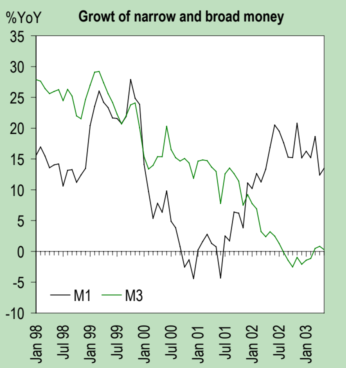
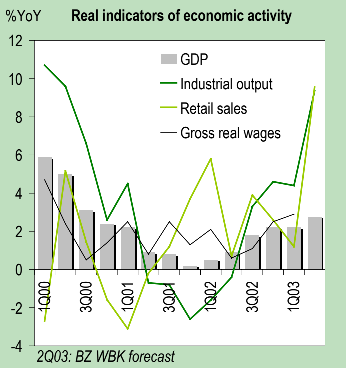
Bank Zachodni WBK

MACROscope

Polish Economy and Financial Markets

July 2003





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Money, money, money

- **The nature of the interdependencies between money and inflation in the Polish economy is not fully known.** This was one of the reasons why in 1998 the NBP moved towards the direct inflationary targeting strategy. Since that time, the importance of monetary aggregates in macroeconomic analysis, following the world's trends, has been diminished. There is no doubt, however, that at turning points of economic development, an in-depth analysis of monetary aggregates can prevent wrong decisions related to monetary policy. As this is the case, a question can be posed whether the Monetary Policy Council attaches enough importance to money supply and its drives and whether it interprets them rightly? The dynamics of money supply measured with the M3 aggregate has indicated for quite a long time that there is an inflation pressure exerted by monetary processes. However, if one takes a look at the narrower monetary aggregate, one will see a totally different picture. Under this month's *Special Focus* we will try to briefly analyse the current trends related to the monetary processes in Poland and we will present the forecast for the upcoming years.

- **In the meantime, favourable inflationary outlook is the main argument for another interest rate cut.** It seems that after six cuts made this year, it is time to take a holiday break. We expect that the Monetary Policy Council will make a decision to further reduce the interest rates, however only after a new member of the Council has been appointed to replace Janusz Krzyżewski. It seems that this year the reference rate could fall below 5% only if the 2004 budget and the package of fiscal solutions presented by the government envisaged actions aimed at reducing the fiscal imbalance by reducing the public spending.

- **However, it is hard to expect a thorough reform of public finance on the spending side, taking account of the statements made by representatives of the government.** We still do not know the key assumptions underlying the budget, but it seems that we can expect an expansive fiscal policy. In addition, for the time being, there are no reasons to believe that the growth in the budget deficit in the years 2004-05 will only be "temporary" in nature what the government wishes for.

- **The macroeconomic data from the recent months clearly confirms that the economy has faced a revival phase** yet the statistics for the GDP growth showed that in 1Q03 the economic growth did not accelerate against the end of the last year. The results for the second quarter should be much better which is confirmed by the increasing number of positive indicators as well as the opinions of representatives of the CSO and practically all independent institutions producing economic projections.

Financial market on 30 June 2003

NBP deposit rate	3.75	WIBOR 3M	5.32	PLN/USD	3.8966
NBP reference rate	5.25	Yield on 52-week T-bills	4.80	PLN/EUR	4.4570
NBP lombard rate	6.75	Yield on 5-year T-bonds	4.97	EUR/USD	1.1438

This report is based on information available until 11.07.2003

Special focus

Underestimated money

Economic literature quotes different definitions of the role that money should play in macroeconomic policy. Some of the theories position money supply and its fluctuations as the key element of macroeconomic analysis. The development of the neo-classical economic theory in the 70's led to a relative consensus in terms of the existence of the relationship between money supply and inflation. The quantity theory of money underlies this way of thinking. According to this theory, the central bank should focus on ensuring that broad money grows at the pace matching the production potential of the economy which ensures stabilisation of inflation at the desired level. The primary objective of the monetary policy should be curbing inflation and not stabilising exchange rates or counteracting short-term fluctuations in GDP or unemployment. This arises from the main idea behind the quantity theory of money according to which in the long-run real economy is not impacted by changes in nominal values, including money supply.

Money supply became a subject of numerous studies and analyses in the period of renaissance of the quantity theory of money, which was accompanied by growing importance and popularity of monetary policy. For a long time, the development of money supply was one of the main elements of the policies applied by central banks and was the so-called intermediate goal of the monetary policy. This target is set by estimating the potential GDP and velocity of money circulation which with the assumed inflationary target enables us to define the permissible dynamics of a money aggregate in a period. Then, any actions aimed at achieving the targeted growth in broad money are taken with the use of monetary policy instruments. The selection of individual methods is primarily driven by the identified channels, which can be used by the central bank to influence money supply. Temporary mismatches between the dynamics of money supply and inflation are treated as disturbances triggered by non-monetary factors. Thus, while estimating money demand, factors such as changes in F/X rates and interest rates, demand shocks, etc. should be taken into account. Lack of disturbances in the relationship between money supply and inflation would mean that the growth in money demand should be pro rata to the real growth in the production potential of the economy.

