact of public finance on the economic development and, at the same time, the playing field of the monetary policy will be subject to a radical reduction.

#### V. Money supply, loans, interest rates.

As compared to the situation a month before, the evaluation of monetary situation was not subject to fundamental changes. The data still indicate that despite a low dynamics of monetary aggregates there are, in this area, some threats to future inflation:

- The annualised dynamics of money supply M3 is maintained at a low level, although as compared to April it increased insignificantly from 2.9% to 3.6%.
- The annualised dynamics of cash in circulation rose from 16.0% a month before to 17.9%. There is maintained uncertainty related to the reasons and possible inflation results of a high dynamics of cash in circulation.
- The deposits of households rose as compared to April by 0.6% but about 70% of this growth resulted from the depreciation of the exchange rate of the zloty. The annualised dynamics of deposits placed by households lowered from 1.9% to 1.6%. In May this year, for the first time an annualised drop of PLN denominated deposits was noted.
- The annualised dynamics of lending to households lowered from 16.5% a month before to 15.8%. Loans to businesses, after two months of the annualised drop (-1.8% and -1.9%, respectively), reached the level observed in May 2001. The annualised dynamics of net debt of Government institutions lowered from 14.5% a month before to 9.3%.
- The earlier cuts of the NBP interest rates have not been fully translated into changes of interest rates in commercial banks yet. In May this year, the average interest rates on loans and deposits at commercial banks dropped:
  - in case of term PLN-denominated deposits of households by 0.4 percentage point to 6.6%;
  - in case of PLN-denominated loans to businesses by 0.3 percentage point to 13.4%;
  - in case of PLN-denominated loans to individuals by 0.2 percentage point to 18.3%.

#### VI. Prices, inflation expectations.

Unexpectedly big price drop in May was mainly caused by factors of temporary nature.

Inflation at a low level, however, is favourable for the strengthening of low inflation expectations. Therefore, the results obtained in May confirm the earlier assessments indicating a sustained nature of disinflation process that gives a chance to stabilise inflation at a low level:

- In May this year – according to expectations connected with a non-typical big price growth in May 2001 – the annualized consumer price index lowered. May this year, however, also appeared to be non-typical. Prices for vegetables, instead of a typical for this period increase, lowered considerably. Due to this, inflation dropped by about 0.5 percentage point more than forecasted to the level of 1.9%.
- All core inflation measures lowered:
  - 15%-cut average from 2.6% to 2.0%;
  - inflation excluding the most variable prices from 2.5% to 2.1%;
  - inflation excluding the most variable and fuel prices from 2.7% to 2.4%;
  - inflation excluding the controlled prices from 2.6% to 1.7%;
  - „net” inflation (excluding foodstuff and fuel prices) from 4.0% to 3.2%.

The drop pace of core inflation measures was slower than the drop pace of consumer price index. In May this year, the majority of core inflation measures (with the exception of inflation excluding the controlled prices) were formed above the consumer price index. The net inflation measure that is at the highest level (by 1.3 percentage point above the consumer price index) illustrates the particularly strong impact of fuels and foodstuffs on the reduction of inflation. The maintained for several months drop of all core inflation measures indicates that the reduction of inflation is not a temporary phenomenon.

- After a significant improvement a month before, the structure of answers to the questions of a survey of inflation expectations of individuals did not change essentially.
- In June, the inflation expectations of bank analysts lowered significantly. Now, they forecast that inflation in December this year will amount to 3.3% as compared to 4.1% a month before, and in the 11-month period – 3.6% as compared to 4.2% a month before.
- The sold industrial output prices were in April this year higher by 0.5% than a year before.
- Since the last meeting of the Council, the forecasts concerning oil prices have not changed. It is forecasted that in 2002 an average oil price will amount to USD 23. As compared to the situation within previous months, a risk of oil price rise decreased. In conditions of demand stabilisation at a low level, the oil supply increased.

#### VII. Decision of the Monetary Policy Council.

1. As compared to the situation observed a month before, the following signals indicating the enhancement of factors that are favourable for low inflation appeared:
  - After a clear improvement a month before, a favourable for future inflation structure of inflation expectations of individuals was maintained and inflation forecasted by bank analysts lowered; inflation at a low level promotes the enhancement of low inflation expectations;
  - All core inflation measures dropped and the annualised dynamics of the sold industrial output prices is maintained at a low level;
  - A risk of oil price growth decreased.
2. The evaluations of the economic activity growth outlook indicate a smaller than a month before probability of a fast growth of domestic demand. It is still assessed that the improvement should begin in the second half this year, however, it will be more perceptible only in the 4th quarter.
3. The reduction of scale of interest rates cut is prompted by:
  - the outlook of a further loosening of fiscal policy in 2003 what constitutes a fundamental reduction of the playing field of monetary policy
  - the drop of the annualised dynamics of deposits of households, and especially the drop of PLN-denominated deposits;
  - a high and growing dynamics of cash in circulation.

It should be also remembered that full results of interest rate cuts by 10 percentage points in total made since February 2001 have not been revealed yet and their forecasts are connected with considerable uncertainty. Moreover, in conditions of lower interest rates their smaller implicit changes mean a similar respective change.

4. Considering these arguments, the Monetary Policy Council decided to:
  - cut the minimum yield on 28-day open market operations from 9.0% to 8.5%;
  - cut the rediscount rate from 10.5% to 10.0%;
  - cut the lombard rate from 12.0% to 11.5%;
  - cut the deposit rate from 6.0% to 5.5%;
  - maintain its neutral position in monetary policy.

## Government and politics watch

- Did Marek Belka burn out?
- New finance minister - The eye of the TIGER
- Budget approved- will it change?
- NBP under attack

### Finance Minister Marek Belka resigned

On 2 July, after the cabinet's meeting Prime Minister Leszek Miller announced that finance minister Marek Belka has resigned. Officially, personal reasons caused Marek Belka to quit, but two other possible explanations included the conflicts over fiscal policy and/or change of central bank law. He said that he has no more energy for this post after eight months in the government refusing to give additional comments.

While one cannot exclude a possibility that 'personal reasons' were behind the decision, undoubtedly there are two other possible explanations and both suggest a conflict between finance minister and the government. These are budget deficit for the next year and change of NBP charter. The former option seems less likely because the government unanimously accepted the MinFin proposal of expenditures level and budget deficit figure (see our comment on the budget draft below). While the deficit is slightly higher than PLN40bn announced earlier by Marek Belka, we do not think that PLN3bn could be the cause to leave. What is more, Belka said explicitly that government perceives PLN43bn deficit as too high and steps towards limiting this figure may be expected. On the other hand, however, Rzeczpospolita daily has published unauthorised interview with Marek Belka saying that if he sees no chance for realisation of his strategy of public finances, he would wait no more than 10 minutes with leaving the post.

The second possibility is indirectly connected with the budget. Budget proposal assumes lower expenditures in nominal terms for several sectors (including sectors sensitive from social point of view e.g. Healthcare Ministry). The only way (in politicians' opinion) to increase the level of expenditures without increasing budget deficit is to increase revenues by higher GDP growth assumption, which may be achieved by significantly lower interest rates and/or weaker zloty. Marek Belka was one of the few politicians from ruling coalition, who was against changing NBP charter and forcing central bank to cut rates drastically. What about Grzegorz Kołodko? What are his plans? Please read the section below.

### New finance minister – Grzegorz W. Kołodko

Professor Grzegorz Kołodko is the director of TIGER – Transformation, Integration and Globalisation Economic Research at the Academy of Entrepreneurship and Management in Warsaw. His biography can be found on the official TIGER website ([www.tiger.edu.pl](http://www.tiger.edu.pl)). He is university professor (and visiting professor at Yale, UCLA and the University of Rochester), researcher and consultant to international organisations (IMF, WB, UN, OECD) and the author of numerous academic books and research papers mainly on globalisation and post-communist transition to a market economy. He was Deputy PM and the Minister of Finance in 1994-97 being nominated as The Best Minister of Finance in East Central Europe in 1996 after Poland joined OECD. This time Poland has a chance to join European Union, however, as we will try to present below, the finance minister's situation is completely different.

