MACROscope
Polish Economy and Financial Markets

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Waiting for the sign

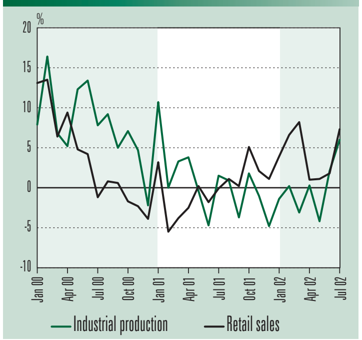
- **In September 2002, the Monetary Policy Council should announce "The guidelines for 2003 monetary policy".** The document will most likely present the information on the changes to the NBP instruments planned by the MPC with a view to harmonisation with the standards of the European Central Bank as stated in August by Dariusz Rosati, an MPC member. In this issue of Macroscope, we are describing the key instruments of the ECB monetary policy and we are trying to understand how this will affect the technical changes in the NBP arising from the requirement to harmonising the instruments. Already now, it is possible to project that all changes will be aimed at limiting the control over a given interest rate (in Poland, currently 1M WIBOR) for the benefit of stabilising the O/N rate by way of more efficient management of banking system liquidity.

- **The statistics published last month indicated still low inflation and better than expected economic activity.** Both consumer inflation and other core inflation measures dropped again triggering decline in the inflationary expectations presented by the economists and households. On the other hand, the production performance in industry and construction, retail sales and the number of new investments could make us optimistic in relation to the expected acceleration of economic growth. The published data should be assessed as satisfactory even though it did not picture a strong bounce-back but rather a gradual improvement of the economic situation. The inflation figures confirm that this year inflation target will be undershot and the next year's mid-term term target does not seem to be at risk. Export performance is still very good even if we take account of the influence of fx changes on the trade performance expressed in USD. No doubt, the positive influence of net exports on GDP growth will continue in the upcoming months. This trend might reverse next year when the (import-consuming) investments clearly bounce back.

- **At the August meeting, the Monetary Policy Council decided to cut the official interest rates again.** The lombard rate was reduced by 100 bp down to 10.5%, the reference rate by 50 bp down to 8.0%, and the deposit rate will remain unchanged at 5.5%. We expect one more interest rate cut by 50 pb this year, most likely in October, with the potential cut by further 50 bp (possibly in two stages by 25 bp) in 2003.

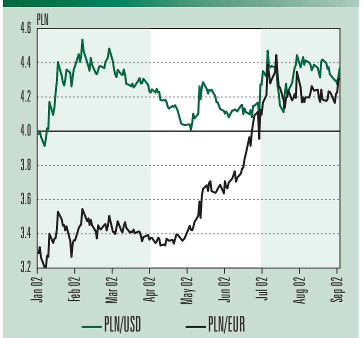
Financial market		on 30 August 2002			
NBP deposit rate	5,50	WIBOR 3M	8,33	PLN/USD	4,1420
NBP intervention rate	8,00	Yield on 52-week T-bills	7,75	PLN/EUR	4,0809
NBP lombard rate	10,50	Yield on 5-year T-bonds	7,40	EUR/USD	0,9814

Real activity indicators YoY



Source: CSO

Zloty exchange rate against US$ and euro



Source: BZ WBK

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Projected changes to the NBP instrument

The "Guidelines for monetary policy in 2003", which should be published in September 2002, will most likely include information on the changes to the NBP instruments projected by the MPC with a view to harmonising it with Eurosystem[1].

In July issue of Makroscope we discussed the prospects for Poland's accession to the European Union, and then to the Economic and Monetary Union (EMU). Following the accession to the EU, Poland, in line with the so-called derogation principle, will participate in the third stage of the economic and monetary integration without the introduction of single currency. In order to become a fully-fledged member of the single currency area, Poland has to meet the nominal convergence criteria (vide: Macroscope July 2002). At the same time, the technical adjustments have to be introduced with a view to developing relevant procedures and then starting to operate in Eurosystem. Therefore, in the pre-accession period, the harmonisation of monetary policy instruments of the National Bank of Poland (NBP) with the Eurosystem instruments gains significance. In July, Dariusz Rosati, member of the Monetary Policy Council (MPC) announced further future changes to the principles of open market operations to be introduced by the NBP with a view to harmonising them with the system applied in the European Central Bank (ECB). The potential changes would be enforced as of January 2003. First of all, the maturities of the NBP bills would be reduced from 28 to 14 days. Moreover, Rosati said that work was underway in the central bank in order to adjust the system of obligatory reserve to the Eurosystem standards. He also stated that NBP was planning to conclude the sale of converted government bonds still held in the central bank portfolio by the end of this year. Their sale would help to reduce the operational overliquidity of the banking system. As the overliquidity in the system will most likely be sustained, and its scale is significant for the process of harmonising the NBP instruments to the ECB standards, the central bank would start selling own debt securities with maturities of / in excess of 3 months.

1) Eurosystem comprises European Central Bank and the national central banks of the countries from the Eurozone.

Conditions for the harmonisation of the instruments

The conditions determining the progress in the harmonisation of NBP instruments to the ECB standards include legal requirements, i.e. the need to change certain provisions of the NBP Act. However, the core differences between the NBP instruments and the ECB result from the fact that Eurosystem witnesses structural underliquidity (because the commercial banks strongly depend on the liquidity provided by the central bank in the form of refinancing operations). As the NBP faces overliquidity on the money market, the instruments it applies are different from those applied by the ECB. This is mainly reflected in the profile of the open market operations and the obligatory reserve system. The need to absorb large liquidity surpluses from the banking sector, recorded for a long time, triggered relatively high obligatory reserve rate in Poland. Moreover, overliquidity results in a situation where the banks are not interested in refinancing from the central bank and the NBP conducts only liquidity-absorbing operations.

Solutions applied in Eurosystem

Controls of the short-term interest rate system in the Eurozone include: open market operations, obligatory reserve and standing facilities. They represent the classic set of instruments by way of which the central bank influences the liquidity of the banking system and, in turn, controls the short-term interest rates.

The regular, weekly open market operations conducted by the ECB are the key instrument of the ECB monetary policy. Eurosystem uses the following five main types of instruments: repo transactions, outright transactions, issue of debt certificates, currency swaps and acceptances. The basic types of operations are repo transactions with 14-day maturity, conducted weekly and aimed at regular ensuring of liquidity. Additionally, long-term repo refinancing transactions with 3-month maturity are conducted. Eurosystem can also conduct fine tuning operations in the form of repo transactions, outright transactions, currency swaps and accepting deposits. Contrary to the operations outlined above which are used to ensure liquidity to the banking system, Eurosystem can also absorb liquidity by issuing debt instruments as well as by long-term reverse repo transactions and outright transactions. In practice, for the purpose of effective management of banking system liquidity and controlling market interest rates, it is sufficient to conduct regular, weekly open market operations. This is also possible owing to the parallel functioning of the standing facility system.

The standing facility instruments support the operations of the open market. The rates applied to standing facility operations define the fluctuation margin for one-day rates of the European money market. Therefore, their key role is to abate the short-term fluctuations, in particular the fluctuations of one-day interbank rates. The standing facilities are capable of limiting the fluctuations of the market interest rates in situations where the open market operations do not fully eliminate the liquidity fluctuations. This is possible owing to the fact that standing facilities are available to commercial banks at all times and the decision to use them is taken independently by individual banks.

The marginal deposit rate sets the price at which the central bank allows the banks to place short-term deposits. The deposit rate is below the open market operation rate. It defines the floor of market rates fluctuation. At the same time, the fluctuation cap is represented by marginal lending rate. Even though standing facility operations are very practical for controlling interest rate volatility, they represent merely several percent of the total value of open market operations. The ECB Governing Council changes the interest rates for the standing facilities at the same time changing the interest rate for repo rate, within the margin defined by those interest rates. This way, it indicates the change in the restrictiveness of the monetary policy pursued by the Council.

The O/N[2] rate fluctuates within the margin defined by the standing facility operations, usually hovering around the middle of the margin, above repo rate. The rate is subject to greater fluctuations only in case of liquidity distortions or on the last day of the obligatory reserve. Nevertheless, it is still constrained by the set fluctuation margin. It is exactly in these periods that the significance of standing facility grows.

The ECB adopted the following key solutions for the obligatory reserve system: the obligatory reserve rate is at 2%; the reserves bear the interest that corresponds to the interest rate applied to the core ECB refinancing operations. Moreover, for the purpose of calculating the provision, the balance of specified liabilities of the banks as at the last day of a calendar month is taken. However, as the funds in the obligatory reserve account bear interest (at market level), no manipulation of the deposit levels, based on which the reserve is calculated, takes place. The obligatory reserve cannot be maintained in cash in the bank, the deposits with maturity in excess of 2 years are not the subject to the reservecalculated on its basis, and for repo operations, 0% reserve requirement is applied.

Changes to the NBP instruments

As of 1 December 2001, when the NBP introduced deposit rate on short-term deposits placed by commercial banks with the NBP, the reference rate has ceased to act as an instrument setting the minimum interbank rates. Nevertheless, it retained its role as an indicator of the current direction of the NBP policy. What is also important, since then, the deposit rate has started to act as a “floor” for the short-term interest rate margin.

The role of the lombard rate has not changed, it will still act as the ultimate cost of money paid by the commercial banks to the central bank. As a result, despite the fact that the open market operations conducted by the NBP based on reference rate run counter to the repo transactions conducted by the ECB, Poland already uses interest rate fluctuation margin similar to that in place in Eurosystem. The lombard rate and the marginal deposit rate (deposits placed with central bank) are the default caps and floors for the fluctuations of one-day deposits on the interbank market. The volatility of the O/N rate is therefore limited to the margin specified above. The O/N rate may, in the future, become the rate officially announced by the NBP as at the end of the settlement day - similarly to EONIA rate in euro zone.

In case of operational underliquidity of the banking system, the mix of interest rates could change slightly. The fixed interest rate for refinancing operations would become the NBP reference rate. Commercial banks would most likely seek refinancing with the central bank by way of 14-day repo operations, which should bring our system much closer to the one in place in Eurosystem. However, even in case of overliquidity, the shift towards 14-day liquidity-absorbing operations would bring our solutions closer to the European ones - at least in terms of maturity. The same effect would be also achieved if the NBP introduced absorbing operations with 3-month maturity period.

With regard to the obligatory reserve system, the need to reduce the obligatory reserve rate (currently, 4.5% in Poland) and to ensure it bears interest corresponding to

2) EONIA (Euro OverNight Index Avearage). It is the average weighted interest rate for the actual interbank market transactions with 1-day maturity

market rates (currently, the obligatory reserve account in Poland does not bear interest at all) will be most significant. These changes will play an important role not only for harmonisation with Eurosystem standards, but also for the competitiveness of Polish banking system when compared to the foreign ones. As the changes to the obligatory reserve system will create substantial cost burden for the NBP, and, what follows, for the budget, they will definitely be spread in time, as it has been done to date.

Theoretically, it is possible for a given country to enter the single money market with overliquidity (which would be immediately absorbed by very deep Eurozone money market). However, from the point of view of efficiency of the process of harmonising the money policy instruments, the best solution would be to gradually move towards the underliquidity situation. Then, commercial banks could smoothly adjust their procedures to the new conditions and the new type of relationship with the central bank. Therefore, the NBP will definitely continue the actions aimed at eliminating operational overliquidity of the banking system. The transition to underliquidity will be easier in the situation of economic recovery and the resulting higher demand for lending. In order to speed up this process, after the sales of converted bonds have been closed, (as projected by Dariusz Rosati) own debt securities of the NBP with maturity of at least 3 months are bound to be issued which would adjust the set of instruments used by our central bank to the ECB standards.

Already at this stage, it can be projected that all changes will aim at limiting the scope of control of the selected interest rate (in Poland, at present it is 1M WIBOR) for the benefit of O/N rate stabilisation by way of more effective management of banking system liquidity.

Characteristics of open market operations conducted by ECB and NBP

	ECB	NBP
Profile of the official rate	Repo rate - min. for auction	Reference rate - min. for auction
Scope of market rate control	No control. O/N rate stabilisation through management of the banking system	1M WIBOR should hover around the intervention rate – short-term deviations possible
The scope of information re. supply offer at auction (ex ante)	The amount of supply is not published	Publication of the amount at a given auction
Criterion for the decision of the central bank	Liquidity projection	Liquidity projection
Operation maturity	2 weeks	28 days
Operation regularity	Regular – once a week (Tuesday)	Regular – once a week (Friday)
Principles of fine-tuning	Applied very rarely. The rate set depending on the purpose of the operation.	1. Issue of NBP bills with maturity between 1 and 7 days. 2. Operation with repo maturity between 1 and 7 days. 3. Earlier repurchase of NBP bills.
Information on liquidity of the banking system published by the central bank	1. The level of obligatory reserve required in a given reserve period. 2. The average balance of funds in the bank accounts as of the beginning of the reserve period. 3. Standing facility as at the end of the previous day. 4. Projection of the autonomy factors for the upcoming week.	1. The obligatory reserve required in a given reserve period. 2. Data re. balance of funds in the accounts for each day of the reserve period.