The strategy based on the intermediate goal became popular in mid 70's, and then in early 80's it became the most frequently applied strategy of monetary policy. In practice, different money aggregates were controlled, both the monetary base (M0) which is directly impacted by the central bank as well as the broadest monetary aggregates (M2, M3). Following the application of financial innovations, which contributed to the increase in liquidity of financial instruments comprised in broader money aggregates, they were more and more frequently used as basic measures of money supply. On the other hand, to respond to the fact that different financial instruments included in the broader money aggregates play the transactional role to a different extent, indexed money measures, i.e. the so-called Divisia's measures were introduced. Different financial instruments are assigned different weights, the higher the liquidity of the instrument the higher the weight. This allows to eliminate the fictitious assumption that there is a perfect substitution for different types of financial instruments.

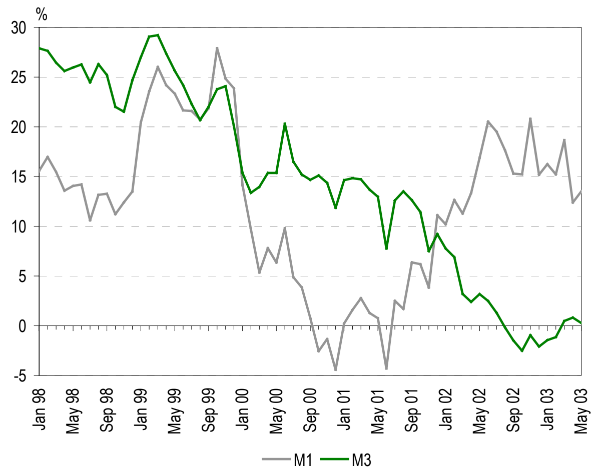
In spite of perfecting the money measures, since the 1980's, we have seen the diminishing relationship between the monetary aggregates and the primary target of the monetary policy, i.e. inflation level. Existence of that relationship is determined by the existence of relatively stable or at least predictable function of money demand (i.e. the relation linking money demand with factors having impact on its development). In reality, for different reasons, the condition is not met in most economies. The estimation of a stable function of the money demand is a strenuous task particularly in countries facing system changes typical of transition period. If this is the case, from the point of view of achieving the inflationary target, using the growth in money aggregate as a monetary policy indicator can be misleading the primary reason being countless innovations on financial markets. They made the differences between money and money-like assets blur. As a result, not only were the relations between the broad monetary aggregate, which constitute the intermediate objective of the monetary policy and the ultimate inflationary target disturbed, but some irregularities in terms of the relationship between the intermediate objective and the monetary base emerged. This is related to substantial fluctuations in money creation multiplier. The relatively weak relationship between the monetary base and the broader money aggregates is confirmed by numerous empirical researches. Additionally in practice, it turned out that the central bank does not have the ability to influence the supply of reserve money, which changes as a result of money changes rather than the other way round.

As a result, most of economies faced significant difficulties with assessing based on changes in money supply, the degree to which the monetary policy is restrictive. The existence of the above problems related to using monetary aggregates explains why in a number of countries the role of money in monetary policy diminished in the 90's. Gerald Bouey, former Governor of the Bank of Canada put it humorously by saying: "...we did not abandon money supply targets, they abandoned us". The growing popularity of the strategy of the ultimate inflation target was, to a great extent, a response to the above phenomena, and at the same time, it further overshadowed the issues related to money supply.

Although the above comments may prompt one to think that the usefulness of money supply in analysis and management of monetary policy is limited, the truth is that monetary aggregates should not be left out while assessing economic development. Undoubtedly, at turning points of economic development, a thorough analysis of monetary aggregates can prevent wrong decisions related to the monetary policy. A question, which should be posed, is whether the Monetary Policy Council attaches enough importance to money supply trends and whether they can rightly assess their development? In an attempt to answer the question, one should primarily rely on the fact that the relationship between the monetary aggregates and the pace of price rise is, to a great extent, driven by the way of structuring monetary aggregates, i.e. a selection of a specific measure to analyse the transmission mechanism in which money affects inflation. However, there are no doubts that there is a long-term relationship between money aggregates (aside its statistical definition), its changes and inflationary processes in individual economies. This is why it is good to remember the quote by Milton Friedman who was repeating that "Inflation is always and everywhere a monetary phenomenon".

For a relatively long time, the dynamics of nominal money supply in Poland defined with M3 have not indicated that there is an inflationary pressure exerted by monetary processes. Since early 2002, the dynamics of monetary aggregates recorded a rapid decline and in the period from February to August 2002, it was even negative. In the subsequent months this year, it was positive but at a very low level. Upon the analysis of the M2 aggregate (which differs from M3 primarily in terms of the size of issues of retail banking bonds allowing to avoid the capital gains tax), it turns out that the dynamics of monetary aggregates in the Polish economy over the recent months has been even lower. However, if one take a look at the development of the narrower monetary aggregate, the picture you see is totally different. M1, the category of money supply that includes the most liquid forms of money, i.e. cash in circulation and demand deposits, has been recording a dynamic growth since the end of 2001. What is important, this is not only driven by a material growth in cash in circulation, which could be explained by, for instance, increased scale of the shadow economy, as the volume of demand deposits is also rapidly growing (and the share of deposits in money supply is higher than the share of cash).

