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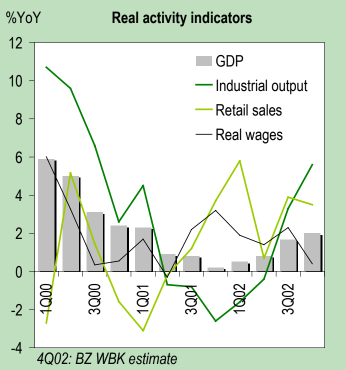
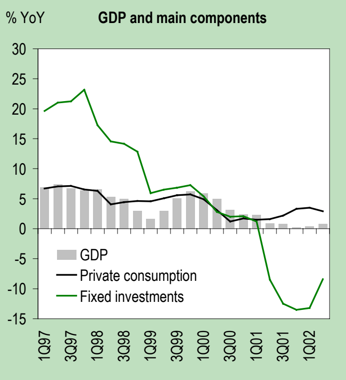
MACROscope

Polish Economy and Financial Markets

January 2003





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Time is money

- **We have made it! Poland has finally completed its membership negotiations with the EU.** Now it is time to analyse in more detail the outcome of Poland's negotiations with the EU and to make an attempt to assess the implications of the won membership terms and conditions for the Polish economy. This is the Special focus in this issue of MACROscope, in which we analyse in particular the decisions made at the Summit in Copenhagen, we present the estimated cash flows between the European Union and Poland and we update the list of the Polish budget costs related to the EU accession presented in November. It seems that the Polish government will have to remind itself a well-known statement of Benjamin Franklin included in the report title – the sooner public finances structure is rebuilt, the bigger the benefits of the Polish economy from the EU accession will be and the better use of the EU's funds.

- **Completing the negotiations with the EU at the Copenhagen Summit does not mean that Poland's membership in the Union is granted.** Poland and the other candidate states still have a few hurdles to overcome, including, among others, the EU accession referendum. The second section of the Special focus includes the analysis of the last stage of preparations at the EU integration path and related problems.

- **Macroeconomic data published in December confirmed the trends observed earlier.** Industrial output and retail sales went up even faster than expected, while the foreign trade was sustained at a high level. This indicates a possibility of further acceleration in the economic growth. In 3Q02, the GDP growth dynamics was 1.6% YoY, i.e. double the growth in 2Q02 and four times as much as in 1Q02. One can hardly expect this trend to be sustained, however, the Polish economy is likely to develop at over 2% already in the first months of this year, and the gradual improvement should bring about an average growth of ca. 3% for the whole year. This will be below the budget projections, however, it will not be the only one ratio overstated by the Ministry of Finance. Contrary to Grzegorz Kołodko's July statements, the unemployment rate did not start to decrease in November. There were no miracles, seasonal factors, which reveal on an annual basis, resulted in the unemployment rate increase up to 17.8%. The continuously difficult situation on the labour market should limit both private consumption and the inflation pressure. The inflation rate is most likely to stay below 1% YoY almost by the end of 1H03. Moreover, we may witness subsequent inflation rate records, as our projection indicates that in January CPI will be lower than at the end of 2002r, and in April 2003 it may be only 0.5% YoY. The MPC is bound to factor in such inflation prospects at its next meeting. Therefore, the recent data increase the possibility of subsequent cut in the interest rates already in January.

Financial market on 31 December 2002					
NBP deposit rate	4.75	WIBOR 3M	6.87	PLN/USD	3.8388
NBP reference rate	6.75	Yield on 52-week T-bills	5.80	PLN/EUR	4.0202
NBP lombard rate	8.75	Yield on 5-year T-bonds	5.46	EUR/USD	1.0473

Special focus

EU accession and the Polish economy

We have made it! Poland has finally managed to complete the membership negotiations with the EU. In the course of the summit in Copenhagen attended by the representatives of the candidate countries all negotiation chapters were closed and the terms and conditions of membership in the enlarged EU were agreed in respect of Poland and the other 9 candidates. In the previous issue of MACROscope we managed to mention that the team of Polish negotiators was successful at the Copenhagen summit obtaining a final agreement with the "15" states on the EU enlargement terms and conditions. The Polish team fought an extremely hard battle at the last stage of negotiations, which were held till late hours on the last day of the Copenhagen summit. They managed to persuade all the existing member states of the EU to change some of the membership conditions proposed to our country and to accept the key postulates of the Polish government. Now it is time to analyse in more detail the outcome of Poland's negotiations with the EU and to make an attempt to assess the implications of the won membership terms and conditions on the Polish economy.

Some facts: The main results of the negotiations

At first we will look at the most important decisions made in the course of the Copenhagen summit. Below you will find listed conclusions from the membership negotiations with the UE regarding Poland's membership in the enlarged European Union. Given the profile of our publication we have focused more on financial terms and conditions, which are of the highest importance for the future macroeconomic standing of Poland.

- According to the European Commission, in 2004-2006 the new UE members will be granted "net" (i.e. having netted off their own contribution to the EU budget) funds totalling €10.3bn, of which ca. 2/3 will be allocated to Poland.
- In its first three years of the membership, Poland is to be granted ca. €7bn net (€1.4bn in 2004, €2.6bn in 2005 and €3bn in 2006). However, the actual payments from the UE budget to Poland in this period will amount to €13.6bn (€11.2bn + €2.3bn payment due from the outstanding pre-accession aid), and our contributions to the EU "purse" will total €6.5bn.
- The total EU's commitments for Poland projected for 2004-2006, including those, which will not be actually paid in this period and thus are postponed to subsequent years, will be €19.2bn (against €40.9bn allocated to all 10 new member states).
- Poland's annual full contribution to the EU budget will be ca. €2.2bn - €2.4bn (the contribution level depends mainly on the national GDP and VAT income). In the first year of membership the contribution will be lower by ca. €0.8bn due to the deferred date of the EU enlargement (May 2004).
- As a result of joining the EU, Poland will lose its custom duty revenues, which will be allocated directly to the EU's budget from the accession date (in 2003 duty revenues are estimated at ca. €900m). However, the loss of those revenues will be partially offset by subsidy paid to the countries, which collect duties on behalf of the EU on its external borders (the subsidy will be calculated based on the total imports to the EU, which will be transported via our borders). Therefore, the estimated loss of duty revenues will total only ca. €213m p.a. (in 2004 it will be less than 60% of the amount).
- In 2004-2006 we will be granted a special cash-flow facility for the improvement of the budget liquidity of €1.443bn (€1bn was relocated for this purpose from the structural funds pool in the last hours of the negotiations in Copenhagen). This money will be allocated directly to the domestic budget, contrary to the better part of the other EU funds that will be allocated to specific projects, in particular to local governments, farmers and economic units.
- At the last stage of negotiations, the EU subsidy for tightening the Polish borders was increased by €108m. In 2004-2006, Poland will be granted for this purpose the total of €280m. Poland undertook to introduce visas for citizens of Russia, Belarus and Ukraine as of 1 July 2003.
- Poland obtained the EU's consent to globally increase the amounts of direct subsidies up to the following maximum: • in 2004 – 55%, • in 2005 – 60%, • in 2006 – 65% of the level prevailing in the existing EU member states. The agreed financial conditions of the membership envisage allocation of the EU budget funds to direct subsidies for the new member states at 25% of the total level in 2004, 30% in 2005, 35% in 2006, 40% in 2007 and their gradual increase by 10% in subsequent years. In addition, Poland will be able to relocate to the

direct subsidies the part of funds allocated for the development of rural areas (a maximum 20% of the commitment appropriations available for 2004-06) – these funds, however, must be co-financed domestically (in 80%). This will allow for increasing the subsidies up to 36%, 39% and 42% of the target level in subsequent years. Any further topping-up can only be financed from national budget and it will be possible if the current standing of the public finances allows for that. From 2007 Poland will be able to supplement the level of direct subsidies with own budget funds by 30% over the level specified for a given year.

- According to the calculations of the Ministry of Agriculture, as a result of the EU integration, in 2004-2006 the Polish agriculture should be granted (only within the funds from the EU budget) €7.4bn, i.e. ca. twice as much funds as the agriculture related budget expenses (excluding KRUS) in 2002. €2.7bn of this amount is to be allocated to the direct subsidies for farmers, €840m for the market interventions and for export subsidies, €2.3bn for the development of the rural areas, and €1.4bn will be represented by the structural funds for the investments in agriculture. Jointly with the domestic subsidies (assuming the maximum direct subsidies) in the first three years of the membership in the EU the Polish agriculture might obtain the total of over €9.9bn. However, the Ministry of Agriculture assumptions disregard the fact that actually the EU's funds for the direct subsidies will be available only in 2005 (which is indicated by the table below).

- As far as the actual cash flows are concerned, in 2004-2006 the biggest line in the EU's grants for Poland will be represented by funds allocated for executing the financial projects with the structural and cohesion funds: €4.7bn. The grants for agriculture and rural areas will be the second largest line: €3.9bn. The EU will also pay €2.3bn of the outstanding pre-accession aid (programmes: PHARE, SAPARD and ISPA). Poland will be granted ca. €1.2bn for the purposes related to the internal affairs, institutional changes, etc.

- Poland will become a member of the European Investment Bank (EIB) and as a result it will have to make a contribution to the Bank's capital and reserves. The contribution will probably be split into instalments: €106m in 2004 and the remaining over €500m in the subsequent years. In exchange for that, Poland is to be granted a substantially increased access to higher, cheap advances for the infrastructure in the following areas: transport, environmental protection, power supply and telecommunication as well as for the SME support. However, similarly to the structural funds, these funds will not flow into the budget but into the accounts of the entities effecting individual undertakings.

- We will have to pay the contribution for European Central Bank (ECB) at ca. 5% of the capital calculated for Poland. In line with the agreements, ca. €14mln of this amount is to be paid on the first day of the EU membership and the rest (ca. €273m) later on.

The table 1 below presents the figures of the EU's commitments and financial payments for Poland in 2004 – 2006.

Table 1. Indicative allocation of EU's commitment and payment appropriations for Poland, *in € millions, 1999 prices*

	Appropriations for commitments				*Appropriations for payments*			
	2004	*2005*	*2006*	*2004-2006*	*2004*	*2005*	*2006*	*2004-2006*
1. Agriculture	**865.2**	**1 749.9**	**1 999.4**	**4 614.5**	**428.2**	**1 512.5**	**1 931.1**	**3 871.8**
1a – Common Agricultural Policy	130.2	899.9	1 041.4	2 071.5	130.2	899.9	1 041.4	2 071.5
- Market measures	130.2	342.8	366.5	839.5	130.2	342.8	366.5	839.5
- Direct payments	0.0	557.1	674.9	1 232.0	0.0	557.1	674.9	1 232.0
1b – Rural development	735.0	850.0	958.0	2 543.0	298.0	612.6	889.7	1 800.3
2. Structural actions after capping	**3 354.2**	**3 391.7**	**4 622.7**	**11 368.6**	**859.0**	**1 776.0**	**2 107.0**	**4 742.0**
Structural Fund	2 076.6	2 339.8	3 218.9	7 635.3	763.5	1 583.9	1 334.6	3 682.0
Cohesion Fund	1 277.6	1 051.9	1 403.8	3 733.3	95.5	192.1	772.4	1 060.0
3. Internal Policies	**625.9**	**602.0**	**588.5**	**1 816.5**	**285.0**	**407.0**	**498.7**	**1 190.8**
Existing policies	428.9	446.5	464.1	1 339.5	154.4	265.9	359.0	779.3
Institution building	103.7	62.2	31.1	197.0	37.3	47.8	46.4	131.5
Schengen - borders improvement	93.3	93.3	93.3	280.0	93.3	93.3	93.3	280.0
Sub-total (1+2+3)	**4 845.3**	**5 743.6**	**7 210.6**	**17 799.6**	***1 572.2***	***3 695.5***	***4 536.8***	***9 804.6***
Cash-flow lump sum	442.8	550.0	450.0	1 442.8	442.8	550.0	450.0	1 442.8
Total commitments/payments	**5 288.1**	**6 293.6**	**7 660.6**	**19 242.4**	**2 015.0**	**4 245.5**	**4 986.8**	**11 247.4**

Commitments – funds granted to Poland for a given year; Payments – the amounts to be really paid in a given year; the difference between commitments and payments cumulates and will be realised in subsequent years.
Source: Own estimates based on the information provided by the European Commission and the press releases

Outcome of the negotiations and the Polish budget

The issue of the potential financial implications of Poland's accession to the EU on the Polish budget in 2004 was broadly discussed in the November issue of MACROscope. This month we update our estimates factoring in the final agreements of the Copenhagen summit and extend the calculations for additional two years. The table below presents the detailed breakdown of the additional budget costs resulting from the EU accession in the first three years of the membership. We are not going to talk through all subsequent lines – the better part of charges resulting from the accession terms and conditions was listed in the bullet points above, and in addition they were discussed in the November issue. Therefore, we will focus on the most important issues.

Table 2. Costs for the Polish budget related to the EU accession

	€m, 1999 prices			*PLNm, current prices**		
Item	***2004***	***2005***	***2006***	***2004***	***2005***	***2006***
Contribution to the EU budget	1 453	2 216	2 282	5 558	8 530	9 202
- VAT resource	194	306	317	742	1 178	1 278
- GNP resource	1 111	1 682	1 727	4 250	6 475	6 964
- UK rebate	148	228	238	566	878	960
Loss of customs duty revenues	123	213	213	470	820	859
Contribution to the EIB	106	212	320	405	816	1 290
Contribution to the ECB	287	0	0	1 098	0	0
Co-financing of structural funds	186	385	457	713	1 484	1 844
Direct subsidies payments	705	279	295	2 698	1 074	1 191
Legal and institutional adjustments	250	150	50	956	577	202
Total costs	**3 111**	**3 455**	**3 618**	**11 898**	**13 301**	**14 588**
Cash flow lump-sum	-443	-550	-450	-1 694	-2 117	-1 815
Funds for institution building	-37	-48	-46	-143	-184	-187
Schengen facility	-93	-93	-93	-357	-359	-376
Net balance	**2 537**	**2 764**	**3 028**	**9 705**	**10 641**	**12 210**

* Estimates based on forecasted €/PLN exchange rate and inflation in the EU
Source: Own estimates based on the information provided by the European Commission, Ministry of Agriculture and the press.

Starting from 2004 the Polish budget will have to find funds to co-finance the EU's projects and to finance those purposes from the EU budget, which are repaid with substantial delay (in particular, direct subsidies for farmers). If these funds are not found, Poland will not be able to fully use the benefits of the negotiated membership conditions, losing some of the potential gains for economy. The share of the Polish public finances in co-financing the domestic structural actions is to be at least 25% of the undertakings cost in the case of the structural funds and at least 15% in the case of the Cohesion Fund. This suggests that the weighted average share of the Polish public finances in co-financing the structural actions will be ca. 21.7%. Paradoxically, "fortunately" for the Polish public finances, the use of the structural funds will be relatively limited in the first years of the membership – in 2004-2006 Poland is to be granted ca. €3.68bn of the actual payments within the structural funds and €1.06bn from the Cohesion Fund. Therefore, one can estimate that within this period Poland will have to find over €1bn to co-finance the projects, which means that the flexibility of the other budget expenses will have to be increased. According to Ewa Freyberg – vice-minister of economy, the state budget will need the additional €900m to co-finance the structural and cohesion funds in the next 7 years. This figure is lower than our estimate, which may be explained, among others, with the fact that the part of the co-financing funds will be represented by the funds which are already allocated to, e.g. road construction, or by the private funds.

Unfortunately, it will not be the case in respect of the direct subsidies for farmers. The Polish government managed to negotiate that the subsidies could amount to the maximum of 55%, 60% and 65% of the full subsidies over the next three years (2004-2006) – €4.6bn in total, of which only €2.9bn could be allocated from the EU's funds (the balance would have to be covered with the Polish budget). However, the first actual flows of the EU's funds for the direct subsidies will materialise only in 2005. As a result, in the first year after the accession the total payments will have to be financed by the Polish government. Even if we assume that the difficult financial standing will not allow for increasing the subsidies ratio over 36%, 39% and 42% (the EU's budget funds + the amount relocated from the rural area development funds), it means that in 2004 the budget will have to allocate over €700m to the direct subsidies (by the end of 2006 this amount will be €1.3bn).

Table 3. Direct subsidies for the Polish farmers

€millions, 1999 prices	***2004***	***2005***	***2006***
Direct payments	**889.0**	**1 006.0**	**1 114.0**
(as a share of full direct payments in EU)	*36%*	*39%*	*42%*
- directly from EU*	0.0	557.1	674.9
- reallocation from rural development fund	183.8	170.0	143.7
- contribution of the Polish budget	705.3	278.9	295.4

* The first actual flows of the EU's funds for the direct subsidies will materialise only in 2005.
Source: Own estimates based on the information provided by the European Commission, the Ministry of Agriculture and the press

In the first years of the EU membership, funds for financing the legal and institutional adjustment costs will have to be allocated in the Polish budget, as we undertook to cover them in the course of the negations – according to some preliminary estimates, these amounts will be higher than in 2002-03 (in particular, this relates to the expenses on the organisation of the agricultural market) and may total €250-500m in the budget expenses.

A problem the Polish budget has in relation to the EU accession stems from the fact that the better part of the accession costs will have to be incurred by the central budget, while the EU's funds will go mainly to the local self-government units and private entities (e.g. farmers). As has already been mentioned, Poland will be granted €1.4bn directly to its central budget. This amount will be specifically assigned to improve the liquidity of the public finances. However, this amount represents only a small percent of the costs incurred in the first years of the membership.

The last line of the table 2 shows what a substantial charge the EU integration costs will be for the budget expenses in 2004-2006. These are fixed charges and therefore their increase by a certain amount will have to result in a relevant decrease in the other types of the budget expenses in order to maintain the deficit at the unchanged level (in order to decrease the deficit, which is the Maastricht criterion of the fiscal convergence, the reductions in the other expenses will have to be substantially higher). As a result, it should be emphasised again that in order to prevent from the public finances crisis or the substantial fiscal policy loosening after 2003, a prompt reform of the public finances is necessary. The desired changes should increase the flexibility and rationality of the public finances expenses and reduce to minimum the scope of the legal regulations bringing about hardening of the substantial part of the annual budget expenses. Of course, it is not the first time we have raised this issue.

EU accession and Polish economy

The increase of budget expenditures or loss of revenue sources does not necessarily mean that Poland will not benefit from EU accession. After the accession Poland will remain the net beneficiary of EU funds and the balance of financial flows will be improving every year after the enlargement (see table 4). The improvement will be especially strong after 2006, when the use of support funds will become more effective. It should have positive impact on the pace of Poland's economic development after EU accession.

Table 4. How much will we gain – Net financial flows between EU and Poland, *in € millions, 1999 prices*

	2004	2005	2006	2004-06
Pre-accession aid	970	823	509	2 302
Agriculture	428	1 513	1 931	3 872
Structural actions	859	1 776	2 107	4 742
Internal actions	285	407	499	1 191
Cash flow lump-sum	443	550	450	1 443
Total allocated expenditure	**2 985**	**5 069**	**5 496**	**13 549**
Loss of customs duty revenues	-123	-213	-213	-549
EU contribution – VAT resource	-194	-306	-317	-817
EU contribution – GNP resource	-1 111	-1 682	-1 727	-4 520
UK rebate	-148	-228	-238	-614
Total own resources	**-1 576**	**-2 429**	**-2 495**	**-6 500**
Net balance	**1 409**	**2 640**	**3 001**	**7 049**

Source: Own estimates based on the information provided by the European Commission and the press releases

Economic integration, however, is related not only to flows of support funds. Additionally, after EU accession Poland may benefit from the number of factors positive for long-term development prospects, which will include: higher stability of economic environment, fall of investment risk, inflow of private investments and know-how, trade development, growth of companies' productivity, weakening of domestic monopolies. On the other hand economic integration will be connected with some costs for Polish economy. Opening domestic market on the competition with well-developed Western Europe might destabilise some sectors of our economy. The theory suggests also the possibility of decline of outlays on research and development and specialisation mostly in the production of labour-consuming goods (especially in the country with excess supply of cheap labour force). The decline of domestic savings is also likely.