Source: NBP, "Open market operations amid banking sector liquidity in 2001"

Economic update

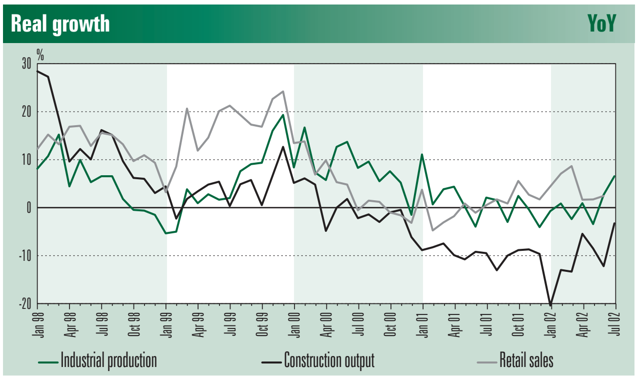
- Much better results of economic activity
- ...but we are waiting for a confirmation of recovery
- Net export still contributing positively on GDP
- CPI inflation below 2% by year-end

Statistical data released last month indicated still low inflation and higher-than-expected economic activity. Consumer inflation as well as all core inflation measures fell again triggering lower inflation expectations of both households' and financial market's participants. On the other hand, the result of sold industrial and construction production, retail sales data and a number of newly started investments bode well for economic activity. Released figures should be regarded as positive, although they do not indicate strong economic recovery, but rather confirm our scenario of gradual improvement. However, released inflation data shows no threat for the central bank's targets in 2002-03. Export results are still very positive even if we take into account the effect of exchange rate changes. Undoubtedly, we should expect a continuation of net exports' positive influence on Polish GDP growth, and this situation could reverse only next year, when an acceleration of fixed investments will take place.

High industrial production - not only the effect of sold ships and working days

In July industrial production turned out to be higher than forecasted for the second month in a row rising by 2.9%MoM and 6.0%YoY (we expected annual increase of 5.1% while market consensus pointed to ca. 4%). What is more positive, the overall growth was driven mainly by manufacturing, which upsurged by 7.8%YoY (after 2.2%YoY growth in June). Seasonally adjusted industrial production increased 3.5%. The factors that could contribute to such output figures are similar as in June: good export performance and possibly slight improvement of fixed investments. The latter is confirmed by lower decrease in the construction sector, which amounted only to 4.0%YoY, the lowest annual drop since November 2000. On a monthly basis output in construction grew for a sixth consecutive month (5.2%MoM). On the other hand, one should remember that the output figure in July was positively affected by higher number of working days. Robust growth of production in manufacturing was also supported by the sale of ships, which were used as collateral for bank's credit to the Szczecin shipyard. This seems to be confirmed by the fact that output growth in "other transport equipment" was one of the strongest this month, reaching 42.6%YoY. Given that "other transport equipment" represents ca. 2.1-2.3% of total industrial production volume, such growth added up ca. 1 percentage point to the total output figure. But even though, July's industrial production looks good. The annual growth was recorded in 21 out of 29 industrial sectors and this suggests something more than just a random factor. At this stage it is impossible to judge exactly to what extent the data reflected actual economic recovery, but it seems that figures are broadly consistent with our scenario of gradual improvement of business activity.

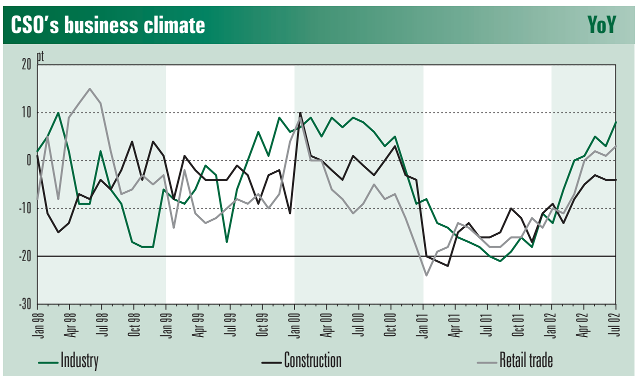
In August, industrial production's increase will be probably lower than in July amid lower number of working days. Although, Polish press reported about the sale of one ship also last month, which would improve the statistics again.



Source: CSO

...business climate index also improved

The CSO's business climate indices in August showed modest improvement of business conditions. Business climate indices in industry and retail trade remained negative but inched up both on a monthly and annual basis. In construction the index recorded seasonal drop on a monthly basis and fell compared to the corresponding month of last year but had still positive value. Entrepreneurs from industrial sector reported improvement of current production levels and demand, which is driven more by foreign than domes-



Source: CSO

tic demand. What is more, better demand encourage enterprises to increase production slightly, and the stock of finished goods is declining. Expectations for future demand and production level are optimistic but slightly less than in July. The negative feature is that firms plan to maintain current pace of layoffs within next three months. Producer prices are expected to increase slightly.

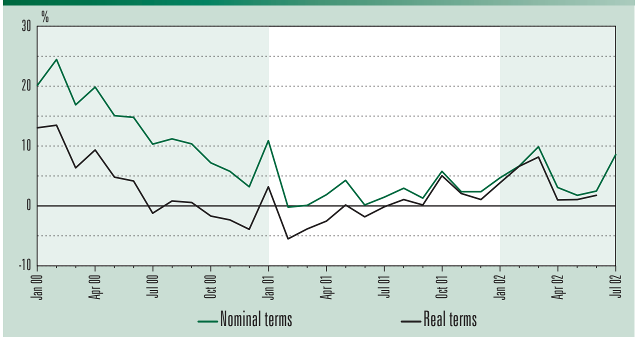
…together with rising propensity to consume

August's results of consumer's optimism survey performed by Ipsos-Demoskop and published by Rzeczpospolita daily showed that overall optimism index inched up by 2 pp in relation to previous month, while households' propensity to consume increased by 3 pp, reaching the highest level since July 2001. At the same time the assessment of current economic situation stabilised at relatively low level. The 12-month changes of the indices show moderate improvement in all three cases however, with the biggest increase for overall optimism (5.5%YoY) and the propensity to spend (4.8%YoY). What is interesting and positive, households reported improvement of their financial situation, the ratio of respondents planning the purchase of durable goods increased, while inflationary expectations declined substantially (see also below). Nevertheless the fear of unemployment still remains at relatively high level, constraining the level of private consumption. Interestingly the assessment of economic situation did not improve despite the changes in PM Miller's cabinet and the measures presented by new finance minister. The survey was performed before Pope's visit to Poland, so its positive influence on the consumer's mood wasn't reflected yet.

…which was confirmed in retail sales data

Improving consumers' confidence and rising propensity to consume was confirmed in July's retail sales data released by the CSO. Retail sales in July increased by 6.5%MoM and accelerated to 8.6%YoY in nominal terms. The improvement was much more significant than last month and this time it was coupled by sharply growing industrial output dynamic (data on industrial production were released earlier last week). In July, the biggest increase of sales value was recorded in pharmaceuticals and cosmetics (26.8%YoY). Robust growth of sales in such groups like textiles, clothing and shoes (up 18.5%YoY), and motor vehicles (up 11.3%YoY - confirmation of previous cars' market analysts' information) shows accelerating consumers' spending. It is supported by data on increasing activity of non-bank creditors. Value of their assets grew by ca. 25%YoY in July. While

Retail sales YoY



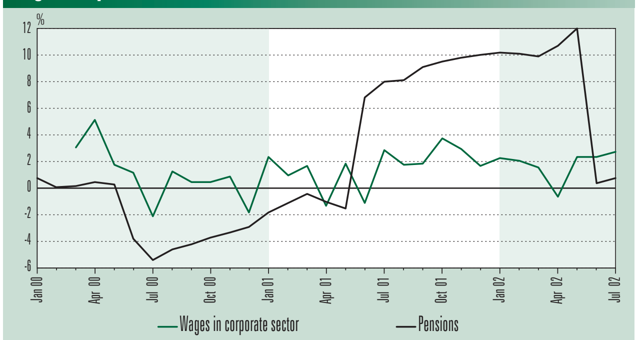
Source: CSO

surprisingly positive July's data may turn out to be only a one-month phenomenon, they suggest that private consumption may not drop substantially in 2H02 and will stabilise economic growth.

No major changes on the labour market

Of course the pace of growth of private consumption will be limited by the situation on the labour market. CSO's data about wages and employment in corporate sector in July did not signal major improvement. Wages in corporate sector increased 4.1%YoY in July (in nominal terms), broadly in line with trend observed in recent months (in June the growth amounted to 3.9%YoY). Employment in corporate sector fell 0.3%MoM and 4.2%YoY. Although real wages growth accelerated to ca. 2.7%YoY (the highest in 8 months) amid declining inflation rate, nominal and real wage bills remained below last year's levels (-0.2%YoY and -1.6%YoY respectively), suggesting that households' purchasing power remains constrained.

Wages and pensions, real terms YoY



Source: CSO

According to official data revealed by the CSO, the unemployment rate in July increased to 17.4% from 17.3% in June. The number of unemployed reached 3.105 million. The figures exactly matched previous predictions of labour minister Jerzy Hausner. He envisages that in August the unemployment rate will stabilise or slightly rise to 17.5%.

The positive factor is that the number of job offers jumped in July by 35.2%MoM and 35.7%YoY. However, in the remainder of the year the unemployment rate is expected to accelerate due to seasonal factors and may be close to 19% in December.

Investments still down in 2Q02

Last month, the statistical office published also data on investments outlyas. Investments in national economy in 1H02 dropped by 15.6%YoY while fixed investments declined by 15.5%YoY. As always, the CSO did not revealed data on investments in the first quarter of the year and therefore it is not possible to see what was the dynamic of investments in subsequent quarters. However, if the released data (they are aggregated on a basis of reports from enterprises with over 50 employees) were comparable with data from System of National Accounts that are used to calculate GDP, it would mean that fall of investments in the economy deepened in 2Q02 (National Accounts indicated 13.6% drop in 1Q02).

This should be not surprising if we remember that own resources (profits) finance most of investments and we look at financial results of the companies in 2Q02. According to CSO's data revealed difficult companies' financial stance was maintained in 2Q02. Total proceeds were lower than in the corresponding period of last year. Nevertheless, firms were able to reduce cost faster than the turnover decreased, which resulted in slight improvement of profitability and liquidity ratios in annual terms. The fact that companies' financial situation in 1H02 improved only slightly in relation to 1H01 suggests that it deteriorated somehow in 2Q02, while in 1Q02 the companies recorded sharp improvement of their financial stance. What is interesting, also exporters recorded improvement of financial indicators despite their claims on overvalued zloty exchange rate, and in fact this was the group of firms among which the improvement was the most significant. It is consistent with the NBP's business climate report indicating that exporters evaluate their current condition better than average entrepreneur and their expectations for the future are also more optimistic.

...but newly started investments increased

On the other hand, investment data has some positive elements. Value of newly started investments in 1H02 was 44.9%YoY higher than in corresponding period of the previous year. In industry alone it jumped by 115.5%YoY. This data are consistent with gradually improving companies' financial stance. While data on investments gives hope for future investments recovery, they should be treated cautiously and one should wait for their confirmation in next quarter. We do not change our view that fixed investments are likely to increase YoY in real terms in 4Q02

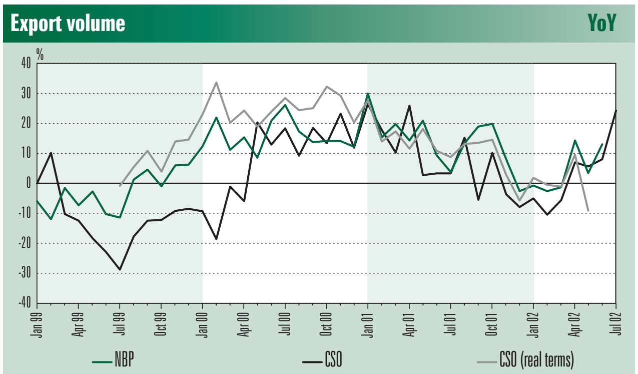
Budget revenues broadly on track after July

The budgetary figures for July confirmed earlier hints given by deputy finance minister Halina Wasilewska-Trenkner. The budget deficit amounted to PLN25.7bn after July, i.e. 64.2% of the plan for whole 2002. Total budget revenues performed quite well, growing 1.1%YoY on cumulative basis (Jan-Jul) and as high as 32.2%YoY in July. The strongest growth was recorded in indirect taxes, which increased 12.2%YoY on cumulative basis and 15.6%YoY in July. Nevertheless, as it was the case last month, this phenomenon could be to some extent the consequence of extension of VAT repayment time for exporters to 60 days, which became effective since the beginning of June. In effect in June and July the net receipts from VAT tax were increased because tax repayments for substantial part of exporting companies were delayed until end of July. Corporate income tax, although looking good at cumulative basis (growth by 9.4%YoY), in July was 13% lower than in corresponding month 2001, which is somehow disappointing. Personal income tax revenues performed relatively well, growing 11.5%YoY in July, which reflected smaller tax allowances this year rather than acceleration of wage bill (the latter still remains below last year's levels, see above). In July budget received inflow of PLN2.6bn from NBP's profit.

One should notice quite vigorous acceleration of government's spending in July. Expenditure growth amounted to 30.4%YoY in single month and 7.3%YoY on cumulative basis, compared to 0.5% and 4.1% respectively in June. The major reason behind it was sharp increase of budget's subsidies for Social Security Fund (FUS). Indeed it seems that very recently ZUS made some progress in paying off the overdue pension premiums, which some of us experienced on their own accounts in pension funds. Good, but before falling into excessive optimism it is worth recalling that last time ZUS accelerated the repayment of overdue premiums, its president lost the job very quickly. All in all, the advancement of central budget after seven months suggests that realisation of this year's budget plan seems pretty safe.

Still good export results

Data on foreign trade on customs basis in June showed that after some downturn of export dynamics in May, it sharply grew in June. The export growth rate in dollar terms for June alone amounted to 13%YoY. In January-June period, exports expressed in dollar terms increased by 4.1%YoY compared to 0.2%YoY after five months of the year. The CSO data on foreign trade are consistent with previously released NBP data on a payment basis, which showed strong export growth. In June also import accelerated to 10.1%YoY and it increased by 2.2%YoY in January-June period, while it stood at 1.8%YoY in May and was flat in annual terms in January-May period.