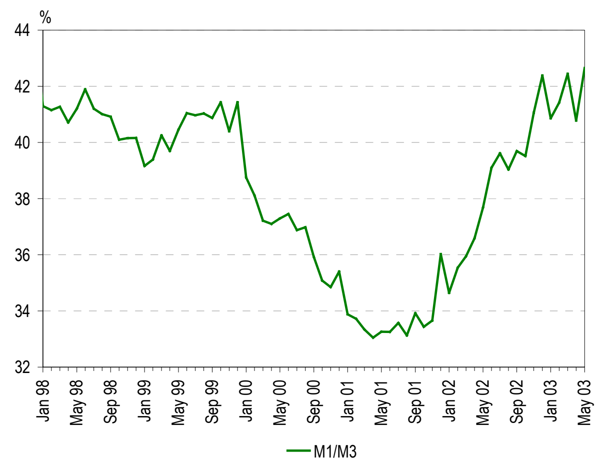
Dynamics of M1 and M3 aggregates



Source: NBP, own calculations

The described trends with regard to money supply development in Poland show that its structure has been significantly changing for several months. Those changes consist in shifting the preferences from longer-term maturity assets towards the most liquid forms of money. Term deposits being substituted by demand deposits and cash in circulation promote the growth in the share of the narrow monetary aggregate M1 in the M3 aggregate. In May this year, the share was 42.7%, which is the highest value since December 1997. To a large extent, this is related to the considerable interest rate cuts and the introduction of the capital gains tax which led to a rapid decline in yields on deposits which prompted households not to invest their financial surpluses in banking term deposits. That means that although broad money supply is stable, we recorded a substantial growth in "moneyness" of money. Well, the very concept behind money is its liquidity. If so, do the monetary processes pose a threat to inflation? At present, it is hard to answer that question unambiguously. In view of the very poor conditions on the labour market, one should not expect that the enhanced liquidity of monetary aggregate would translate into growth in consumption. With the currently low costs of keeping the most liquid forms of money, this may simply mean that cash in circulation and demand deposits, apart from being a medium of exchange, will, to a growing extent, play the role of a medium for storing values over time. The trends on the side of money creation, i.e. the fact that in spite of the evident economic revival recorded recently, there are no signs of growth in credit activity, cannot be that easily explained. The most likely hypothesis is that in view of the fact that high NPL charges are disclosed in banks balance sheets, the credit risk is high in the banks' minds and this translates into lower willingness to sanction loans. However, when the economy picks up, the perception of the borrower's standing in the eyes of financial institutions may quickly alter and lead to a rapid growth in credit activity, which will also bring about more intensive inflationary pressure from monetary processes.

M1 share in M3



Source: NBP, own calculations

The analysis of monetary trends in the Polish economy has surely not been easy recently and can be really troublesome for the central bank. In circumstances when different money aggregates are starting to change for different reasons and in different ways, the monetary authorities will face the need to choose an appropriate trend ratio with regard to monetary processes. In such a case, they may be tempted to use an aggregate which best matches their subjective opinions on the economic development scenario. This approach, however, may backfire and lead to wrong decisions on the monetary policy. In our opinion, the ambiguous behaviour of monetary aggregates should make the Monetary Policy Council more cautions while making next decision on interest rates.

The monetary processes projected for the upcoming years also indicate a necessity to act cautiously with regard to the monetary policy. The starting point for forecasting individual element of money supply and the factors of its creation is producing an estimate of money demand from households and businesses, which is consistent with the projected economic growth and inflation. While estimating the money demand, the existence of a stable function of money demand is of key importance. The following variables are significant in terms of the function: the dynamics of economic growth and alternative cost of keeping money (inflation and/ or interest rates). The growth (drop) in the GDP increases (decreases) demand for money used for transactional purposes. The growth (drop) in inflation leads to a drop (growth) in money demand, which is related to expectations that the value of money in real terms will change. According to the neo-classical monetary theory, the growth (fall) in interest rates in the environment of developed financial markets leads to the fall (growth) on money demand in view of the growth (fall) in the rate of return from other financial assets (e.g. securities). Empirical research indicates, however, that in the environment of poorly developed financial markets, where there are not many financial instruments alternative to money, the growth (drop) in interest rates can lead to growth (drop) in money demand.

On the basis on the above relationships, two general approaches can be used for forecasting money demand. The first one is based on the estimation of the money demand regression equation. The other approach boils down to the qualitative analysis of trends in the velocity of money in circulation or the opposite ratio which is the ratio of monetisation in economy, i.e. the relation between money supply and the nominal value of the GDP. The selection method is determined by the availability of relevant statistical data and the permanent nature of institutional solutions in individual countries.

Empirical research indicates that parameters of the money demand function in Poland are unstable. That means that the assumption made in the first approach that the relation between the money amount and the factors impacting it should not change over time, is not met. As this is the case, the usefulness of the method for forecasting monetary aggregates, which consists in estimation of the money demand equation is limited. The major difficulty is insufficient length of time series as the NBP publishes the comparable time series covering the period since December 1996 only. The comparable time series related to the GDP are only a little longer, as they cover the period since 1995.