### Finance minister in three cabinets

Grzegorz Kołodko was finance minister in the government formed by SLD-PSL coalition. At the beginning, the cabinet was headed by Waldemar Pawlak from PSL, then by Józef Oleksy and Włodzimierz Cimoszewicz (SLD). Grzegorz Kołodko resigned at the beginning of 1997 and was replaced by Marek Belka. Leaving the post in 1997, Kołodko said that the Polish economy is in Olympic shape and explaining reasons of his dismissal he said he wanted to return to academic life and avoid getting drawn into tough parliamentary elections. We remember PM Cimoszewicz stressing that there would be no shift of direction in government policy as a result of the change of finance minister from Kołodko to Belka. Should we expect no change in fiscal policy also this time? When Grzegorz Kołodko was finance minister for the first time, fiscal policy was relatively easy to conduct. High GDP growth of 6-7%YoY, which was quite easy to achieve at the beginning of transformation, provided large budgetary revenues. However, these revenues were not used for balancing the budget (or decreasing the deficit), as surplus on the primary balance fell from 2,1% in 1995 of GDP to 0,6% in 1997 (it moved to a deficit in the following years). The circumstances have changed dramatically, as now Kołodko will face 5% of GDP deficit with low revenues amid low GDP growth. This means that there is no money to spend, local government elections are coming and pressure on finance minister from other ministries will rise. The situation is different and we will see within next few weeks whether Kołodko is still the same. Remember that Kołodko left his post in 1997, as he wanted to avoid getting drawn into tough parliamentary elections.

### **The budget – what about spending?**

Surprisingly, after his nomination Grzegorz Kołodko was supported not only by the government's coalition, but also by Andrzej Lepper's Samoobrona. PSL and Samoobrona are very enthusiastic with Kołodko as finance minister and his zloty devaluation proposal from mid-May was the most likely explanation. It seems that politicians are likely to force also softer approach to fiscal policy. However, it is not very likely that Grzegorz Kołodko could change significantly budgetary assumptions prepared by Marek Belka, as the government supported them unanimously. Budget deficit should remain at around PLN40-45bn (representing expansive fiscal policy), but another quite dangerous possibility on the fiscal side is an increase of tax burden. It would bring higher revenues giving possibility to spend more before local governments elections. In such a case Belka's rule concerning expenditures growth limit of 1% over inflation would not be binding. Another risk is an increase of spending outside the central budget via budgetary funds and agencies. This would substantially increase economic deficit of the whole public finances sector, limiting the scope for further monetary easing.

Another plausible scenario is that Grzegorz Kołodko will remain resistant to politicians' calls and suggestions keeping budgetary spending under control. In this scenario, however, Polish political scene and the government could be a subject of deeper reconstruction, including a collapse of the ruling coalition. If Kołodko does not satisfy the most populist politicians, Andrzej Lepper's Samoobrona would just continue criticism of the government increasing its popularity before local governments elections. But the condition of the second farmer's party, SLD coalition partner PSL (and possibly of SLD itself as well) would be opposite, as it would be their electorate changing preferences. Tensions within the government would be possible, especially as at the end of the year Poland will enter the most important part of negotiations with the EU – structural funds and funds for agriculture. While the SLD should be more elastic during this debate, PSL may be inflexible with its demands – deputy agriculture minister Jaroslaw Kalinowski announced already that lower-than-expected funds are unacceptable.

### **The zloty – is currency board plausible ?**

In mid-January 1997, then Finance Minister Kołodko presented his plan aimed to lead the Polish zloty into the European Monetary System (Euro 2006). He proposed the way to introduce euro (by abolishing crawling peg system, reduction of the zloty's trading range from the current to +/-2.25%), but also did not exclude a possible one-off

devaluation of the parity rate to maintain the competitiveness of Polish exports.

In late May this year, Grzegorz Kołodko presented similar views in an article in Trybuna (affiliated with SLD) daily. He said that zloty devaluation (to 4.35 per euro – lower rate would not allow two-digit exports growth) is the only way to substantially accelerate GDP growth via higher competitiveness of Polish exports. Also, as imports of intermediate investment goods would become expensive, it would be crowded out by Polish production (this may be also a reason why Kołodko used to support import tax idea a year ago). This would increase corporate income tax revenues improving fiscal policy performance and making possible decrease of taxes in the medium term. According to Kołodko, such level of the zloty should be maintained under the currency board regime (until the adoption of the euro), which may be easily achieved with high level of Polish FX reserves. Kołodko does not expect any problems with acceptance of such scenario from the European Union side. What are the costs of such operation? Kołodko said that one-off increase of inflation would be moderate of 1-2pp (increase to 4% and fall to Eurozone level after 12 months) and higher costs of foreign currency denominated credit may be balanced by special tax allowances (especially for mortgage credits).

We do not know yet whether the government will support Grzegorz Kołodko's idea. Prime Minister Leszek Miller said that pegging the zloty with euro is an interesting idea and new finance minister will present the plan (not only concerning this issue), that will be discussed by the government. The problem is that if the government wanted to change FX regime, it would be almost impossible to do without NBP's approval. Although NBP vice-president used to support the idea of unilateral euroisation a few years ago, it now seems that the NBP's view on exchange rate policy is straightforward: free float is the best solution for Poland until we enter EU. Even if one could imagine consensus over FX policy between the two institutions, the remaining conflict will concern adopted EUR/PLN parity. While the government and MinFin would like to see the zloty at 4.35 against euro, it may be the level to high for the central bank ... and for the European Union.

There was already the idea to change article 24 of NBP law and hand over the full control over exchange rate regime to the government and now the probability of such steps substantially increases. But on the other hand the legislation process connected with such solution would be very long, and finally could not materialise, as some experts say it is inconsistent with the constitution. And while the process would be long and risky, it would make

little sense. Simply, the implementation of such idea could be possible not earlier than some 6 months before Poland's entry to EU and ERM2. Another way to change foreign exchange regime is to change the constitution. One can imagine that two-thirds of the parliament accepts (SLD-UP, PSL, Samoobrona) a change of article 227 of the constitution (about the central bank policy) and change of the central bank law. President could not veto such a change.

The hope for financial markets are European Union institutions, which may be against both import tax introduction and changing FX regime. Gerassimos Thomas, spokesman of economic affairs commissioner, said that Poland is free to choose its foreign exchange policy. However, Thomas reiterated that official stance of finance ministries of the EU concerning this issue was already released at the end of 2000. This statement said that the ECOFIN Council position is „no” to euroisation and „perhaps” to currency board – currency boards might be feasible under some circumstances – as an appropriate means to combat the classic inflationary risk, for a small open economy with flexible wages and prices and with fiscal discipline. Well, these conditions are hardly met in current situation of the Polish economy.

Of course, one could imagine a change of FX regime at the beginning of 2003 despite the EU discontent, but such a change could be probably binding only for short period of time. According to above-mentioned EU declaration, currency board could not substitute for the ERM2 system. Although the appropriateness of currency boards would have to be determined on a case by-case basis, the central rate chosen for the exchange rate system must be acceptable to all sides. We do not think that 4.35 against euro preferred by Grzegorz Kołodko would be acceptable for the EU in the long-term.