Source: GUS, NBP

...and high trade turnover also on payment basis

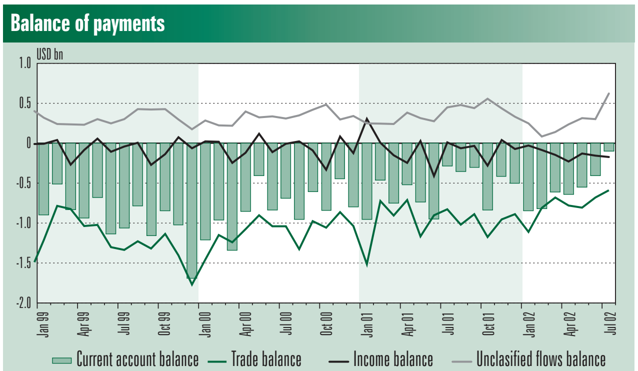
Balance of payments data released at the end of August positively surprised the market. Current account deficit fell sharply in July to US$97m from US$408m (revised up) in June. Trade deficit amounted to US$588m amid very strong exports (US$3.02bn, growing 18.6%MoM and 24.2%YoY) and improved import volume (US$3.19bn, 12%MoM and 11.3%YoY). Export payments exceeded the level of US$3bn for the first time since the beginning of 90s. Rapid improvement was also recorded on the unclassified flows balance, which reached the surplus of US$624m, more than twice as high as in last two months. The ratio of cumulative 12-month C/A deficit to GDP declined to ca. 3.5% from 3.7% recorded in June.

When interpreting very strong export performance in July one has to bear in mind the factor that also was affecting industrial production's figures - the sale of ships from Szczecin shipyard that were used as a collateral for bank's loan. This one-off factor somehow limits the optimism regarding export rebound and suggests that next month's figures might not be that impressive. Nevertheless even accounting for this factor, the data still look good, confirming that foreign demand for Polish products remains robust.

At the same time import also exhibits some signs of revival, signalling that domestic demand might be recovering from depression as well. To some extent it is understandable, as many exporters are at the same time importers of intermediate goods and raw materials and so the two figures move together to some extent. But improved import growth might also reflect acceleration of consumption demand (mind that retail sales surged 8.6%YoY in July, mostly amid car sales growth) and gradual improvement of investment activity. Sharp zloty depreciation in July strongly supported the unclassified flows balance, which achieved the record-high surplus in July. It might have resulted mainly from two factors: increase of cross-border trade while the attractiveness of Polish products to our neighbours improved sharply after currency weakening, and intensified exchange of household's savings held in foreign currencies into zlotys after the exchange rate plummeted.

In the light of very optimistic export and import turnover now it is easier to understand why MPC members repeated several times during last press conference that they have to wait until next month to be sure whether the real economic recovery is becoming a fact. They clearly realised that strong July's data (which they knew already) might partly reflect one-off factors and wanted to see whether the strong foreign trade performance is confirmed in the subsequent month. Probably if export and import growth in August will be as good as in July, the interest rate cut would be postponed for at least one month.

The data were clearly very positive, improving the chances that recent signs of economic recovery in Poland are not only the random disturbances, but reflect some actual trends in the economy. The possible one-off factors limit the optimism to some extent, but we believe the data confirm our gradual recovery scenario.



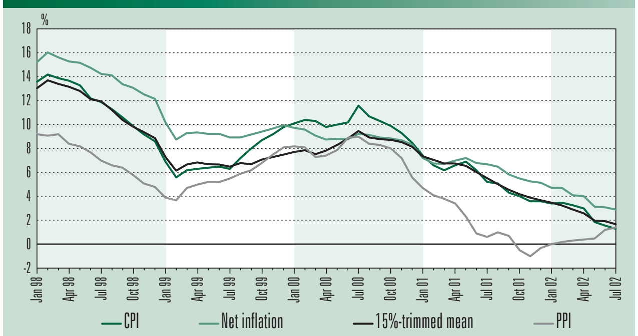
Source: NBP

Inflation - another new record low

Data on economic activity confirm our scenario of gradual GDP acceleration. However, this should not affect expectations for interest rates reduction, especially as the central bank is not very optimistic about the perspective of economic recovery. On the other hand, inflation prospects are still favourable. Despite the fact market consensus points to inflation increase by year-end, it has to be noticed that last month a significant downward revision of forecast was observed.

Last month CSO released that inflation in July fell to another record low level of 1.3% falling on monthly basis by 0.5%. Figures were in line with forecasts - as expected July was the third consecutive month of seasonal deflation, which happened for the first time in the history of Poland's economic transition. The fall of prices on a monthly basis was driven mainly by food prices, which declined by 2.9%MoM. It was not fully offset by factors fuelling inflation. Electricity prices, affected by excise tax hike, increased 6.5%MoM - higher than 5.7% forecasted by the URE (energy market regulator), but lower than expected in the most pessimistic scenarios. Also transportation prices, including fuel costs, grew only moderately by 0.7%MoM. It seems that the zloty weakening observed since the beginning of May did not passed through on prices. Other components of the consumer's basket were roughly stable last month, which confirms that demand is still stagnant. The CSO released also producer prices data, which were above market expectations reaching 0.5%MoM and 1.4%YoY (data for June were revised upward to 0.2% and 1.2%, respectively). Slightly accelerating producer prices dynamic seem to stem partly from the zloty depreciation, which increases mainly fuel prices. Its second-round effects may be observed also in August. The gradual acceleration of annual growth rate of PPI is also a consequence of low-base effect.

Measures of inflation YoY



Source: CSO, NBP

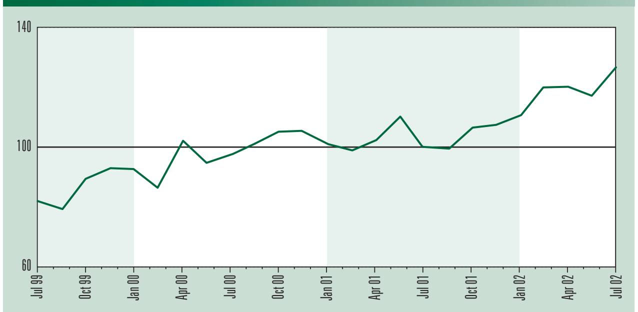
...and all core inflation measures down in July

All five measures of core inflation computed by the National Bank of Poland declined in July, reaching - similarly to CPI - the lowest levels in their history. In three out of five cases the collapse of core inflation's annual growth rate was deeper than the fall of headline inflation. But the two measures most closely watched by the central bank, i.e. net inflation and 15%-trimmed mean, declined slightly less than CPI (they fell from 3.1% and 1.94% to 2.9% and 1.7%, respectively). In July the lowest level reached inflation excluding controlled prices, which grew 0.8%YoY. Only net inflation was above the lower end of NBP's inflation target of 2%. In general, the core inflation statistics proved once again that there are no signs of inflationary pressure in the economy at the moment and that medium-term inflation prospects seem pretty favourable.

(Almost) everyone optimistic on inflation

In the interview given to Polish Radio (see also Government and politics watch section) finance minister Grzegorz Ko_ odko told that inflation rate at the end of 2002 will reach 1.6-1.8% - no less, no more. Kolodko's optimism regarding inflation seems to be shared by public opinion. According to Ipsos-Demoskop survey, households' inflation expectations fell substantially in August. Recently we have also observed sharp downward revision of market participants' inflation expectations.

Households' inflationary expectations



Source: Ipsos-Demoskop

Note: higher values indicate falling inflationary expectations.

Also, the results of opinion polls among financial market's participants showed a rapid fall of inflationary expectations. Inflation rate forecasted for December 2002 declined sharply to 2.3%YoY in Reuters' poll and to 2.15%YoY in PAP's survey (from 2.8% and 2.7%, respectively recorded last month). Analysts forecast July's inflation (to be released on 19th) at 1.4% with a ±0.1pp tolerance band. In Reuters' poll inflation in July 2003 is forecasted at 3.1%YoY, which signals that even in medium term the price rebound is seen to be rather limited. One should expect another fall of inflation consensus forecast (probably below 2%) after August's food prices release.

Inflation below the target … again

Prices of food and non-alcoholic beverages in the first half of August fell by 1.7%MoM and again it was far deeper than the decline expected by the market, proving one more time that the excess supply on the food market remains substantial. In the second half of last month the prices' fall was less significant bringing the average monthly figure to -1.5%MoM. Ministry of Finance's research department forecasts August's inflation at 1.2%YoY against 1.3%YoY in July. However, it will depend on a performance of other CPI components and the most important is to what extent the effects of electricity tariffs hikes and fuel prices increases observed in July, were continued in August. While we do not think that increases of these two components will be sufficient to cause an increase of annual CPI in August, it is to be seen if another fall is possible.

MinFin said also that CPI inflation is likely to be stable in September and at the end of the year should reach 1.6-1.7%YoY. End-year forecast is consistent with our expectations, but we expect inflation to increase moderately in September (assuming food prices increase of 0.7-0.8%MoM).

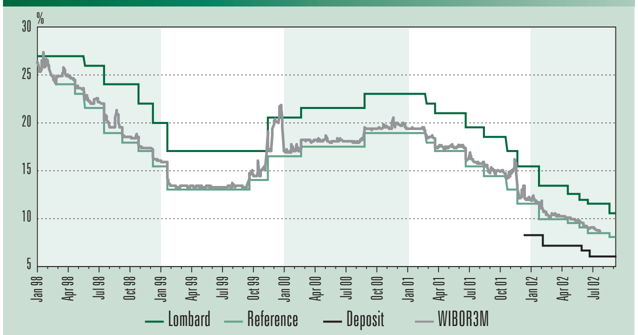
Central bank watch

- As expected, rates down in August
- …and this is not over
- Euro adoption not earlier than 2007

More rate cuts expected

In August the MPC cut the official interest rates. Lombard rate have been reduced by 100bp to 10.5%, reference rate by 50bp to 8.0%, and deposit rate remained at 5.5%. MPC maintained the neutral bias in its monetary policy. The decision was surely no surprise and was anticipated both by the market and by nearly all the economists. The fact that not all the interest rates have been cut in the same scale resulted from the desire to narrow the fluctuation band for interbank interest rates, as the absolute level of interest rates declined.

Interests rates



Source: BZ WBK

During the press conference Leszek Balcerowicz said that low inflation and better prospects for CPI inflation in the near term (lower inflation expectations of both households and economists) were the main reason for eleventh rates reduction. While the MPC members positively perceive signs of higher economic activity (good industrial production, retail sales and high number newly started investments), in their opinion recovery is likely to be gradual, which does not create risk for the realisation of the inflation target. This is exactly our view as well. It seems also that the MPC members' view on short-term inflation development is similar to our forecast, as Grzegorz Wójtowicz said that August's CPI inflation is likely to fall to 1.2% - this could suggest that such a fall was already priced-in by the Council. As usual, the MPC indicated the risk of expansive fiscal policy (high economic deficit), high dynamics of cash in circulation and the risk of fuel prices increase, as the reasons limiting the scale of monetary easing.

After the decision and quite dovish Council's statement we do not change our view that rates' reduction process will be continued this year. Grzegorz Wojtowicz's statement concerning future monetary policy was quite interesting, as he said "after eleven rate cuts, the one sure thing is that the next eleven cuts will not take place … unless these would be cuts of 10bp each". Such a view suggests that the dovish faction within the MPC see the chance of additional 100bp reduction within next couple of months. However, in TV interview Wójtowicz added that he hopes for the change of policy mix, which means that the Council will very closely watch next year's budget proposal and that the scale of next reductions will depend on economic deficit. As we do not expect the expansiveness of fiscal policy to change dramatically (even lower central budget deficit would not necessarily mean lower deficit of total public finances sector), we expect 50bps reduction this year with a chance for another 50bps (possibly two moves of 25bps) in 2003. While rate cut in September cannot be completely ruled out (if economic activity data do not confirm higher growth perspectives), we would attach higher probability to October-November scenario.

Is euro adoption possible in 2006?

The Ministry of Finance and the NBP decided that they would not comment in the media on the details of the consultations of joint committee that started to co-operate several weeks ago in order to work out the country's FX strategy in context of EU and EMU entry. However, both sides have revealed recently that they have already agreed that the most beneficial for Poland's economy would be to join EMU as fast as possible after entering EU. NBP governor Leszek Balcerowicz announced such a statement after the MPC meeting and the similar view was represented made by deputy finance minister Ryszard Michalski in the interview published on FinMin's web site.

Reuters reported that Balcerowicz mentioned 2006 as a most wanted date of EMU entry, while PAP reported that he only said about „two years after joining EU", adding that „it would require meeting Maastricht convergence criteria in 2005". Let's recall that we have analysed the possible timeline of euro adoption in Poland in the July's issue of MACROscope. According to the most optimistic scenario that we have outlined, the earliest possible date seems to be the beginning of 2007, mostly due to technical reasons and the length of the EU's procedures. We maintain this view, as it is hard to expect that we would enter the Eurozone as soon as at the beginning of 2006 if the eligibility was supposed to be checked on basis of economic performance in 2005 (the first official data about 2005 will be known in first quarter of 2006).

In the above-mentioned interview with minister Michalski he revealed also that while the both sides agree on the general principles of FX strategy, the difference is that the government is more concerned with short- and medium-term zloty developments, while central bank is concentrated on long-term developments. Therefore - said Michalski - the ministry plans to buy foreign currencies for repayment of interest on Polish foreign debt on the FX market, creating additional pressure for zloty weakening.

In our opinion euro adoption in 2007 is more likely, but the strong commitment of both NBP and the central bank could be positively accepted by the markets increasing the investors' confidence in nominal convergence, resulting in zloty appreciation and yields' decline. Such an effect is more likely after the official announcement of joint statement, which according to NBP vice-president Andrzej Bratkowski is likely to take place in October at the latest.

Only two against the rate cut in June

The results of MPC members' voting in June were published in the government's Monitor last month. As in May only two MPC members were against 50bps rate cut in June. However, this time, except Marek Dąbrowski who always opposes monetary easing, the vote against was also made by Jerzy Pruski. Similarly to April's voting results, the rationale behind Pruski's decision is hard to guess. One possibility is that he supported deeper rate cut at the time. The second one is that he was against any rate cut at all. Bearing in mind MPC voting results in January the latter option seems more likely. Pruski was then against 200, 150 and 100 bps rate cut while other "hawks" voted for 100 bps reduction.