As this is the case, while forecasting monetary aggregates, we should apply the approach which is based on observing changes in monetisation rate (velocity of money in circulation), taking account of factors which may influence this rate in the future. This approach has its benefits as the forecast produced that way is not distorted by behavioural relationships from the past while it can take account of processes observed in the recent periods and all information about new phenomena which can have a potential impact on the development of monetary aggregates. The following factors can destabilise the money demand function and at the same time have a significant impact on the monetisation rate (velocity of money in circulation):

- development of payment systems,
- size and cycle of payments,
- velocity of commodity turnover,
- development and speed of telecommunication infrastructure functions,
- the period of settling liabilities applied in practice,
- difference in income earned by the society,
- savings preferences (which may arise from tax solutions), etc.

The money demand forecast is produced when we refer the projected monetisation rate (velocity of money in circulation) to the projected nominal value of the GDP. Having obtained the projected money demand, the next assumptions are made with regard to the development of the structure of money supply (e.g. based on the structure of money supply and its evolution in the EU member states). By doing that, we will be able to assume the share of the following components in the M3 aggregate: cash in circulation, total deposits and other items. Next step will be making assumptions for the change in the deposits structure (taking account of two aspects: sector classification of entities and maturity term). By making all the consecutive steps, we produced the M3 forecast and the forecast for money supply elements and factors of their creation in the years 2003-2006, which are presented in the table on the right.

Forecast of M3, deposits and credits

% YoY, end of period	2003	2004	2005	2006
M3	3,8	5,8	8,9	10,8
Total deposits	2,0	6,6	9,6	11,7
Deposits of individuals	0,8	5,7	8,6	10,1
- demand	3,7	9,2	15,0	11,5
- term	0,1	4,8	6,9	9,6
Other deposits	4,6	8,3	11,4	14,9
- demand	17,2	10,8	13,9	15,9
- term	-11,0	4,3	7,1	13,2
Loans and other claims	9,1	11,9	15,6	15,5

Note: deposits include deposits with agreed maturity over 2 years and deposits redeemable at notice over 3 months, reported by the NBP in counterparts of money supply
Source: BZ WBK

The above forecast assumes a stabilisation of the monetisation rate at 41% - 42% in the years 2003-2006. The monetisation rate will be favourably impacted by the acceleration of the GDP growth in real terms. Empirical research indicates that there is a strong positive correlation between the level of GDP *per capita* and the monetisation rate. In the well-developed countries, value of money stock substantially exceeds the nominal GDP value. In the Czech Republic, which records a comparable economic development level to Poland, the monetisation rate is at ca. 80%. In Poland, since the beginning of the transformation period, the rate has been regularly growing from 32% in 1991 to 41.8% in 2002. Maintaining relatively low inflation will also have a favourable impact on the monetisation rate. The growth in money demand will be also enhanced if low interest rates are sustainable, which will reduce the attractiveness of alternative financial assets. On the other hand, the growth in the monetisation rate will soon be hindered by the growing role of non-banking financial institutions in the financial intermediation.

Apart from the level of the monetisation rate, our forecast assumes that the share of cash in circulation in the money will be on the wane (15% in 2003 and 14% in 2006). The decrease in the share of cash in circulation in money supply will be the continuation of the trend observed in Poland since the beginning of the transition period, which was related to the development of the banking sector (growing number of banking accounts, increased number of non-cash transactions). At the same time, it will be an adjustment of the money supply structure to the one in the countries of Western Europe – in the Eurozone the share of cash in circulation in the M3 aggregate is as little as ca. 5%. On the other hand, as we previously mentioned, keeping the share of cash in circulation in the broadest monetary aggregate at a relatively high level will be triggered by interest rate cuts which will cause a shift in preference of households and businesses towards more liquid forms of money. Furthermore, we assumed a gradual growth (from 1% in 2003 to 1.6% in 2006) in the share of other items in money supply, which will follow the development of the market of debt securities issued by banks.

Following the drop in the share of cash in circulation and a slight growth in other M3 components, the share of deposits in money supply will be growing. In the deposit structure, the share of demand deposits (both business and personal) will increase. This will be driven by the reduction of costs of keeping money and the growing importance of non-cash turnover in the Polish economy (on well developed financial markets, demand deposits are considered a perfect cash substitute). Thus, we can expect, which has been observed recently, that the volume of the most liquid M1 money, which is directly used for transactional processes will be growing more dynamically than M3. Furthermore, the expected growth in demand for banking loans seems very important. It will be fuelled by improving sentiment of consumers and entrepreneurs and flow of the EU funds, which require co-funding by both public and private sectors.

The developed scenario of the development of monetary processes indicates that the Monetary Policy Council should focus on money to a greater extent. It goes without saying that implications of the negligence can be serious. In 1999, the Council saw the evidence of it.

Economic update

- **No clear improvement of economic situation in 1Q03**
- **...but subsequent months show stronger and stronger economic recovery going on**
- **Still, there is no improvement on the labour market**
- **...and no visible inflationary pressure**

Even though GDP statistics showed no acceleration of economic growth in 1Q03 in relation to the final period of last year, macroeconomic data from recent months more and more clearly confirm that economy is on a path of recovery. The results of 2Q03 should be much better, which is confirmed not only by the growing number of positive figures, but also by the opinions of CSO officials and virtually all institutes dealing with economic forecasting in Poland.