### **Budget 2003 approved, but may be changed**

On 2 July the government accepted budget draft for 2003. The government decided that budget deficit in 2003 would amount to PLN43bn. The council of ministers agreed on budget assumptions for 2003 prepared and presented by finance minister Marek Belka, and – as PM Miller stressed it – it was the unanimous decision. The bill assumes that central budget expenditures growth in 2003 will be constrained by „inflation+1%” rule, and would amount to PLN192.5bn, while state revenues are forecasted at PLN149.5bn. Economic deficit is estimated at 4.5% of GDP for 2003. Although the importance of the whole document becomes somehow questionable amid change on finance minister's position, below we present the short review of the draft.

The table presents the projected revenue and expenditure growth. It is worth to notice that next year revenues are planned to increase by merely 3% while nominal GDP growth amounts to 6%. This is to large extend explained by the decrease of tax burden for entrepreneurs in 2003 – the CIT tax rate will be reduced from 28% to 24% and the government plans to introduce new amortisation scheme granting to companies generous 30% tax allowance. However the overall revenue forecast looks rather conservative. What is interesting is the clear statement on the first page of the document that the revenue forecast for 2003 is a subject to change later this year because it heavily depends on the actual revenue growth in 2002. We guess that it means the potential for upward revision. This in turn raises a serious concern, as such a possibility may be easily exploited by MPs to increase the expenditures rather than to limit the deficit level during works over budget in the parliament.

**Revenues and expenditures of central budget in 2001-2005**

PLN m	2001	2002	2003	2004	2005
	execution	budget act	assumption	forecast	forecast
<b>REVENUES</b>	140 526.9	145 101.6	149 500.0	157 565.7	169 975.8
<b>Tax revenues</b>	123 161.8	135 177.7	139 676.1	148 284.6	160 077.4
indirect taxes	82 422.9	91 324.5	95 994.5	102 281.4	109 768.0
PIT	13 219.7	13 833.8	13 780.4	14 231.1	15 873.1
CIT	23 444.2	26 540.4	26 717.6	28 410.5	30 400.4
Non-tax revenues	16 192.2	9 857.8	9 761.6	9 231.1	9 847.4
Foreign	1 172.9	66.1	62.3	50.0	51.0
<b>EXPENDITURES</b>	172 885.2	185 101.6	192 500.0	200 200.0	208 400.0
<b>DEFICIT</b>	-32 358.3	-40 000.0	-43 000.0	-42 634.3	-38 424.2

Source: Finance Ministry

The big question mark should be put over the budget spending limit set at PLN192.5bn. The draft says it explicitly that only five major tickets in next year's budget will exploit the whole expenditure growth for 2003 (these include: debt servicing costs, subsidies to social security funds, budget for the army, wage indexation, and subsidies for labour fund). Therefore sticking to „inflation+1%” rule would require maintaining zero nominal growth on average in all other areas (including healthcare, infrastructure, agriculture etc.), and it means practically that in some sectors the expenditures would have to decline in nominal terms in 2003. You might easily imagine how likely it is ahead of local elections. The conflict over expenditure growth would be the most plausible explanation for Marek Belka dismissal ... but the fact is that the ministers have agreed unanimously on the proposed spending limit, which suggests that the quarrel was not so serious.

We have to reiterate what we had written many times before, that maintaining budget deficit well above PLN40bn next year represents in fact loosening of fiscal policy, especially amid GDP growth acceleration to 3.1% in 2003 from 1% in 2002. Notwithstanding this, the market reaction to such figure, if only it has not been accompanied with Marek Belka's dismissal, would be probably rather moderate, as the market players got used to even to higher figures of PLN45-46bn repeated several times in previous week.

The bill accepted by the government does not account for any potential consequences of changing public finance law (increasing the share of local governments in tax revenues) and restructuring special funds and agencies.

### **NBP under never-ending attack**

In July Sejm's sub-commission for banking system and monetary policy recommended that parliament should proceed with two motions changing NBP charter: one submitted by the government, and one by PSL-UP. The sub-commission ignored lawyers' opinions saying that the measures included in PSL-UP's bill might be incompatible with the Polish Constitution. Those measures include introducing additional primary goals for monetary policy (i.e. growth promotion and unemployment fight) as well as increasing the MPC's headcount from 9 to 15. Head of public finance commission Miroslaw Czerniawski (SLD) said he is surprised with sub-commission decision, because legal opinions cannot be totally ignored. Nevertheless, while it seems very clear now that introducing additional goals for monetary policy is against Constitution, lawyers' opinions about enhancing the MPC's headcount are divided. Czerniawski said he has ordered additional legal analyses on that matter, but it is unlikely to change the fact that the views are far from uniform. We think that there is still high probability that the final draft of NBP charter amendment will include the proposition to increase the number of MPC's members. What is more there is still substantial chance that the bill in such shape would be passed by the Lower House. But, as we wrote many times before, President Kwasniewski would send such bill to the Constitutional Tribunal instead of signing it, which limits the probability that the assault on NBP's independence would materialise.

Czerniawski said that public finance commission is very busy until 24 July with confidence vote for the government, which is the high priority task. This implies that Sejm may not deal with NBP charter amendment before summer holidays because on 24-26 July it holds the last session before summer break. Clearly the scenario that we have forecasted in the middle of May materialises

now: the final round of debate over NBP charter is postponed until early autumn, closer to local elections date, to make it a big event during election campaign. Anyway, now the markets and public opinion are busy enough with the change on the finance minister's post. You might take a breath... and prepare for the final battle in parliament in September.

Public finance committee representative announced that it is going to decrease MPC's members and NBP executive board salaries. However, committee's chairman, Mieczyslaw Czerniawski, said that it will depend on the results of Grzegorz Kolodko talks with the MPC, NBP governor and the committee. Such blackmail may of course negatively influence relations between the government and MPC members.



# COMMENTS OF THE GOVERNMENT MEMBERS AND POLITICIANS

In June most of politicians' comments concentrated on criticism of monetary policy without presenting government's strategy (excluding a few comments of former finance minister). Again, Prime Minister Leszek Miller called for monetary easing, but the conflict between the government and the NBP was a subject of President Aleksander Kwaśniewski mediation. Negotiations did not bring the expected result, PM Miller called it a failure, which might be connected with presidential consequence to support the independence of the central bank. Disagreement over the central bank has shown again differences between President and Prime Minister.