The NBP adjusts its instruments to ECB standards

MPC member Dariusz Rosati said that the NBP wants to replace 28-days open market operations with the shorter ones lasting 14-days from the beginning of 2003. It is aimed at increasing elasticity of banking system liquidity management and harmonising Polish open market operations with ECB standard (the basic ECB instrument is 2-week repo operation). The NBP also plans to introduce fine-tuning operations (with maturity from 1 to 7 days), which will be conducted ad hoc and structural operations (up to 3 months), probably carried out on a regular basis. Rosati added that MPC is working also on adjusting the reserve requirement to ECB standards, which means charging interest on the obligatory reserves and lowering the ratio from present 4.5% to 2%. According to Rosati the NBP wants to complete the sell of converted bonds (representing government's debt to the central bank) until the end of 2002. MPC member concluded that if excess liquidity in the banking sector maintained, the NBP would be selling its own papers with the maturity of 3 months or longer.

Changes to the NBP instruments intended to adjusting them to ECB standards will shorten the section of the yield curve directly controlled by the central bank. On the other hand it will mean more effective control of up to 14-days segment.

Comments of the MPC members

In the first half of August, because of holiday season, the representatives of the central bank were not present in the media. Their first comments were heard only after the publication of better than expected economic figures for July. The opinions of the MPC members seemed to be divided. Whereas Cezary Józefiak seemed surprised with the record low inflation level, Grzegorz Wójtowicz and Dariusz Rosati were not astonished at all. Moreover, the MPC 'doves' said they did not see any major threats for the medium-term inflation, even though they realised that it would not keep on dropping forever. Andrzej Bratkowski, vice-president of the NBP presented the bank's projection for economic growth, which, surprisingly, is one of the most pessimistic on the market. With such projections, it would be strange if the MPC refrained from further loosening of monetary policy. Dariusz Rosati also mentioned the planned changes to the open market operations in 2003 (this issue was discussed at the beginning of the report).
In the last week of the month, the comments of the representatives of the central bank mainly referred to inflation, foreign trade and the prospects for economic growth. Grzegorz Wójtowicz projects that August will be the fourth deflation month in a row, and following the surprisingly good news on July payment balance, he is also more optimistic with regard to the current account deficit / GDP ratio this year. Dariusz Rosati believes that the supply factors will no longer positively influence inflation; however, he does not expect a major inflation increase in the upcoming months. In his opinion, 3Q02 should be the period of substantial growth in economic activity. Leszek Balcerowicz, NBP President, also sees some positive trends in the economy, especially in exports. On the other hand, he is cautious when it comes to fiscal policy. Whereas Balcerowicz confirmed that the NBP also anticipated continued deflation, he also said that the latest figures indicated the need to remain a prudential approach to the monetary policy.

WHO? WHERE? WHEN?	QUOTE
Leszek Balcerowicz; NBP governor;	
PR1, 29 Aug	What is worrying is that public debt relation to GDP begins to sharply rise from the level of below 42%, and now we hear that it is approaching 50%. It might exceed some limits established in law on public finances. The modified forecasts are within the current range of forecasts of the national bank. The question, which arises in this case, is how it will affect tax collection in the long-term and propensity to pay taxes. The second question is to what extent current regulations allows for attaining results, which the new law is aimed at. For instance, do current regulations not allow tax officers to check property of people who are supposed to receive incomes from hidden sources. One cannot rule it out (speculative attacks on the zloty within ERM2). Therefore it is worth to shorten transitory period, i.e. promoting joining the eurozone as soon as possible. This means that faster fulfilling of Maastricht criteria.
Reuters, 28 Aug	Inflation at low level supports low inflation expectations. The low level of inflation itself did not have influence on the MPC decision. It might be that signals of upcoming economic recovery have strengthened. Also data on exports are good. We will release this data officially on August 30, but I can say already today that they confirm previous trend. Macroeconomic data, showing growing chances of economic recovery, point to a need for cautious monetary policy. So far we have agreed on one thing: both the NBP and the finance ministry consider the earliest possible accession into the eurozone as the best option. The best option would be to join the euro zone two years after we join the European Union accession, which implies fulfilling Maastricht criteria in 2005. I think that this strategy ("small steps approach" in the process of monetary easing) is correct. The scale of uncertainty regarding fiscal policy constrains room for monetary policy manoeuvres. We hope that the economic deficit of the whole public finances sector will be smaller that forecasted up to date. Much indicates that the economic deficit might be higher than 5% (of GDP).
Andrzej Bratkowski, deputy governor of NBP	
PAP, 22 Aug	We were counting on demand from abroad but outside growth still seems to be meagre. [High retail sales growth in July] It is one more piece of information, which increases the likelihood that the recovery has begun. But I would be very cautious. It would be hard to see the [current account] deficit at more than four percent [this year]. We estimate GDP growth in 3Q02 at below 1%, in 4Q02 at around 1%, and in whole 2002 at 0.7%. It seems that industrial production growth in June and July was caused by export growth. We cannot count on strong production acceleration but we expect that such moderate production growth would be maintained, despite we expect more difficult situation. Inflation remains under control, probably in August it will be close to July's level and since autumn one could expect its gradual growth. I think that it [works of joint FinMin-NBP's team for the FX strategy ahead of EMU entry] should be completed in October the latest. Finishing the works in August is unlikely. I am against hurrying up […]. We talk, exchange the views, it takes time. When it comes to the general principles I think our views are very close. But we still discuss how to realise those general objectives.
Dariusz Rosati, MPC member,	
PAP, 26 August	Core inflation results are good, they confirm that even inflation measures without seasonal and one-off effects, such as food or fuel prices show permanent fall of inflation. On the one hand this is surely good news but on the other hand the situation in the real sphere remains difficult and there are no significant signs of demand recovery. With regard to core inflation, we do not expect changes. On the other hand, CPI will be changing because seasonal factors, most of all food prices development, will stop to affect it. Moreover, it will be accompanied by lagged consequences of hikes in excise on electricity and, to some extent, influence of fuel prices increases. At the same time, clearly fundamental factors from the demand side are not likely to change in the nearest time. Upward trend in industrial production will sustain, maybe it will not be such jump as in July, even taking into account the number of working days. I expected stronger recovery already in 2Q02 but it is late somehow due to situation on the foreign markets. However, 3Q02 will surely be a period of significant increase of economic activity.
PAP, 21 Aug	We would like to swap 28-day open market operations into 14-day operations since January 2003. It would be the primary instrument of the OMO. It would give greater elasticity and would allow banks to plan their liquidity better. We would perform two-week operations in a way to keep short-term WIBOR rates above reference rate. It would be exactly the same as now, but with shorter papers. Second introduced change would be tuning-up operations, short-term with the maturity of 1-7 days, responding to abrupt and short-lasting fluctuations in market liquidity. We also consider structural operations - medium-term with the maturity of three months. These are the main directions of considerations, the eventual shape of these proposals would be articulated in monetary policy guidelines for 2003 that would be ready in September. Some of the details might be discussed until the year-end. We still plan to finish this operation [sell-off of bonds from converted Treasury debt in NBP] by the end of this year and I think we will make it. But much depends on the market liquidity, which is difficult to forecast. There is the idea

	that FinMin would place the money also in commercial banks, then the liquidity conditions in banking sector would be different. If large excess liquidity in banking sector would maintain, then NBP would use 3-month or even longer bonds.
Puls Biznesu, 20 Aug	At present there are no factors that could reverse the trend of low inflation. There is no threat for inflation target […]. CPI in December could be at 2.5%.
PAP, 19 Aug	There is still substantial uncertainty regarding next year's budget, especially regarding the deficit level. From the fiscal policy side there is the biggest threat for low and stable inflation. MPC must look forward when making the decisions […] Therefore we are awaiting budget draft for 2003 with big concern. […] Inflation would rise, slowly but systematically. Personally I think that July's [CPI] level of 1.3% is the minimum for this year. In August it should reach ca. 1.5%.
Grzegorz Wójtowicz, MPC member,	
PAP, 30 Aug	The data published today are good. There is a chance that good export data will be maintained, which does not mean however that there will continuos progress. Exceptionally low C/A deficit has brought 12-month cumulative C/A deficit to GDP ratio to 3.6%. We have problem of low domestic demand. In such situation enterprises have lower chances to sell their products in the country and this make them to increase sale on foreign markets and we observe its results. Even assuming economic recovery in the second half of the year I think that C/A deficit at the end of the year will be closer to 4% of GDP than to 4.5% previously expected by me.
PAP, 28 Aug	After food prices one can expect that also August will be the month of deflation. In August 2001 it was -0.3% and it is probably that this year it will be similarly. But if it will be deep, it will by 0.1 pp, which means CPI fall to 1.2%YoY.
PAP, 20 Aug	I think that 2Q02 will be better than 1Q02. The growth should be below 1% but above 0.5% while at the end of the year we should exceed 1% of growth rate.
Reuters, 20 Aug	There is high probability that such recovery in 2H02 will come up. […] There are no revelations here but data on industrial production indicate that the optimists may be right.
Rzeczpospolita, 20 Aug	All in all theses are data for July, i.e. the period of lower economic activity and they do not mean that this is sustained upward trend. Such monthly data have to be confirmed at least two times. Inflation in July was not a surprise. We are approaching the lowest level. One cannot exclude that inflation in August will be lower than in July. The indicator that was revealed shows how big influence has weather on the Polish economy. […] This is too early to talk about deflation in Poland. […] Monetary policy is connected with the future and the revealed information concerns the past.
Reuters, 19 Aug	Everything is in line with expectations […] Last year we had deflation in August and it seems that it will be the case also this year. If it will be so, we will have fourth consecutive month of monthly deflation but I think that it will be relatively small. Since September we can have increasing monthly dynamics [of prices] and we can see upward trend in 12-month indicator […] possibly around 3,0% at the end of the year but it might be slightly lower.
Cezary Józefiak, MPC member,	
PAP, 19 Aug	The situation is somehow different than many thought, including me. I did not expect such food price deflation. I did not think that fuel prices performance would be like this. At the moment, no one estimates that these prices could deteriorate, at least in the short-term. Lowering the excise tax on alcoholic drinks may affect inflation this year. According to some estimates it may amount to 0.4 pp. One does not know an impact on inflation of interventions on the grain market and changes of exchange rate.

Information on the meeting of the Monetary Policy Council on august 27-28, 2002

The Monetary Policy Council held its meeting on August 27-28, 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. The Council discussed the external conditions of the Polish economy and tendencies in the real sector of the economy, in the area of wages and social benefits, money supply, lending and interest rates, in public finance sector, and the formation of inflation expectations, prices and the inflation outlook.

Decision of the Monetary Policy Council

In August, the enhancement of a low inflation level was observed. As compared to the situation observed a month before, factors that reduce inflation growth in future have strengthened:

- the expected level of inflation has been subject to a further reduction;
- all core inflation measures lowered;
- the dynamics of money supply M3 dropped to the level of 1.2%;
- the dynamics of lending to households lowered significantly, a low dynamics of lending to businesses is maintained;
- a moderate growth of wages does not threaten in a form of a growth of inflation pressure;
- a limitation of labor market stiffening - thanks to a partial liberalization of the labor code -will support the maintaining of inflation at a low level;
- the outlook of an accelerated growth in the USA and the European Union got more distant.

With less optimistic growth outlook for the world economy, in Poland, the signals of the economic boom got confirmed:

- the output in industrial processing grew in July by 7.8%;
- budget revenues from indirect taxes have been bigger than expected;
- export revenues have increased again;
- a material growth has been noted in newly begun investments;
- retail sales in current prices grew in July by 8.6%.

A moderate pace of the economic boom, in the Council's opinion, does not pose a threat to the accomplishment of the inflation target at the moment.

Factors that could threaten the stabilization of inflation at a low level are still observed:

- a drop of the annualized dynamics of household deposits takes place while at the same time a high dynamics of cash in circulation is maintained;
- an outlook of a high public finance sector deficit within the conditions of the planned economic growth in 2003, together with the forecasted increase of the scale of extended guarantees and allowances, means a further loosening of fiscal policy; so far there is no substantial proposals of reforms in the system of public expenses that would enable a sustained and effective reduction of a present high level of budget deficit;
- there is still maintained uncertainty related to the supply driven factors, especially fuel prices.

Considering these arguments, the Monetary Policy Council decided to:

- cut the minimum yield on 28-day open market operations from 8.5% to 8.0%;
- cut the rediscount rate from 10.0% to 9.0%;
- cut the lombard rate from 11.5% to 10.5%;
- maintain the deposit rate at the unchanged level (5.5%);
- maintain its neutral position in monetary policy.

The next meeting of the Monetary Policy Council will be held on September 24-25, 2002.

Government and politics watch

- The government prepares pre-accession programme
- …while budget for 2003 still unknown
- When public debt will exceeds 50% of GDP?

Pre-accession Economic Programme 2002

The Ministry of Finance has published Poland's Pre-accession Economic Programme. The programme was approved by the government at the beginning of August and summarises the government's social and economic initiatives until the end of 2005. The document also contains government's projection of economic situation in Poland. According to the text the GDP growth is expected to reach ca. 1% in 2Q02, and accelerate slightly in 2H02. The main driving force behind growth acceleration will be private consumption amid still positive net export's contribution to GDP growth. Fixed investments are forecasted to remain in red until the end of 2002, nevertheless they would recover as soon as in 2003 and will be one of the key factors contributing to economic recovery in the subsequent years. The GDP forecasts for whole 2002 and 2003 remained unchanged in relation to the former FinMin's assumptions and amounted to 1% and 3.1%, respectively.

The document reveals that the government plans to increase excise tax on cigarettes and tobacco by 6.3-6.4% annually in 2003-05. Assuming the same scale of retail prices increase, such hike would translate into ca. 0.17pp increase of CPI growth rate. Still, the government's inflationary expectations written down in the programme are quite optimistic, although they seem to be out-of-date. As we have already written before, today the government will discus the consequences of lowering inflation forecast for 2002-2003 to 2.1% and 2.3% respectively, while the document still assumes 2.5% and 3.0%. The inflation is expected to remain below 3% in 2004-2005, which is positive in context of meeting Maastricht convergence criteria.