The assessment of macroeconomic consequences of European integration, that would take into account all the above-mentioned effects is extremely difficult, e.g. because in fact those effects would be heavily dependent on the quality of domestic economic policy in next couple of years. Considering the experiences of other European countries that have joined EU in previous decades it seems likely that the attained conditions of EU membership should allow Poland for accelerating the pace of economic growth under the condition that we will be able to exploit the potential gains effectively. Nevertheless the example of Greece shows clearly that we are not doomed for the success. According to finance minister Grzegorz Kołodko and deputy minister of economy Ewa Freyberg "because of EU accession the economic growth in Poland should be higher by 1 percentage point, compared to the situation when we do not enter EU; it would ensure additional revenues for the budget amounting to PLN1bn".

In the middle of January the government accepted the first National Development Plan (NDP) for 2004-06. The document establishes the framework for exploiting the EU funds from structural and cohesion funds and defines the structure of flows of support funds into specific sectors of the Polish economy. The government decided that the majority of financial assistance from the EU must be spent on pro-development objectives. Substantial part of the money (almost 40%) will go for the regional investments (mainly in infrastructure). Also, nearly 20% of funds is supposed to support the competitiveness of Polish economy (R&D, support for companies), and 16% will go for development of human capital. Such allocation of EU funds increases the chance that they will contribute to faster economic growth.

The Ministry of Economy has ordered a special simulation of possible benefits for the Polish economy arising from implementing NDP[1]. Such analysis has been prepared by the staff of Institute of Social and Economic Research in Dublin and Wrocław Institute of Technology. The results of the survey might be used as an approximation of potential impact of economic integration with EU on the agreed conditions on Poland's economy. However, it must be remembered that the results should be only treated as indicative, e.g. because the simulation assumes that Poland will be able to exploit EU structural funds with 100% efficiency, which has not been achieved so far by any European country.

The table 5 below shows the estimated impact of NDP on the level of real GDP (expressed as a percentage change compared to situation when NDP is not implemented) and on the unemployment rate (expressed as a difference with the scenario when NDP is not implemented). This simulation reflects both the direct effects on the demand side of the economy, as well as the improvement of the supply side connected with development of infrastructure, human resources etc. The results indicate that the NDP should boost GDP and reduce the unemployment rate in Poland after the accession. The biggest positive effect on GDP should be achieved in 2006 – the level of GDP will be higher by 3.5% due to realisation of NDP. At the same time the unemployment rate should be lower by nearly 2pp. However, it is worth to mention that other factors (especially demographic ones) are likely to keep the unemployment at still relatively high level.

Table 5. NDP impact on GDP and unemployment

	GDP	*U*
2003	0.00	0.00
2004	1.05	-0.68
2005	2.27	-1.38
2006	3.46	-1.96
2007	2.79	-1.26
2008	1.39	-0.12
2009	1.01	0.13
2010	0.92	0.22

Note: GDP – percentage change comparing to the no-NDP scenario; U – difference in unemployment rate comparing with the no-NDP scenario
Source: John Bradley and Janusz Zaleski, op.cit.

Basing on the published results of the simulation one could draw the following conclusions for future development of economic situation in Poland within the European Union:

- Implementation of NDP will be more positive for development of services sector than for the industry – in 2006 the growth of industrial production will be higher due to implementation of NDP by 4.5%, while the positive impact on services will reach 5.7% (compared to no-NDP scenario). In the services sector also the growth of employment will be higher than in the industry.
- Realisation of NDP should bring about the rapid growth of investments – in 2006 they are supposed to be boosted by 11%. However, also private and public consumption should improve as well (by 2.7% and 1.5% respectively in 2006).
- The simulation results suggest that there might be a minor growth of prices at the beginning of NDP realisation (amounting to 0.02% p.a.). Nevertheless, since 2006 the consumer prices should be dragged down by the effects of the Plan. The impact on wages in the industrial sector should be positive, and the strongest in 2006-07 period. However, despite growing wage pressure the unit labour costs should remain under control, declining gradually amid systematic improvement of competitiveness of Polish economy.

[1] John Bradley and Janusz Zaleski "„Wyniki modelowania wpływu funduszy strukturalnych i funduszu spójności na gospodarkę polską przy zastosowaniu polskiej implementacji modelu HERMIN", Ministry of Economy, 2002

Still a few hurdles to overcome

Exactly half a year ago we defined the difficulties that Poland must overcome in order to successfully complete the EU accession negotiations. In line with expectations, the outcome of Irish referendum was positive and the schedule of negotiations was met. However, completing the EU negotiations at the Copenhagen summit does not mean that Poland's membership in the Union is guaranteed. Poland and other candidates still have a few hurdles to overcome. Last month we said that in 2003 one of the most important events would be the EU accession referendum in Poland. Its outcome, and first of all the preceding expectations and speculations are bound to have a substantial impact on the situation on the Polish financial market. Besides the referendum, on our way to the EU there will be still a few more other difficulties which will have to be sorted out timely:

- January/ February 2003 – a development of the accession treaty draft (over 6,000 pages in 21 languages) as well as the negotiations re. joining the European Economic Area,
- March 2003 – the European Commission will present its opinion on the draft,
- 21 March 2003 – the European Council (i.e. Prime Ministers and heads of the EU member states) will express its opinion on the accession treaty,
- 9 April 2003 – the European Parliament will ratify the accession treaties,
- 14-15 April 2003 – the Council of the European Union, i.e. ministers of the member states must unanimously decide on accepting the treaties,
- 16 April 2003 – signing of the accession treaty at the summit in Athens,
- 8 June 2003 – a probable date of a referendum on Poland's accession to the EU,
- July 2003 – a report of the European Commission on the progress of the candidate states,
- July 2003 – April 2004 – ratification of the accession treaties in the member states,

Negotiations continued ...

Only after overcoming all the above-mentioned schedule will Poland become the EU member on 1 May 2004. The above list of events indicates that in practical terms the negotiation process has not been fully completed yet. Besides arduous negotiations of the accession treaty details, Poland has still to undertake negotiations (started on 9 January 2003) re. terms of membership in the European Economic Area (EEA). Poland must become the EEA member due to the stipulations of art. 128 of the EEA agreement, which states that each new member state must become the EEA member. Therefore, Poland and other new EU member states will have to negotiate the terms of joining the EEA before signing the accession treaty planned for mid April. Besides the EU member states, the EEA members are: Norway, Island and Liechtenstein (EFTA countries). Fishing, among others, may be one of the problems in the EEA. In addition, a disputable issue – between both the EU and EFTA, and Poland and the EU – may be the increase in funds allocated by the rich non-EU EEA countries to the poorer EEA members. In exchange for the access to the joint market, Norway, Island and Liechtenstein must pay grants to these EU members whose wealth is below the EU's average. In 1998-2003 it was €120mln p.a. Poland may pressurise a substantial increase in this amount justifying it with a benefit for EFTA countries in the form of an increased access to the market of the new EU member states. Should it be successful, another dispute may be related to the actual allocation of funds (Poland will certainly want to be granted the better part of additional funds, but the European Commission may be of another opinion and allocate part of the funds even to the "old" EU members). In our opinion, however, neither the Norwegian salmons nor several million Euro will impinge on the EU enlargement process and Poland will accept the EEA accession terms timely – even if they are imperfect.

Agreeing and approval of the treaties by the EU

Another problem may be represented by delays in the development of the accession treaties. Work on the contents of the multilateral international agreements on the candidate states accession to the EU has been in place since the completion of the negotiations. General agreements of the Copenhagen summit must be translated into the detailed language of the European Law and translated into all languages of the EU. The Greek, currently presiding over the EU, planned that the official signing of the accession treaties will be held on 16 April 2003 at the summit in Athens. However, in the first place the wording of the treaties must be accepted by candidate states, the European Commission, the European Parliament and the heads of the UE member states. Should the treaty not be ready by the end of February, the completion of the entire procedure, which must be effected before signing, would be delayed.

According to the press releases, ca. two-thirds of the 6-7k pages thick treaty have been translated into Polish. However, only half of it, i.e. one–third of the entire treaty, was agreed with the Polish side. The European Parliament will need at least a month for analysing the contents of the treaty and for its approval. The European Parliament deputies would like to be provided at least with the drafts of all treaties by 15 February 2003. The EU Commission officials say that even if the complete treaties are developed later there will not be any delay as the EU deputies will be gradually provided with subsequent parts of the documents. Working regularly on the submitted documents, the European Parliament should complete the analysis stage by 9 April, when it is most likely that the treaty will be voted at the session of the European Parliament in Strasbourg. Before the Euro-parliament makes its decision on the accession treaties negotiated by the 10 candidate states in Copenhagen they must be positively recommended by the European Commission. Candidate states will be voted separately in the European Parliament. The risk of rejecting the accession treaties by the European Parliament is assessed as purely theoretical. In order for the documents to be approved, the absolute majority of the deputies must vote "for", i.e. 314 out of 626. The surveys effected so far in the Euro-parliament clubs indicate that ca. 600 deputies will vote "for" the accession of Poland. Thus, even if there should be some differences in the number of votes "for" the accession, which would result in a some sort of a ranking of the candidate states, this should not do any harm to Poland. This is even more so, as the further process of the accession treaties ratification in the individual EU member states, contrary to the European Parliament, will consist in simultaneous voting for/ against the accession of all the candidate states. As a result, also the decisions of the "15" national parliaments should be positive for Poland. Given the existing political structure in all EU member states one can hardly expect that any parliament of the "15" could make a decision on blocking the entire process of the EU enlargement.

Who is for and who is against the integration?

Pursuant to the Constitution, there are two ways to grant the approval to transfer the state authority powers to an international organisation. It can be granted by either *Sejm* or *Senat,* by way of separate votes, or by the citizens in the referendum. All political forces in the Polish parliament agree that the final say in the issue of integration should be given by the society taking part in a national referendum. Therefore, the accession referendum becomes the key obstacle for the Polish journey to the EU. It is most likely to be held on June 8 2003. This date was set by Leszek Miller, the Prime Minister and accepted by Aleksander Kwaśniewski, the President.

Having come back from the Copenhagen summit, Leszek Miller announced that he intended to canvass Poland to convince the Poles to vote 'yes'. At the same time, for fear that the accession referendum might be treated as a vote of confidence for the government, the Prime Minister withdrew from his earlier announcement (which said that the government would resign if the Poles voted 'no' in the referendum). President Aleksander Kwaśniewski also announced his active participation in the pre-referendum campaign. After Copenhagen secured the minimum interest of Polish agriculture, Jarosław Kalinowski (Deputy Prime Minister, Minister of Agriculture and the Leader of the Polish Peasants Party), who originally was sceptical about the accession, is now in favour of the integration. The non-governmental forces also contribute to the 'vote yes' campaign. The initiative taken by the opposition of the right (the Civil Platform (PO), the Conservative Peasants Party (SKL), the Freedom Union (UW), Social Movement (RS)) which established the civil movement for the Poland's accession to the EU can be given as an example.

However, strong opponents of the Poland's integration with the EU can be also found among the significant political forces. The League of Polish Families (LPR) say 'no' to the EU. Moreover, part of the Polish Peasants Party (PSL), member of the coalition in the government, is also against the integration (e.g., one of its regional leaders, Mr Zdzisław Podkański, calls for a 'no' vote).

In order to increase the chances for a positive accession referendum result, the sequence of referendums in all the candidate countries had to be adequately agreed. The first referendum is to be held in Hungary where, traditionally, the support for integration is the highest. Once the Hungarians say yes to the integration, the other candidate countries may follow suit. The table below presents the agreed or most likely dates of the accession referendums in the candidate countries.

Table 6. Schedule of accession referendums in the 10 candidate countries

Country	Date	Outcome	Min. turnout
Cyprus	none	-	-
Czech Rep.	15-16 June 2003	Binding	Not required
Estonia	14 September 2003	Non-binding	Not required
Lithuania	May 2003	Binding	50%
Latvia	20 September 2003	Binding	50%
Malta	1st half 2003	Non-binding	Not required
Poland	8 June 2003	Binding	50%
Slovak Rep.	16-17 May 2003	Binding	50%
Slovenia	23 March 2003	Non-binding	Not required
Hungary	12 April 2003	Non-binding	Not required

Source: PAP, Reuters, Rzeczpospolita

Turnout might be a problem

According to the most recent public opinion poll in Poland, the EU-enthusiasts substantially outnumber the EU-sceptics - even more so following the Copenhagen summit (vide *EU negotiations watch)*. Even though we can expect that after the negative campaign has been commenced by the EU-opponents, the support for the EU membership might decline, this decline should not be dramatic and the support should still be above 50%. The real problem related to referendum in Poland is not about the support for integration but about the turnout. Pursuant to the constitution, in order to deem the referendum result valid, the minimum turnout requirement is at 50% of the eligible to vote. The public opinion polls have indicated for some time now that the turnout might be too low. This is why, e.g. a decision was taken to develop a National Referendum Act. A relevant legislative initiative was put forth by the President of the Republic of Poland. In the course of work on this Act in the lower house of parliament, fearing that the turnout might be too low, proposals of substantial changes to the voting system in the referendum emerged. They were developed, at the request of the MPs, by the Public Affairs Institute. One of the most breakthrough proposals was to organise a 48-hour vote (such an option will be applied in, e.g. the Czech Republic), mail vote and on-line vote, allow voting outside the registered place of residence, grant authorisation to represent one in the vote and extend work time of the ballot committees. Of all the proposals only the last two are likely to be approved and, as a result, the ballot committees are most likely to work from 6 a.m. to 10 p.m. (to date, they closed at 8.00 p.m.).

What will happen, in view of the stipulations of the Constitution and the new Referendum Act if, despite all efforts, the turnout proves too low? The draft Referendum Act stipulates that if the turnout was too low, the government would have the right to withdraw from the parliament the accession treaty and renegotiate it. Then, the referendum could be held once again, because it would refer to a different treaty. Unless the Council of Ministers withdraws the treaty in time, Sejm can (but does not have to) take another decision by way of a resolution, whether to organise another referendum to ratify the treaty or to go the legislative path. In the latter case, the authorisation for the President to sign the accession treaty would have to be given by the majority of 2/3 votes in each of the houses.

It seems that one way or another, in view of both the existing and the projected support for the integration and the intentions of the dominant Polish political forces, Poland will enter the EU. It is difficult to even try to envisage the reaction of the financial markets and the resulting implications for the entire Polish economy if we failed to do so.

Economic update

- **Positive November's economic data**
- **…which bodes well for GDP growth in 4Q02**
- **No miracles – unemployment rate increased**
- **…and another record low inflation levels soon**

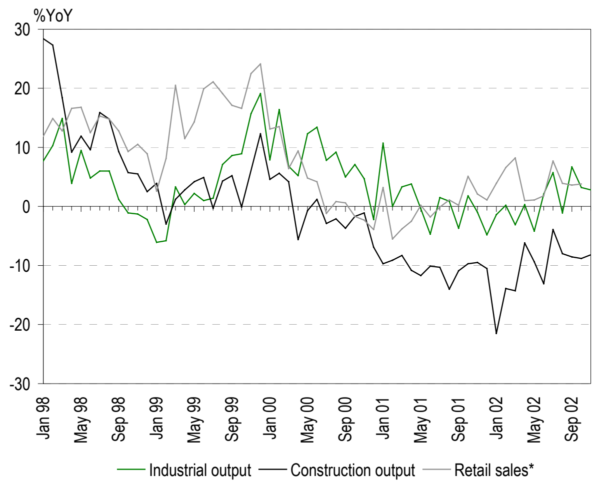
Macroeconomic data published in December confirmed the trends observed earlier. Industrial output and retail sales went up even faster than expected, while the foreign trade was sustained at a high level. This indicates a possibility of further acceleration in the economic growth. In 3Q02, the GDP growth dynamics was 1.6% YoY, i.e. double the growth in 2Q02 and four times as much as in 1Q02. One can hardly expect this trend to be sustained, however, the Polish economy is likely to develop at over 2% already in the first months of this year, and the gradual improvement should bring about an average growth of ca. 3% for a year. This will be below the budget projections, however, it will not be the only one ratio overstated by the Ministry of Finance. Contrary to Grzegorz Kołodko's July statements, the unemployment rate did not start to decrease in November. There were no miracles, seasonal factors, which reveal on an annual basis, resulted in the unemployment rate increase up to 17.8%. What is more, further moderate increase is possible in December 2002 and at the beginning of 2003, and then a stabilisation at this high level. The continuously difficult situation on the labour market should limit both private consumption and the inflation pressure. We think that high private consumption growth of 3% should not maintain in the following quarters, although it might be still high in 4Q02. The inflation rate is most likely to stay below 1% YoY almost by the end of 1H03. Moreover, we may witness subsequent inflation rate records, as our projection indicates that in January CPI will be lower than at the end of 2002r, and in April 2003 it may be only 0.5% YoY. The MPC is bound to factor in such inflation prospects at its next meeting. Therefore, the recent data increase the possibility of subsequent cut in the interest rates already in January.

Surprisingly high industrial production growth

Surprisingly, industrial production figures for November were not announced by the statistical office, as before the official data release, the finance minister Grzegorz Kołodko, who was testifying before the Lower House, revealed those numbers to the deputies (we mention this also in *Government and politics* section).

Even as surprising as the way of publication, were the numbers themselves. Industrial output declined only 5.9%MoM, which gave 2.8%YoY growth, while the market consensus pointed to –8.8% and –0.1%, respectively. Please recall that the decline in relation to preceding month was caused by the lower number of working days. After the seasonal adjustment the annual growth amounted to 6.5%YoY, the highest since January 2001. The figures definitely confirmed that the situation in the Polish industry keeps improving in 4Q02. Although, it has to be stressed that such strong result might have been biased upwards by some extra transactions in shipyard industry, as the production of "other transport equipment" exhibited the growth of 28.8%YoY. This may not repeat in subsequent months. Anyway, in November's data there were clear signs that things are going for better – 21 out of 29 industrial sectors recorded higher production than a year ago. Moreover, it is worth noticing that the overall output figure has been dragged downwards by the weak performance of mining and the contraction in the supplies of water and energy. Production in manufacturing sector was much stronger, growing 4.4%YoY (after the seasonal adjustment probably ca. 8%YoY), which delivers even stronger confirmation of real activity expansion.

Real growth, %YoY



Source: CSO, BZ WBK

...retail sales also better than forecasted

The CSO said also that retail sales increased by 5.9%YoY in nominal terms in November after growing by 6.1%YoY on average in 3Q02 and 5.1%YoY in October. The structure of the growth was similar as in previous quarters. The fastest growth was recorded in cosmetics and pharmaceuticals (24.0%YoY) and in non-specialised shops selling mostly groceries and tobacco (19.4%). Also retail sales of clothing and footwear continued to rise significantly (15.1%). For a second month in a row, significant increase took place in motor vehicles (12.9%YoY). The CSO revealed also data on real growth of retail sales in October. It amounted to 3.8%YoY after 3.6%YoY in September. Given higher nominal figure and record low level of inflation in November one may expect that retail sales growth in real terms in November was even stronger. This suggests that private consumption will positively influence GDP growth also in the 4Q02.

It seems that positive retail sales figure maintained also in the last month of 2002, as according to the data from Samar – the company monitoring car market in Poland - the sales of new vehicles fell by 2%MoM in December, which means that annual dynamics significantly improved to 27%YoY (from 19.1% in November). A continuation of the upward trend observed since several months suggests that private consumption remains robust also in 4Q02. Although it is to be seen whether this trend maintains at the beginning of 2003, as car dealers suggest that high figure for December 2002 could be affected by special promotion campaign. On cumulative basis, in the year 2002 as a whole, new car sales fell moderately by 6%.