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WHO? WHERE? WHEN? QUOTE

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Leszek Miller, PM; PR1, TVP1, 3 Jun	<p>„We want President to study the government's stance in detail. It's necessary for at least two reasons: First of all, Sejm proceeds with legislation regarding NBP charter [...] Second, President has three representatives in MPC and also he recommended NBP governor Leszek Balcerowicz for the post, therefore he has larger possibilities to influence MPC policy than government does.”</p> <p>„Let me remind you that the MPC consists of people elected by the AWS and Freedom Union, and I would like to say it in open text that those people together with Leszek Balcerowicz realise the [economic] program of former government which has been rejected by the society and that has lead to heavy crisis of the state.”</p> <p>„Sejm must make the next step forward. Because it can't be that way that the MPC ignores the Polish parliament without consequences.”</p>
Radio Zet, 7 Jun	<p>„When I look at MPC's voting results I often notice that Leszek Balcerowicz votes for lowering interest rates. From this point of view I think he does right. Anyway, compared to his other colleagues he is a moderate one.”</p> <p>„Leszek Balcerowicz votes often for lowering interest rates but not as often as he should.”</p>
PAP, 12 Jun	<p>„Sejm passed the special resolution a few weeks ago, criticising the NBP's monetary policy. It should be expected that [...] Sejm will proceed with NBP charter amendment.”</p> <p>„I don't consider increasing MPC headcount as limiting their competence and this hypothesis seems to be difficult to prove.”</p>
PAP, 17 June	<p>„We don't see any effort to correct this false [monetary] policy.”</p> <p>„So far the MPC's policy is not profitable for the Polish economy, but only supports the speculative capital.”</p> <p>„The value of the zloty is not the result of competitiveness and efficiency of the economy, but of the presence of speculative, short-term capital, that benefits from high interest rates.”</p> <p>„Zloty exchange rate depends on MPC and on the Central Bank. In this issue we are facing sharp conflict between the government and the MPC.”</p> <p>„Now it's not even the conflict with the government but with Polish entrepreneurs which are more and more anxious and signal overvalued zloty and high interest rates as discouraging for taking loans.”</p>
TVP1, 19 June	<p>„We are very happy that interest rates are lowered from time to time. But still they remain the highest in Europe.”</p> <p>„I think that [SLD deputies] will support it [the motion to increase MPC headcount], because all of them are aware that the mediation possibilities are over and now the voice belongs to parliament.”</p> <p>„Tuesday meeting between President and the MPC is a failure.”</p> <p>„We will see what Mr. President does. Now it's hard to tell. But I don't think that President remains unaware that many Polish entrepreneurs face growing difficulties and their situation depends not only on the exchange rate and interest rates, but also on the other factors.”</p>
Andrzej Raczko, deputy finance minister; ISB, 4 Jun	<p>„In my opinion, the proposals put forward to the MPC should not be made public. We are discussing the exchange rate mechanism.”</p> <p>„The responsibility for realisation of the exchange rate is held neither by the government, nor by the Finance Ministry but by the National Bank of Poland. The government is only responsible for setting up, together with the Monetary Policy Council (MPC), the zloty exchange regime.”</p> <p>„In favour of interventions' efficiency we should not reveal any details about our discussion with MPC on the FX regime.”</p>
Aleksander Kwasniewski, president; PR1, 7 Jun	<p>„I will talk to NBP governor too, he will present his opinion. Probably (though it's not determined yet) I will invite the MPC too [...] Three of my representatives for sure, but maybe it's worth meeting whole MPC to listen to their arguments.”</p> <p>„The constitution says: Government [...] has huge competence in the Polish system, but the MPC and the central bank have their constitutional independence, and the President is to guard the Constitution.”</p> <p>„Inflation cannot be disregarded. I leave it up to the MPC. [...] On the other hand [...] zloty exchange rate is so high that it's harmful for large number of exporters.”</p>
PAP, 12 Jun	<p>„The government was very critical about central bank's policy and appealed for President's help in achieving the co-operation between the MPC and the government.”</p> <p>„No change that is inconsistent with the Constitution could take place, because it would be questioned by the President or by the Constitutional Tribunal.”</p>
PAP, 18 June	<p>„I think we agree on the main objectives but not on the way to achieve them.”</p> <p>„We've jointly agreed that the co-operation between the government and the MPC is necessary.”</p> <p>„MPC proposed to start talks with the government on several issues. It's the discussion on lessening appreciation pressure on the zloty and exchange rate strategy, especially in light of Poland's EU and EMU entry.”</p> <p>„There is no doubts about MPC independence and the President is the guardian of this independence.”</p>
PAP, 28 Jun	<p>„No only the MPC decisions are important for GDP growth, but also other factors like high taxes, which are the most important incentive for enterprises, next year budget, liberalisation of labour market, infrastructure programmes.”</p> <p>„I hope the ministry of finance will present responsible budget proposal, which will ensure 3% GDP growth next year.”</p> <p>„Ways to achieve higher growth are far more complicated than an increase of the number of MPC members.”</p>

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Marek Belka, deputy PM, finance minister;	
PAP, Reuters, 11 Jun	„Initial assumption for next year’s budget construction is that spending limit amounts to PLN192.5bn.” „Expenditures in 2003 will rise according to rule inflation plus 1%, that was also used to build the budget for this year.” „Expenditures can go up or down depending on inflation. If inflation would be higher than 3% then the limit would be higher as well. This acts also in the opposite direction.”
PAP, Reuters, 13 Jun	„[During Cabinet Council] we will consider the consequences of various institutional proposals that are being discussed by the parliament, and which relate to the Monetary Policy Council. And we are going to discuss various scenarios and the consequences of various solutions.” „I expect to fine-tune my proposals [for NBP] after Cabinet Council meeting. After the meeting I will ask NBP governor for the meeting.”
Radio ZET, 19 June	„[Government’s stance is supposed to refer to] overall assessment of economic situation and the role of monetary policy and exchange rate policy in this regard. Secondly, exchange rate strategy for today, the possibilities of tactical influence on the zloty at the moment, and exchange rate strategy in light of European integration.” „Central budget deficit might be slightly higher than PLN40bn, but much depends on the economic growth.” „For me the key issue is that budget expenditures will comply with the rule inflation plus 1%.” „I would not rule out [FX interventions] in some specific situation. Because contrary to simple opinions the intervention is not acting against the market. There are various situations. Sometimes interventions make no sense indeed and cause nothing but costs, but there are also different situations.”
RMF FM, 20 June	„I think that it [FX intervention] should not be interpreted as abandonment of current exchange rate policy” „I think that Sejm will pass the NBP charter amendment increasing the MPC headcount, It’s not the articulation of my hopes but rather my fears.” „We’ve undertaken talks with NBP over long-term exchange rate policy in light of European integration. It does not concern short-term actions. When it comes to long-term perspectives we’ve approached some convergence of views. But the differences still remain about what should be done today or tomorrow; there is divergence of views between PM and the President. PM is more under pressure, the government is under pressure, I am under pressure – the pressure of economic news, economic situation, present social sentiment.” „None of us lives in the long term, we all live day after day.”
Reuters, PAP, 21 June	„I am very glad that the government agreed on the expenditure limit at PLN192.5bn, in line with earlier assumptions.” „We assume that budget deficit in 2003 should not be higher in nominal terms than in 2002, it should not exceed PLN40bn.”
Polish Radio 3, 27 Jun	„I am happy to see rate cut in June, but I share concerns that such policy of small reductions will be a factor strengthening the zloty. As far as we have gradual loosening of monetary policy, markets expect another reduction and it such a possibility was not excluded by NBP president.” „The MPC said that a reduction by 200bps would destabilise the market. I do not share such opinion, markets could be destabilised by completely different factors. Such deep cut could calm down expectations for further monetary easing.” „I think that conflict between the government and the NBP will cool down in the future because of several factors. First, budget 2003 should satisfy the MPC. Second, this year’s budget realisation shows that situation in public finances is under control. Third, situation on the world markets (strong Euro) should calm down conflict over foreign exchange policy.”
PAP, 30 Jun	„Discussion over foreign exchange policy should calm down because euro has strengthened significantly.” „This trend is favourable for Polish exporters – their profitability could increase even by 10% within last months, which may stimulate the economy.” „I would expect zloty weakening against both dollar and euro, but strong makes competitiveness pressure on Polish enterprises.”

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Witold Orłowski, economic advisor to President;	
Rzeczpospolita, 11 Jun	„NBP will not be able to resist constant market pressure [...]. But if the government is right that [...] zloty is temporary above the equilibrium level, then we have the speculative bubble that can be pierced through. In such situation even relatively small and not costly, non-sterilised or partly sterilised FX intervention could cause permanent outflow of portfolio capital and lead to sustainable zloty depreciation.” „We won’t have answer to this question if NBP does not try to intervene. Intervention would have to be of unannounced scale and be very cautious. If there would be no possibility to weaken the zloty permanently with limited cost, then we would have to accept strong currency and stop the interventions. Without such try we would never find out whether current exchange rate seriously deviates from equilibrium level or it does not.”