Zloty is expected to depreciate gradually in 2002 against both dollar and euro and to start to appreciate against US dollar since the beginning of 2003. After 2003 the government expects zloty to fluctuate within ERM2 bands.

What about next year budget?

Last month the government did not decide about budget assumptions for 2003 and we still do not know the limit of public spending or budget deficit level. The government changed only average inflation forecast for 2003. It is assumed to amount to 2.3%, down from previously planned 3%. Contrary to expectations, it was not followed by lowering of the next year's wage increases in public sector, which means that real wage growth in public sector will increase to 1.7% from earlier planned 1.0% (additional budgetary spending of PLN 0.25bn). It will also mean higher indexation of social benefits (additional spending of PLN1bn).

After one of the cabinet's meetings labour minister Jerzy Hausner said that the government did not discuss other elements of 2003 budgetary assumptions (GDP growth or budget deficit level). Nevertheless, he confirmed that Marek Belka's "inflation plus 1%" rule for total central budget spending growth is still binding. Minister Hausner also confirmed Finance Minister's pledge to reduce budget deficit below previously assumed PLN43bn. What is more, according to the Polish Press Agency one of SLD's deputies said that Grzegorz Kołodko has ensured that budget deficit for the next year will not exceed PLN38bn. It is to be seen how such a level will be achieved. In our opinion it will be much more difficult, as the government will have to find additional spending cuts amounting to around PLN1.3bn to make up for the faster real wage growth. And this means that some ministers will have to agree for nominal reduction of spending level in comparison with this year.

While the cabinet did not reveal what is the final assumption concerning GDP growth next year, Dariusz Rosati told yesterday that he expects the government to be more conservative in its growth forecast, cutting the GDP growth assumption to 2.2-2.5%. This, together with negative effect on revenues coming from downward revision of inflation, would make lowering the central budget deficit below PLN40bn really difficult. Of course, the government may for example decide to increase central bank's revenues or to buy-back Brady bonds (additional revenues from selling collateral) or to spend some money outside the central budget, and such tricks would make possible to achieve lower deficit. We would like to reiterate, however, that not only central budget, but total public finances sector balance is a measure of fiscal policy restrictiveness in Poland and this is the factor analysed by the Monetary Policy Council. Therefore, the final budget proposal, which according to the government's spokesman will be released very soon (earlier than the deadline of 30 September), should be very closely watched.

When public debt will exceed 50% of GDP?

At the end of August, the government discussed finance minister's information about the threats connected with the level of public debt. The document says that in case the privatisation revenues this year prove to be much lower than planned (they reached only 13% of annual plan until 20 August), the level of public debt might exceed 50% of GDP already in 2002. Mind that treasury minister Wiesław Kaczmarek said in one of interviews in public radio that achieving privatisation revenues of PLN6.7bn planned for this year may be difficult. The substantial increases of guarantees and credit assurances that have been granted in 2001-2002 might raise additional concern. Part of them is very likely to become payable in the medium term (those granted to state railways, Szczecin shipyard, steel mills, coal mining companies etc.) increasing the forecasted public debt in the coming years. The level of public debt remains a serious concern, because if still growing, it might increase the risk of downgrade of Poland's debt ratings (as was the case in July with S&P's). At present however, it should still have little impact on the market. Present FinMin's forecasts of the level of public debt (in relation to GDP) look as follows:

Public debt / GDP tab. 1

2002	2003	2004	2005
49,8%	52,3%	54,1%	54,3%

Source: Finance ministry

...And forgiveness for all

At the end of August the parliament returned to work after the holiday break and started to debat over the couple of bills connected with the government's 'anti-crisis' package. As we have written in August's edition of MACROscope, the proposed measures are concentrated mainly on improving microeconomic effectiveness of the ailing companies, e.g. by the forgiveness of overdue debts that are perceived as impossible to be repaid, granting special tax credits, facilitating companies' restructuring, and so on. The bills have been sent to Sejm's public finance committee for further analyses.

The government revealed also that state's generosity would not be constrained only to entrepreneurs. The cabinet accepted the Ministry of Finance's plan to grant the tax abolition for taxpayers that would reveal their hidden income that has not been taxed so far. According to these plans all the citizens would have to present the detailed account of their property and indicate the source of funding. The disclosed "grey-sphere" income would be only charged by 7.5% fee. However if the tax office discovers the revenue source that was not revealed, the penalty tax rate would equal to 75%.

Rating maintained ... but fiscal policy criticised

International rating agency Fitch Ratings published official release about Poland's fiscal policy. In the commentary named "The Polish Fiscal Glass - Half Empty or Half Full?" the agency criticised recent developments in the Polish fiscal policy, namely "sharp increase in the general government deficit to 6% of GDP and a reversal of the previous steady decline in general government debt". They pointed out that ahead of local elections current government had focused on employment preservation and economic growth stimuli rather than necessary expenditure restraint, while the latter was crucial for medium-term fiscal perspectives. Fitch Ratings remained very sceptical about the beneficial effects of government's "Entrepreneurship-Development-Employment" programme and recent "anti-crisis" package and said that it could add to the fiscal burden in the medium term.

Notwithstanding all the criticism the agency underscored the role of positive stabilising factors, i.e. restrictions on public debt imposed by Public Finance Act and the Constitution, and the perspective of Polands' EU accession. "The risks and offsetting positive factors associated with the medium-term fiscal balance remain consistent with the Stable Outlook on the Long-term foreign currency (BBB+) and local currency (A+) ratings." - concluded the Fitch's report.

The similar analysis was prepared by Moody's Investors Service, which said (as it pre-announced at the beginning of August) that it holds its ratings for Poland. Rating for long-term foreign currency debt still stands at Baa1. The agency said in its official statement that maintaining of the rating in the future would depend on improvement of the situation on the current account of the balance of payments and at least stabilisation of the fiscal stance in the medium-term. Moody's believes that Poland's financial standing will be strengthened by membership in the EU. However, the agency sees many dangers. The most important is budget deficit, which (if maintained at the current level in the future) may lead to increase of public debt above constitutional limits. Besides Moody's points to structural problems of the Polish economy, such as uncompleted privatisation and labour market rigidities. The agency is also afraid of the government's economic program, which might cause sharp increase of state's guarantees.

While Fitch Ratings and Moody's decision constrains previous negative influence of S&P's decision to downgrade Polish rating, its statement may be also perceived a warning signal for fiscal authorities.

Will support for the government stabilise?

According to the most of last month opinion polls, the public support for SLD-UP coalition increased to above 30% in August, although one of polls showed even 37% support. Minor coalition partner PSL has stable popularity of around 10%, while its main competitor among farmers' electorate Samoobrona sees the downward trend of public support. O the right wing, civic Platform and Law and Justice have stable popularity of 10-15%. However, according to PBS opinion poll anti-EU League of Polish Families reached the highest popularity of 11%, while two other parties (civic Platform and Law and Justice) have 10%.

Still high popularity of the government's parties may be surprising if one looks at recent results of OBOP opinion poll, according to which only 19% of Poles assessed present government as "rather good" in August, while 45% expressed negative opinion and 24% said it is very bad. In July the corresponding numbers stood at 21%, 45% and 23% respectively. For the second consecutive month there was no single person who said the government is "very good". At the same time the support for PM Leszek Miller is declining as well. It seems that the reshuffle in the cabinet made in July, the 'anti-crisis' package presented by finance minister, and Grzegorz Kołodko's heavy struggle to inject a substantial load of optimism into people's heads did not manage to improve government's image so far. This raises the questions about next government moves before local elections.

Labour code signed, local elections date known

Polish president Aleksander Kwaśniewski signed the new labour code passed by the Lower House in July and approved by the Upper House at the beginning of August. We wrote about the most important changes, aiming at increasing labour market's elasticity and decreasing labour costs, last month. Amendments have been worked out with the support of the pro-government OPZZ trade union. However, works on changes to the labour code were opposed from the very beginning by main right-wing union, "Solidarity". Its chief Marian Krzaklewski announced that "Solidarity" will appeal against the new law to the Constitutional Tribunal.

On 10 August Prime Minister Leszek Miller announced that local elections will be held on 27 October and the second round would take place two weeks later, on 10 November.

Comments of the government members and politicians

At the beginning of the month, voices were heard saying that the referendum on Poland's accession to the EU would be postponed from autumn to spring next year. The comments of the politicians indicate that so far the government has not made an internal decision in this respect.

Representative of the Ministry of Finance said that it would be prudential to lodge budget deposits with commercial banks. The Ministry also adjusted downwards its inflation forecast for August, after exceptionally good figures for food prices were published. It also announced projections of lower inflation for 2003, which slightly complicates the plan of the next-year budget as it requires additional curbing of expenses - especially in face of the recent government's approval of higher real growth in social benefits and remuneration in the public sector.

Jarosław Kalinowski, Minister of Agriculture, tried to be more active and announced an increase in the state intervention on the agricultural market. Despite the recent 'silence' of the government in response to the actions taken by the MPC, Leszek Miller, Prime Minister, could not stop himself and stated that he expected interest rate cuts. He also complained about the relationship between the government and the central bank, which seems strange as only positive signals have been heard in this respect. In the meantime, Grzegorz Kołodko, Deputy Prime Minister, seemed to be very optimistic, he did not complain about anything and he tired to share his optimism with the society. He was extremely satisfied with excellent July figures, which, in his opinion, reflected the first positive effects of his appointment to the post (this is what we call fast and effective transmission of economic impulses). Kołodko also projected continued economic recovery in 2H02 and said the inflation was to be at 1.6-1.8% YoY in December. The Deputy Prime Minister also praised the new bankruptcy law and, most importantly, the tax abolition proposal. President Kwaśniewski expressed his approval for the tax abolition, which increases the chances for the implementation of Mr Kołodko's proposals.

Jerzy Hausner, Minister of Labour, stated that the unemployment growth in August would still be curbed, whereas Marian Krzaklewski, leader of the trade unions, said that "Solidarność" was going to file a claim against the amendment to the Labour Code with the Constitutional Tribunal.

As before, the Ministry of Finance refused to comment on the MPC decision. Witold Orłowski, President's Economic Advisor, said that interest rate cut would be justified in the current situation. Head of the Research Department of Finance Ministry presented optimistic inflation forecasts. Ryszard Michalski, Deputy Finance Minister, said that in the upcoming years, the Ministry of Finance was going to finance the repayment of interest on the foreign debt by way of buying the required currencies on the market, whereas the principal will be rolled-over on the international capital market. According to Wiesław Kaczmarek, Treasury Minister, it will be very difficult to achieve the inflows from privatisation figures projected for this year.

WHO? WHERE? WHEN?	QUOTE
Aleksander Kwaśniewski; President;	
PR3, 29 Aug	This conception is clearer with regard to both tax declarations and tax abolition. This is a chance to make things clear before very strict requirement such as property declaration. I think that, like professor Ko_odko says, this is favour for those who forgot, fill documents up wrong or maybe did not have enough of good will. Thus, before introducing property declarations, which will very precisely monitor everyone assets, not only deputies, not only politicians, ministers, President, but also all citizens. Tax abolition was used in some countries and I think that this is the main argument to try this method. In my opinion this is (shrinking of shadow economy), I hope so, the most important result of the decision. I would believe to a lesser extent in higher budget revenues. I do not think that it will enable to collect extraordinary revenues although some revenues will surely be. Such state should be created in which tax matters will be treated very serious and all those who have illegal incomes will be afraid of it. Thus, not the abolition is the most important instrument but property declarations. And I think also that this is the first serious idea how to fight corruption.
Mirosława Melasa; FinMin's press office;	
PAP, 28 Aug	No comments from our side [on the MPC decision].
Mariusz Łapiński; health minister;	
PAP, 27 Aug	I am supporter of heath-care contribution increase but it will be very difficult in the present situation of public finances. This will be matter of choice: education or health-care or combating unemployment. I will try to promote higher health-care contribution but I will not achieve it alone.
Ryszard Michalski; deputy finance minister;	
PAP, 27 Aug	We will want to refinance its principal part (of servicing foreign debt) on international markets, i.e. we will try to roll the old papers over new ones. However, we will finance interest part buying foreign currency on the FX market. In coming years we will face problem of significant spending related to foreign debt. 2004-2009 years will see the highest amount of foreign debt repayments. The service of this debt will reach level of US$3-3.5bn at the end of this period. Our common success is agreement that the best for Poland would be fast joining the eurozone. The difference is that the government is more concerned with short- and medium-term zloty developments, within next months and later when the zloty will be in ERM2. Meanwhile, the central bank is concentrated on long-term developments and sees only advantages in such time horizon. Besides we see problem of sharp change of monetary policy at the beginning of 2004 when the new MPC will be constituted. From not only our ministry's point of view it is very important that present eurozone members and the ECB would present their opinion about timing of Polish accession to the eurozone.
Witold Orłowski, chief economic advisor to the President	
PR3, 23 Aug	We have relatively high interest rates, at the same time no inflationary threat is visible. The economy is growing and there is no reason to keep interest rates at such high level. They can be reduced without any worry. MPC will consider this, because there are sound reasons to believe that the rates can be cut.
Marian Krzaklewski, head of „Solidarity" trade union	
PAP, 21 Aug	The president disdained very serious arguments, because we've called for not signing the [labour code] bill and sending it to Constitutional Tribunal, having the awareness of how much mistakes there is both against the Constitution and against Poland's international conventions. We will appeal [to Constitutional Tribunal] as soon as possible, i.e. on the day when the bill is published.
Leszek Miller, Prime Minister	
PR3, 21 Aug	It should happen [MPC should cut the rates this month], although […] for some time we try to be modest in commenting MPC's activity in order not to give a reason, that MPC would not bow, would not listen to government's suggestions. But the inflation in Poland is lower than in the EU and considering that we are all waiting for the stimulus for the economy, then lowering interest rates […] becomes evident. Anyway I am concerned that in EU15 or in the USA rates would have been lowered under similar circumstances.