The improvement, although is clear, still does not apply to all sectors of the economy. There are no clear signs of revitalisation in monetary statistics yet – demand for banking credit remains weak and the outflow of households' deposits is continuing, mostly into alternative saving products. No improvement can also be seen on the labour market. The fall of unemployment rate results only from seasonal effect and companies are still cutting employment, which accompanied by decelerating wages results in contraction of households' disposable income (at least from registered sources). Situation on the labour market is favourable for low inflationary pressure – despite the downward trend of CPI concluded, inflation should be around some 1.5% at the end of this year.

No visible growth acceleration in 1Q03

According to the CSO Polish GDP increased by 2.2%YoY in 1Q03 after growing at the same pace in 4Q02. The figure was very close to our expectations of 2.3%. However, the structure of GDP growth was quite surprising. While it turned out that the fall of fixed investment outlays was even a bit smaller than we predicted (-3.6%YoY against our forecast -5%), the data also showed significant deceleration of private consumption dynamics – down to 1.4%YoY in 1Q03 from 3.5% in 4Q02. According to our estimates, deterioration was also experienced in public consumption (which fell by 0.5%) and in net exports (as its negative balance widened by ca. 5.5%). Please see the table on the right for detailed quarterly GDP figures.

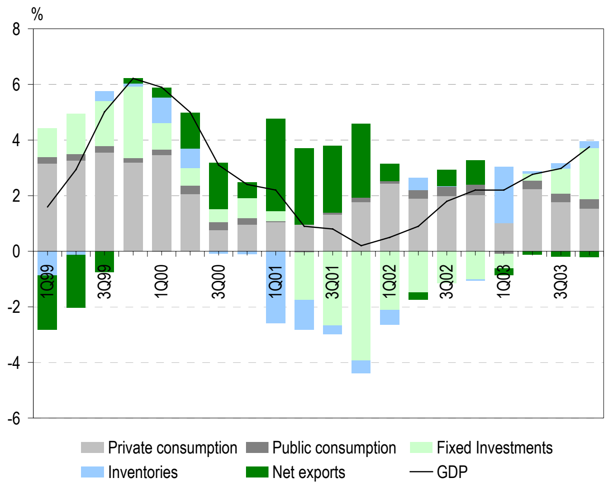
GDP and its components, %YoY

	1Q02	2Q02	3Q02	4Q02	1Q03
GDP	0.5	0.9	1.8	2.2	2.2
Domestic demand	-0.1	1.1	1.2	1.3	2.3
Total consumption	2.8	2.6	2.8	3.2	1.0
Private consumption	3.5	2.9	3.1	3.5	1.4
Public consumption*	0.4	1.6	1.8	2.2	-0.5
Gross accumulation	-17.9	-5.5	-5.6	-3.7	12.7
Fixed Investments	-12.8	-7.9	-5.9	-3.6	-3.6

Source: CSO, BZ WBK; * BZ WBK estimates

Somewhat surprisingly, the change in inventories had the biggest impact on the overall GDP growth rate. This component, having the smallest share in the nominal GDP value (well below 1%), was responsible for ca. 2 pct. points of GDP growth in 1Q03 (see the graph below). If the change in inventories was excluded from the statistics, the economic growth would amount to merely 0.2%. The change of inventories is quite hard to interpret – it is a residual variable for the statistical office in construction of the national accounts and therefore it happens that its fluctuations do not properly reflect the developments in the economy. We tend to believe that it was also the case this time. Similar developments (although with an opposite sign) took place two years ago, in 1Q01. Most likely this is mostly a statistical disturbance resulting from the methodology of national accounts.

Contribution of demand components to GDP growth



Source: CSO, BZ WBK; Note: 2Q03-4Q03 – BZ WBK forecasts

Although a deceleration of private consumption growth was substantial in 1Q03, it seems quite likely that it was only a one-off statistical phenomenon resulting from the shift of demand between March and April (to a large extent due to later Easter this year). As in case of retail sales, we expect to see a substantial acceleration of private consumption in 2Q03, however in the subsequent quarters its growth might be dying off gradually amid declining purchasing power of households. Dynamics of fixed investment, which is crucial for the scenario of economic recovery, was still below zero in 1Q03, which was consistent with expectations. However, the rate of fall in investment outlays was already quite small and one could hope that it would turn into black already in the second quarter. Net exports' contribution to GDP growth was slightly negative, and we guess it would remain negative in the remainder of the year. Although a continuation of strong exports performance is expected, recovering domestic demand should stimulate import growth, which could outpace export growth already at the end of this year.

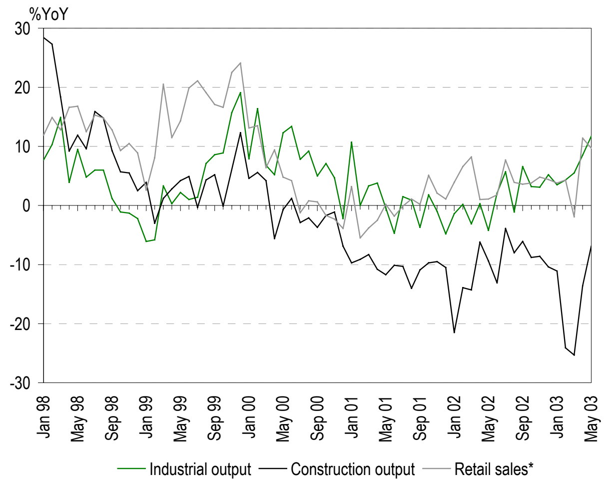
In general, even though the GDP figures showed no acceleration of economic growth at the beginning of 2003, we argue that they were not contradicting the scenario of economic recovery in the remainder of this year. The CSO vice-president Halina Dmochowska said that according to statistical data available so far, it seems that the second quarter of this year will be much better than the first one and one should see significant improvement of demand from both households and companies. This confirms our expectations as regards the path of consumption and investment changes later this year. We forecast that GDP should be around 3% in both 2Q03 and 2003 as a whole.