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Stanisław Gomułka, finance minister’s economic advisor;	
Reuters, 11 Jun	„Deep interest rate cut that would weaken the zloty, could solve the conflict between the government and central bank on the FX regime.” „Considering inflation and unemployment there is still the space for 200-300bps rate cut.” „We need 5-10 percent zloty adjustment that could be achieved due to interest rate change.” „Zloty should be at 4.0-4.2 against euro.”
Reuters, 18 June	„Budget deficit at PLN40bn is the maximum level, that could be safely financed [in 2003]. PLN45 bn seems hard to finance without raising more privatisation revenues.”

**Market monitor**

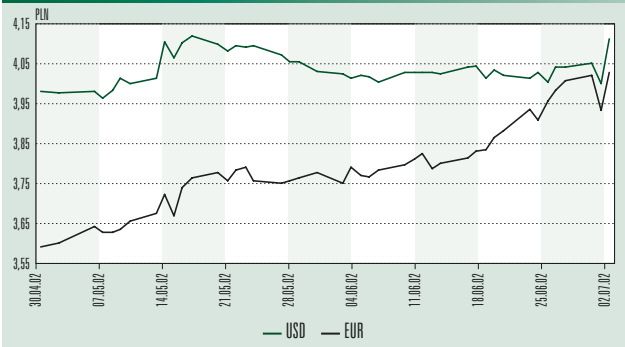
- At the beginning of July the zloty weakened considerably
- The main reason was finance minister, Marek Belka's dismissal
- Turmoil also on the treasuries market with yields increase, as a result.

**Zloty stable in June, but fell sharply at the beginning of July.**

In June, the zloty was stable against US dollar, ranging between PLN 4.00 and PLN 4.05. At the same time, the euro gradually weakened from PLN 3.75 to slightly above PLN 4.00. It stemmed from appreciation of the euro against US dollar on the global markets. At the end of June EUR/USD rate increased to the level of USD 0.999, but it was followed by a correction and parity was not reached. However, it was achieved in the beginning of July and for the first time since February 23, 2000 the dollar was cheaper than the euro.

At the time when the euro was the strongest in June (on June 28) it was traded on the Polish market at PLN 4.07 – the higher level since October 13, 2000. One of the reasons behind weakening of the zloty at the end of June was very critical statements of NBP governor, Leszek Balcerowicz, concerning fiscal policy during press conference after MPC meeting. It decreased expectations for further interest rate cuts in the near term.

**Zloty FX rate in the last 2 months**

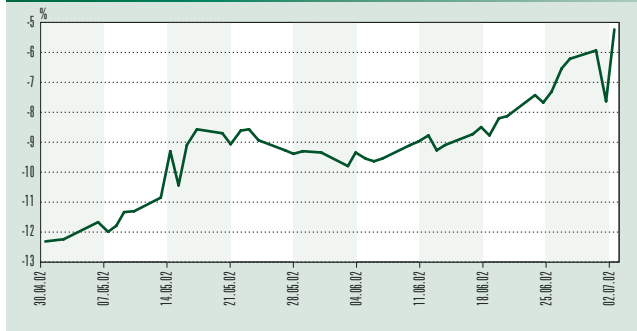


Source: BZ WBK

When the zloty gained a bit on 1 July and it seemed that the forthcoming week could bring stabilisation of the zloty exchange rate, as it was expected to be quite calm with very few economic data releases, unexpectedly political turmoil began. After finance minister, Marek Belka dismissal was announced in the late afternoon on 2 July, the market reacted very nervously and the zloty considerably depreciated, falling by around PLN0.1 during the day. The following day saw a deepening of this tendency with the

zloty exchange rate against the euro at PLN4.07 and against the dollar at 4.14. The deviation from parity amounted to 4.5%, while a month ago it was 9.8%.

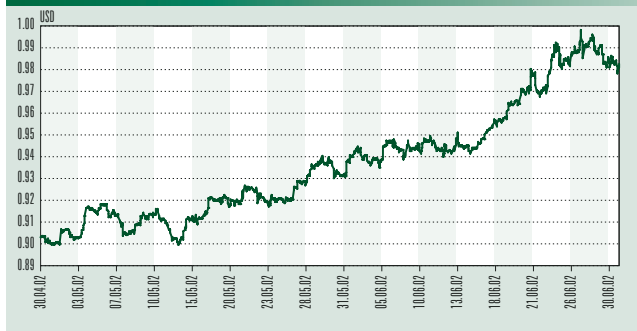
**Deviation of the zloty from the parity**



Source: BZ WBK

Increased uncertainty on the market resulting in high volatility of the exchange rate remained until nomination of the new finance minister. However, candidature of Grzegorz Kołodko for this post was not welcomed enthusiastically by the market, as everyone remembered his recent proposals to change FX regime in Poland. The situation on the market calmed down somehow after first statements of the new minister suggesting continuation of the previous fiscal policy. While one can expect that the zloty exchange rate will gradually return to the levels before Belka's dismissal, the uncertainty over governments' strategy concerning FX policy and budgetary spending will remain a risk factor.

**EUR/USD rate**

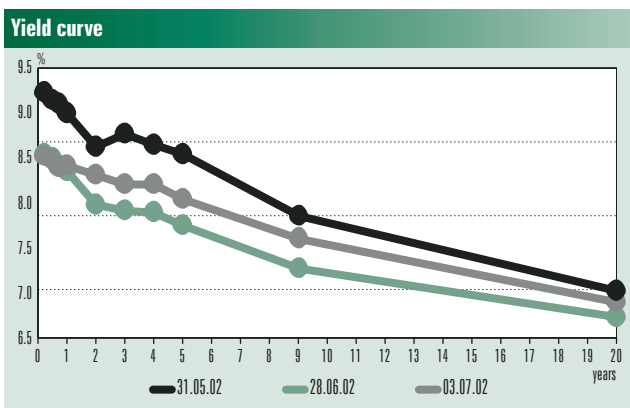


Source: Reuters

**Bonds' yields increased on Marek Belka dismissal.**

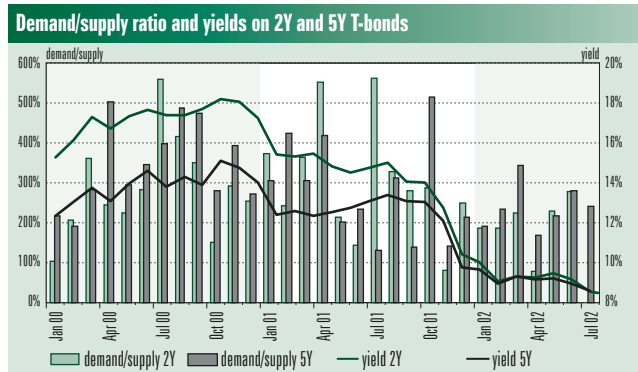
For the whole June yield curve has continued its downward shift. At the end of month treasuries yields on the secondary market were by around 70-bps lower than in the end of May. Big interest among investors for Polish T-bills and T-bonds maintained as factors that previously encouraged to buy Polish treasuries (low inflation, expectations for interest rate cuts, prospects for integration with EU) were accompanied by unfavourable situation on the stock exchange markets, which inclined rather to buy debt instruments.

Everything changed with unexpected dismissal of finance minister. Bond market reacted very negatively and investors began to sell Polish bonds. As a result, yields sharply increased – in very short time yield curve moved up by 30-bps on average in the 2-20 years segment. Now, much will depend on the new finance minister strategy regarding exchange rate and further work on the next year's budget. After first statements of Grzegorz Kołodko, yields declined and positive sentiment on the bonds market should be back, unless exchange rate risk will remain and budgetary spending would not increase. In our opinion yields should go down amid markets expectations for further interest rate cuts.



Source: BZ WBK

During the auction on 3 July the finance ministry sold 2-years bonds in the amount of PLN1.922bn, while the offer was PLN2.6bn. Demand was much bigger and reached PLN6.38bn but the ministry did not want to sell the whole offer because of high yields. Average yield amounted to 8.342% and was 23-bps lower than in the previous month, but recent events on the market caused that it was by 30-40-bps higher than the finance ministry could have expected just two days earlier.