	If there is something that I regret, it's that there is no satisfactory co-operation between the government and the central bank, which is and will remain independent. There is a chance for co-operation but we observe for a longish time that they talk a lot about it, there are plenty of declarations and very good intentions are articulated. But when it comes to action, it's much worse. We need action and we long for it.
Wiesław Kaczmarek, treasury minister;	
PAP, Reuters, 26 August	Realisation of PLN6.7bn revenues from privatisation is a difficult task. We try to carry out privatisation projects in such a way that would enable to execute the budgetary norm. If meeting the budget target will threaten the (government's) economic plans and the situation on the market it may mean that we will miss the target. Because the budget is for one year and consequences of privatisation are long-term one cannot focus on execution of the plan only.
Jarosław Kalinowski, agriculture minister;	
PAP, 18 Aug	We have guaranteed subsidies to 5.4 m tons of grain (1.4 m more than last year), but it is not enough because the whole system of state intervention is bad. This sick system has to be changed. We want in next year, the same as EU, to ensure subsidies to production of every hectare of grain. This is a gossip [about possible treasury minister dismissal]. Minister Kaczmarek took part in the government's meeting until the end.
PAP, 13 Aug	We guarantee that even despite budgetary difficulties there will be such subsidies. (…) We give possibility to pay subsidies to farmers, who stock grain in their own farm until the end of October. We are prepare for paying subsidies to 5.4m t of grain. Farmers are upset and this is not surprising. They want to sell grain with subsidies. The Agency [of Agricultural Market] will be regularly verifying contracts. Thus, those organisations, which will not be able to buy grain, e.g. because of lack of bank credit, will be able give their limits to other organisations, which declare such possibility. Decreasing of intervention price and increase of subsidies will cause that we will become grain exporters. Already now there are organisations interested in export of Polish wheat. This should improve situation on the market.
Marek Pol; infrastructure minister;	
PAP, 13 Aug	No, there was no such announcement [if any minister resigned]. Such issues are not discussed at ministerial meetings but rather in the premier's office. The Act enables writing off of operator's liabilities in the exchange for realisation of telecommunication investments, particularly in rural areas.
Jerzy Hausner; labour minister;	
PAP, 21 Aug	There will be no substantial increase of the unemployment rate in August. If the increase happens, it will be very slight, because I already have the data for the first half of month. After the first half of August the growth is much lower than after the first half of July. The unemployment rate could reach 17.4-17.5% in August.
PAP, 12 Aug	Effective realisation of the government's program "The first job" will not allow the unemployment rate to exceed 19% [at the end of 2002].
Ryszard Straus, director of govt's EU information office	
PAP, 11 Aug	The weather is better in the spring than in the autumn, and accordingly people's optimism and social climate are better. Experts say that more people would participate in the [EU accession] referendum [if it is held] in the spring rather than in the autumn.
Tadeusz Iwiński, international affairs minister in PM's office	
PAP, 11 Aug	[Moving the date of referendum] is highly unlikely. I've never heard about the idea of organising the referendum in the spring. Personally I think it's a bad idea.
Piotr Marczak, deputy director, FinMin's public debt dept.	
PAP, 8 Aug	Such idea [budget's deposits at commercial banks] is being considered for a longish time, but the situation was not supportive so far because of banking sector's high excess liquidity. In such circumstances placing the money outside NBP would mean that banks would bring this money back to NBP. Effect would be the same, but we would receive lower interest. There is a bid for banks that would have status of treasury market dealer. Those banks, at least at the early stage, would have the privilege to make [deposit] transactions with us. Interest rate at NBP need not to be higher [than in commercial banks]. Deposits at NBP are also dependent on sort of market conditions, based on market rates and t-bills' yields. In some countries the institutions managing public debt manage cash also by conditional or unconditional purchase of treasuries on domestic and offshore markets. We don't plan it in the short term. Nevertheless […] sooner or later we will do it.
Grzegorz Kołodko, deputy PM, finance minister;	
Reuters, 28 Aug	Until the end of 2002 one will be able to present one-off declaration revealing previously hidden income sources and pay this fee. We will create system of monitoring and controlling taxpayers' behaviour in the future in the form of property declaration. However, it will concern only part of taxpayers because very high limit was introduced, below which one will not have to declare anything. If people made a mistake over the past six years, they can put it right by the end of December. Then they will be able to sleep easy and work. A stage of the transformation is coming to an end. Now we are creating an effective, modern tax system, in line with world standards.
PR1, 22 Aug	I agree with the Pope, I agree with the bright and modern-thinking economists. For sure the policy conducted by Leszek Miller's cabinet and the social, economic and financial policy that I co-ordinate treat people and their interest, especially employers' interest, as a primary objective. It's a good news [that inflation collapsed to 1.3% in July], it's a proof that fiscal discipline is maintained, that competitiveness in our economy grows. But again -surely the news is not good for everyone. […] E.g. for farmers it is much less favourable news than for consumers. All those who spend much on consumption, on food, and these are mostly not wealthy households […] for them it's a good news. But for producers […] it's not good news. But let's remember that they also benefit from low inflation […]. It [economic growth] was very weak, in 1H02 it was very low, last year it was also low, but now we have excellent data for July, clearly Polish economy gains momentum, it gets moving… Experts say different things. It depends on who pays them for what they say. Those who say that it is not the proof of persistent trend, they are right. I'm the expert myself. And I've just told that the growth was weak in 1H02 […] But when we compare July, when some changes started taking place, also connected with the package that I'm working on and I'm implementing […] then there are already positive developments. […] And this excellent indicator, 6% production growth - I can tell you as an expert - we cannot be misleaded too easily, because there was one working

	day less than in July last year and it has to be taken into consideration. E.g. in August due to Pope's visit and to a public holiday we had very short week. It would be reflected in the statistics. But I believe that there are already positive developments in Polish economy due to realisation of Leszek Miller's cabinet's programme "Entrepreneurship first" and now the stimulus delivered by the anti-crisis package, it should support the trend if those positive developments would cumulate, then we will feel it more and more clearly in 2H02 and in subsequent years. In December [inflation] will reach ca. 1.7%… I think that it will be no less than 1.6% and no more than 1.8%. It's because there is very solid ground for low inflation, but of course depends on whether we will manage to work out what we are working on now very intensely. I mean budget of stabilisation and development, which will be presented to the parliament at the beginning of October, and to social partners (e.g. trade unions) much earlier.
Reuters, TVP, 13 Aug	We want to make sure there is no domino effect where one failed company affects others and causes a chain reaction. While we respect the free market, we want to intervene wherever needed to create new jobs. We want to protect the creditors. Soon everyone will hear about Chapter Four. This is equal to the Chapter 11 proceedings in the U.S.
Polish Radio 1, 8 Aug	[…] First of all we have to remain calm, because the times are not easy, but the more peaceful we are, the more hardworking, the more reasonable, the more calm there will be. And we wish it all. Let people smile to one another from time to time, then maybe it would be easier to find a way out of this difficult situation, which we were pushed in to by pointless cooling down of Polish economy. And we are approaching it already. And let's hope it would continue. Therefore sometimes, ladies and gentlemen, let's smile to each other.
Jacek Krzyślak, head of research at FinMin	
PAP, 27 Aug	After the food data we forecast prices will fall by 0.4 percent month-on-month in August, lowering the annual (consumer price) index to 1.2 percent . We maintain our previous forecast that inflation will decrease to 1.6% at the end of the year from 3.6% last year.
Halina Wasilewska-Trenkner; deputy finance minister;	
PAP, 6 Aug	Revenues from VAT and excise tax are accomplished in 55-56%. PIT revenues are at 43-44%, so there is slight slippage here. At this point we don't know yet how PIT after all tax repayments will look like. Revenues from the NBP and non-tax inflows are executed at ca. 70%, but this makes up for only 10% of budget revenues. Revenues are not bad, although it is still too little to claim with certainty that they will be higher than assumed in the budget bill. Budget realisation proceeds in line with the plan. We have the problem, possibly the inflation rate would be lower next year, but these are only preliminary estimates. If everything goes well, inflation could be lower by 0.3-0.4 pp. Government has decided to take significant risk and support the [Szczecin] shipyard. In case the shipyard fails to deliver the ships on time, we would have to pay PLN100m for payments connected with guarantees next year.

EU negotiations watch

- Ireland prepares for „Nice Treaty" referendum
- Majority of Poles support EU accession
- EU's report on candidate countries to be released soon

Pre-referendum campaign in Ireland

At the beginning of September, an information campaign was launched in Ireland before the second referendum on the Treaty of Nice. The Irish government decided that one of the reasons for rejecting the Treaty in the first referendum held in June 2001 (54% votes against) was poor promotional campaign. Therefore, this time round, EUR 600,000 was earmarked for mailing information brochures to all Irish households. The date of the second referendum in Ireland has not been set yet, it is to be announced in October, after a two-week parliamentary debate. Let us remind you that, in line with the analysis presented in July issue of MARKOskop, even if the Irish referendum has a negative outcome again, the worst that can happen is a few months delay in the integration process yet the sole fact of enlargement will not be at risk.

Support for integration still high

The date for the Polish referendum has not been set yet either and it looks as the Polish government cannot decide itself. However, Danuta Hubner, the Head of the European Integration Committee was quoted as saying that the referendum should be held as soon as possible following the closing of negotiations with Brussels. The public opinion poll published by "Rzeczpospolita" daily at the turn of August indicates that the support for Poland's accession to the EU has remained flat for the past two months (57%), however, there are still twice as many Eurocrats than Eurosceptics (23%). 71% of Poles who declare the will to vote in the next-year referendum on European integration will vote "for" it. Let us hope that the fact that S_awomir Wiatr (who is in charge of informing the Poles on the benefits arising from the European integration) had worked for the special forces in the Polish People's Republic, will not affect the referendum outcome. What will also be interesting is the analysis of the influence of the upcoming elections to local government units on the negotiation process. This refers, in particular, to agriculture, as we will definitely be offered less funds than the Polish government hopes for. Fortunately for the ruling coalition, the EU's internal debate on financing the enlargement process can move to the decision-taking stage after the election in Germany (to be held on 22 September) at the earliest, and most likely it will postponed till November.

... but the low support in the Czech Republic requires joint action

The support for the integration process is not equally high in all countries of the region. The Slovaks and the Hungarians might be even more optimistic than Poles (58% and 72% respectively), however only 47% of the Czechs support the enlargement. In view of the above, Vaclav Havel, the Czech President, put forth the idea (approved by the Polish president) of the so-called 'cascade voting' in national referenda. It would work as follows: the referendum would be first conducted in the countries where the greatest support was recorded, so as to boost the support for enlargement in the other countries.

Positive EU Report soon

The Annual Report of the European Union will be ready as late as in mid-October, however the Rzeczpospolita daily already now stipulates that the outcome for 10 candidate countries should be positive. Obviously, there will be concerns (such concerns will probably still be voiced after the accession), such as: inefficiency of courts, EU food standards and the allocation of pre-accession funds. At the turn of August, the EU officials were concerned about the allocation of pre-accession funds, and in particular the selection of SAPARD managers - the Commission even sent a special letter to the Polish government in this case.

However, according to Daniel Gros, Chief Expert on EU Enlargement, the membership will not be determined by the improvement in the areas mentioned above. After the report has been published, the heads of the EU member states will meet with a view to defining the enlargement conditions which have to be met by the candidate countries in order to take a decision about joining the EU by 10 new members at the Copenhagen Summit on 13-14 December.

Taxes and steelworks - to be continued

We still do not know when the Polish government will decide to submit the request for renegotiating the VAT rate for construction. According to Gazeta Wyborcza daily, this should happen as late as in the second part of October, following the publication of the EU Annual Report when much more serious issues are to be tabled for negotiations, thus making it easier to obtain the approval for lower VAT rate.

There is still no agreement on the restructuring plan for the steelworks industry, which is debated under the competition policy chapter, But probably, one way or another, Poland will manage to close this chapter until the end of September. There is still no agreement on the Polish steelworks will most likely be forced to organise further employment cuts and will have to do with lower state aid.

Market monitor

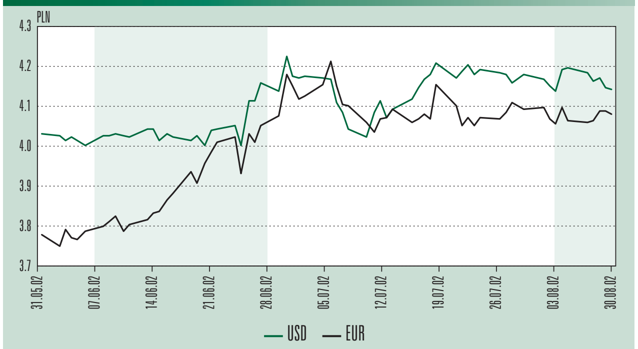
- Stabilisation on the domestic…
- …as well as on the global FX market
- Positive sentiment on the fixed income market

Zloty stable but weaker

After the period of uncertainty in the currency market, driven primarily by the change in the position of the Ministry of Finance which was translated into the instability of the PLN exchange rate in July, August saw appeasement and reductions in daily rate fluctuations. However, it should be highlighted that the situation stabilised at higher levels. In August, zloty was relatively weak, weaker than in the previous months.

At the NBP fixings, US dollar was quoted between PLN 4.1368 (21 Aug) and PLN 4.2108 (2 Aug), i.e. PLN 4.1755 on average (against PLN 4.1180 in July and PLN 4.0863 in H1 2002). While Euro was valued from PLN 4.0536 (6 Aug) to PLN 4.1554 (2 Aug), i.e. PLN 4.0804 on average (PLN 4.0855 in July and PLN 3.6664 in H1 this year).