Robust data from the real economy in May

Industrial production in May grew by 1.2%MoM and surged by 11.7%YoY. Seasonally adjusted growth of sold industrial production amounted to 8.8%YoY. Both unadjusted and adjusted figure has been the highest for more than two years. Therefore, the data show that industry keeps expanding steadily, which in turn confirm expectations for acceleration of the economic growth in consecutive quarters of this year. Similarly to previous months, the fastest growth in output was recorded in manufacturing (13.8%YoY), Production in utilities dipped by 1.9%YoY while in mining inched up by 1.8%YoY. Growth of manufacturing production was especially strong in export-oriented branches. However, the number of branches which record annual growth of output in May increased in comparison with the previous month (to 22 out of 29 branches from 20 in April), which may indicate that also domestic demand rebounds.

Optimistic signals came also from data on construction output. Its annual dynamics, although still negative, improved to -6.9%YoY from -13.6%YoY in April and -20.2%YoY on average in 1Q03. One should remember that the improvement resulted to some extent from a shift in construction sector activity from the first months of the year (due to very bad weather conditions in this year's winter) and higher number of working days (seasonally adjusted data pointed to 12.2%YoY decline in construction output). Nevertheless, even taking it into account it seems that construction sector recovers from severe downturn and this may signal long awaited rebound in investment activity.

Real activity indicators



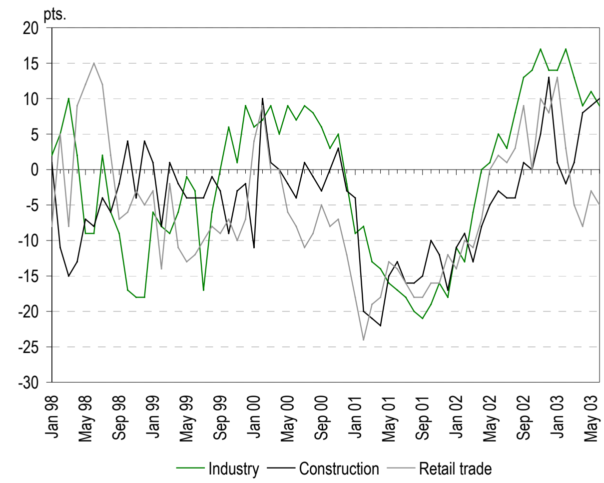
Source: CSO, BZ WBK; * May 2003 – BZ WBK estimate

Retail sales figures were equally optimistic. Its growth reached 9.7%YoY after growing by 11%YoY in April. In our opinion this confirms that private consumption growth remains strong, despite continuing fall of employment in corporate sector and deceleration of wage growth. Especially, that the structure of sales growth shows high demand for goods like vehicles, furniture, electronic equipment and household appliance, clothing and footwear. This suggests that the growth of private consumption should recover in 2Q03 after a deceleration to 1.4%YoY recorded in the first quarter, as we have written above describing GDP figures.

...confirmed by business climate survey's results

Results of business climate survey for June released by the CSO were consistent with the results for a few previous months. Indices for industry and construction are still above zero and they keep growing robustly in annual terms (by 9 and 10pts, respectively) while index for retail trade is negative and is falling compared to the corresponding period of last year (by 5pts). In industry enterprises declared that they slightly decreased production. Forecasts of orders portfolio and production are still optimistic but more conservative than a month ago. A signalled dip in new orders was to a larger extent a result of smaller export orders than domestic ones. In the nearest months financial situation of enterprises is expected to improve while employment is forecasted to record further decline. Enterprises from construction sector said they recorded an increase of orders portfolio but expectations for its growth in the nearest three months are slightly less optimistic than in May. However, evaluation of current and future production in construction sector is better than last month. Financial situation of construction firms is still perceived negatively, but brighter than in the previous month – during next three months it is expected to slightly improve. Downward tendency of employment in construction was maintained. However, further layoffs are declared to be smaller in months to come. In retail trade, enterprises declared that limitations in current sales are bigger than last month. In the nearest months scale of sales is predicted to be limited on a similar scale as it was forecasted a month ago. Prices of sold goods are expected to grow faster than it was envisaged in May.