Source: BZ WBK

**T-bill auctions in June and July 2002**

Date of auction	OFFER (SALE)		
	13-week	52-week	sume
03.06.2002	–	600 (600)	600 (600)
10.06.2002	–	500 (500)	500 (500)
17.06.2002	–	900 (900)	900 (900)
24.06.2002	100	900 (900)	1000 (1000)
<b>Total</b>	<b>100 (100)</b>	<b>2900 (2900)</b>	<b>3000 (3000)</b>
01.07.2002	100	500	600 (600)
08.07.2002	100	500	600
15.07.2002	100	500	600
22.07.2002	–	600	600
29.07.2002	–	600	600
<b>Total</b>	<b>300</b>	<b>2700</b>	<b>3000</b>

Source: Finance Ministry

**T-bond auctions in 2002**

month	1st auction						2nd auction				
	date	T-bonds offer (PLN m)	sale (PLN m)	T-bonds offer (PLN m)	sale (PLN m)	date	T-bonds offer (PLN m)	sale (PLN m)			
January	09.01	OK1203	2 800	2 800	PS1106	1 900	1 900	16.01	DS1110	1 800	1 800
February	06.02	OK1203	2 000	2 000	PS1106	2 900	2 900	13.02	DZ0811	500	495,5
March	06.03	OK1203	2 000	2 000	PS1106	1 800	1 800	20.03	DS1110	1 400	1 400
April	03.04	OK0404	2 500	1756,5	PS1106	1 200	1 200	10.04	WS0922	400	400
May	08.05	OK0404	1 500	1 500	PS0507	2 400	2 400	–	–	–	–
June	05.06	OK0404	1 000	1 000	PS0507	2 800	2 800	–	–	–	–
July	03.07	OK0404	2 600	1922,1	–	–	–	17.07	DS1110	–	–
August	07.08	OK0804	–	–	PS0507	–	–	–	–	–	–
September	04.09	OK0804	–	–	PS0507	–	–	18.09	DS1110	–	–
October	02.10	OK0804	–	–	PS0507	–	–	–	–	–	–
November	06.11	OK0804	–	–	PS1107	–	–	20.11	DS1112	–	–
December	04.12	OK1204	–	–	–	–	–	–	–	–	–

Source: Finance Ministry

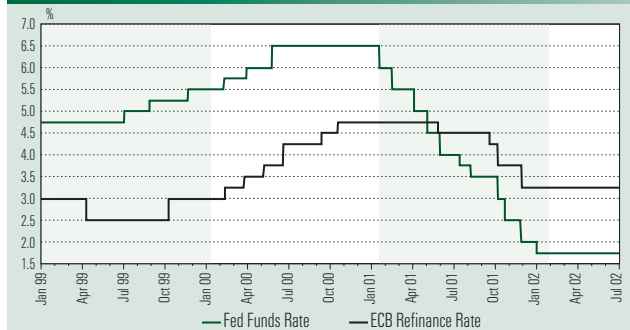
## International review

- Eurozone's inflation fell below 2% for the first time in two years
- Interest rates in the USA and the Eurozone still unchanged
- US activity indicators are rising but consumer sentiment is deteriorating

In June monthly report, the European Central Bank increased its inflation forecasts. Under the assumption of unchanged interest rates the ECB expects that average Eurozone inflation would reach 2.1-2.5% in 2002, while earlier forecasts pointed to 1.1-2.1%. Additionally ECB expects that by the end of year GDP growth would reach 2.5%.

Final data on Eurozone inflation in May confirmed the preliminary estimations at the level of 0.1% MoM and 2.0% YoY. Additionally, according to preliminary data, Eurozone's annual inflation rate fell to 1.7% in June. It was the first fall below 2% ECB's target ceiling since 25 months, which again allowed for postponing the decision to hike interest rates.

### US and Eurozone's interest rates



Source: Reuters

US inflation amounted to 0.0% MoM in May after a 0.5% MoM increase in April. Core inflation was in line with expectations amounting to 0.2% MoM.

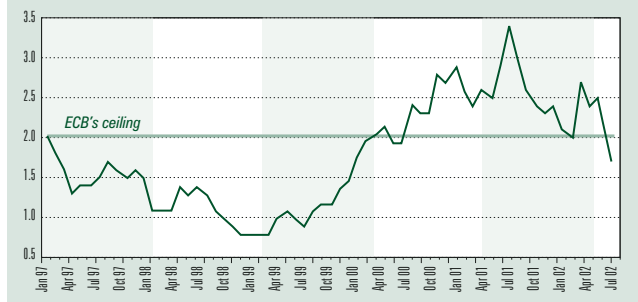
At the last meeting Fed left interest rates unchanged, in line with market expectations. Federal funds rate remained at 1.75%. In the statement Fed pointed out that demand growth was observed, but the scale of recovery this is still uncertain. Fed reiterated also that there is a balance between the risk of recession's come back and inflation.

Final data on US GDP growth for 1Q02 has been revised up to 6.1% QoQ from preliminary estimates at 5.6% against 1.7% recorded in 4Q01.

Trade deficit of the United States increased by 10% MoM in April to record level of USD 35.9bn, against forecasts at

### Eurozone's inflation

YoY



Source: Reuters

USD 32.5bn. Data on current account deficit in 1Q 02 were released as well. The record level of USD 112.5bn was seen here too, also significantly higher than expected USD 107.4bn. Both these figures contributed to considerable dollar weakening.

In May US retail sales figures proved to be very weak. The sales dropped by 0.9% MoM (the deepest fall since November 2001), while market expected -0.3% MoM. On the other hand producer prices data surprised with 0.4% decline while markets expected 0.1% MoM growth. Industrial output increased in May by 0.2% MoM, a bit below expectations at the level of 0.3% and inventories fell by 0.2% MoM, in line with market expectations.

Eurozone's retail sales fell by 0.6% MoM in April and rose by 0.1% YoY. The data was quite different from expectations at 0.0% and 1.3% respectively.

Euro-zone industrial output fell by 0.5% MoM in April after an increase by 0.5% in March. Markets expected increase in output in April of 0.2%.

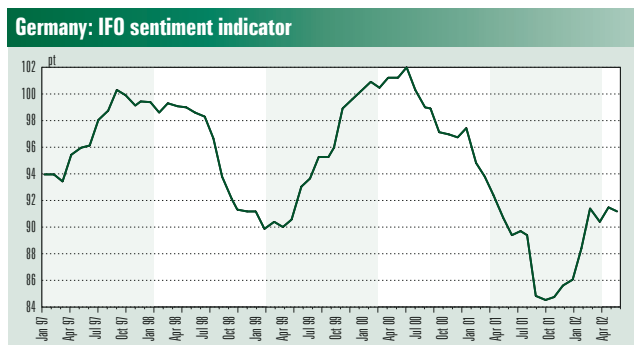
Industrial production in Germany increased by 0.2% MoM in April compared to 0.5% expected by the market, after 0.3% MoM decline recorded in March. Weaker than expected figure was the result of worse business climate in construction sector that recorded 3% MoM decline. In annual terms industrial production improved to -2% YoY from -3.2% in March.

According to final data release Italian GDP increased by 0.2% QoQ and 0.1% YoY in 1Q 02. The annual growth was the lowest in last five years.

Eurozone's money supply M3 surprisingly accelerated in May to 7.8% YoY from 7.4% in April. Analysts expected money growth rate to remain at 7.4%.