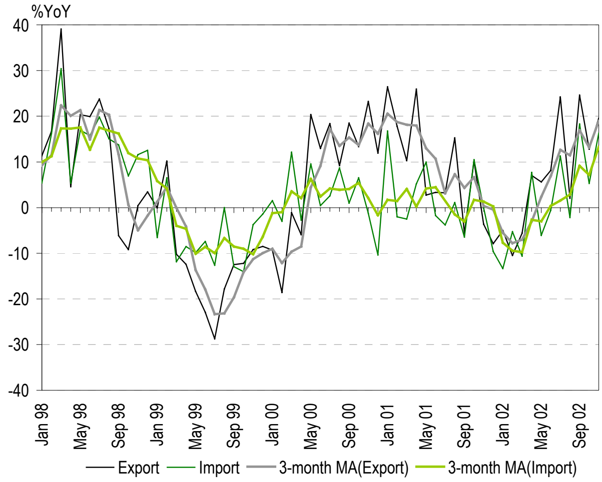
Foreign trade turnover still high

The CSO customs-based foreign trade statistics for January-October 2002 period also confirmed trends observed in previous months. Exports in US$ terms were growing 5.1%YoY in October and 8.9%YoY in January-October period against 9.4%YoY after first three quarters of 2002. Imports grew 5.4%YoY in October while in January-October period the increase amounted to 6.4%YoY – 0.1pp lower than after September. The CSO's figures showed, for the second month in a row, that growth rates of exports and imports converged and imports is growing faster than exports (after over two years of the opposite situation). This seems to reflect gradual acceleration of domestic demand (stable consumption growth coupled with lower negative value of investments). On the other hand, exports dynamics is still strong showing that foreign demand for Polish products does not fall despite weaker economic situation of our partners. To some extent, this is possible thanks to a change in the geographical structure of exports (decreasing share of slower growing Germany and increasing share of France, Russia and Sweden).

…also in payments statistics

Balance of payments data for November released by the NBP very closely matched our expectations. Current account deficit increased to US$740m (slightly above our forecast of US$700m and well above market consensus at some US$470m) from October's revised shortfall of US$606m. According to our estimations cumulative 12-month C/A deficit reached 3.5% of GDP rising from 3.4% in October. As we expected the C/A deficit increase resulted from lowering of surpluses in net transfers and unclassified flows. The latter dropped to US$298m from over US$400m in three previous months showing seasonal worsening in cross-border trade.

Foreign trade turnover



Source: NBP, BZ WBK

Despite worsening in the whole current account, trends in foreign trade remained positive. In line with our expectations both exports and imports recorded double-digit growth rates increasing by 19.6%YoY and 16.3%YoY, respectively, suggesting that domestic demand is slowly increasing while external demand remains at quite high level. However, one should remember that as usual in recent months, balance of payments figures denominated in dollars were affected by €/$ movements. In euro terms exports and imports recorded only single-digit growth rates (see table below). This means that improvement in foreign trade is not as impressive, as it seems at first glance.

Export and import growth in November, %YoY (revised October's figures in brackets)

	in USD	in EUR	in PLN	2/3EUR / 1/3USD*
Exports	19.6 (12.8)	6.1 (4.2)	15.5 (12.4)	10.2 (6.9)
Imports	16.3 (5.3)	3.1 (-2.8)	12.3 (4.9)	7.2 (-0.3)

*Note: * the relation approximately reflects currency structure of Poland's foreign trade*
Source: NBP, own calculations

Stable foreign debt in 3Q02

In December the NBP released also foreign debt data after the first three months of 2002. There were no major changes in comparison with the situation after the first half of the year. Total debt decreased moderately from US$78.76bn to US$78.74bn and its structure remained almost unchanged – public sector debt increased by US$0.5bn to US$34.1bn, banking sector's debt remained almost unchanged at slightly above US$7bn and the remaining (the debt of enterprises) fell by US$400m to US$37.3bn. The share of short-term debt in total debt remained at a bit above 14% and short-term debt amounted to US$11.1bn at the end of September, which equalled almost 40% of Polish FX reserves.

GDP growth was not a "positive surprise"

The data presented above suggest that GDP growth in 4Q02 accelerated as compared with 3Q02 figure, although the pace of improvement was not substantial.

Meanwhile, finance minister Grzegorz Kołodko's hint concerning GDP growth turned out to be not as precise as the one about industrial output. Contrary to his announcement, Poland's GDP growth in 3Q02 was not "surprisingly strong" and amounted to 1.6%YoY. In January-September period GDP increased by 0.9%YoY.

The CSO released GDP data computed according to the new methodology, compatible with the European Union standards (for 3Q02 and the preceding quarters, starting from 2000).

Methodology changes:

- transactions in the sector of general government and local governments are based on an accrual basis instead of a cash basis,
- part of public entities conducting business activity was shifted from the enterprise sector to the government's sector, which caused a change in a way of estimation of value added in this entities,
- fixed assets were valued in market prices instead of book value.

Source: CSO

Despite these changes, the overall GDP growth figures for previous quarters recorded only slight changes. The growth rate for 2Q02 remained unchanged at 0.8%YoY and for 1Q02 was revised downwards by 0.1pp to 0.4%YoY. Also growth rates of particular components of GDP did not experience significant changes, and the most important revision concerned the nominal value of public consumption. Detailed GDP growth statistics are presented in the table below.

Real growth of GDP and its components, %YoY

	1Q01	2Q01	3Q01	4Q01	1Q02	2Q02	3Q02
GDP	2.2	0.9	0.8	0.2	0.4	0.8	1.6
Domestic demand	-1.1	-1.7	-1.5	-2.3	-0.2	1.0	1.1
Total consumption	1.2	1.1	1.7	2.7	2.8	2.6	2.8
Private consumption	1.5	1.5	2.1	3.2	3.5	2.9	3.1
Public consumption*	0.2	-0.2	0.4	1.0	0.4	1.6	1.8
Gross accumulation	-12.6	-12.2	-12.5	-13.0	-18.3	-5.9	-6.0
Fixed Investments	2.1	-8.0	-11.7	-12.0	-13.2	-8.4	-6.3
Inventories*	-295.0	-76.0	-28.6	-41.0	30.8	130.0	1.4
Net exports*	-42.0	-35.5	-44.8	-45.5	-13.0	6.5	-17.0

*Source: CSO, BZ WBK; * BZ WBK estimates*

In line with expectations, the main driving force behind the GDP growth was private consumption and its growth rate (3.1%YoY) surpassed our forecast (2.5%YoY). On the other hand, dynamics of fixed investments disappointed, as its fall diminished to a lesser extent (to -6.3%YoY against -8.4%YoY in 2Q02) than it was expected (we predicted drop of 3.5%YoY). In total, domestic demand grew by 1.1%YoY. As fixed investments were lower, net exports positively affected the overall GDP growth, after the negative contribution to GDP growth in 2Q02.

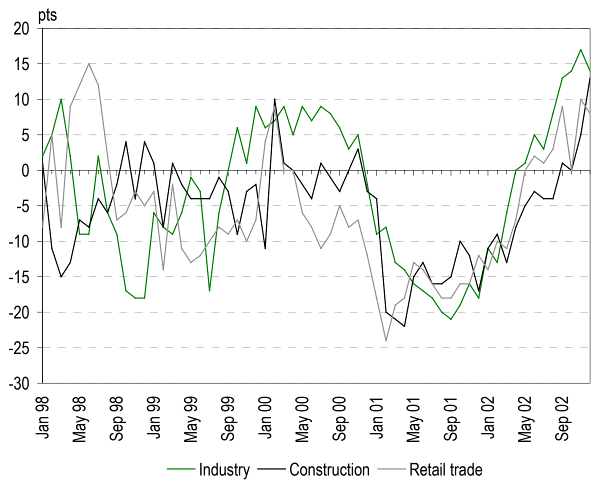
In general, the GDP figures for 3Q02 did not influence us to change our expectations for the overall GDP growth in the following quarters. We do not change our economic scenario presented in the previous MACROscope and we still forecast 2% growth in 4Q02, 1.3% growth in the whole 2002 and 3% in 2003. However, a composition of the growth may be somewhat different than we predicted so far. While we still believe that fixed investments growth should be the main driving force behind the economic growth in 2003, it seems that improvement in this component of GDP may be slower than previously expected and there was another fall of investments in the last quarter of 2002. On the other hand, while private consumption growth should decline slightly in the quarters to come (there will not be "positive inflation surprise" effect as in 2002), but it seems this was not the case yet in 4Q02, which was suggested by high retail sales figures, mentioned above. Finally, net exports contribution to GDP growth in 2003 may be less negative than previously forecasted.

Business climate better than a year ago

As we wrote above, we expect an acceleration of GDP growth in the following quarters, as compared with 1.6% growth in 3Q02. Business climate surveys for December 2002 seem to confirm such a view, although it has to be stressed that the presented picture is not very clear. All indicators were lower than in November, however, annual changes were very positive. The situation was also different in various sectors of the economy. According to the CSO survey, business climate indices for industry, construction and retail trade were much better than in corresponding period of 2001 and entrepreneurs were optimistic about the future, expecting growth of the demand and some improvement of their financial situation and planning (cautious) production expansion. On the other hand, in the results of IBnGR survey positive value was recorded only in trade and services and the worst evaluation of the business climate was observed in the industry sector. Similarly to the previous months, entrepreneurs plan further reduction of employment.

In turn, the results of business economic climate prepared by the Institute of Economic Development (index down by 6 pts MoM, but higher by 11 pts than a year ago), showed that the general assessment of the economy is worse in small companies in the private sector and public firms' (especially those employing more than 2000 people) expectations are more optimistic. Such a result suggests that one should not expect sharp economic improvement, as it is difficult to imagine that mining sector and steel mills could be the drivers of the economy and they can hardly be classified as competitiveness leaders.

Business climate, YoY



Source: CSO, BZ WBK

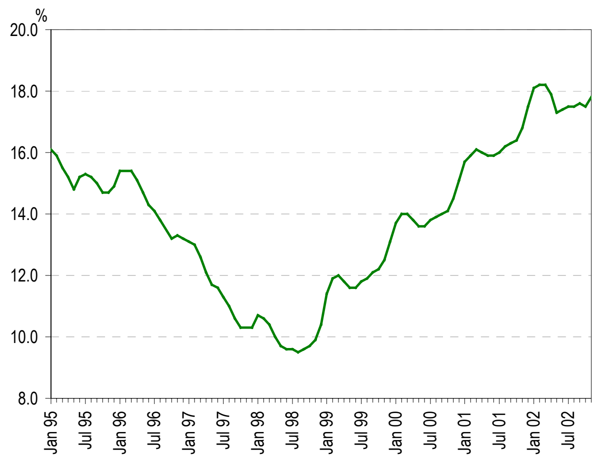
Seasonal fall of consumers' optimism

As we wrote above, GDP growth data in 3Q02 showed high private consumption, but in our opinion its growth level of around 3% should not be maintained in the nearest quarters, although it might be still high in 4Q02. This was supported by the results of latest consumer's optimism survey performed by Ipsos-Demoskop institute in December. The overall optimism index increased by of 2.7%YoY, while households' propensity to consume increased by 3.7%YoY. Both indices fell on monthly basis due to seasonal factors. On the other hand, the assessment of economic climate fell on both monthly and annual basis – by 8 pp and 3.2%, respectively. Households reported a moderate growth of inflationary expectations, lower propensity to consume and high fear of unemployment.

No miracles – unemployment rate up in November

There were no miracles. When Grzegorz Kołodko took over the post of finance minister in July he announced that the unemployment rate would begin to decline in November 2002. While labour minister Jerzy Hausner was less optimistic about the situation on the labour market he assured recently that the unemployment rate in November would not rise significantly and would not exceed 17.7%. However, actual data released by the CSO disappointed, as the Office said that the unemployment rate in November increased to 17.8% from 17.5% in the previous month and from 16.8% in November 2001. The number of unemployed reached 3.151m rising by 4.3%YoY (against 5.6%YoY in October). We expect the unemoployment rate to increase further in December.

The unemployment rate, %



Source: CSO

As expected, November brought seasonal weakening of the situation on the labour market but the upward trend of unemployment diminished again. Since the beginning of 2002 the pace of unemployment growth decreased by more than a half. One can expect that this process will be gradually continued in the future. We predict that due to the strong seasonal effect the unemployment rate will sharply increase in December exceeding 18%.

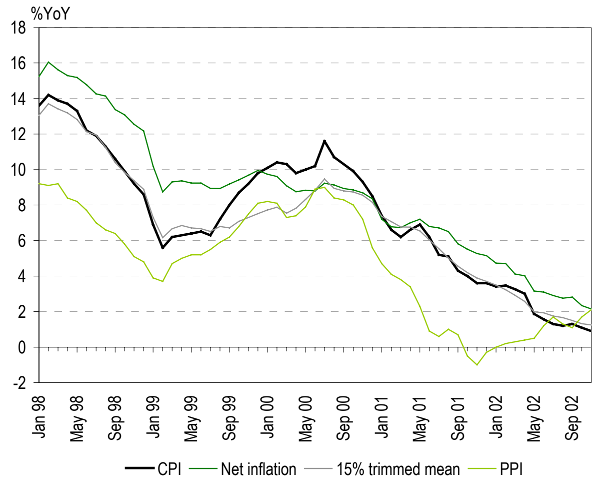
...and labour market data quite weak

Also, monthly statistics from the labour market were not optimistic, as after 0.1%MoM increase in October average employment in the enterprise sector fell again in November. The fall exactly matched our expectations and amounted to 0.2%MoM and 3.2%YoY, but once again annual drop of employment in the enterprise sector diminished and was the lowest since May 2001. The pace of labour shedding process is still strong and one has to wait for a visible improvement of the situation on the labour market. Weak labour demand and high unemployment constrain wage pressure. According to the CSO, average wage in the enterprise sector in November grew by 3.5%MoM, which stemmed from seasonal hikes in wages. Nevertheless, while wages growth in annual terms accelerated in comparison with only 0.5%YoY in October it remained relatively low and amounted to 1.8%YoY. Real wages grew by only 0.9%YoY in real terms, against 2.3%YoY on average in 3Q02. Moreover, as a result of falling employment and low wages' dynamics, the wage bill in the enterprise sector in nominal terms decreased in comparison with the corresponding period of the previous year for a ninth consecutive month (by 1.4%YoY) meaning that corporations continue to reduce labour costs.

No surprises - inflation below 1%

Inflation figures for November exactly matched our forecasts. CPI inched down by -0.1%MoM and the annual inflation rate declined to 0.9%YoY - another record low level in the history of Poland's economic transition. The structure of CPI change was also consistent with expectations – the prices were dragged down mostly by falling prices of food (-0.3%MoM), alcohol (-1.4%MoM), tobacco (-0.4%MoM) and fuel (-0.3%MoM), while other prices remained stable or increased only marginally. The fall of food prices, which has never happened before in November, signals that very strong positive supply shock on the food market still has its effect on inflation. It also confirms central bank's expectations included in the Inflation report for 3Q02.

Measures of inflation, %YoY



Source: CSO, NBP

…food prices still low in December

Food prices were again lower than expectations. Especially in the first half of the month, as they increase only by 0.2% MoM. Prices of fruits and vegetables were pushing food prices up, but it was offset by prices' falls of other food products, with the most significant drop in a case of meat. On average food prices grew by 0.3%MoM in December, which led to revisions of inflation forecasts. Especially, as the effect of lower excise tax on alcoholic beverages was still visible and prices of this component declined again.

The two above-mentioned factors are very positive for the short-term inflationary outlook, and it seems that forecasts for December and several consecutive months should be revised downwards. Of course one very uncertain factor is the effect of hikes in rents in privately own housing, which could be introduced since December due to the Constitutional Tribunal's sentence. However, we think that CPI growth should not exceed 0.9%YoY in December 2002 and it is likely to remain below 1%YoY almost until mid-2003. What is more, we could see another record low inflation level in 2003, as according to our forecasts CPI can reach 0.5%YoY in April 2003. The MPC will surely take such inflation perspective into account during its next meeting, therefore recent data increased the probability that the next interest rate cut will be delivered already in January.

… and core inflation reached new record lows

Following CPI fall to record low level of 0.9%YoY in November all core inflation measures also declined to the lowest levels in their history. In line with our estimations net inflation (CPI excluding oil and food prices) dropped to 2.15%YoY from 2.34%YoY in October. The most important measure, 15% trimmed mean, fell slightly to 1.25%YoY from 1.32%YoY in the previous month. Also remaining three measures recorded decrease and one of them – inflation excluding controlled prices – is as low as 0.25%YoY. The figures released by the NBP confirm that inflation pressure is very low. Such a situation is very likely to be maintained in the following months.

Producer prices down

PPI growth accelerated to 2.1%YoY in November from 1.7% in the previous month. The figure was in line with market's expectations and slightly lower than our forecast of 2.3%. As we have written before, higher annual growth rate was caused by very low base from 2001 rather than the acceleration of current price growth. In fact, the PPI was lower than in October by 0.1%, which indicates that the revitalisation of industrial production have not intensified the pressure on producer's prices yet. Fall of producer prices on monthly basis was most probably connected with low fuel prices and strong zloty.

Therefore, we do not agree with several comments saying about a potential impact of rising PPI (on annual basis) on CPI inflation in the near future. Simply, very cheap fuel in October 2001, which decreased statistical base, is not likely to influence consumer prices in the following months.

Monetary statistics worse than expected

Also the NBP monetary statistics for November were weaker than expected. Broad money M3 contracted by 1.0% both on a monthly basis and in comparison with the corresponding period of the previous year (we predicted increases of 0.5%MoM and 0.4%YoY). It was the fourth consecutive month of money supply decline in annual terms. M2 aggregate (broad money according to the "old definition") recorded the first annual fall (by 0.1%) since the beginning of publication of monetary statistics. The growth of cash in circulation reached 14.9%YoY being only 0.1pp higher than in the previous month. Deposits continued to leak out from the banking sector. Despite low base last year, which was connected with the introduction of withholding tax, deposits declined by 1.2%MoM and 3.1%YoY (households' deposits alone dropped by 1.8%MoM and 1.6%YoY). This could suggest that we experience a sharp fall of propensity to save. However, one should remember that a part of households' savings withdrawn from the banking deposits were invested in banks' bonds, which issues were launched in November. It is confirmed by the fact that "other elements of M3", including bank's liabilities in the form of bonds, significantly grew by 177.4%MoM and 50.4%YoY. These figures, together with data reported by investment funds, suggest that households change structure of its savings, shifting from banking deposits to more profitable financial instruments. Also, deposits' dynamics expressed in PLN were negatively affected by the zloty appreciation. Thus, although households' deposits substantially decreased, propensity to save did not necessarily decline to the same extent.

The Monetary Policy Council also noticed this phenomenon, as in the statement after the December's meeting said that considerable money supply fall was connected with incorrect commercial banks' reporting (see also *Central Bank Watch* section)

Credit growth recorded only slight increase in November and reached 0.3%MoM and 4.7%YoY. Households borrowed 7.8% more than in the corresponding period of last year and enterprises only 1.2% more than in November 2001.

Central budget deficit on track, but higher economic deficit

After eleven months of 2003 the central budget deficit reached 92.7% of the plan assumed in the budget act. At the same time the revenues stood at 89.9% and expenditures at 90.5%, respectively. On the revenue side the most impressing growth was recorded in corporate income taxes (CIT) – they grew 12.3%YoY in January-November (19% in November alone), while the government planned 4.2%YoY for the whole year. Indirect taxes were also growing steadily, though still below plan (9%YoY against planned 10.9%). The weakest performance was observed for PIT inflows, as they grew by only 3.4%YoY in first eleven months against 13.5% planned. The growth of tax revenues suggests one more time that the economic situation, and especially financial stance of Polish companies, improves. Although, it has to be stressed that a number of small companies pay their taxes according to PIT (not CIT) standards.