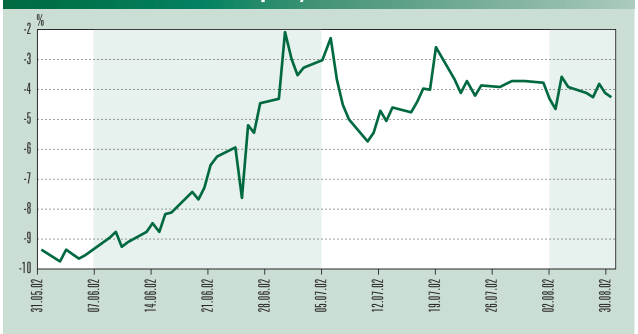
Zloty exchange rate



Source: BZ WBK

It can be stated that August was a very boring month on the currency market which is characteristic of a holiday season, provided however, that nothing special is happening in the country (a good exception confirming the rule was July this year). No domestic events shocked the market, and furthermore, in the mid month, there was the so-called long weekend which always etherises the markets and this time, the dormant period lasted for over a week. The Monetary Policy Council meeting also passed unnoticed as all investors shared the same expectations with regard to the meeting outcome, while the Monetary Policy Council made decisions in line with those expectations.

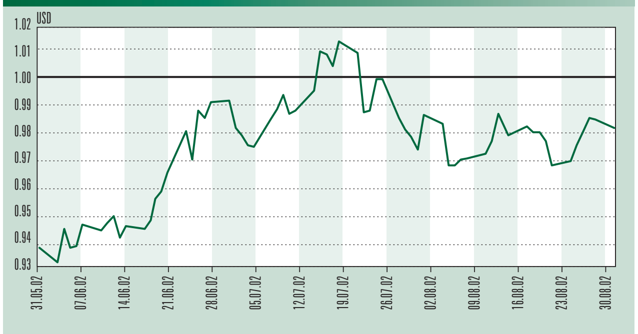
Deviation from the old central parity



Source: BZ WBK

In view of the above, the most important factor impacting the quotations on the domestic currency market was EUR/USD exchange rate on global markets. However, also in this case, the stormy July was followed by peaceful August. The fluctuations of EUR/USD exchange rate were clearly lower and the rate was "safely" away from parity without making any attempts to breakg it.

EUR/US$ exchange rate

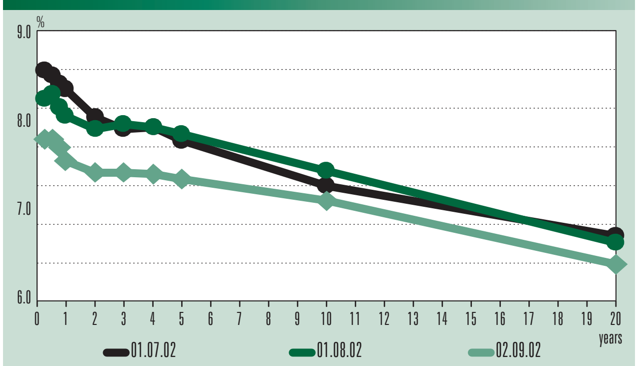


Source: Reuters

Strong market of treasury securities

The treasury securities market was also quiet in August. All month long, there was a positive sentiment on the market. In early August, the market strengthened, after announcing the data on food prices pointing out to low inflation in July, which indicated that interest rate cuts are likely in August. By the meeting of the Monetary Policy Council, the yields had been stable, as nothing that could change the market expectations had happened. While in late August, yields decreased again after the expected decision and communication of the Monetary Policy Council that further interest rate cuts would be announced soon.

Yield curve

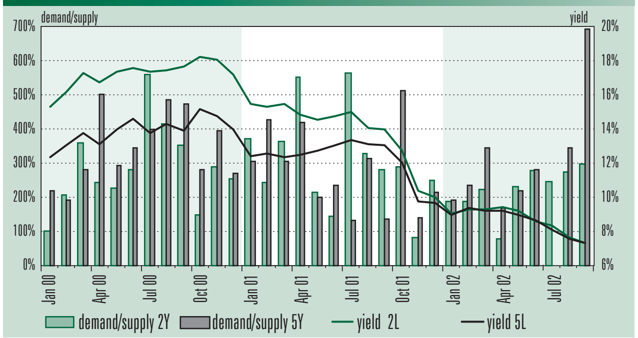


Source: BZ WBK

At T-bond auction on Wednesday 4 September very high demand for offered two- (OK0804) and five-year (PS0507) papers was observed. Especially in a case of the latter a surplus of demand over supply was enormous. Total demand exceeded PLN14bn, which was a record level and in this situation the ministry sold all offered bonds easily. The yields fell significantly compared with last month's tender, but they also were a little lower than at closing of secondary market on previous day. Moreover, still on this day the secondary market strengthened further and at the end of the day the yields were below the levels from the auction.

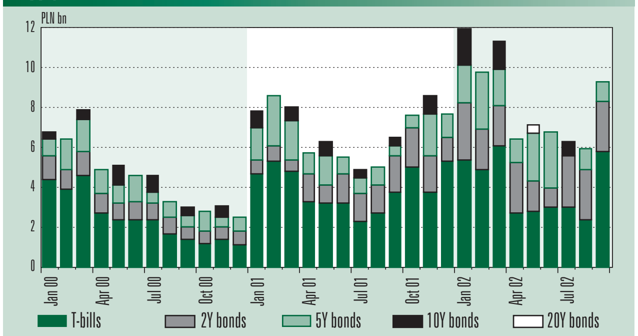
In August the finance ministry informed about changes in T-bond issue schedule for last four months of this year. On 11 September a second 20-year bond (WS0922) auction will be held. A planned for September 10-year bond issue have been moved to 9 October and on this day new benchmark bonds with maturity date in October 2013 (DS1013) will be offered. Moreover, starting from November a new 5-year benchmark (PS0608) will be issued and it will no more be sold with 2-year bonds, but instead separate auction will be held.

Auctions of 2- and 5-year T-bonds



Source: BZ WBK

Supply of treasuries



Note: Sep-02 without 20Y

Source: Ministry of Finance, BZ WBK

T-bill auctions in August and September 2002 **PLN m**

Date of auction	OFFER (SALE)			
	13-week	39-week	52-week	total
03.08.2002	–	–	600 (600)	600 (600)
10.08.2002	–	–	400 (400)	400 (400)
17.08.2002	–	–	700 (700)	700 (700)
24.08.2002	–	–	700 (700)	700 (700)
Total	**–**	**–**	**2400 (2400)**	**2400 (2400)**
02.09.2002	–	–	800	800
09.09.2002	100	–	700	800
16.09.2002	100	–	700	800
23.09.2002	–	–	800	800
30.09.2002	–	1300	1300	2600
Total	**200**	**1300**	**4300**	**5800**

Source: Finance Ministry

Treasury 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	700	700
August	07.08	OK0804	2 500	2 500	PS0507	1 000	1 000	–	–	–	–
September	04.09	OK0804	2 500	2 500	PS0507	1 000	1 000	11.09	WS0922	–	–
October	02.10	OK0804	–	–	PS0507	–	–	9.10	DS1013	–	–
November	06.11	OK0804	–	–	–	–	–	20.11	PS0608	–	–
December	04.12	OK1204	–	–	–	–	–	–	–	–	–

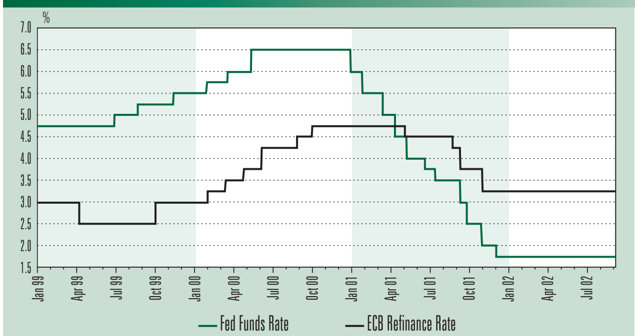
Source: Finance Ministry

International review

- Rates in US and the Eurozne still unchanged
- …meanwhile inflation rises
- …and economic growth is weak
- Bad business climate and sentiment

At the meeting on Tuesday 13 August FOMC decided to leave interest rates unchanged. The main official federal fund rate remained at the level of 1.75%, the lowest for 40 years. However, Fed said in an official statement that slower economic growth is more serious threat for the US economy than inflation. Recenently, analysts have been telling rather about a possibilty of another interest rate cut than about a necessity to increase them. Similar attitude is observed in the Eurozone, where the ECB meeting si planned for 12 September.

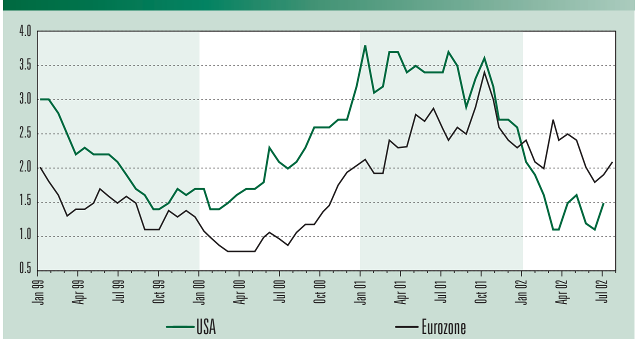
Interest rates in the USA and Eurozone



Source: Reuters

In line with expectations, in July consumer prices in the Eurozone fell by 0.2% MoM, which translated into a rise in annual inflation rate to 1.9% from 1.8% in June. These data were consistent with preliminary estimations of the Eurostat. However, according to provisional estimations, annual inflation rate in the Eurozone increased to 2.1% in August. It means that target ceiling at 2.0% imposed by the ECB, as medium-term price stability level was broken.

Inflation **YoY**



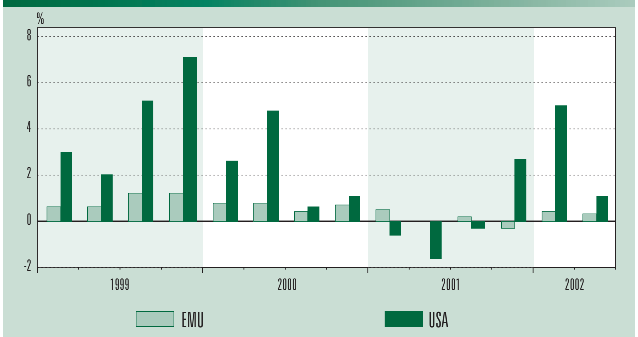
Source: Reuters

In July inflation in the United States amounted to 0.1% MoM, which was close to market expectations. Taking into account rising food, energy and medical care costs, the price hike was little as it was offset by sharp drop in clothing prices. However, annual price growth rose substantially to 1.5% from 1.1% in June.

Third release of Eurozone's GDP growth in 1Q02 confirmed previous estimates. Growth reached 0.3%QoQ and 0.3%YoY. In first release, data on economic growth in 2Q02 were in the lower end of European Commission's forecasts range of 0.3-0.6%. GDP rose by 0.3%QoQ, and on annual basis it increased by 0.6%. At the same time, second month in a row, the European Commission lowered its growth forecast for 3Q02 to 0.3-0.6%QoQ from previous 0.6-0.9% and they published 4Q02 forecast of 0.3-0.6%. Data and forecasts releases confirm poor Eurozone's economy performance.

In August preliminary data on economic growth in 2Q02 were released in the United States. In line with advanced information released a month earlier, US GDP rose by 1.1%QoQ, while markets expected a slight upward revision to 1.2%. These data mean a confirmation of a considerable slowdown in the US economy in the second quarter, as in the first quarter it grew by 5.0%QoQ.

GDP **QoQ**



Source: Reuters

In July Eurozone's producer prices remained unchanged compared to June, while analysts forecasted a fall of 0.2%MoM. Stable price level on monthly basis translated into a fall in annual deflation rate to 0.6% from 1.1% in June. June's data on industrial production in the Eurozone were slightly worse than expected. A rise in production of 0.5% MoM was recorded against 0.7% expected and a May's figure was revised downward to 0.0% MoM. Anual growth rate remained unchanged comparing to May, totalling -1.2%, while an improvement to -1.1% was expected. Retail sales fell much more than expected in June. Falls of 0.5%MoM and 0.9%YoY were recorded, while expectations were defined at declines of 0.1% and 0.2%, respectively.

Producer prices in the United States declined 0.2%MoM while markets expected growth by 0.1%. The figure indicates lack of pressure on prices in American economy. Total industrial output in the US recorded higher than expected growth in July, boosted by increased car production. It was announced that industrial production hade risen 0.2% MoM after a revised gain of 0.7% MoM in June. The economy operated at a slightly closer level to their full capacities in July. Retail sales increased by 1.2% MoM in July, while sales outside of the auto sector grew by 0.2%. Both the overall figure and sales excluding autos were precisely in line with expectations.

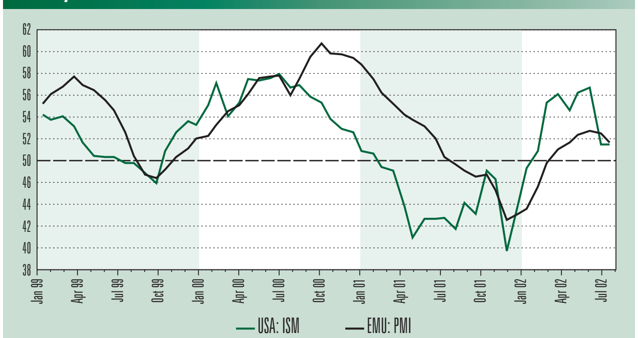
Eurozone's unemployment rate amounted to 8.3% in July, unchanged compared with June (after revision of June's data from 8.4%). Still the highest unemployment rate is in Spain (11.3%) and the lowest in Luxembourg (2.4%).

US unemployment rate fell to 5.7% in August, i.e. the lowest level for 5 months, while markets expected maintaining at July's level of 5.9%. However data on number of new jobs were not that optimistic, since in August only 39,000 jobs increased while in July there was 67,000 new jobs.