German IFO index, the main business climate indicator in the biggest European economy, unexpectedly fell to 91.3 p. in June from 91.6 p. in May, while a growth to 91.9 was forecasted. German entrepreneurs' sentiment deteriorated mainly regarding their assessments of prospects for the next six months (subindex fell from 106.2 to 104.9 p.). On the other hand, current situation on the market is perceived slightly better than a month ago (improvement to 78.3 from 77.7 p.). Data from IFO institute were below expectations and temporary stopped the upward trend of the euro FX rate.

Analogous indicator for United States ISM recorded an increase to 56.2 pts in June from 55.7 pts in May, while analysts expected only slight rise to 55.8 pts.

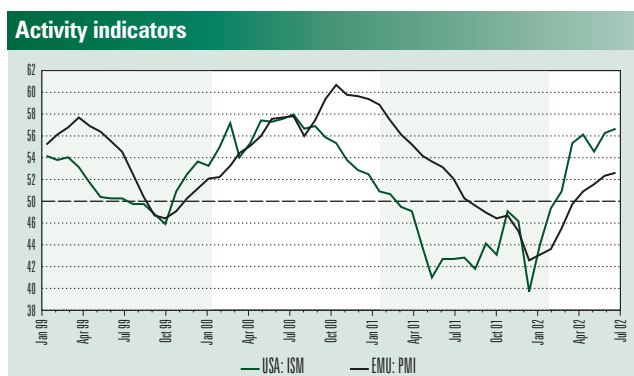


Source: Reuters

US consumer confidence index decreased to 106.4 points in June from 110.3 pts in May. The fall of this indicator is a negative signal for condition of the American economy, because it may point to process of limiting consumption spending that account for two third of GDP in United States.

University of Michigan consumer sentiment index decreased to 92.4 points in June from 96.9 in May. In mid-June preliminary poll results pointed at deeper fall to 90.8.

In June economic activity improved in Eurozone's industry. Activity indicator increased for a third month in a row to 51.8 pts from 51.5 in May, a bit stronger than market expected. The indicator for German economy – the largest in the Eurozone – rose to 50.2 pts in June from 49.8 pts in May, crossing for the first time since March 2001 the level of 50 pts, which means turning from recession to development.



Source: Reuters

**What's hot this month**

Monday	Tuesday	Wednesday	Thursday	Friday
<b>1 July</b> POL: T-bill auction (PLN 600m) EMU: Retail sales (Apr)	<b>2</b> EMU: Unemployment (May) EMU: Business climate (Jun) EMU: Economic sentiment (Jun)	<b>3</b> POL: T-bond auction OK0404 (PLN 2.6bn) EMU: Producer prices (May) USA: Factory orders (May)	<b>4</b> EMU: ECB meeting GER: Industrial orders (May)	<b>5</b> POL: Food prices (2H Jun) FRA: GDP (1Q) USA: Unemployment (Jun)
<b>8</b> POL: T-bill auction (PLN 600m)	<b>9</b> GER: Industrial output (May) GER: Unemployment (Jun) EMU: GDP (1Q)	<b>10</b>	<b>11</b> USA: Producer prices (Jun)	<b>12</b> POL: Money supply (Jun) POL: Wages & employment (Jun) FRA: Inflation preliminary (Jun) FRA: Industrial output (May) USA: Retail sales (Jun)
<b>15</b> POL: Inflation (Jun) POL: T-bill auction (PLN 600m) ITA: Industrial output (May)	<b>16</b> ITA: Inflation final (Jun)	<b>17</b> POL: Industrial output (Jun) POL: Producer prices (Jun) POL: T-bond auction DS1110 EMU: Inflation final (Jun)	<b>18</b> POL: MPC meeting POL: Business climate (Jul) EMU: Industrial output (May)	<b>19</b> POL: MPC meeting (decision) USA: Inflation (Jun) USA: Foreign trade (May)
<b>22</b> POL: Unemployment (Jun) POL: T-bill auction (PLN 600m) EMU: Foreign trade (May)	<b>23</b>	<b>24</b> FRA: Inflation final (Jun)	<b>25</b> EMU: Money supply (Jun)	<b>26</b> POL: Food prices (1H Jul) EMU: Retail sales (May)
<b>29</b> POL: T-bill auction (PLN 600m)	<b>30</b>	<b>31</b> POL: Balance of payment (Jun) ITA: Inflation preliminary (Jul) EMU: Inflation preliminary (Jul) USA: GDP (1Q)	<b>1 August</b> EMU: ECB meeting EMU: PMI (Jul) USA: ISM (Jul)	<b>2</b>

Source: CSO, NBP, Finance Ministry, Reuters

**Data release calendar**

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
MPC meeting	29-30	26-27	26-27	24-25	28-29	25-26	30-31 <sup>a</sup>	27-28 <sup>a</sup>	24-25 <sup>a</sup>	29-30 <sup>a</sup>	26-27 <sup>a</sup>	17-18 <sup>a</sup>
CPI	15	15 <sup>b</sup>	15 <sup>c</sup>	15	15	17	15	16 or 19	16	15	15	16
PPI	18	19	18	18	20	19	17	20	18	17	20	18
Industrial output	18	19	18	18	20	19	17	20	18	17	20	18
Gross wages, employment	15	14	14	15	17	18	12	14	13	14	18	13
Trade	About 50 working days after reported period											
Balance of payments	31	28	28	30	29	28	31	30	30	-	-	-
Money supply	14	14	14	12	14	14	12	14	13	-	-	-
NBP balance sheet	7	7	7	5	7	7	5	7	6	-	-	-
Business climate indices	7 <sup>d</sup> & 22 <sup>e</sup>	20	20	18	21	19	18	22	19	18	21	19
Food prices, 1-15	-	8 <sup>e</sup> & 27 <sup>f</sup>	27	26	27	27	26	27	27	25	27	30
Food prices, 16-30	3	8	8	5	7	6	5	6	6	7	6	6

a) according to the preliminary schedule, b) preliminary data, c) final data (January, February), d) December 01, e) January 02, f) February 02