After all, it seems that after the whole year the government might be some PLN1-2bn short of revenues compared to the initial budget assumptions (shortage in indirect taxes and PIT of almost PLN4bn should be to some extent covered by higher revenues in other areas). This should not imply overshooting the level of targeted budget deficit, assuming that the finance minister will be able to cut or block some expenditure. One of the easiest ways to do this (commonly exercised in the past) is to postpone certain payments by one or two months, until the beginning of the new budget year. Of course it does not necessarily limit the size of ‘real’ public finance imbalance, however enables to end the year without breaching the constraints of the budget law.

Looking at the expenditure side of budget after eleven months, we seem to discover some signs of this procedure in November. The subsidies for the Labour Fund and for the Social Security Fund (FUS) declined substantially in the last month despite there was virtually no improvement on the labour market, nor one could see the reason for significant deceleration of pension premium growth. One could guess that those two funds would have to borrow on the market more heavily at the end of the year. According to Rzeczpospolita FUS will take commercial credit of PLN300m in December, while the Fund borrowed already PLN1.5bn in 2002. Also, the local governments still receive smaller funds than assumed in the budget act, which could lead to increase of their debt. In general we think that the deficit of the central budget will not exceed projected PLN40bn in 2002. However this would be achieved at the expense of higher borrowing of other public finance entities. All in all the economic deficit of public finance should remain high, probably close to the level forecasted by the NBP, i.e. 5.5% of GDP.

Central bank watch

- **The MPC did not surprise in December**
- **...and the NBP president's decisive vote was crucial for the surprising October's decision**
- **Wiesława Ziółkowska would like to cut rates by 100-150 bp in 2003**

The MPC did not surprise

As expected, the MPC kept interest rates unchanged in December and maintained neutral bias in monetary policy. At the beginning of the official statement the Council said that since the last MPC meeting there appeared very little new information describing economic situation, which confirmed our line of reasoning presented in recent days. As we have also argued before, record low inflation in November was not considered as the argument for rates' reduction and this was confirmed during the press conference by NBP president Leszek Balcerowicz.

It seems that the MPC's assessment of the overall economic situation remained broadly unchanged, which is not very strange given the shortage of new economic data. The MPC noticed the developments that were promoting low inflation environment in Poland. They included: low inflation expectations of both households (fall from 0.9% to 0.8% in December) and banking analysts, low dynamics of broad money, stabilisation of cash in circulation growth and low credit growth, weak growth of wages, which does not create the inflationary pressure. However, at the same time the MPC members remained concerned about several factors that could be potentially harmful for inflation stabilisation. They included the risk of loosening fiscal policy; collapse of households' deposits in banks; risk of war in Iraq and protests in Venezuela influencing fuel prices; chance for higher inflationary pressure amid accelerating economic growth. The most significant threat was the situation of public finance, namely high probability that the economic deficit will be much higher than planned in 2002 and 2003 (and will reach 5.8% and 5.4% of GDP, respectively). Leszek Balcerowicz said during the press conference that the MPC still has very tiny hope that the much-needed radical reform of public finances would be undertaken. This might suggest that the central bank might wait with the next interest rate change until Grzegorz Kołodko shows the first proposals of the public finance reform (at the beginning of 2003).

The MPC noticed the improvement of economic situation, however their predictions for 2003 are still rather conservative. Leszek Balcerowicz said during the press conference that the MPC forecasts GDP growth for 2003 at 2.5%. However, at the same time Dariusz Rosati, who did not participate in the conference, said that in his opinion GDP might grow by 3.5% in 2003.

What is interesting, according to the MPC statement, the dramatic collapse of broad money in November (M3 contracted by PLN3.1bn) was caused to a large extent by the incorrect commercial banks' reporting of the funds collected from the bonds issue, and the figures shall be recalculated and revised upwards in the following months. According to the central bank, most of the money that left households' banking accounts in November went to other saving facilities, in particular: investment funds (PLN1.4bn), T-bonds (0.6bn), and commercial banks' bonds (1.3bn). Another interesting information from the MPC's statement was that the 12-month average inflation rate computed for Poland according to the European Union's standards (HICP) amounted to 2.4% in October, while it stood at 2.0% in the EU at the same time. This – Leszek Balcerowicz explained – contradicts that we are approaching deflation in Poland. It is worth noticing that the 12-month average HICP inflation was exactly the same as the adequate CPI measure.

The MPC decided also during December's meeting to shorten to 14 days the maturity of open market operations (NBP bills) since the beginning of 2003, in line with the ECB's standard. This measure was not a surprise, however, as it has been announced earlier in the *Monetary policy guidelines for 2003*.

Balcerowicz cut rates in October

In December, the results of MPC's voting over unexpected 50 bps rate cut in October were published in the Government's Monitor. This time hawkish faction within the MPC was unanimous in its opinion on appropriate level of interest rates. Marek Dąbrowski, Bogusław Grabowski, Cezary Józefiak and Jerzy Pruski voted in harmony against the rate cut. Also Wojciech Łączkowski wanted to keep rates unchanged. On the other hand, all doves, i.e. Dariusz Rosati, Grzegorz Wójtowicz and Wiesława Ziółkowska voted for rate cut and they were supported by Janusz Krzyżewski. In such a situation, similarly to several meetings in 2002, decisive voice belonged to NBP governor Leszek Balcerowicz. For the third month in a row his decision was consistent with dovish faction. It seems that also in the nearest future MPC's decisions will depend on Balcerowicz's opinion about the appropriate level of interest rates.

Wiesława Ziółkowska wants to cut, which is not surprising

At the beginning of 2003 the MPC member Wiesława Ziółkowska said that food prices are likely to remain quite stabile until mid-2003, which will transfer into low inflation. She expects that CPI in December 2002 amounted to 0.8-0.9%YoY and at the end of 2003 it should accelerate to around 2%YoY. As Ziólkowska does not see significant revival on the demand side of the economy she thinks that economic recovery is moderate and predicts GDP growth in 4Q02 at ca. 2%. Despite quite modest growth in the last quarter of 2002, which is consistent with our forecast, Ziółkowska believes that there is a chance for 3.5% GDP growth in 2003. However, she said that expected faster pace of economic growth in 2H03 will not increase inflationary pressure amid high unemployment and low dynamics of households' income.

According to Ziółkowska lack of inflationary pressure allows for 100-150bps interest rates cuts in 2003. While we agree that inflation processes justify further monetary easing we believe that the scale of rate cuts in 2003 will be lower and should not exceed 75bps. One should remember that Ziółkowska represents dovish faction within the MPC and the remaining part of the Council may have a different view on a proper level of interest rates. Actually, given the fact Ziółkowska usually supports the deepest rate cuts and she is very likely to vote for interest rates reduction each month in 2003, the presented scale of room for potential monetary easing may be even disappointing for the market.

MPC voting results in 2002

	Jan	Jan	Jan	Mar	Apr	Apr	May	May	Jun	Jun	Jul	Aug	Aug	Sep	Oct	Nov
Change (bp)	-200	-100	-150	-100	-100	-50	-75	-50	-100	-50	-50	-75	-50	-50	-50	-50
Decision	NO	NO	YES	NO	NO	YES	NO	YES	NO	YES	NO	NO	YES	YES	YES	YES
Balcerowicz	-	-	+	-	-	+	-	+	-	+	-	-	+	+	+	n/a
Dąbrowski	-	-	-	-	-	-	-	-	-	-	-	-	+	-	-	n/a
Grabowski	-	+	-	-	-	+	-	+	-	+	-	-	+	-	-	n/a
Józefiak	-	+	-	-	-	+	-	+	-	+	-	-	+	+	-	n/a
Krzyżewski	-	-	+	-	+	+	-	+	-	+	+	-	+	+	+	n/a
Łączkowski	-	+	-	-	-	+	-	+	-	+	-	-	+	+	-	n/a
Pruski	-	-	-	-	-	-	-	+	-	-	-	-	+	-	-	n/a
Rosati	+	-	+	+	absent		+	+	+	+	+	absent			+	n/a
Wójtowicz	+	-	+	+	+	-	+	+	+	+	+	+	+	+	+	n/a
Ziółkowska	+	-	+	+	+	-	+	-	+	+	+	+	+	+	+	n/a

Source: NBP, Government's Monitor

Comments of the MPC members and central bank representatives

In December, while politicians focused on benefits and costs of the EU accession, the central bank's representatives looked ahead a little bit further presenting profits of early accession to the Eurozone. Of course, at the same time they emphasised that the decrease in the budget deficit is necessary not only to meet the Maastricht Treaty criteria, but to achieve sustainable and continuously higher economic growth in the long run. However, before we join the Euro zone, obligatory reserve will be gradually decreased to the level prevailing in the EU. This step, as officially announced by Mr Balcerowicz, the NBP President, will be preceded by the purchase of bonds indexed against inflation and issued in 1999.

The central bank' representatives also referred to the official statement of the NBP of early December which related to the exchange rate policy – we discussed this issue last month. According to the MPC members, the exchange rate should remain free floating, without any interventions, as long as possible, although one cannot exclude shortening of the transitory period in ERM2.

As usual, the MPC members commented their decision, this time, on leaving the interest rates unchanged. Once again, there were some comments that financial markets may be overoptimistic in their assessment of the EU accession. The MPC members expect some slight acceleration in the economic growth. We heard that the economy is about to "take off" (Mr Rosati) and that the investments will drive the growth in 2003 (Mr Grabowski), which will be accompanied by the stabilisation of the inflation rate. Grzegorz Wójtowicz tried to advise against the consumption of alcohol despite the fact that the November inflation fall resulted from the decrease in the excise duty on alcohol beverages.

WHO, WHEN, WHERE	COMMENT
Leszek Balcerowicz; NBP governor; PAP, 30 Dec	We have to answer on what date we should join the EMU because it depends on us. Poland would benefit from the earliest possible date. It remains to be specified whether it can be 2007 or even 2006. Maybe 2007. We check if 2006 is possible due to procedural reasons. If not, then 2007 would be the optimal date from the point of view of the economic growth. Why is it worth to join the EMU? Firstly, the sooner we meet Maastricht criteria the better for the economic growth in the long-term. Secondly, the longer the transitory period, the longer the time when certain complications might happen related to huge inflows and the potential of outflow of short-term capital. Finally, the faster Poland joins Eurozone, the faster it gains the associated benefits. I mean the benefits like elimination of exchange rate risk, which would be profitable for trade development, therefore strengthening economic growth. Entering the Eurozone would ensure more transparent conditions for competition, not mentioning such factors like the ease of travelling. In my opinion it is the double win strategy – it is beneficial from several points of view. One could build a good strategy around the Eurozone entry. [Shortening of period within ERM-2] is not only up to us, it requires the EU's approval. But there was a precedent once, Finland stayed within ERM-2 only for 16 months, but I don't know if it is any conclusion for us. [...] If one intended to enter the Eurozone as fast as possible, we should also join the ERM-2 as soon as possible. And the reform of public finance is the strategic condition for reaching the objective of the Eurozone entry. I believe that we could and we ought to start the negotiations [regarding zloty parity against the euro before EU accession]. Poland already meets most of the Maastricht criteria, e.g. inflation lies within EU's required range and according to the NBP's estimates since October the yield on 10-year T-bonds is below the reference value [...]. The public debt lies within the limits set by Maastricht criteria, i.e. it's lower than 60% of GDP. But it is important that it should stop growing, therefore we should limit budget deficit below 3% of GDP. It is in our interest, because too large deficit means that public debt has to be increased rapidly, which encourages portfolio capital creating appreciation pressure on the zloty, which is not compensated (contrary to case of foreign direct investments) by the increase of companies' competitiveness. It also means that some of the banking sector's funds, instead of going to the companies, are covering the budget gap. Permanent improvement of the situation in public finances is not only the fundamental condition of the early EMU entry but it is also needed to benefit to the maximum possible extent from the membership in the Eurozone. Programs aimed at stabilisation of public finances succeed much more frequently if expenditures are reduced rather than taxes are increased. The sooner we meet these conditions the better for our economic growth in the long run. We announced that theses bonds [issued in 1999] will be bought back. This step logically proceeds reduction of obligatory reserve requirements, which has similar effects. The decision has already been made, inflation-indexed bonds will be bought back in March. From the central bank's point of view there is no reason that would unable reduction of obligatory reserve requirements. However, the government's stance is important. The reduction depends only on the MPC but good practice requires consulting such step with the government because it has some fiscal consequences.
Reuters, PAP 18 Dec.	The MPC had less current information than usual, but there are some signs of gradual GDP growth acceleration, and industrial production data confirm our judgement. It seems there is a tendency of recovery despite stagnation in Germany. According to the central bank's forecast GDP growth next year will amount to 2.5%. The MPC did not take into account lower inflation in November when deciding about maintaining rates unchanged. Current indicators depend on past factors, but decisions in monetary policy are forward-looking. Low level of inflation in November was driven by temporary factors.
PAP, 13 Dec	The next goal is to enter the Eurozone. It would be the best to join it as soon as possible what in practice means 2006 or 2007. Poland has already met inflation criterion, criterion concerning long-term interest rates criterion requiring public debt level below 60% of GDP. This has to be maintained and we have to reform public finances. However, public finances reform is a fundamental of sustained economic growth, so this is not any special sacrifice for the EU. Poland's membership in the EU means that Poland will be safe and well anchored in the European system for decades. It also means that Poland got new chances for economic growth. Final conditions of the enlargement are much better than offered earlier and this is some relief for the budget in 2004-2006.
PAP, Reuters, 10 Dec	Maximum elasticity in the exchange rate mechanism as long as possible is the best strategy according to the MPC. We should join the Eurozone as soon as possible – in 2006-07 – and that is why meeting Maastricht criteria is the most important. Lowering budget deficit in the following years is the most important. The rationale behind the MPC decisions is long-term, not current situation. Also the fact that inflation fell to another record low level is not a reason to cut rates, and the majority of information will not be known before December's meeting. It is obvious that inflation at around 1% is driven by one-off factors, such as food prices decrease.
Andrzej Bratkowski, deputy NBP president; PAP, 5 Dec	Taking into account low inflation we do not expect fluctuations of the exchange rate but we are ready to hear arguments why the Ministry of Finance would like earlier introduction of exchange rate band. There is no sense limiting exchange rate movements because it would mean earlier introduction of a parity and there is no need to introduce it earlier than it is necessary. The later we introduce a parity, the more information we will have on a proper level of a parity in order to get through the ERM2 without any tensions. We predict very slow acceleration of inflation. Non-monetary factors, which led to sharp disinflation will not act forever.

Reuters, 3 Dec	We want to prepare the economy [to meet Maastricht criteria] for 2005 and I think that we will be ready until then. I would assess it [probability of meeting Maastricht criteria] at 90%. To meet inflation criterion it is necessary to continue cautious monetary policy and carry out public finances reform, which was announced by finance ministry. It is very likely that in 2003 and 2004 we will experience higher economic growth but also extraordinary expenditures from the budget related to the EU membership. These factors will act inflationary. It is difficult to say whether current level of interest rates reflects long-term equilibrium or not. It is not known if and to what extent monetary policy can be less restrictive taking into account uncertainty connected with cumulated effect of interest rates reductions made so far. (...) This and uncertainty connected with the final shape of fiscal policy justify need of very cautious monetary policy also in the next year. I do not think that there may be any reasons, which would justify FX interventions. Experiences of Czech Republic, Hungary and Poland show that a country, which does not want to defend any level of exchange rate is to a least extent endangered by the need to defend it in the future. We must take into account that considering high potential growth for Polish economy and growth of labour efficiency, the real appreciation of the zloty would follow. [...] The key issue is to agree with ECB over the credible parity at the moment of zloty's entry to ERM2, which would also allow the economy to grow. I do not believe that those two criterions, fast EMU entry and maintaining fast economic growth, exclude each other. But I believe that we should try to stay in ERM2 as short as possible, possibly even shorter than required 2 years, of course if ECB agrees. The ultimate date of EMU entry is a technical issue, we want to be ready in 2005.
Marek Dąbrowski, MPC member; Reuters, 18 Dec	The market probably is too optimistic about the process of joining the European Union. The market's expectations are excessive and future months will determine if there will be a correction and how deep it will be.
Bogusław Grabowski, MPC member; Rzeczpospolita, 31 Dec	2003 will see end of the economic slowdown in the global economy and gradually all the most important regions will begin to revive – although in different pace. Initially, the recovery will take place in the US economy, then in Europe but it will be visible only in 2H03r. The recovery will take place at latest – and will be relatively the weakest - in these countries, which have unresolved structural problems. [...] Unfortunately, this also concerns Poland, where the recovery took place earlier. Thus, despite we have the worst behind us and the economic growth in 2003 will be faster, because of structural problems we can count on GDP growth at 4% at most.
PAP, 20 Dec	GDP growth in 4Q02 will amount at least 1.6%YoY and some 1.2-1.3% in the whole year. Fixed investments' growth is the factor, which can improve GDP growth dynamics. In 2003 we can already observe a growth of this indicator. A large part of investments was blocked to a large extent by slow privatisation and restructuring process. This does not change a macroeconomic picture, which the NBP has – moderate economic recovery amid higher domestic demand, especially consumption, and higher exports. The scenario of slowly accelerating growth is materialising, but we cannot expect that the economy will now enter the path of very fast growth. This will be gradual process depending on the situation in the world economy. As for now, there are no factors supporting higher, than previously expected growth. We should not expect fast acceleration of investments, we will see whether they recover in the first, or rather second or third quarter of the next year. The MPC forecasted 2-3% growth next year, depending on what would happen in the world. Recently, we have observed several factors pointing to lower growth forecasts in our main trading partners, which means that GDP growth next year may be closer to 2%.
Reuters, 16 Dec	We concentrate on 2H03, especially 4Q03 – this is our horizon in the decision making process. Then [at the end of 2003] we will see accumulation of the factors accelerating inflation a bit. „A bit" means that we will not allow inflation to increase to the levels observed one, two or three years ago.
PAP, 5 Dec	I remain sceptical about the declaration that direct inflation targeting strategy is compatible with restricting the freedom of exchange rate fluctuations. I am surprised with this NBP's statement. It has not been consulted with MPC. The only body able to construct monetary policy is MPC, according to the constitution and law. However, I agree with large part of the statement. The necessity to restrict the band for exchange rate fluctuations in future stems from the need to meet Maastricht criteria on the road to euro adoption. The criterion is that the currency must stay two years within ERM-2 system, but it does not stem from the logic of direct inflation targeting.
Cezary Józefiak, MPC member; „Gazeta Bankowa" weekly, 31 Dec	In my opinion the main reason for a slowdown of the Polish economy, excluding external factors, was an investment boom in 1995-97. Investments in the enterprise sector rose then by 17%, 19% and 22%, respectively while GDP growth was growing 7% a year. This had to destabilise the economy. An increase of financial liabilities of investing enterprises began to exceed incomes from the new assets. There is again some possibility of contact between officials of the NBP and the Ministry of Finance, which was dramatically reduced when the previous finance minister was in the post. The MPC has welcomed finance minister's statement that we will be able to meet them [Maastricht criteria] in 2005. Interest rates always have some impact on the economy. However, our economic situation did not depend and does not depend mainly on interest rates but on the lack of structural reforms and improper co-ordination of fiscal and monetary policies.
Reuters, 16 Dec	I do not think that there would be significant changes in inflation until year-end. I think inflation should remain at the level slightly below 1%.
Janusz Krzyżewski, MPC member; PAP, 5 Dec	[In November] We have made the move anticipating such possibility [that inflation could fall to 0.9% in November]. We have considered such trend. [During last meeting] Most of us did not see the need to react more [than 25bp]. If such wonderful situation occurs, if prices converge to stability, then our further steps are for inflation stabilisation, because inflation should be harmonised with economic growth. Still, we don't see the clear signs of the situation that would require accelerated action in monetary policy, i.e. big steps. It surely does not mean that we are unanimous, but it's majority's opinion.
Dariusz Rosati, członek RPP; PAP, 20 Dec	GDP data for 3Q02 are disappointing and recovery is very slow. GDP growth in 4Q02 and 1Q03 would be at 2.5%, and more significant rebound is possible may be expected in 2H03. GDP growth forecast of 3.5% is realistic, although very optimistic. Industrial production will be the main driver of growth acceleration. We will see also consumption increase at quite high level. External demand should also influence the Polish economy positively. However, as for now, GDP growth rate is lower than I expected. [Possible inflation risks] are not likely to materialise in the near future.
PAP, 18 Dec	These are good data, which confirm that the economy gets ready to take off. This is fourth consecutive month of stable annual growth. We will see gradual improvement, not very dynamic. I think we won't see problems, as all factors responsible for growth are likely to improve. Domestic demand should increase as a result of lower rates and loose fiscal policy. All forecasts indicate that next year wee will improvement in the German economy and the Eurozone. I expect GDP growth of 1.5% this year, especially as in 4Q02 growth would amount to 2.5%. GDP growth of 3.5% in 2003 is possible.
PAP, 13 Dec	There will be some effect on the markets. Markets have already discounted this fact, there was minor probability that something might go wrong, but one should not be surprised if zloty appreciates a little.