A growth rate of M3 money supply in the Eurozone stabilised in July at the level of 7.1%YoY, while slight rebound to 7.2% was forecasted. In order to remind, in June a rapid slowdown in money supply to 7.1%YoY from 7.8% in May took place.

In August economic activity in Eurozone's industry deteriorated. PMI indicator declined to 50.8 pts (against 51.0 pts expected) from 51.6 pts in July. Key sub-indices (of production level, new orders and employment) deteriorated. Analogous indicator for American industry ISM stabilised at the level of 50.5 pts, while after sharp and unexpected fall in July a rebound to 51.6 pts was expected. Both the figures point to slight rate of growth, since the indices approached 50 pts level, i.e. the line separating development from contraction.

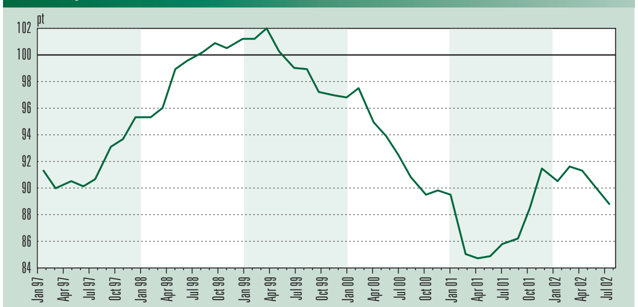
Activity indicators



Source: Reuters

Index of German entrepreneurs' sentiment IFO, major business climate indicator for German economy, recorded a third consecutive fall in August to 88.8 pts from 89.9 pts in July. The fall was a bit more significant than expected, as expectations were at 89.0 pts. Moreover a subindex of expectations for future economic stance decreased more than that of assessment of current situation. IFO data may be perceived as clear signals that the path of economic revival in Germany is a subject of slowdown in last months.

Germany: IFO index



Source: Reuters

American consumer confidence indicator recorded a second consecutive dramatic fall on monthly basis. In August it amounted to 93.5 pts against 97.2 pts expected. Yet in June the indicator was at 106.3 pts and in July at 97.4 pts. Similarly, US consumer sentiment indicator by University of Michigan fell to 87.6 pts in August from 88.1 pts in July and it was lower than 87.9 pts recorded in preliminary survey. Analysts expected upward revision of the data to 88.3 pts.

What's hot this month

Monday	Tuesday	Wednesday	Thursday	Friday
2 September POL: T-bill auction (PLN 800m) *EMU: PMI (Aug)* *EMU: Retail sales (Jun)*	**3** *EMU: Producer prices (Jul)* *USA: ISM (Aug)*	**4** POL: T-bond auction OK0804 & PS0507 (PLN 2.5 and 1.0bn) *FRA: GDP (2Q)* *EMU: Unemployment (Jul)*	**5** *GER: Unemployment (Aug)* *GER: Industrial orders (Jul)* *USA: Industrial orders (Jul)*	**6** POL: Food prices (2H Aug) *GER: Industrial output (Jul)* *EMU: GDP (2Q)* *USA: Unemployment (Aug)*
9 POL: T-bill auction (PLN 800m)	**10** *ITA: GDP (2Q)*	**11** POL: T-bond auction WS0922	**12** *EMU: ECB meeting*	**13** POL: Money supply (Aug) POL: Wages & employment (Aug) *FRA: Inflation preliminary (Aug)* *USA: Producer prices (Aug)* *USA: Retail sales (Aug)*
16 POL: Inflation (Aug) POL: T-bill auction (PLN 800m) *ITA: Inflation final (Aug)*	**17** *FRA: Industrial output (Jul)*	**18** POL: Industrial output (Aug) POL: Producer prices (Aug) *EMU: Inflation final (Aug)* *USA: Inflation (Aug)* *USA: Foreign trade (Jul)*	**19** POL: Business climate (Sep)	**20** POL: GDP (2Q) *ITA: Industrial output (Jul)* *EMU: Industrial output (Jul)* *EMU: Foreign trade (Jul)*
23 POL: Core inflation (Aug) POL: T-bill auction (PLN 800m)	**24** POL: MPC meeting *USA: Fed meeting*	**25** POL: Posiedzenie RPP (decyzja) *FRA: Inflacja finalna (sie)*	**26** *EMU: Money supply (Aug)*	**27** POL: Food prices (1H Sep) *ITA: Inflation preliminary (Sep)* *USA: GDP (2Q)*
30 POL: Balance of payment (Aug) POL: T-bill auction (PLN 2 600m)	**1 October** *EMU: PMI (Sep)* *EMU: Retail sales (Jul)*	**2** *EMU: Producer prices (Aug)* *EMU: Unemployment (Aug)* *EMU: Economic sentiment (Aug, Sep)* *EMU: Business climate (Aug, Sep)*	**3**	**4** *USA: Unemployment (Jul)*

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	18-19	27-28	24-25	29-30[a]	26-27[a]	17-18[a]
CPI	15	15[b]	15[c]	15	15	17	15	19	16	15	15	16
Core Inflation	21	-	21	18	20	21	22	26	23	22	25	23
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	31	29	27
Money supply	14	14	14	12	14	14	12	14	13	14	14	13
NBP balance sheet	7	7	7	5	7	7	5	7	6	7	7	6
Business climate indices	7[d] i 21[e]	20	20	18	21	19	18	22	19	18	21	19
Food prices, 1-15	-	8[e] i 27[f]	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

Wskaźniki miesięczne

		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	Aug 02 forecast	Sep 02 forecast
GDP	% YoY	x	x	0.8	x	x	0.2	x	x	0.5	x	x	0.7	x	x	1.1
Industrial output	% YoY	1.5	0.9	-3.7	1.8	-1.0	-4.8	-1.4	0.2	-3.1	0.3	-4.2	2.1	6.0	0.5	8.4
Retail sales***	% YoY	1.5	3.0	1.3	5.8	2.4	2.4	4.7	6.7	9.9	3.1	1.8	2.5	8.6	-	-
Unemployment rate	%	16.0	16.2	16.3	16.4	16.8	17.4	18.0	18.1	18.1	17.8	17.2	17.3	17.4	17.5	17.7
Gross wages**	% YoY	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	4.4	5.3
Exports (acc. to NBP)	USDm	2 556	2 616	2 287	2 778	2 555	2 540	2 308	2141	2 467	2 739	2 610	2 678	3 175	3 016	3 016
Imports (acc. to NBP)	USDm	3 382	3 635	3 176	3 953	3 509	3 430	3 418	2 952	3 148	3 521	3 416	3 360	3 763	3 782	3 895
Trade balance (acc. to NBP)	USDm	-826	-1 019	-889	-1 175	-954	-890	-1 110	-811	-681	-782	-806	-682	-588	-766	-879
Current account	USDm	-287	-354	-304	-838	-417	-500	-847	-820	-612	-643	-549	-408	-97	-296	-729
Budget deficit	PLN bn	-19.4	-21.0	-21.8	-24.6	-27.7	-32.6	-6.9	-13.7	-16.4	-20.0	-23.0	-25.0	-25.7	-26.8	-28.8
Inflation (CPI)	% YoY	5.2	5.1	4.3	4.0	3.6	3.6	3.4	3.5	3.3	3.0	1.9	1.6	1.3	1.3	1.5
Producer prices (PPI)	% YoY	0.6	1.0	0.7	-0.5	-1.0	-0.3	0.0	0.2	0.3	0.4	0.5	1.2	1.4	0.9	0.8
Money supply	% YoY	12.4	13.4	12.3	11.0	7.2	8.7	7.3	6.7	3.5	2.9	3.6	2.5	1.3	-	-
Deposits	% YoY	14.0	14.9	13.3	11.5	7.0	8.3	6.4	5.5	2.0	1.2	1.3	0.5	-0.8	-0.6	0.6
Credits	% YoY	11.5	11.8	11.5	9.7	8.9	9.3	9.0	8.8	7.1	6.6	7.9	9.4	7.5	10.0	10.0
USD/PLN	PLN	4.19	4.25	4.22	4.13	4.09	4.01	4.06	4.19	4.14	4.06	4.05	4.03	4.12	4.18	4.10
EUR/PLN	PLN	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	4.08	4.02
Intervention rate*	%	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	8.00	8.00
WIBOR 3M	%	16.01	15.35	14.73	14.01	13.91	12.29	11.04	10.60	10.32	10.20	9.88	9.30	8.89	8.70	8.30
Lombard rate*	%	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	10.50	10.50
Yield on 52-week T-bills	%	15.38	14.61	14.01	12.64	11.80	10.66	9.62	9.68	9.62	9.56	9.22	8.54	8.35	7.86	7.30
Yield on 2-year T-bonds	%	15.13	14.40	13.57	11.36	11.00	10.70	9.11	9.37	9.32	9.22	9.03	8.27	8.12	7.60	7.15
Yield on 5-year T-bonds	%	13.85	13.50	12.92	11.32	10.13	9.91	8.91	9.26	9.11	9.02	8.90	8.17	8.11	7.62	7.10
Yield on 10-year T-bonds	%	11.87	11.97	11.57	10.31	9.19	8.92	8.25	8.34	8.25	8.19	8.02	7.55	7.63	7.29	6.80

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

Source: CSO, NBP, BZ WBK

Wskaźniki kwartalne i roczne

		1998	1999	2000	2001	2002	2003	1Q 01	2Q 01	3Q 01	4Q 01	1Q 02	2Q 02	3Q 02	4Q 02
						forecast								*forecast*	
GDP	PLN bn	553.6	615.1	685.0	721.6	749.9	800.0	165.4	176.5	179.6	200.0	172.2	182.3	185.4	209.9
GDP	% YoY	4.8	4.1	4.0	1.0	1.3	3.4	2.3	0.9	0.8	0.2	0.5	0.7	1.1	2.6
Industrial output	% YoY	3.5	3.6	6.8	-0.2	1.6	3.4	4.5	-0.7	-0.8	-2.6	-1.6	-0.3	4.3	4.0
Real retail sales	% YoY	2.6	4.0	1.0	0.4	x	x	-3.1	-0.2	1.2	3.7	5.8	0.7	x	x
Unemployment rate*	%	10.4	13.1	15.1	17.4	19.0	19.0	16.1	15.9	16.3	17.4	18.1	17.3	17.7	19.0
Real gross wage	% YoY	3.3	4.7	1.0	3.3	0.6	1.5	2.5	.0.8	2.5	1.3	2.1	0.6	-0.5	0.0
Exports (acc. to NBP)	USDm	30 122	26 347	28 256	30 276	34 309	35 000	7 436	7 508	7 459	7 873	6 916	7 347	9 208	10 158
Imports (acc. to NBP)	USDm	43 842	40 727	41 424	41 955	43 602	48 000	10 584	10 286	10 193	10 892	9 518	9 621	11 440	12 347
Trade balance (acc. to NBP)	USDm	-13 720	-14 380	-13 168	-11 679	-9 294	-13 000	-3 148	-2 778	-2 734	-3 019	-2 602	-2 274	-2 233	-2 189
Current account	USD	-6 862	-11 558	-9 946	-7 075	-6 195	-9 913	-2 170	-2 205	-945	-1 755	-2 279	-2 075	-1 122	-1 194
Current account	% PKB	-4.3	-7.4	-6.3	-4.0	-3.4	-4.8	-4.9	-5.2	-4.2	-4.0	-4.0	-4.0	-4.0	-3.6
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	-25.0	-28.8	-40.0
Budget deficit*	% PKB	-2.4	-2.0	-2.2	-4.5	-5.3	-5.0	-9.1	-2.2	-1.7	-5.3	-9.5	-3.4	-2.1	-5.3
Inflation	% YoY	11.8	7.3	10.1	5.5	2.1	2.7	6.7	6.6	4.9	3.8	3.4	2.1	1.4	1.6
Inflation*	% YoY	8.6	9.8	8.5	3.6	1.8	3.3	6.2	6.2	4.3	3.7	3.3	1.6	1.5	1.8
Producer prices	% YoY	7.3	5.7	7.8	1.6	1.1	2.5	4.2	2.2	0.8	-0.6	0.2	0.7	1.0	2.4
Money supply	% YoY	25.3	24.6	15.2	12.1	3.9	11.0	14.7	11.8	14.1	12.9	5.9	2.7	-	-
Deposits	% YoY	28.4	26.4	17.2	13.5	1.7	10.5	17.1	13.6	15.7	13.3	4.8	0.8	0.1	0.1
Credits	% YoY	30.0	28.6	24.7	11.3	9.4	15.0	15.4	9.7	11.3	8.1	8.3	8.0	9.2	12.0
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	4.13	4.02
EUR/PLN	PLN	3.9231	4.2270	4.0110	3.6685	3.85	3.93	3.7765	3.4884	3.7551	3.6549	3.6199	3.72	4.06	4.00
Intervention rate*	%	15.50	16.50	19.00	11.50	7.50	7.00	18.00	15.50	14.50	11.50	10.00	8.50	8.00	7.50
WIBOR 3M	%	21.34	14.73	18.78	16.08	9.26	7.20	18.53	17.09	15.37	13.45	10.65	9.79	8.63	7.98
Lombard rate*	%	20.00	20.50	23.00	15.50	10.00	9.50	22.00	19.50	18.50	15.50	13.50	11.50	10.50	10.50
Yield on 52-week T-bills	%	18.59	12.95	17.77	14.77	8.41	6.80	17.02	15.70	14.67	11.72	9.64	9.11	7.84	7.07
Yield on 2-year T-bonds	%	18.08	12.41	17.37	13.91	8.18	6.80	15.59	14.91	14.37	10.83	9.27	8.84	7.62	6.98
Yield on 5-year T-bonds	%	15.83	10.87	14.00	12.59	8.08	6.70	13.12	13.38	13.43	10.45	9.09	8.69	7.61	6.93
Yield on 10-year T-bonds	%	x	9.60	11.79	10.74	7.52	6.50	10.46	11.22	11.81	9.48	8.28	7.92	7.24	6.63

** at the end of period*

Source: CSO, NBP, BZ WBK

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