Business climate, YoY change

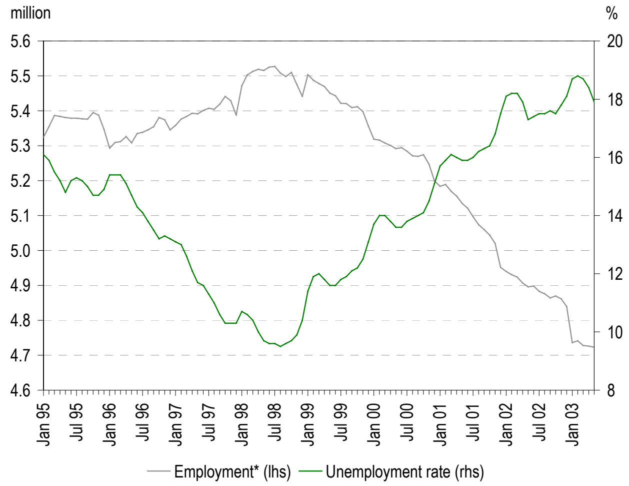


Source: CSO

No changes on the labour market... unfortunately

In May, the annual rate of employment fall in companies with personnel of more than 9 people picked up a bit, suggesting that the job destruction process is gradually loosing its momentum. In relation to May 2002 the number of employed was lower by 173,000 i.e. 3.5%YoY against 3.7%YoY fall in April. However, on monthly basis the average employment was still falling (even though slowly) at -0.1%MoM, while we hoped for its stabilisation.

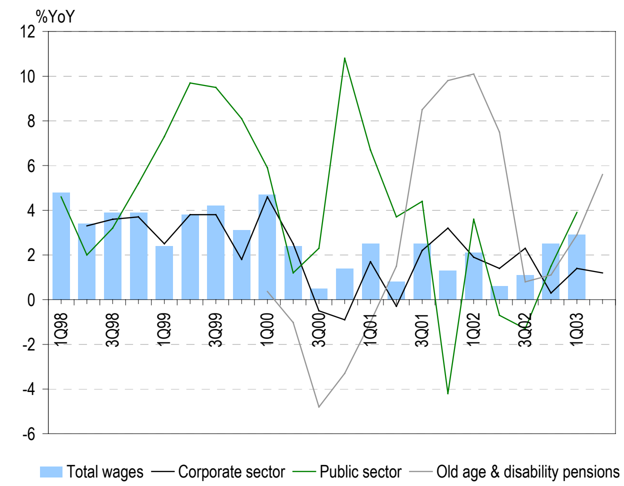
Corporate employment and unemployment rate



* Data adjusted by the CSO's change in methodology in 2000.
Source: CSO

Registered unemployment rate dropped to 17.9% in May from 18.4% in the previous month. Similarly to April, the fall of the unemployment rate was only a seasonal phenomenon while in annual terms it kept growing. The number of unemployed reached 3.160m in May, rising by 3.1%YoY against only 1.3%YoY growth in April. This confirms that despite we observe seasonal dip in the unemployment, tendencies on the labour market are still far from real improvement. However, we expect that along with further acceleration of the economic growth (stemming from rebound in investment activity) upward trend of the unemployment will gradually reverse in the remainder of this year. We predict that the unemployment rate will stabilise slightly below 18% until December (in June it should amount to 17.8%) when it will breach this level again.

Real growth of wages and pensions



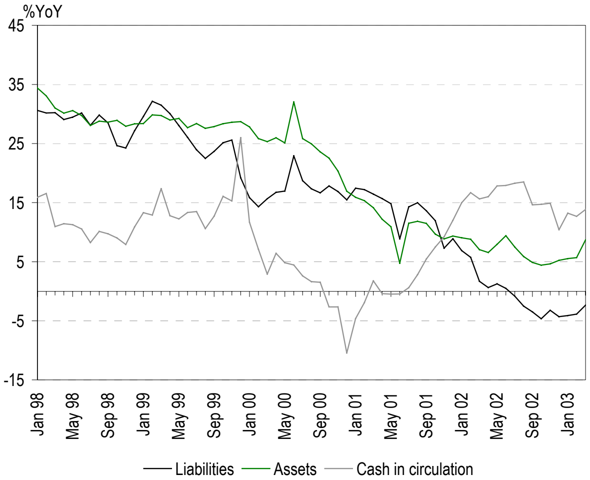
Source: CSO, BZ WBK; Note: 2Q03 – BZ WBK forecasts

Wages in corporate sector fell -2.9%MoM fall against 1.3%MoM increase recorded in May 2002. As a result, the annual growth rate of salaries fell to 0.0%YoY, down from 4.2%YoY recorded last month and 2.4%YoY on average in January-April period. Of course, such figures are not supportive for fast growth of private consumption demand in 2Q03, as the nominal wage bill in corporate sector fell by 3.6%YoY in May – the biggest drop recorded for a number of years – and real wage bill plummeted by 4.1%YoY. The data also suggest that one should not be afraid of strong wage pressure on prices growth this year, as very tough situation on the labour market clearly limits wage claims, resulting in a very limited growth of salaries.

No signs of improvement in monetary figures

Monetary statistics still do not reflect any sign of recovery experienced in the real sector. In May broad money M3 increased 0.9%MoM while its annual growth rate fell to 0.2%YoY from 0.8%YoY in April. The main vehicles for monthly increase of money supply were the deposits of enterprises, growing 5.3%MoM (9%YoY), while households' deposits kept falling: -0.8%MoM and -7.1%YoY (against -6%YoY in April).