	As far as we already know, we have achieved great success [on the Copenhagen summit]. [Premiums to EU budget] could be financed without the necessity to raise taxes and without significant increase of budget deficit. It is possible by expenditure cuts and due to effect of higher economic growth.
PAP, 6 Dec	The NBP suggested some time ago that the government should buy foreign exchange on the market [not in the central bank]. The operation will not have influence on inflation because its potential impact on the zloty weakening will be small (we talk about US$1-1.2bn). Everything indicates that inflation in November will be below 1%YoY. We face very low level of inflation and it is worth to make conclusions from this fact.
Reuters, 5 Dec	In the horizon of several months there is a scope for cautious interest rate cuts, however the reductions should be smaller rather than bigger. In November the inflation rate would fall to 0.9% and until March 2003 it would remain at 1.2-1.5%. At the end of next year inflation would rise to 2-2.5%. I am glad that such comment [of deputy minister Michalski] was made. The ministry needs money for foreign debt servicing and in market economy it should buy it on the market, which would have such advantage that it would act towards weakening of the zloty. In general thinking about permanent zloty weakening is a daydream amid fundamental factors acting towards constant zloty appreciation, like the perspective of EU accession, caiptal inflows and low inflation. [...] From this point of view permanent zloty weakening in my opinion is not plausible. I think that finance minister does not aim at it, however the amounts that the ministry would buy are big enough to smooth the exchange rate fluctuations and with a bit of intelligent moves, one could avoid upward departures from trend.
Grzegorz Wójtowicz, MPC member; PAP, 27 Dec	The current account deficit for the past 12 months rose to 3.6% of GDP after November against 3.5% after October. Earlier forecasts that end-year deficit figures will not be above 3.7% are still valid. Both exports and imports figures show the economy on an upswing, so there are no surprises here. On the other hand, we have seasonal drop in unclassified flows surplus, which means that better period for cross-border trade has ended.
ISB, 20 Dec	According to reasonable estimates, adopting the euro by Poland is a question of the year 2007 or 2008 (...) Poland will not enter the euro-zone in isolation, but with other countries. It is hardly imaginable that only one candidate joins the euro-zone per year, as this would diminish the transparency of the negotiation system. EMU's enlargement by these 10 countries will be as important as Spain's accession. The EMU accession of Poland will proceed in the same way as in the countries that have already adopted the euro. Poland must, however, wait for final solutions, as the EMU enlargement requires, among others a reform of the EMU institutions. ECB is simply not prepared for this operation. Its representatives say, however, that we are not prepared. And they are also right to some extent. Many of these remarks are connected with the uncertainty concerning the functioning of the new system of decision-making. The real convergence issue will be actual for several dozen years. Only after the aims of the public finances' reform are presented at the beginning of the year, the major doubt will clear up. A reform of public finances is anyway inevitable in Poland. Maintaining such a level [3% of GDP] of the deficit afterward seems here to be of a particular importance. If a tight rein is kept on public debt, fulfilling the criterion of long-term interest rates should not be a problem.
Polish Radio III, 17 Dec	"Inflation for abstinent" did not fall in November, as this factor [alcohol] was influencing the consumer prices index. Does it mean we should drink more? Absolutely not!
Reuters, 16 Dec	I do think that December could bring major changes in inflation. In January 2002 inflation increased by 0.8%MoM and in 2003 this growth may be lower, which would bring 12M index down. In February-March this year the monthly growth was relatively low, so we can see some increase of 12M inflation in 2003. But this would be still low inflation, and it may fall again in April. We will have very low inflation, but we will se whether we would stabilise it.
PAP, 16 Dec	Monthly deflation in November shows there is no inflationary pressure. In December, in January, inflation should remain a low level, close to November's. Most likely, starting from February-March we will see inflation increase. There is a chance that CPI will be at 2-2.5% at the end of the next year. The MPC is forward-looking and thinks about future inflation, not current level, when deciding about interest rates. It would be great if Poland could enter the ERMII as soon as possible, close to the EU accession date. If Poland meets Maastricht criteria, it could enter the Eurozone at the beginning of 2007. However, recently we were told (semiofficially) that we should not enter too early.
PAP, 14 Dec	Information about budget reimbursement payments cancels out the question marks that accompanied the necessary reform of public finance.
Reuters, 11 Dec	Analysing what happened in other countries, it would not be easy. When we'll see economic recover, higher demand, higher consumption and investments, it is highly probable that inflation will rise. In general we have to keep inflation at around 2.5%, of course with some tolerance, as some short-term events may also influence this indicator. Maintaining inflation at around 2.5% increases the probability to meet Maastricht criterion on inflation. Today's level of inflation is exceptional; it is a deviation from the long-run trend. There are many signs that we have economic recovery starting from the 2H02. It is GDP growth of around 2% in both 3Q and 4Q02. In my opinion GDP growth will amount to some 1.3% in 2002 and some 2.5% next year. The battle with inflation is the most important for the MPC, despite the fact that it fell record low levels. There is no change in monetary policy strategy, we have direct inflation targeting, floating exchange rate, and there are unexpected events, such as supply shocks (positive or negative), which sometimes gives inflation increase, but they recently led to fall of CPI.
PAP, 10 Dec	I doubt we had deflation in November. Inflation in December may be above 1% amid Christmas shopping. Most probably, we will not enter the ERM2 system together with other candidate countries. Some countries have already introduced currency board regime and they may join earlier.
PAP, 5 Dec	There is no way that floating exchange rate could be abandoned before ERM2 entry. We have the direct inflation targeting strategy since 1998, we are employing it and will be employing it further. We used it under managed float exchange rate system, now with free floating exchange rate and will be using it after fixing the zloty against euro in ERM2.
Wiesława Ziółkowska, MPC member; PAP, 30 Dec	There is no doubt that offset investments will improve the economic situation. This will be an instrument of combating unemployment. Average annual inflation in 2002 and 2003 will be around 2%.
PAP, 12 Dec	The Council does not intend to lower inflation target for the next year, there are too many unknowns to make it possible to revise the target. Inflation should be slightly higher than 1% in near months, obviously reaching the level around 1% at the end of this year. I cannot see any risk of demand pressure or any other shocks, unless a war in Iraq breaks out, which would undoubtedly result in increase in crude oil prices. Inflation will be influenced by rising prices of agriculture products. Downward trend of prices of pork that we observe now can reverse next year given lower supply of it. Similarly, falling prices of milk and wheat may result in their slight rebound in the future. We must focus more on inflation forecasts and it is very natural, if one starts to stabilise prices instead of fighting with inflation. To less degree one pays attention to current effects of falling inflation, and to bigger degree on forecasts.

	From January the RPP will shorten maturity time in basic open market operations, and in the 1H03 it will seek to buy back the inflation indexed bonds issued to banks in 1999. The shortening of maturity time would improve liquidity management in the banking sector. Similar period of mandatory reserve settlements on monthly basis to 28-day maturity of open market operations makes liquidity management difficult. 14-day operations are more effective and it is another step in adaptation to ECB standards. If there are no changes in budget spending, we will be threatened with the rise of budget deficit in 2004-2005. The rise may reach even 1% of GDP but depends on the success of making expenditures more flexible. Keeping budget deficit at no more than 3% of GDP will be the most difficult challenge in meeting Maastricht convergence criterions and it is a negative consequence of giving up the reform of budget spending. We are very close to meeting criterions of long-term interest rate, inflation and public debt. There is no threat of exceeding a limit of 60% of GDP. We are threatened with exceeding first warning limit of 50% of GDP. One cannot believe that the finance ministry planned purchase of foreign currencies in the first half of 2003 will weaken the zloty for good. But it is possible in this way to prevent temporary excessive appreciation of the zloty. […] The successful end of negotiations on joining the EU will increase investors' confidence in Poland and will stabilize the macroeconomic situation in their opinion. I am inclined to think that the zloty is overvalued at the moment. But one has to take into account that rapid depreciation would have a negative influence on inflation processes. Central parity in ERM2 system will be determined by the new Council. Possible depreciation on entering ERM2 depends on conditions under which Poland joins the EU and future shaping of the exchange rate and economy.
TVN24, 4 Dec	Inflation would reach ca. 1% in December and in January it will be only marginally higher. Much depends on external environment, i.e. on how fast Western economies would recover from crisis, on oil prices and food prices. It is another year when MPC undershot inflation target. One could be happy about it, except the fact that it happened under very low economic growth.

INFORMATION AFTER THE MONETARY POLICY COUNCIL MEETING ON 17-18 DECEMBER 2002

The Monetary Policy Council held its meeting on December 17-18, 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, in public finance sector, in the area of money supply, lending and interest rates, and the formation of inflation expectations, prices and the inflation outlook.

Decision of the Monetary Policy Council

Within the period that passed since last meeting of the Monetary Policy Council there appeared a few data illustrating the development of the economic situation. In November, the 12-month inflation lowered to the level 0.9% from 1.1% in October. The price level in November as compared to October lowered by 0.1% what was mainly affected by the drop of foodstuffs and non-alcoholic beverages prices and the drop of alcoholic beverages prices. It should be emphasized that the mid-year inflation in Poland in October this year calculated according to the methodology used in the European Union (HICP) can be estimated at 2.4% (as compared to 2.0% in the EU).

Good results of the Polish foreign trade got confirmed, but as compared to the previous year the turnover dynamics is slower. The latest survey about the economic situation by GUS indicates the climate improvement in processing industry. These data complement the estimate made a month before about a gradual improvement of the economic activity. After the decisions made at the summit in Copenhagen, finishing Poland's negotiations about the European Union accession, it should be expected that integration processes within the EU would support a further economic boom.

In November 2002, in the economy there were still observed the phenomena that support
- the enhancement of a low level of inflation:
- inflation expectations of individuals and bank analysts are maintained at a low level,
- a low annualised dynamics of total money supply is maintained, the cash dynamics stabilised, and the annualised lending dynamics is still at a low level,
- a moderate wage increase does not threaten in a form of the inflation pressure growth.

Considering that the effects of the interest rate cuts made so far have not been revealed yet, it is necessary to preserve caution in monetary policy. Moreover, the importance of factors that can impede the stabilisation of inflation at a low level has not diminished yet:
- there is a threat in a form of a bigger economic deficit of public finance sector than it was planned in the draft act on the state budget for the year 2003,
- there is still observed a drop of deposits placed by households at banks,
- as a result of a persistent threat of an armed conflict with Iraq and the prolonging strike in Venezuela, oil on the world markets, after price drops in October, gets more expensive again,
- together with the improvement of the economic growth dynamics, the inflation pressure can appear.

Considering the above mentioned conditions, the Monetary Policy Council decided to maintain the basic interest rates of the NBP at the present level and maintain its neutral position in monetary policy.

The work on a medium-term strategy of monetary policy has been continued. Moreover, the Council discussed the balance of payments for 3 quarters of 2002. The Council has also adopted a resolution on principles of conducting open market operations shortening the time frame of basic operations from 28 to 14 days.

The next meeting of the Monetary Policy Council will be held on January 28-29, 2003.

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Evaluation of the economic situation

In November this year, the atmosphere in the American economy visibly improved (the Conference Board's index measuring consumer confidence increased from the level 79.6 in October to 84.1 in November, while the NAPM index – the purchasing managers index (PMI) increased from 48.5% to 49.2%, respectively). Favourable conditions for investing have been additionally confirmed by: growth trend on the stock market maintained since October, better than expected results in labour efficiency in the U.S. industry in the 3rd quarter this year, and a repeated boost in retail sales in November and December.

However, no signs of the situation improvement in the euro zone have been noted. In November, consumer confidence indices worsened again (the European Commission's index for Germany increased its drop to the level –17 as compared to –11 in October), while the European managers confidence did not change as compared to the results noted in October. In October this year, the drop of industrial output in Germany increased (-1.4% as compared to –0.7% in September).

According to market expectations, in December this year, the ECB cut the main refinancing operations rate by 50 basis points to 2.75% - the lowest level in three years. Among the main reasons for this decision there was mentioned the weakening of the economic growth pace and a drop of inflation pressure in the euro zone.

Still a factor associated with a high level of uncertainty is the formation of the world oil prices. In November 2002, the average price for Brent oil lowered by USD 3.4 per barrel as compared to October. In the half of November, it reached its minimum getting below USD 23 per barrel. In the second half of November, the oil prices rose again. At the beginning of December this year, prices stabilised at a relatively high level of USD 26 per barrel. Despite the ongoing UNO inspection in Iraq, the market participants think that the war in the Persian Gulf is inevitable. A high price level is also affected by: a prolonging strike in Venezuela (this country is the third big oil supplier to the American market), the attack of winter in the USA, and the uncertainty about the relationship between supply and demand that results from speculations related to decisions of the December summit of OPEC countries.

The current account deficit in October this year amounted to EUR 578 million (USD 562 million) as compared to EUR 539 million (USD 534 million) in September this year and EUR 923 million (USD 836 million) in October last year. The trade deficit amounted to EUR 1 billion. Exports evaluated on the basis of the information on payments in EUR increased in October this year as compared to the same month last year by 4.9% and imports lowered by 2.8%. Exports denominated in USD increased by 13.6% and imports increased by 5.3%. Therefore, a big dynamics of foreign trade turnover denominated in USD has been in part achieved as a result of exchange rate changes and the appreciation of the euro against the dollar on the international currency market. Good export results are caused by a change of the geographic structure of Polish exports – less exports to Germany, the main trade partner, have been compensated by more exports to the Central and East European countries and some EU countries.

The economic situation survey by GUS indicate that in November 2002 as compared to October this year the evaluations and forecasts for the processing industry and construction (seasonally adjusted data) improved. The evaluations became optimistic and in forecasts a considerable improvement of generally optimistic expectations was observed. In case of the processing industry it means a considerable improvement of the expectations related to the climate of the economic situation as compared to the same month of 2001, and in construction – reaching the level noted a year before. In sales, the climate of the economic situation is evaluated as negative, although better than a year before.

Situation in public finance sector

The NBP data on the state budget accomplishment after November this year indicate that the budget deficit will be accomplished at the level planned in the act on the state budget for the year 2002, i.e. PLN 40 billion (5.4% of GDP). Current forecasts of the state budget revenues are slightly below the level accepted in the act. A revenue shortage will be compensated by the adequate reduction of state budget expenses. The convergence of indices illustrating the accomplishment of the plan of both revenues and expenses of the state budget within a recent couple of months this year indicates that expenses are under control and adjusted to the revenue situation.

Available information on funds and agencies do not basically change the picture of the financial situation of these entities as compared to the picture drawn within previous months. According to the NBP forecasts, the economic deficit of the whole public finance sector in 2002 will be at the level of approximately 5.8% of GDP and 5.4% of GDP in 2003.

Money supply, loans, interest rates, exchange rate

According to the interim information from commercial banks in November 2002 – as compared to the situation as of the end of October this year – the M3 money supply decreased by PLN 3.1 billion. However, in fact this drop was smaller by about PLN 1-1.1 billion and amounted to about PLN 2 billion. This difference is a result of the incomplete taking into account of the resources gathered by banks due to the issue of bonds (about PLN 1-1.1 billion). After the bond issue program is completed, this amount will be finally booked accordingly and it will increase the M3 aggregate.

The decrease of deposits placed by households and deposits placed by businesses by PLN 3.6 and 1.0 billion, respectively, contributed to the drop of the M3 aggregate. A considerable drop of deposits of households is a result of the matured one-year placements that were not eligible for the interest income tax and were made in November last year. A considerable part of the deposited funds (about PLN 2 billion) flowed out of banks to investment funds (PLN 1.4 billion), Treasury bonds (PLN 0.6 billion), and approximately PLN 1.3 billion has been placed in bank bonds (of which only PLN 0.3 billion has been reflected in M3).

The annualised dynamics of cash stabilises at the level of approximately 15% (14.9% in November this year). As far as the annualised dynamics of M3 and deposits of households are concerned, their jump growth observed in November this year (from –2.5% to –1.0% and from –5.6% to –1.6%, respectively) is exclusively a result of the statistical effect of a low base. At the same time, the base effect is a reason for a rapid drop of the annualised dynamics of deposits with maturity over 2 years from 156.7% in October this year to 15.6% in November this year.

The second month in a row, a drop of loans to households is noted. However, the loans to businesses rose. The annualised dynamics of these categories in November this year amounted to 7.7% and 1.2% respectively, while in October this year it amounted to 8.3% and 0.5%. In November this year, a visible appreciation tendency of the zloty took place. The exchange rate of the Polish currency appreciated against both the dollar (by 4.6%) and the euro (by 2.9%). A stronger appreciation of the zloty against the dollar resulted from the depreciation of the dollar on the world market.

Prices, inflation expectations

In November this year, the 12-month inflation lowered to the level 0.9% as compared to 1.1% in October this year. At the 12-month scale the biggest growth has been observed in case of prices for goods and services connected with transportation (by 4.3%), housing (by 4.1%), healthcare (by 3.7%), and education (by 2.5%).

The consumer price index lowered in November as compared to October by 0.1% the main contributor to which was the drop of prices for alcoholic beverages by 1.4%, tobacco products by 0.4%, foodstuffs and non-alcoholic beverages by 0.3%, and fuels by 0.3%.

Inflation on a low level supports the enhancement of low inflation expectations. In December this year, the annualised inflation rate expected by bank analysts by the end of this year lowered by 0.4 percentage point as compared to November declarations and amounted to 1.1%. The annualised inflation rate expected by bank analysts by the month preceding the same month next year (i.e. November 2003) remained at the level 2.5%, while the mid-year inflation rate for 2004 amounted to 2.6% what means its decrease by 0.1 percentage point as compared to the expectations expressed in November this year.

In December this year, inflation expectations of individuals lowered as well. The inflation rate expected within the year to come amounted to 0.8% what means its decrease by 0.1 percentage point as compared to the measurement made in November this year.

The Monetary Policy Council held its meeting on November 26-27. 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, in public finance sector, in the area of money supply, lending and interest rates, and the formation of inflation expectations, prices and the inflation outlook.