Source: CSO, NBP

**Monthly indicators**

		May 01	Jun 01	Jul 01	Aug 01	Sep 01	Oct 01	Nov 01	Dec 01	Jan 02	Feb 02	Mar 02	Apr 02	May 02	Jun 02	Jul 02	
																<i>forecast</i>	
GDP	% YoY	x	0.9	x	x	0.8	x	x	0.2	x	x	0.5	x	x	0.7	x	
Industrial output	% YoY	-0.4	-4.7	1.5	0.9	-3.7	1.8	-1.0	-4.8	-1.4	0.2	-3.1	0.3	-4.1	0.0	5.0	
Retail sales***	% YoY	4.3	0.2	1.5	3.0	1.3	5.8	2.4	2.4	4.7	6.7	9.9	3.1	1.8	x	x	
Unemployment rate	%	15.9	15.9	16.0	16.2	16.3	16.4	16.8	17.4	18.0	18.1	18.1	17.8	17.2	17.3	17.8	
Gross wages**	% YoY	8.8	4.9	8.0	6.9	6.2	7.8	6.6	5.3	5.7	5.5	4.8	2.3	4.2	3.9	4.1	
Exports (acc. to NBP)	USDm	2 472	2 477	2 556	2 616	2 287	2 778	2 555	2 540	2 308	2 141	2 467	2 739	2 642	2 721	2 748	
Imports (acc. to NBP)	USDm	3 638	3 379	3 382	3 635	3 176	3 953	3 509	3 430	3 418	2 952	3 148	3 521	3 404	3 506	3 576	
Trade balance (acc. to NBP)	USDm	-1 166	-902	-826	-1 019	-889	-1 175	-954	-890	-1 110	-811	-681	-782	-762	-785	-828	
Current account	USDm	-737	-948	-287	-354	-304	-838	-417	-500	-847	-820	-612	-643	-484	-630	-353	
Budget deficit	PLN bn	-20.4	-18.7	-19.4	-21.0	-21.8	-24.6	-27.7	-32.6	-6.9	-13.7	-16.4	-20.0	-23.0	-24.0	x	
Inflation (CPI)	% YoY	6.9	6.2	5.2	5.1	4.3	4.0	3.6	3.6	3.4	3.5	3.3	3.0	1.9	1.6	1.5	
Producer prices (PPI)	% YoY	2.3	0.9	0.6	1.0	0.7	-0.5	-1.0	-0.3	0.0	0.2	0.3	0.4	0.5	0.7	0.6	
Money supply	% YoY	12.8	7.5	12.4	13.4	12.3	11.0	7.2	8.7	7.3	6.7	3.5	2.9	3.6	3.0	3.0	
Deposits	% YoY	14.6	8.6	14.0	14.9	13.3	11.5	7.0	8.3	6.4	5.5	2.0	1.2	1.7	1.1	0.7	
Credits	% YoY	10.9	4.8	11.5	11.8	11.5	9.7	8.9	9.3	9.0	8.8	7.1	6.6	7.9	9.2	9.5	
USD/PLN	PLN	3.98	3.97	4.19	4.25	4.22	4.13	4.09	4.01	4.06	4.19	4.14	4.06	4.05	4.03	4.10	
EUR/PLN	PLN	3.49	3.39	3.60	3.82	3.85	3.74	3.64	3.58	3.59	3.64	3.63	3.59	3.71	3.85	4.08	
Intervention rate*	%	17.00	15.50	15.50	14.50	14.50	13.00	11.50	11.50	10.00	10.00	10.00	9.50	9.00	8.50	8.50	
WIBOR 3M	%	17.22	16.88	16.01	15.35	14.73	14.01	13.91	12.29	11.04	10.60	10.32	10.20	9.88	9.30	8.90	
Lombard rate*	%	21.00	19.50	19.50	18.50	18.50	17.00	15.50	15.50	13.50	13.50	13.50	12.50	12.00	11.50	11.50	
Yield on 52-week T-bills	%	15.67	15.61	15.38	14.61	14.01	12.64	11.80	10.66	9.62	9.68	9.62	9.56	9.22	8.52	8.17	
Yield on 2-year T-bonds	%	14.92	15.22	15.13	14.40	13.57	11.36	11.00	10.70	9.11	9.37	9.32	9.22	9.03	8.36	8.01	
Yield on 5-year T-bonds	%	13.38	13.29	13.85	13.50	12.92	11.32	10.13	9.91	8.91	9.26	9.11	9.02	8.90	8.26	8.06	
Yield on 10-year T-bonds	%	11.30	11.74	11.87	11.97	11.57	10.31	9.19	8.92	8.25	8.34	8.25	8.19	8.02	7.55	7.50	

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

Source: CSO, NBP, BZ WBK



**Quarterly and yearly**

		1998	1999	2000	2001	2002	2003	10.01	20.01	30.01	40.01	10.02	20.02	30.02
						<i>forecast</i>							<i>forecast</i>	
GDP	PLN bn	553.6	615.1	685.0	721.6	754.2	810.0	165.4	176.5	179.6	200.0	171.4	184.3	194.1
GDP	% YoY	4.8	4.1	4.0	1.0	1.3	3.2	2.3	0.9	0.8	0.2	0.5	0.7	1.1
Industrial output	% YoY	3.5	3.6	6.8	-0.2	1.7	3.4	4.5	-0.7	-0.8	-2.6	-1.6	-1.3	3.3
Real retail sales	% YoY	2.6	4.0	1.0	0.4	x	x	-3.1	-0.2	1.2	3.7	5.8	x	x
Unemployment rate*	%	10.4	13.1	15.1	17.4	19.5	19.0	16.1	15.9	16.3	17.4	18.1	17.3	17.8
Real gross wage	% YoY	3.3	4.7	1.0	3.3	0.7	1.5	2.5	.0.8	2.5	1.3	2.1	1.0	-0.5
Exports (acc. to NBP)	USDm	30 122	26 347	28 256	30 276	32 327	35 000	7 436	7 508	7 459	7 873	6 916	8 102	7 944
Imports (acc. to NBP)	USDm	43 842	40 727	41 424	41 955	43 337	48 000	10 584	10 286	10 193	10 892	9 518	10 431	11 089
Trade balance (acc. to NBP)	USDm	-13 720	-14 380	-13 168	-11 679	-11 010	-13 000	-3 148	-2 778	-2 734	-3 019	-2 602	-2 329	-3 145
Current account	USD	-6 862	-11 558	-9 946	-7 075	-7 875	-9 913	-2 170	-2 205	-945	-1 755	-2 279	-1 757	-2 000
Current account	% PKB	-4.3	-7.4	-6.3	-4.0	-4.3	-4.8	-4.9	-5.2	-4.2	-4.0	-4.1	-3.8	-4.6
Budget deficit*	PLN bn	-13.2	-12.5	-15.4	-32.6	-40.0	-40.0	-15.0	-18.8	-21.9	-32.6	-16.4	-24.0	x
Budget deficit*	% PKB	-2.4	-2.0	-2.2	-4.5	-5.3	-4.9	-9.1	-2.2	-1.7	-5.3	-9.6	-4.1	x
Inflation	% YoY	11.8	7.3	10.1	5.5	2.6	4.0	6.7	6.6	4.9	3.8	3.4	2.2	1.9
Inflation*	% YoY	8.6	9.8	8.5	3.6	3.1	4.0	6.2	6.2	4.3	3.7	3.3	1.6	2.3
Producer prices	% YoY	7.3	5.7	7.8	1.6	0.7	2.5	4.2	2.2	0.8	-0.6	0.2	0.5	0.4
Money supply	% YoY	25.3	24.6	15.2	11.9	x	11.0	14.7	11.8	14.1	12.9	5.8	3.2	3.0
Deposits	% YoY	28.4	26.4	17.2	13.2	x	10.5	17.1	13.6	15.7	13.3	4.6	1.3	0.6
Credits	% YoY	30.0	28.6	24.7	11.3	x	15.0	15.4	9.7	11.3	8.1	8.3	7.9	9.8
USD/PLN	PLN	3.4937	3.9675	4.3465	4.0939	4.08	3.91	4.0876	3.9895	4.2168	4.0805	4.1303	4.05	4.09
EUR/PLN	PLN	3.9231	4.2270	4.0110	3.6685	3.86	3.93	3.7765	3.4884	3.7551	3.6549	3.6199	3.72	4.08
Intervention rate*	%	15.50	16.50	19.00	11.50	7.50	7.50	18.00	15.50	14.50	11.50	10.00	8.50	8.00
WIBOR 3M	%	21.34	14.73	18.78	16.08	9.29	8.00	18.53	17.09	15.37	13.45	10.65	9.79	8.63
Lombard rate*	%	20.00	20.50	23.00	15.50	10.50	10.50	22.00	19.50	18.50	15.50	13.50	11.50	11.00
Yield on 52-week T-bills	%	18.59	12.95	17.77	14.77	8.57	8.20	17.02	15.70	14.67	11.72	9.64	9.10	7.99
Yield on 2-year T-bonds	%	18.08	12.41	17.37	13.91	8.38	7.80	15.59	14.91	14.37	10.83	9.27	8.87	7.84
Yield on 5-year T-bonds	%	15.83	10.87	14.00	12.59	8.28	7.80	13.12	13.38	13.43	10.45	9.09	8.73	7.82
Yield on 10-year T-bonds	%	x	9.60	11.79	10.74	7.52	7.30	10.46	11.22	11.81	9.48	8.28	7.92	7.43

\* at the end of period

Source: CSO, NBP, BZ WBK



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