Government and politics

- **The second government reconstruction**
- **Budget Act for 2003 signed**
- **Finance Minister advises a purchase of foreign currencies**

Another cabinet reshuffle

I the first week of the new year Prime Minister Leszek Miller informed about the second government's reshuffle within the last six months. During the special press conference Miller said that taking into account international experiences he decided to merge labour and economy ministries. Economy minister Jacek Piechota was appointed deputy minister in the new office and labour minister Jerzy Hausner became the chief of the joint super-ministry for economic and social affairs. This change was quite surprising as previously the economy ministry was expected to be merged with the treasury ministry. However, the changes concerned also the treasury ministry. Its chief Wiesław Kaczmarek was replaced with Sławomir Cytrycki. Kaczmarek's dismissal was in line with expectations, howver, his successor Cytrycki was not widely known. PM Miller said that Cytrycki is specialist in the field of finance and capital markets (for more information on new treasury minister see biographic note below), which means that such a change on treasury ministry post will help to accelerate privatisation process. Miller also announced that treasury ministry will be merged with the new joint ministry in the future but he did not give any details concerning timing of this action. Witold Orłowski, chief economic adviser to President Aleksander Kwaśniewski hopes that now the privatisation process will speed up. He said that he was of a very good opinion of minister Cytrycki. Orłowski said that Cytrycki's long-time co-operation with Bank Handlowy and more recently his work in the Prime Minister's office as co-ordinator of economic policies were good references. Orłowski thinks that Cytrycki is more of a technocrat than a politician. Presidential advisor has no doubt that Cytrycki is competent but he is afraid whether he will survive in the treasury ministry, which Orłowski regards as a "minefield".

Another change made by Miller was a promotion of his chief adviser Lech Nikolski to the minister rank, handing him responsibility for the strategy on winning the accession referendum scheduled for June. Former chief of the EU information campaign Sławomir Wiatr was given a secondary role in the cabinet.

Biographical note - new treasury minister

Sławomir Cytrycki graduated from the Institute of Finance and Economics in Leningrad (presently Saint Petersburg). He also studied at University of Łódź where he became an assistant at the Faculty of Political Economics. In 1982-1987 he was special assistant to deputy secretary of the United Nations. After he returned to Poland in 1987 he became adviser to Prime Ministers Messner and Rakowski. In 1989-1990 Cytrycki worked in President Wojciech Jaruzelski's administration. Later he was the managing director in Bank Handlowy in Warsaw. Recently, he was under-secretary at the Chancellery of the Prime Minister. Cytrycki admitted that before 1989 he was informer of communist-era security services.

Although some cabinet reshuffle was broadly expected, the timing was quite surprising. However, it was not likely to influence the financial markets anyway. It should not also have significant impact on the economy. However, the main reason of changes in the cabinet seems to be a change of its image in face of falling popularity of the ruling coalition and Prime Minister's himself, as replaced ministers were very often mentioned as controversial and unpopular. Some hopes may be connected with the change on the post of treasury minister, particularly as Miller stressed that the government would like to accelerate the privatisation process. The strengthening of the labour minister Hausner's position may be perceived as positive because he was quite effective in the labour code modification and other activities. Also, it is quite probable that the so-called reform of public finances will be prepared by Kołodko together with Hausner, especially as some changes in expenditures require social approval. However, *Rzeczpospolita* daily suggests that the proposal of these changes may be postponed a few months.

Budget for 2003 signed into law

During the parliamentary before Christmas, the deputies finally passed the budget bill for 2003. The deputies boosted both government's revenues and expenditures by PLN0.9bn (to PLN155.677bn and PLN194.411bn respectively), keeping the level of deficit unchanged. Sejm accepted 42 out of 50 amendments made by the Upper House. Our assessment of the budget did not change, however adding extra PLN0.9bn by the deputies even strengthened the argument that the level of budget revenues is overestimated. But, as we have written before, the scale of revenue shortage this year should not be a real headache for the finance minister.

The work on budget for 2003 has finally ended. Now, one should await proposal of public finances' reform to be presented by finance minister at the beginning of 2003.

President Aleksander Kwaśniewski signed budget act for 2003 into law in December. This is the first time in the short history of the market economy in Poland when budget will be valid from the very first day of the year it was prepared for. However, it does not mean that at the same time this is a very good budget. As we wrote many times in the past it does not include necessary changes in the structure of expenditure and does not reduces tax burden. Quite the contrary, the deputies accepted the law, which assumes that the contribution for the healthcare fund will increase by 0.25pp not only in 2003, but also for the five consecutive years - up to 9% in 2007. As the increased contribution (above 7.75% level) could not be deducted from the income before taxation, this change means the gradual increase of tax burden for households.

At the beginning of January finance minister Grzegorz Kołodko convinced the Council of Ministers to not increase the contribution for the healthcare fund. Undoubtedly the Kołodko's proposal should be regarded as good news for taxpayers. But at the same time this was well against the idea of the healthcare minister, who planned to finance the spending of the new-formed Healthcare Fund from this source. Therefore, one could expect that decrease of the contribution by senators would increase the probability of the resignation of healthcare minister Mariusz Łapiński. However, Łapiński said that he agrees with the government's stance and will do everything to maintain the contribution at 7.75%.

In December the MPs also dealt with the no-confidence motion against the finance minister Grzegorz Kołodko, submitted by the opposition party Civic Platform after the Constitutional Tribunal rejected the tax abolition bill. Of course nobody expected this motion to be successful and a vast majority rejected the no-confidence vote.

Public debt at 46.2% of GDP in 3Q02

The Ministry of Finance released information about Poland's public debt after the first three quarters of 2002. At the end of September debt of the whole public sector reached PLN353.5 growing by 3.5% from PLN341.5 after 1H02. The relation of public debt to GDP went up to 46.2% from 44.9% recorded at the end of June 2002. The most of public debt increase resulted from a surge in state treasury's debt (PLN10.4bn or 3.3%). Out of this PLN4.6bn was an increase of domestic debt (it reached PLN214.7bn growing by 2.2%) and growth of PLN5.8bn was recorded in foreign debt (it amounted to PLN114.8bn growing by 5.3%). The debt of Social Security Fund increased to PLN10.0bn from PLN9.1bn (i.e. by 10.3%) after the first six months of last year. Local governments continued to be relatively cautious in increasing their borrowing: their debt inched up by PLN0.6bn or 4.6%. The figures confirm that the debt-to-GDP ratio is gradually growing but they also suggest that it is not likely that it exceed 50% threshold in 2002.

The Ministry of Finance said also that it is going to launch an up to €5bn bond issue in the coming years with the first issue worth €750m in 1Q03. The ministry said in the official statement that thanks to this program it would be able to react more flexible to changes on international capital markets, which will lead to lowering of foreign debt servicing costs. Let us recall also that Poland has to increase international bond issues, as its foreign debt costs pile up in years to come.

Kołodko advises to purchase foreign currencies

At the beginning of the year Grzegorz Kołodko said that the zloty is overvalued partly due to the interest rates differential and that the zloty strength does not reflect the condition of the economy. He expects the zloty to weaken and the government's activity would aim to boost this process. This "government policy" means most likely buying foreign currencies for servicing the foreign debt on the FX market, which was already announced a few weeks ago. However, there is also another explanation. Quite surprisingly, he said twice that everybody should buy dollars and euros now - both people as well as banks and businesses - because this is the cheapest they will get. Maybe Kołodko hopes that intensified government's calls and requests would be heard by the society, which would weaken the zloty. But we do not think so.

Deputy PM Kołodko said also that taxes decrease in Poland would be possible only when GDP growth accelerates significantly - to the levels of 6-7%, as lower taxes cannot create a risk of lower social spending.

Comments of the government members and politicians

As expected, the better part of the December comments of the government representatives related to the conditions, costs and benefits of joining the EU. Although the EU accession referendum has not been won yet (however, reading the comments of politicians one can observe that the unofficial campaign has been started), more frequently a question arises in respect of some further future and the prospects of joining the Eurozone. Among others, this issue was a leitmotiv of the broad interview of vice-minister Michalski given to PAP (Polish Press Agency). Also the main negotiator with the EU mentioned the possibility of shortening a two-year period of being in the ERM2 system. Grzegorz Kołodko once again assured that Poland is going to meet all the Maastricht criteria in 2005 and announced that the Poles will use euro already in 2007. However, one should not forget that in order for this prediction to come true, public finances must be rebuilt to some extent. The presentation of the preliminary plan of this reform was announced at the beginning of this year not only by deputy Prime Minister and the minister of finance, but also by the President and the Prime Minister. Economic growth is bound to be an element of the plan of decreasing the public finances deficit as it would increase budgetary revenues. However, as evidenced by Witold Orłowski - an economic adviser to the President, this year one should not expect a substantial improvement in this respect. According to the government, one of the instruments, which could bring about the economic growth, could be weakening of the PLN, which is overvalued due to "inadequate levels of interest rates and speculative movements". Vice-minister Kołodko himself stated, however, that little can be done in this respect, as "the government has no impact on the exchange rate either in short or medium term". This is because the "decisions on the exchange rate system are made jointly by the government and the NBP, and the NBP does not see a need to change the system".

One of more interesting comments in the last month of 2002 was the information on the industrial production growth dynamics. This was because it was unexpectedly announced by Grzegorz Kołodko – the MF, during his testimony in the Lower House and not by the Central Statistical Office which used to reveal it first. Maybe the ministry of finance showed those numbers to the deputies to prove that the economy is booming under his governance, but it is interesting whether the president of the CSO would show any data (for the government's representative) before the official publication in the future.

WHO. WHEN. WHERE	COMMENT
Aleksander Kwaśniewski, President; Reuters, 23 Dec	This budget gives us hope of faster growth, stable public finances and good preparations for joining the European Union the following year.
Reuters, 19 Dec	Turnout [in the accession referendum] is not a problem we have invented - it is real. In our campaign we must pay attention to two things: convincing people to support the EU entry, and reaching those people who do not play a part in public life.
Leszek Miller Prime Minister; PAP, 23 Dec	This budget's quality rests on the fact that, for the first time since 1987, it will be valid from the very first day of the year. The problem [concerning milk production after joining the EU], that whipped up our partners so much lies in one sentence, which was not precisely written and suggests that there will be a review what will be the actual production in 2003. In English version of the text the word "review" was used but translators in the Ministry of Agriculture translated it into Polish as a "revision".
PAP, 19 Dec	The limit of 8.5m tonnes for milk was agreed and there is no question about it.
Reuters, 19 Dec	I hope this good trend will be sustained, and this result will be achieved in the referendum. I am delighted so many Poles believe the terms we won in Copenhagen are good. Grzegorz Kołodko proposed a low of important bills, he tried to influence the Polish entrepreneurs with his optimism, he proved that he is well qualified, but also that he can be finance minister in Poland.
PAP, 18 Dec	This (resignation threat) limits potential allies by making the ballot into an ultimatum...I am aware that backing for accession is larger than that for the government.
Reuters, 16 Dec	Any renegotiations of accession conditions are impossible, as the negotiations finished. When Poland enters the EU we will participate in the decision making process concerning limits, quotas, procedures during the next couple of years. We will have our vote in the EU.
PAP, 16 Dec	I am not pleased by this [strengthening zloty]. I believe it is overvalued. Of course a country which is nearly in the EU will always have a strong position in the eyes of investors. If we did not enter the EU or finish accession talks, investors would surely leave. This would cause the zloty rate to weaken, but it could go much further and endanger our country's financing safety.
Rzeczpospolita, 16 Dec	Decisions about direct subsidies will be taken by the government and the parliament in the following years. But now, we also pay for agriculture. The reform of public finances is necessary because of the EU accession, but it is also necessary because of our internal problems. In January 2003 finance minister will propose the assumptions of the reform.
RadioZet, 15 Dec	8th of June 2003 is very likely [as the date of accession referendum].
PAP, 14 Dec	The level of augmenting direct subsidies for farmers from domestic budget will be dependent on the possibilities of the budget and on the decision of the government and the parliament.
PAP, 13 Dec	I have good news for you. After the whole day long, difficult, and sometimes very dramatic negotiations all the postulates that we have brought to Copenhagen with us have been accepted. It allowed me to announce in the name of Polish government that we accept the conditions of our membership in the European Union. The negotiation strategy proved successful. Hard and determined talks until the last minute yielded the results and the success is mutual.
Grzegorz Kołodko, finance minister; Reuters, 18 Dec	Public debt would be around 50 percent of GDP in 2002, and would be kept between 50-55 percent in the coming years. The ratio is lingering around 50 percent now.
PAP, 18 Dec	Nominal revenues this year will be lower by PLN1bn comparing to the plan However, this is not a threat to the realisation of the budget, and deficit will not exceed PLN40bn. All spending connected with EU accession are estimated at PLN11bn, which includes co-financing of direct payments for farmers. In general, Poland will receive above PLN 13.1bn from the EU, but this would depend on our possibilities of absorption. This is positive balance. New expenditures include – our contribution to the EU budget, which would amount to PLN7bn in 2004, but will rise to PLN10.9bn in 2005. The most significant threat is that the Polish companies will be the subjects of even higher competitiveness. However, this would be their chance at the same time. The EU accession will bring additional 1pp of GDP growth. This is also additional PLN1bn for our budget. In the enterprises employing more than 9 people, industrial production increased by 2.8% in November, and production adjusted for seasonal factors rose by 6.5YoY and 2.2%MoM.
TVP 3, 18 Dec	This is very clear trend [industrial production].
PR1, 18 Dec	I will do my best to not allow the healthcare contribution to increase tax burden. This year's budget will be realised on the spending side. As far as I know, President will sign the Budgetary Act for 2003 on Monday.

PAP, 13 Dec	The possibility to increase direct subsidies to 55%, 60% and 65% from our own budget [...] it would of course depend on the financial situation of the state. The decisions in this regard are not automatic, they would be dependent on budget situation in a given year. I am 100% sure that we will win the referendum. The majority of Polish citizens will opt for joining European Union. The only question is how big will be the margin of majority.
PAP, 10 Dec	GDP in 3Q02 will increase by 1.9-2.0% and in 4Q02 by 2.1%. Average annual inflation [in 2002] will amount to 1.9% and CPI in December will slightly exceed 1%YoY. We will aim at meeting [Maastricht] criteria in 2005. (...) In 5 years Poles will use euros. The zloty exchange rate against the dollar and the euro is overvalued. This is a result of the incorrect management of interest rates and speculative moves, and the government has no influence on it in the short- and medium-term. (...) In the longer run reduction of budget deficit should enforce interest rates reduction. The exchange rate regime is designed jointly by the government and the NBP. The NBP's stance is well known and publicly expressed. The NBP does not see any need to change the FX regime. This rules out any discussions on the change of FX regime. We are threatened by a collapse of the budget in next years if we will not undertake necessary actions. If the share of inflexible expenditures will rise the budget may collapse. We want to counteract it.
PAP, 4 Dec	Already now the pace of GDP growth stands at 2% against 0.2% last year and this is a result of better co-ordination [of fiscal and monetary policy] and restructuring process. For the next year we forecast GDP growth of 3.5% and in 2005 it may fluctuate around 5%. Inflation in November is lower than 1% but we do not know whether it is 0.8% or 0.9%. At the end of the year it will slightly exceed 1%. We do not know whether there will be external shocks, e.g. temporary increase of oil prices, it is also difficult to count on continuation of food deflation. However, there are no macroeconomic factors, which could lead to inflation acceleration in the next year. Thus, I can say that with high probability average annual inflation will amount to ca. 2% [in 2003]. One should not think that inflation rebound is not possible at all at the moment. It [stabilisation of inflation] requires consequent conduction and proper co-ordination of fiscal and monetary policy.
Ryszard Michalski, deputy finance minister; PAP, 5 Dec	Poland will be able to join the Euroland only at the start of 2007 as the effect of postponing the EU enlargement date by four months, which means that all criterions, besides a forex criterion, must be met in 2006. It means that we have additional breath for putting public finance in order. I am an optimist and believe we will succeed. However, it will depend on economic situation in the whole European Union and in particular in Eurozone's countries if we will decide to join it on 1 January 2007. We fulfil four out of five Maastricht criteria […]. The only criterion that requires meeting is high level of general government deficit. […] The problem of 2004 arises with the EU offering us less funds than we have expected. That is why budget burdens related to EU joining will be bigger than we expected. Even if the 2004 budget deficit will be high temporarily at 5% of GDP, it will be possible to cut it significantly in 2005. It is probable that, in line with minister Kołodko's comments, we will be able to reach a below 3% limit for general government budget deficit already in 2005. […] Certainly [in 2002 budget deficit] it will not exceed 50% of GDP. When calculated according to ESA standard public debt is below 45%. It would be advisable to shift to the managed exchange rate system earlier than envisioned by our monetary union joining timetable. […] We may imagine that we are introducing an euro-pegged band earlier than our joining the ERM 2. Under Polish legislation this requires an agreement with the NBP. […] The government is inclined to accept this solution, treating exchange rate regulation as a useful tool of influencing economic activity and preventing excessive exchange rate volatility. The FinMin supports certain elements of managing. For now the NBP does not feel like changing the exchange rate regime. […] Official devaluation requires approval of the two institutions responsible for the principles of the forex policy. The Ministry believes that market condition not necessarily reflect the fundamentals of our economy. We see some disturbances related to speculation around the zloty and interest rate disparity. We think that one should venture FX rate more favourable for exporters than the present one. We are facing various political events, such as an accession referendum, to which markets may react. At the turn of 2003 the composition of the MPC will be changed. In my opinion, the more conservative the monetary policy of the present council is, the more innovative the future monetary policy will be. [in 2003] We are likely to begin with the issue in the USA in view of favourable profitability there. Later we will issue bonds in Japan. […] By 2010 we will have piled up payments and we will want to cover them from new issues of longer duration. In line with market expectations in April we will conclude the buy-back of PDI bonds at their nominal price. Buying foreign currency to repay interest will have a positive effect by weakening the zloty. It should be tested in spring. Interest repayment pile up usually takes place in March. […] We have to become a normal actor on the market. I accept the suggestion from the colleagues from the central bank.
Halina Wasilewska-Trenkner, deputy finance minister; PAP, 3 Dec	We estimate GDP growth at some 2% in 3Q and 4Q, and at 1.3-1.4% in the whole year. Tax revenues will be realised this year despite lower than planned inflation.
Jarosław Kalinowski deputy PM, agriculture minister; PAP, 19 Dec	During Copenhagen negotiations there was no conditional agreement on the limit of milk production. The limit of 8.5m tonnes is the final amount and this will not depend on milk production level in 2003. This is crucial thing for the Polish economy and for Polish agriculture and therefore I think that PM Miller will clarify this during the meeting with Schroeder and Verheugen.
PAP, 16 Dec	This [the financial conditions of enlargement] is everything we could achieve in current situation.
PAP, 15 Dec	The summit in Copenhagen has strengthened the ruling coalition, although there were extremely hard times, it was very close to the edge. I cannot say that it is a success in the agricultural area, although I state with all the responsibility that is a good result. [...] The result, which opens the chance. The levels that I have assumed before the summit, regarding the milk quotas and direct subsidies, has been achieved. Therefore I will recommend to the General Council [of the PSL] the positive assessment of this area.
Włodzimierz Cimoszewicz; foreign affairs minister; PAP, 23 Dec	The priority of our foreign policy in 2003 is an effective ending of the European project – preparation of the Accession Treaty and support of its ratification process. The cost [of Poland's promotion in the EU] will depend on what forms of promotion we will choose. If it will be traditional one – conferences, seminars – then costs will be relatively lower. If we decided to reach hundred millions of people in Europe then the cost would be higher. Poland wants to play a role of "advocate" of all the Eastern neighbourhood of the enlarged EU.
PAP, 4 Dec	Despite the fact that we hear continuously, that there is no agreement on Danish proposal, I do not believe that Danes submitted proposal that was not consulted at all. Though the heads of "15" did not gather and did not say 'yes', there are foreign affair ministers in these countries, ministers for European affairs and ambassadors.

Jerzy Hausner, labour minister; Onet.pl, PAP, 19 Dec	After the EU accession the unemployment in Poland will fall, but the positive effect will not be very immediate, as shown by Irish or Spanish examples. My problem is to bring the unemployment down as soon as possible, as I want to be sure that the EU accession will not have negative impact. I claimed that the unemployment rate will start to fall in spring 2003 and I am sure this forecast will materialise. A fall will not be very significant, though.
PAP, 11 Dec	At the end of November the unemployment rate will reach 17.7%. If nothing dangerous happen, we will end this year below 18%.
Danuta Huebner, minister ds. europejskich; PAP, 18 Dec	We had a chance to listen in the parliament that Poland will be the EU member of secondary category. There is no such a category. We will have our representatives in all European institutions with the same rules as current members. Polish language will be one of the official EU languages, which means that all European legislation will be published also in Polish. At the current stage, oiur aim is guarantee that the Polish society will take the decision consciously. The government will do everything to give full and clear information about the EU accession.
PAP, 17 Dec	The intention is to enter the Eurozone as soon as possible, but the final decision is still unknown. It is theoretically possible to enter the ERMII mechanism at the moment of the EU accession.
PAP, 16 Dec	The enforcement of this process [support of majority of political parties for EU accession] is the most important now. We have adopted a solution to have a possibility to add 30 pp to direct subsidies from our budget.
Jan Truszczyński, główny negocjator z UE;	The last stage before joining the Eurozone will be the participation in the ERMII mechanism. Starting from the date of EU accession Poland will enter the Monetary Union with the derogation – a member without euro adoption, but with the zloty with the fluctuation band against the euro of +/- 15%.
PAP, 16 Dec	There is no such point in negotiations, according to which the limit of investing abroad for Polish pension funds would be increased. However, this does not change the situation – in the future we could increase this threshold to diversify the risk to increase the return on investments.
PAP, 3 Dec	There is much more flexibility in these areas, which are directly related to finances and increase overall outflow from the EU budget. Discussion on such elements is likely to end only at the Copenhagen summit and decisions will be made at the highest political level on 13 December.
Andrzej Szarawarski; economy minister; PAP, 27 Dec	From the point of view of the economy there are a few interesting proposals in the direct offset, above all orders for aviation industry in Świdnik, Mielec, Wrocław, Rzeszów, Kalisz and Krosno. They concern production of aircraft engines and their components, elements of cars and trains, different parts of aircraft, and elements of F-16, including export orders for Israeli enterprises producing weapons. There is also offer aiming at intensification, through necessary promotion, of Polish exports to the United States – this offer is worth US$700m. There are also many offers of know-how transfer worth US$1.2bn in total.
PAP, 23 Dec	In next year steel industry in Poland will be not only consolidated but also privatised. Today, treasury ministry sends invitations to privatisation of PHS [Polish steelworks holding]. The pace of the process is impressive compared to what was happening in previous years.
Józef Oleksy, chief of parliamentary European committee; PAP, 4 Dec	Being close to the finish we cannot asses all the arrangements and negotiation process from the point of view of one sphere [agriculture]. Though it is difficult for some people to accept this fact, it is truth. It is more important to obtain bigger compensations to support Polish budget than 1-2% increase of direct payments. The struggle for the right of government to pay [to farmers] additionally is a struggle for nothing, since we know that budget condition will not allow it. I believe that at the end of negotiations on 13 December in Copenhagen the candidates will retrieve €1bn, that remains to be retrieved from primary proposals of European Commission, that were cut in Brussels. […] So I would focus on it and I believe the government will do it too, so that we will gain the most compensations due to our budget strains and we will be ultimately sure that there is no threat that at any moment we will become a net payer.
Witold Orłowski; chief economic advisor to the President; Rzeczpospolita, 31 Dec	It is more difficult to forecast situation abroad than in Poland because there is more uncertainty, especially related to politics. I expect that it will not be the best year for the global economy. While the US economy will be in a better shape, the situation of the European economy will be worse mainly due to problems of Germany. On the other hand, we should see clear signs of recovery in Poland, particularly if there will not be problem with the accession referendum. However, the improvement will not mean that it will be year of excellent economic situation, especially if Germany will experience stagnation. I expect 3% of GDP growth, low inflation, though above 1%, and strong zloty exchange rate.
Jacek Krzyślak, dyr. dep. w Min. Fin.; PAP, 20 Dec	GDP growth of above 2% in 4Q02 is still possible. We expect significant growth acceleration in 2H03.

EU negotiations watch

- **Sejm happy about the results of negotiations**
- **Strong support for Poland's accession to the EU**
- **How to increase the turnout?**
- **What are the reasons quoted by the potential voters?**

Most of the information referring both to the results of negotiations with the EU and the pre-accession scenario was presented in the special feature at the beginning of this report.

Sejm happy about the results of negotiations

At the beginning of January, *Sejm* approved the information presented by the government in relation to the results of the EU summit in Copenhagen. The MPs rejected the motion tabled by one of the MPs from the opposition to vote against this information, with the majority of 272 against 124. This means that 31.3% of the existing MPs (64 MPs were absent) voted *no* to the results of negotiations. It is worth noting here that in line with the Polish law, the referendum turnout has to be at least 50% to deem the referendum results binding (we also mentioned that in the special feature at the beginning of the report). If the turnout is too low, the two houses of the parliament will have to take the decision (by way of two separate votes), and then the majority of 2/3 votes will be required. In view of the above, the result of the vote do not make us too optimistic as with only 2% of votes more the motion would have been rejected.

Strong support for Poland's accession to the EU

According to the public opinion poll, the vast majority of Poles who intend to take part in the accession referendum will be *for* the accession. The poll which was conducted on Monday, Dec 16th, i.e. after the accession negotiations have been closed, indicated that 82% of those who plan to take part in the referendum will vote "YES", only 8% will vote "NO" and 10% have not made up their minds yet. The strong support for the integration suggests that Poles have appreciated the efforts taken by the government in the last round of negotiations and that the negotiated better financial conditions of the membership improved the chance for a positive result of the referendum. This is good news for the referendum, which is to be held in June. However, the problem in the poll mentioned above was that the share of the surveyed who declared certainty to take part in the referendum was low – merely 53%. The politicians are trying to do their best to ensure higher turnout. They decided, for example, that the voting time would be extended till 10.00 p.m. Another proposal which was put forth by the Public Affairs Institute, and which can be tabled as a legislative initiative by the Civil Platform, is to organise a two-day vote (also on a Saturday).

What are the reasons quoted by the voters?

The Centre for Public Opinion Research in a separate poll organised in November asked about the reasons for voting in the accession referendum. What is interesting, only 55% of those who support the idea of the integration expect that it will bring benefits for Poland and 42% see it as the only way forward for the country (3% of the polled did not give any reason). The bulk (81%) of the EU-enthusiasts are young people – up to 24 years of age.

Reasons why the Euro-enthusiasts will vote *yes* and the Euro-sceptics will vote *no* are presented below. It seems that the hopes for unemployment reduction and the improvement in the job opportunities are the key drivers in those who support European integration. On the other hand, the concerns of having the national assets acquired by the foreign capital are on the top of the list of arguments against the enlargement, which means that the Polish government should indeed enhance the information campaign before the June referendum.

Arguments for the accession quoted by those who intend to vote YES:

- better job opportunities (67%)
- better prospects for the next generations (57%)
- faster economic growth (42%)
- benefits arising from the opening of borders (39%)
- improvement of the financial standing of the households (33%)
- stronger position of Poland (27%)
- Polish economy is too weak to stay outside the EU (20%)

Arguments against the accession quoted by those who intend to vote NO:

- risk of being acquired by foreign capital (54%)
- negative implications for Polish agriculture (43%)
- Poland is not ready yet (42%)
- loss of sovereignty (40%)
- Poland will not be able to face competition in the EU (39%)
- unfavourable terms and conditions of accession (31%).

Market monitor

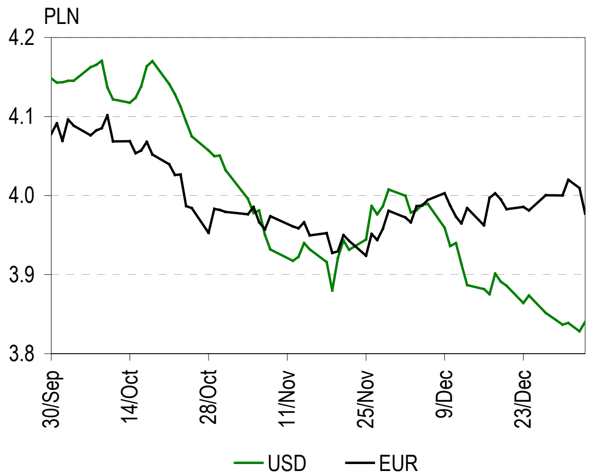
- **The zloty is still strong and the dollar is the weakest in last three years**
- **T-bond yields down again**
- **High demand on first T-bond auction in 2003**

Zloty strong after closing negotiations

In the first half of December, the activity on the domestic FX market was relatively high, as approaching end of accession negotiations was perceived as uncertainty factor influencing the market. On the contrary, starting from mid-December when Christmas time was approaching and during the holiday period the activity on the market decreased significantly. Turnover was very low, and the zloty exchange rates followed the global market. During the whole month the situation on EURUSD market was the main factor influencing the zloty. At the end of December, the Polish currency was significantly stronger against the US dollar and slightly weaker against the common European currency. On global market the dollar was weakening against other main currencies for the whole month and at the end of December the EURUSD rate reached the highest level in last three years. It resulted from uncertainty before possible war with Iraq.

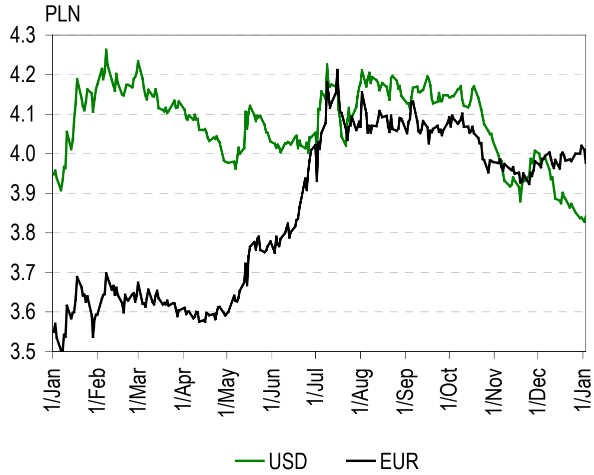
According to the December's NBP fixings the dollar was traded between PLN 3.8369 (on 30 Dec) and PLN 3.9998 (2 Dec) and the average rate was PLN 3.9136 (against PLN 3.9496 in November). The euro rate ranged from PLN 3.9625 (on 16 Dec) to 4.0202 (31 Dec) and the average rate was at PLN 3.9874 (compared to PLN 3. 9555 in November). The average USDPLN rate was close to our forecast at 3.92, and the zloty was weaker against the euro, which resulted from higher than we forecasted appreciation of the euro against the dollar on global market.

Zloty FX rate recent months



Source: NBP

Zloty FX rate in 2002

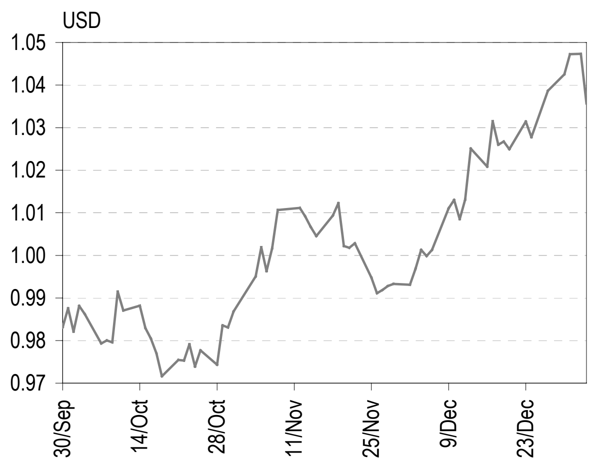


Source: NBP

The beginning of December brought ending of massive profit taking that was observed at the end of November. It allowed the zloty to strengthen, though at first the strengthening was rather slow. However, in the second week of the month, shortly before closing accession negotiations with the EU the zloty strengthened significantly especially against the globally weakening dollar. Within the first two weeks of December the zloty gained 1.5% against currency basket of two main currencies.

During the remaining part of December nothing relevant happened on domestic FX market. As mentioned above, on low liquidity zloty rates were influenced by the situation on global market. However it is worth stressing that investors sentiment to the zloty was positive and its quotation against currency basket remained relatively stable despite significant changes against both the currencies included. Also in the first half of January similar situation was observed on the market.

EUR/USD FX rate



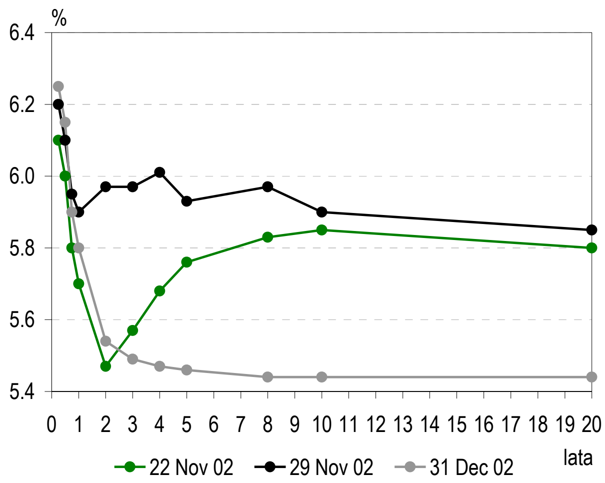
Source: NBP, BZ WBK

T-bond yields fell after the ECB's decision

After the correction (of the downward trend in yields lasting from July on T-bonds market) that appeared at the end of November after the MPC's decision, in December the market was strengthening again. The most significant fall in yields took place already in the first week of the month, since the interest rate cut in the Eurozone increased the attractiveness of Polish bonds. In next weeks the market was quite unstable. At first it was under the influence of uncertainty before the summit in Copenhagen and then it was shocked with the comment from minister Kołodko, who made known data on production before official release. During Christmas period the liquidity was very low, but offer levels pointed to a slight strengthening due to good data on food prices.

In December average yields nearly matched our forecasts included in previous MACROscope – it was exactly the same in a case of 2-year T-bonds and slightly lower for 5- and 10-year papers.

Yield curve

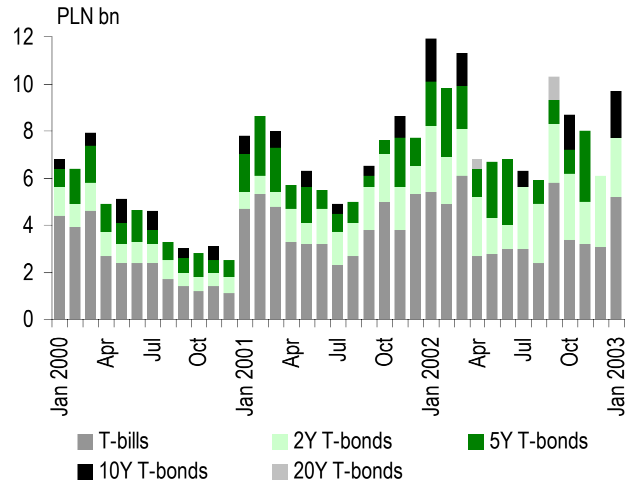


Source: BZ WBK

On 8 January a second tender of 2-year bonds OK1204 attracted a sizeable interest among investors. The demand for bonds was almost four times bigger than the supply from the Finance Ministry and amounted to PLN9.3bn. Obviously all the offered bonds were sold and average yield fell to 5.513% - by 33 bps compared to December's auction - which was below both expected and current market level.

The Finance Ministry informed that they were going to sell PLN6.3-7.5bn worth of T-bonds in January. At the auction on Wednesday, 15 January PLN2.0bn worth of 10-year bonds (DS1013) were offered. Moreover, an auction of 5-year bonds (PS0608) is scheduled and it will be held on next Wednesday, 22 January. According to our estimates, the supply should amount to at least PLN2.0bn.

Supply of treasuries



Note: Jan 2003 without 5Y T-bonds (PS0608)

Source: Finance Ministry, BZ WBK

Treasury bill auctions (PLN m)

	OFFER (SALES)			
Date of auction	*13-week*	*26-week*	*52-week*	*Total*
02.12.2002	-	-	1000 (1000)	1000 (1000)
09.12.2002	100 (100)	-	700 (700)	800 (800)
16.12.2002	100 (100)	-	1200 (1200)	1300 (1300)
December total	**200 (200)**	**-**	**2900 (2900)**	**3100 (3100)**
06.01.2003	100	400	900	1400
13.01.2003	100	300	900	1300
20.01.2003	-	200	1000	1200
27.01.2003	-	300	1000	1300
January total	**200**	**1200**	**3800**	**5200**

Source: Finance Ministry

Treasury bond auctions in 2003 (PLN m)

Month	*First auction*				*Second auction*				*Third auction*			
	date	*T-bonds*	*offer*	*sale*	*date*	*T-bonds*	*offer*	*sale*	*date*	*T-bonds*	*offer*	*sale*
January	08.01	OK1204	2 500	2 500	15.01	DS1013	2 000	-	22.01	PS0608	-	-
February	05.02	OK1204	-	-	12.02	20Y	-	-	19.02	5Y	-	-
March	05.03	OK1204	-	-	12.03	10Y	-	-	19.03	5Y	-	-
April	02.04	OK0405	-	-	16.04	5Y	-	-	-	-	-	-
May	07.05	OK0405	-	-	21.05	5Y	-	-	-	-	-	-
June	04.06	OK0405	-	-	18.06	5Y	-	-	-	-	-	-
July	02.07	OK0405	-	-	9.07	10Y	-	-	-	-	-	-
August	06.08	OK0805	-	-	-	-	-	-	-	-	-	-
September	03.09	OK0805	-	-	10.09	20Y	-	-	17.09	5Y	-	-
October	01.10	OK0805	-	-	08.10	10Y	-	-	15.10	5Y	-	-
November	05.11	OK0805	-	-	19.11	5Y	-	-	-	-	-	-
December	03.12	OK1205	-	-	-	-	-	-	-	-	-	-

Source: Finance Ministry

International review

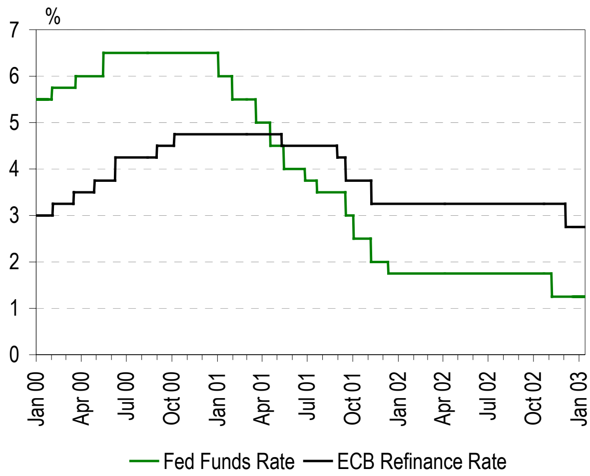
- **Interest rates unchanged**
- **Inflation in line with expectations**
- **The Commission thinks about negative growth**
- **Higher economic activity in the United States**
- **Bush cut taxes, Schröder was criticised**

Interest rates unchanged

As expected, the European Central Bank left interest rates unchanged during its meeting in January. The main refinance rate stands presently at 2.75%, the lowest level for last three years, after it has been reduced in December by 50bp. Explaining the decision during the press conference, ECB President Wim Duisenberg said that inflation and growth perspectives remained unchanged since the last meeting. The decision did not have big influence on the market, as it was anticipated by most of the investors.

The Federal Open Market Committee did not meet since the publication of our December's monthly report the next meeting is scheduled for 29-30 January, however, there is a consensus that also Fed will leave rates unchanged this time - at the lowest level within last 40 years of 1.25%.

Interest rates in the USA and Eurozone



Source: Reuters

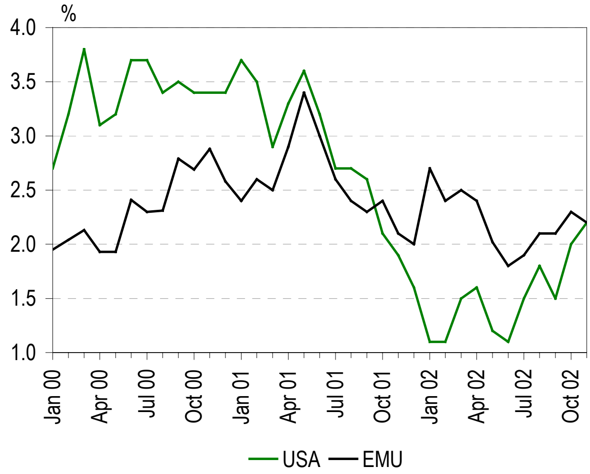
November inflation in line with expectations

Prices in the Eurozone decreased in November by 0.1%MoM bringing annual inflation to 2.2%YoY, down from 2.3%YoY in October. The figures matched preliminary data released in November and were in line with market expectations. November's prices' growth in the Eurozone means that it was fourth month in a row when annual inflation was above 2% ceiling target imposed by the ECB.

Also in December, according to preliminary estimation, inflation in the Eurozone remained at the level of 2.2%. However, the Eurostat added in a statement that the December's estimate had a greater uncertainty due to the launch of euro cash at the beginning of 2002.

In the United States, in line with expectations, inflation inched up in November as falling prices for energy and clothing offset increases for medical care and food. CPI rose by 0.1%MoM after 0.3%MoM in October. Annual inflation grew to 2.2%YoY from 2.0%YoY.

Inflation YoY



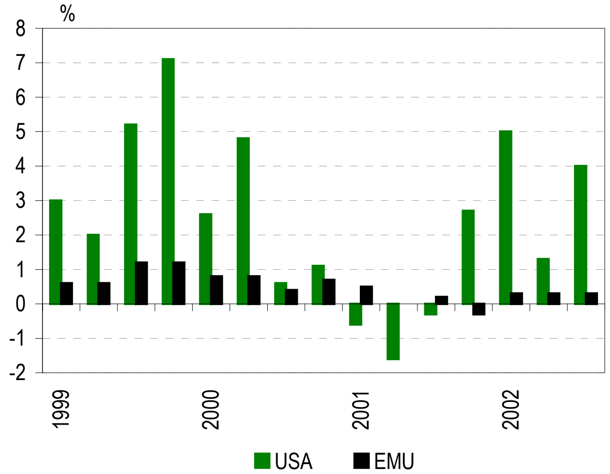
Source: Reuters

The Commission said negative growth is possible

According to the Eurostat, GDP growth in EU12 countries amounted to 0.3%QoQ and 0.8%YoY in 3Q02. It was the second release of the figure, which exactly matched previous estimates and was consistent with market expectations. The European Commission said it has revised down its Eurozone's GDP forecasts for 4Q02 and 1Q03. In 4Q02 economic growth is estimated at 0.1-0.4%QoQ compared to previous forecasts at 0.2-0.5%. As regards 1Q03, GDP growth might fall –0.1%QoQ in the most pessimistic scenario, and it could grow 0.3%QoQ at most. Although the beginning of the 2003 is expected to be weak in terms of economic growth, the economy should revive later during the year, as the Commission forecasts GDP growth for 2003 at 1.8% against 0.8% in 2002.

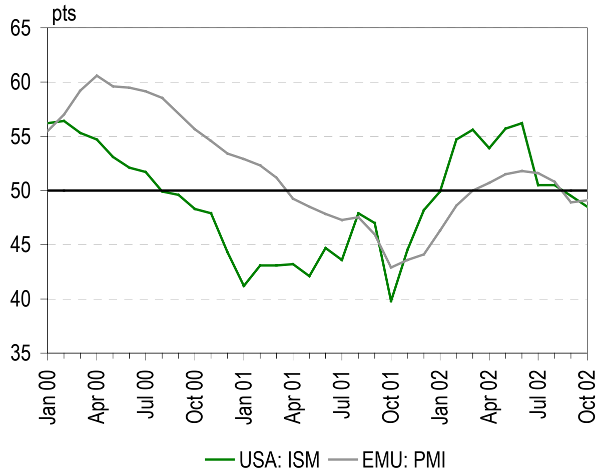
The U.S. Commerce Department said that GDP in the United States rose by 4.0%QoQ in 3Q02 against 1.3%QoQ in 2Q02. The department's third and the final assessment of GDP growth in 3Q02 was consistent with preliminary figures published a month ago. They were also in line with market expectations and had little impact on financial markets.

GDP growth QoQ



Source: Reuters

Economic activity



Source: Reuters

Higher economic activity in the United States

The publication of ISM index for December in the United States surprised the markets, as it grew much above expectations of 50.2pts and reached 54.7pts against 49.3pts in November. The ISM new orders index surged to 63.3pts from 49.9pts in November – the largest increase on a monthly basis since 1980.

Consumer confidence indicator for December was not as positive, as unexpectedly, it dropped to 80.3 pts from a revised 84.9 pts in November. This resulted from rising unemployment and weak labour market prospects.

Contrary to ISM index in the United States, analogous indicator for the Eurozone – Reuters PMI – recorded fall to 48.4pts from 49.5pts in December. The result was worse than market expectations of 49.7pts. The index has now been below the 50.0 "no change" level, indicating worsening of business conditions, for four consecutive months. The decline in December was the largest observed since January 2002. The drop was a result of slowdown in output growth, increase in the number of job losses and sharp decline in new orders.

In the largest European economy, Germany, BME/Reuters PMI recorded considerable decrease to 46.9pts from 49.0pts in November, which was well below predictions pointing to slight decline to 48.9pts.

Bush cut taxes, Schröder was criticised

At the beginning of the year, US president George W. Bush unveiled the plan aimed at boosting the American economy, which assumes abandoning taxes that investors pay on dividends and speeding income tax reductions. The measures also include more generous incentives for small businesses to invest in new equipment. The new programme is supposed to give the economy an additional US$674bn injection in course of next ten years. Analysts estimate that implementation of this plan would cause 10% hike in stock prices and acceleration of GDP growth by 0.5 percentage point per annum.

The European Commission issued the report including tough appraisal of the budget plans drawn up by Germany, France and Italy, saying they were based on perhaps over-optimistic growth forecasts. The critique especially addressed the Germany, which exceeded the deficit limit of 3% of GDP and the Commission included a package of recommendations to Berlin on reducing its shortfall. The Commission gave Germany four months to prepare the package of radical structural reforms that would allow bringing its budget deficit within EU limits. If Germany does not manage to reduce the deficit below 3% of GDP within a year, it might have to pay the penalty fees reaching up to 0.5-1% of its GDP to the EU budget.

What's hot this month

Monday	Tuesday	Wednesday	Thursday	Friday
6 January POL: T-bill auction (PLN 1.4bn)	**7** POL: Food prices (2H Dec) *EMU: Producer prices (Nov)* *EMU: Unemployment (Nov)* *EMU: Economic sentiment (Dec)* *EMU: Business climate (Dec)* *USA: Factory orders (Nov)*	**8** POL: T-bond auction OK1204 (PLN 2.5bn) *EMU: Retail sales (Oct)*	**9** *EMU: ECB meeting* *EMU: GDP (3Q)*	**10** *USA: Unemployment (Dec)*
13 POL: T-bill auction (PLN 1.3bn) *GER: Industrial output (Nov)*	**14** POL: Money supply (Dec) *GER: Inflation final (Dec)* *FRA: Inflation preliminary (Dec)* *FRA: Industrial output (Nov)* *ITA: Inflation final (Dec)* *USA: Retail sales (Dec)*	**15** POL: Inflation (Dec) POL: Wages & employment (Dec) POL: T-bond auction DS1013 *USA: Producer prices (Dec)*	**16** *USA: Inflation (Dec)*	**17** *ITA: Industrial output (Nov)* *EMU: Industrial output (Nov)* *USA: Foreign trade (Nov)* *USA: Industrial output (Dec)*
20 POL: Industrial output (Dec) POL: Producer prices (Dec) POL: T-bill auction (PLN 1.2bn)	**21** *EMU: Foreign trade (Nov)*	**22** POL: T-bond auction PS0608 POL: Business climate (Jan) *EMU: Inflation final (Dec)*	**23**	**24** POL: Core inflation (Dec) *FRA: Inflation final (Dec)* *EMU: Retail sales (Nov)*
27 POL: T-bill auction (PLN 1.3bn)	**28** POL: MPC meeting *GER: IFO (Jan)* *EMU: Money supply (Dec)*	**29** POL: MPC meeting *USA: Fed meeting*	**30** *USA: Fed meeting*	**31** POL: Balance of payment (Dec) *EMU: Inflation preliminary (Jan)* *EMU: Economic sentiment (Jan)* *EMU: Business climate (Jan)*
3 February POL: T-bill auction *EMU: PMI (Jan)* *USA: ISM (Jan)*	**4** *ITA: Inflation preliminary (Jan)* *EMU: Producer prices (Dec)* *EMU: Unemployment (Dec)*	**5**	**6** *EMU: GDP (3Q)*	**7** POL: Food prices (1H & 2H Dec) *USA: Unemployment (Jan)*

Source: CSO, NBP, Finance Ministry, Reuters

Data release calendar for 2003

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
MPC meeting	28-29	25-26[a]	25-26[a]	29-30[a]	27-28[a]	24-25[a]	29-30[a]	26-27[a]	23-24[a]	28-29[a]	25-26[a]	16-17[a]
CPI	15	17[b]	14[c]	14	14	16	14	14	15	14	14	15
Core inflation	24	-	24[c]	23	23	24	22	25	23	22	24	23
PPI	20	19	19	17	20	17	17	20	17	17	20	17
Industrial output	20	19	19	17	20	17	17	20	17	17	20	17
Gross wages, employment	15	14	14	14	16	13	14	14	12	14	18	12
Trade	about 50 working days after reported period											
Balance of payments	31	28	31	30	-	-	-	-	-	-	-	-
Money supply	14	14	14	14	-	-	-	-	-	-	-	-
NBP balance sheet	7	7	7	7	-	-	-	-	-	-	-	-
Business climate indices	22	21	21	23	22	24	22	22	22	22	21	22
Food prices, 1-15	-	7[d] i 27[e]	27	25	27	27	25	27	26	27	27	29
Food prices, 16-30	7	7	7	7	7	6	7	7	5	7	7	5

[a] according to preliminary schedule,
[b] preliminary data, January, [c] January and February, [d] January, [e] February
Source: CSO, NBP

Economic data and forecasts

Monthly economic indicators

		Dec 01	Jan 02	Feb 02	Mar 02	Apr 02	May 02	Jun 02	Jul 02	Aug 02	Sep 02	Oct 02	Nov 02	Dec 02	Jan 03
GDP	%YoY	0.2	x	x	0.4	x	x	0.8	x	x	1.6	x	x	2.0	x
Industrial production	%YoY	-4.8	-1.4	0.2	-3.1	0.3	-4.2	2.1	5.7	-1.1	6.7	3.2	2.8	10.9	5.9
Retail sales ***	%YoY	2.4	4.7	6.7	9.9	3.1	1.8	2.5	8.6	5.1	4.7	5.1	5.9	5.9	8.7
Unemployment rate	%	17.5	18.1	18.2	18.2	17.9	17.3	17.4	17.5	17.5	17.6	17.5	17.8	18.1	18.4
Gross wages ** ***	%YoY	5.3	5.7	5.5	4.8	2.3	4.2	3.9	4.1	2.8	3.8	0.5	1.8	1.8	2.5
Export (acc. to NBP)	USDm	2 540	2 308	2 141	2 467	2 739	2 610	2 678	3 175	2 669	2 850	3 134	3 057	3 149	2 870
Import (acc. to NBP)	USDm	3 430	3 418	2 952	3 148	3 521	3 416	3 360	3 763	3 556	3 758	4 161	4 082	4 327	3 800
Trade balance (acc.to NBP)	USDm	-890	-1 110	-811	-681	-782	-806	-682	-588	-887	-908	-1 027	-1 025	-1 178	-930
Current account balance	USDm	-500	-847	-820	-612	-643	-549	-408	-108	-265	-534	-606	-740	-913	-720
Budget deficit (cumulative)	PLNbn	-32.6	-6.9	-13.7	-16.4	-20.0	-23.0	-25.0	-25.7	-27.3	-29.8	-34.0	-37.1	-40.0	-6.3
CPI	%YoY	3.6	3.4	3.5	3.3	3.0	1.9	1.6	1.3	1.2	1.3	1.1	0.9	0.9	0.7
PPI	%YoY	-0.3	0.0	0.2	0.3	0.4	0.5	1.2	1.7	1.3	1.1	1.7	2.1	2.5	2.6
Broad money (M3)	%YoY	9.2	7.8	6.9	3.2	2.4	3.2	2.5	1.3	-0.2	-1.5	-2.5	-1.0	-2.3	-2.0
Deposits	%YoY	8.9	6.9	5.7	1.7	0.6	1.3	0.5	-0.8	-2.5	-3.5	-4.6	-3.2	-4.4	-2.6
Credits	%YoY	9.3	9.0	8.8	7.1	6.6	7.9	9.4	7.5	5.9	4.9	4.4	4.6	5.3	5.5
USD/PLN	PLN	4.01	4.06	4.19	4.14	4.06	4.05	4.03	4.12	4.18	4.15	4.12	3.95	3.91	3.83
EUR/PLN	PLN	3.58	3.59	3.64	3.63	3.59	3.71	3.85	4.09	4.08	4.07	4.04	3.96	3.99	4.01
Reference rate *	%	11.50	10.00	10.00	10.00	9.50	9.00	8.50	8.50	8.00	7.50	7.00	6.75	6.75	6.50
WIBOR 3M	%	12.29	11.90	10.83	10.32	10.20	9.89	9.30	8.89	8.55	8.07	7.45	6.81	6.83	6.63
Lombard rate *	%	15.50	13.50	13.50	13.50	12.50	12.00	11.50	11.50	10.50	10.00	9.00	8.75	8.75	8.50
Yield on 52-week T-bills	%	10.66	9.62	9.68	9.62	9.56	9.22	8.54	8.35	7.86	7.25	6.77	5.88	5.78	5.63
Yield on 2-year T-bonds	%	10.70	9.11	9.37	9.32	9.22	9.03	8.27	8.12	7.60	7.16	6.62	5.78	5.75	5.54
Yield on 5-year T-bonds	%	9.91	8.91	9.26	9.11	9.02	8.90	8.17	8.11	7.62	7.07	6.57	5.91	5.67	5.50
Yield on 10-year T-bonds	%	8.92	8.25	8.34	8.25	8.19	8.02	7.55	7.63	7.29	6.79	6.22	5.89	5.69	5.55

Source: CSO. NBP. BZ WBK

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

Quarterly and annual economic indicators

		1999	2000	2001	2002	2003	1Q02	2Q02	3Q02	4Q02	1Q03	2Q03	3Q03	4Q03
GDP	PLNbn	615.1	685.0	749.3	770.6	804.5	177.9	188.8	190.5	213.4	183.5	195.7	199.4	225.8
GDP	%YoY	4.1	4.0	1.0	1.3	3.0	0.4	0.8	1.6	2.0	2.5	2.7	2.9	3.5
Total consumption	%YoY	4.4	2.4	1.8	2.7	2.2	2.8	2.6	2.8	2.7	2.3	2.3	2.2	2.2
- Private consumption	%YoY	5.2	2.6	2.1	3.1	2.4	3.5	2.9	3.1	2.9	2.5	2.5	2.3	2.2
Fixed investments	%YoY	6.8	2.7	-10.2	-6.2	6.6	-13.2	-8.4	-6.3	-2.0	3.0	5.2	7.0	8.5
Industrial production	%YoY	3.6	6.8	-0.2	1.7	4.5	-1.6	-0.4	3.3	5.6	4.8	4.4	4.7	4.0
Retail sales (real terms)	%YoY	4.0	1.0	0.2	3.5	3.2	5.8	0.7	3.9	3.5	4.0	3.0	3.0	2.6
Unemployment rate *	%	13.1	15.1	17.4	18.1	18.5	18.1	17.4	17.6	18.1	18.2	17.7	17.7	18.5
Gross wages (real terms)	%YoY	3.3	1.3	1.6	1.5	2.1	1.9	1.4	2.3	0.4	1.6	2.3	2.4	2.1
Export (acc. to NBP)	USDm	26 347	28 256	30 276	32 977	35 015	6 916	8 027	8 694	9 340	7 600	8 300	9 130	9 985
Import (acc. to NBP)	USDm	40 727	41 424	41 955	43 462	47 050	9 518	10 297	11 077	12 570	10 700	10 900	11 850	13 600
Trade balance (acc.to NBP)	USDm	-14 380	-13 168	-11 679	-10 485	-12 035	-2 602	-2 270	-2 383	-3 230	-3 100	-2 600	-2 720	-3 615
Current account balance	USDm	-11 558	-9 946	-7 075	-7 045	-9 009	-2 279	-2 075	-907	-2 259	-2 635	-1 950	-1 496	-2 928
Current account balance	% GDP	-7.4	-6.3	-4.0	-3.7	-4.3	-3.9	-3.8	-3.8	-4.0	-4.1	-3.9	-4.1	-4.3
Budget deficit (cumulative)*	PLNbn	-12.5	-15.4	-32.6	-40.0	-38.7	-16.4	-25.0	-29.8	-40.0	-17.1	-24.5	-30.0	-38.7
Budget deficit (cumulative)*	% GDP	-2.0	-2.2	-4.3	-5.2	-4.8	-9.2	-13.2	-2.5	-4.8	-5.2	-5.0	-5.1	-4.8
CPI	%YoY	7.3	10.1	5.5	1.9	1.6	3.4	2.1	1.3	1.0	0.8	1.1	2.0	2.4
CPI*	%YoY	9.8	8.5	3.6	0.9	2.6	3.3	1.6	1.3	0.9	0.9	1.6	2.0	2.6
PPI	%YoY	5.7	7.8	1.6	1.1	2.0	0.2	0.7	1.3	2.1	2.6	2.4	1.5	1.6
Broad money (M3)	%YoY	24.6	15.2	12.1	1.6	2.2	5.9	2.7	-0.1	-1.9	-1.1	1.3	3.1	5.5
Deposits	%YoY	26.4	17.2	13.5	-0.2	5.0	4.8	0.8	-2.3	-4.1	-1.2	2.5	5.9	12.8
Credits	%YoY	28.6	24.7	11.3	6.8	11.0	8.3	8.0	6.1	4.8	6.4	8.9	10.9	17.9
USD/PLN	PLN	3.97	4.35	4.09	4.08	3.83	4.13	4.04	4.15	3.99	3.84	3.81	3.82	3.85
EUR/PLN	PLN	4.23	4.01	3.67	3.85	3.88	3.62	3.72	4.08	4.00	3.96	3.89	3.82	3.85
Reference rate *	%	16.50	19.00	11.50	6.75	6.00	10.00	8.50	7.50	6.75	6.25	6.00	6.00	6.00
WIBOR 3M	%	14.73	18.78	16.08	9.09	6.38	11.02	9.80	8.50	7.03	6.62	6.28	6.30	6.30
Lombard rate *	%	20.50	23.00	15.50	8.75	7.50	13.50	11.50	10.00	8.75	7.75	7.50	7.50	7.50
Yield on 52-week T-bills	%	12.95	17.77	14.77	8.18	5.48	9.64	9.11	7.82	6.14	5.60	5.50	5.40	5.40
Yield on 2-year T-bonds	%	12.41	17.37	13.91	7.94	5.45	9.27	8.84	7.63	6.05	5.55	5.45	5.40	5.40
Yield on 5-year T-bonds	%	10.87	14.00	12.59	7.86	5.50	9.09	8.69	7.60	6.05	5.55	5.50	5.50	5.45
Yield on 10-year T-bonds	%	9.60	11.79	10.74	7.34	5.49	8.28	7.92	7.24	5.93	5.55	5.50	5.45	5.45

Source: GUS. NBP. BZ WBK

* at the end of period

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