Banking system's assets and liabilities



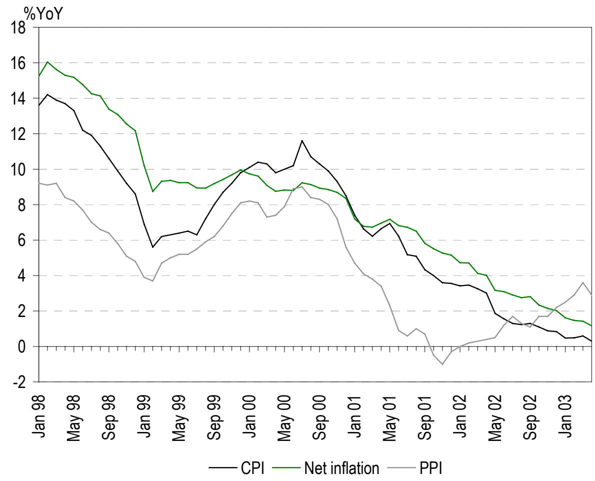
Source: NBP

Weakness was also visible on the loans market. Total loans picked up only by 0.6%MoM, while in the corresponding month of 2002 they increased 1.4%MoM. This was caused mainly by a stagnation of corporate loans, growing merely 0.4%MoM and 5.4%YoY. Meanwhile, households' loans recorded a 1.4%MoM hike, accelerating to 7.2%YoY from 6.5%YoY last month. Probably, the increase of households' loans to a large extent reflected mortgages amid quite favourable environment for buying real estate at the moment.

Inflationary pressure still very low

In May prices of consumer goods and services remained unchanged on a monthly basis and increased by 0.4%YoY against 0.3%YoY growth in April. The figures were lower than expected CPI in May due to two factors. The first one was lower than anticipated growth of food prices. Preliminary CSO data indicated 0.6%MoM dynamics while actual increase of food prices in CPI data amounted to only 0.4%MoM. The second reason for only slight acceleration of annual CPI in May was deeper than we assumed decline of fuel prices. They dropped by 4.2%MoM and increased by 7.8%YoY (against two-digit growth rates in previous months) bringing the annual dynamics of transport prices down to 4.6%YoY from 6.5%YoY in April. Prices of other CPI components changed broadly in line with expectations – their annual dynamics were the same or very similar as in April.

Measures of inflation



Source: CSO, NBP

Producer prices in May dropped by 0.5%MoM bringing annual PPI down to 2.1% against revised 2.7%YoY in April. This was well below market consensus and our forecast. As one could have expected after CPI data release, deceleration of producer prices growth rate was mainly a consequence of falling fuel prices (fall of prices by 8.5%MoM in this sector). This supply factor pushed temporary PPI inflation upward in 1Q03, and it is dragging it down presently. Also, the fact that PPI grows at faster pace than CPI stems from low base effect and not from underlying inflationary pressure which could translate into higher growth of consumer prices in future. All in all, CPI and PPI figures confirmed that there is no threat of sharp inflation acceleration in the Polish economy at the moment. However, what should be important from monetary policy perspective is not the current level of PPI or CPI, but inflation outlook in the longer run. This in turn will depend on developments in the real sphere of the economy, which is expected to accelerate.

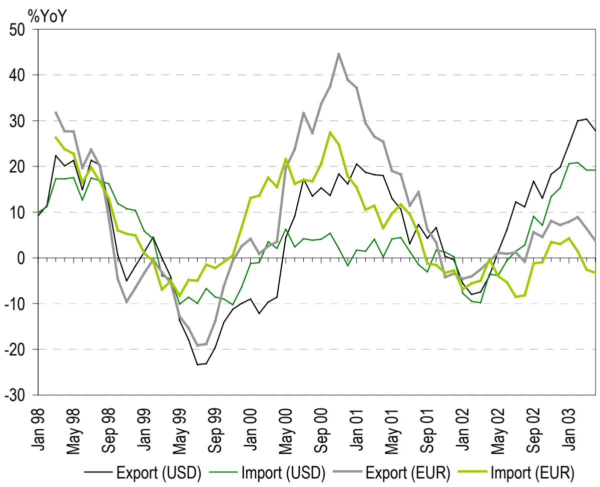
Only one out of five measures of core inflation recorded a drop in May – CPI excluding the most volatile prices, which fell from 0% to -0.1%YoY. The remaining measures remained stable or increased, however still having very low levels, which confirms there is no threat for short-term inflation perspectives. Growth rate of three indices was below zero, and the highest core measure "net inflation" (excluding food and fuels) grew by 1.2%YoY, at the same pace as in April but still well below the lower end of this year's inflation target (2-4%). Although such results still show that inflation outlook remains optimistic, the fact that most of core inflation measures are not falling any more should limit expectations for further interest rate cuts in future.

We expect an acceleration of consumer price growth from 0.4%YoY in May to 0.8%YoY (or even 0.9%YoY) in June – mostly due to much lower drop of food prices (-0.2%MoM) than recorded last year. Still, inflation perspectives for the rest of this year look quite optimistic and in December CPI growth should amount to ca. 1.5%YoY.

Exports keep growing, C/A deficit keeps shrinking

We still see positive from Polish foreign trade. In May current account deficit amounted to €327m, and in relation to GDP 12-month cumulative C/A deficit dropped to 2.8% from 2.9% after April. Fall of C/A deficit in comparison to the corresponding period of last year stemmed from lower trade gap and higher surpluses on transfer account and unclassified flows balance. On the other hand, May saw higher than expected and higher than last year deficit on the income account.

Foreign trade turnover (3-month moving average)

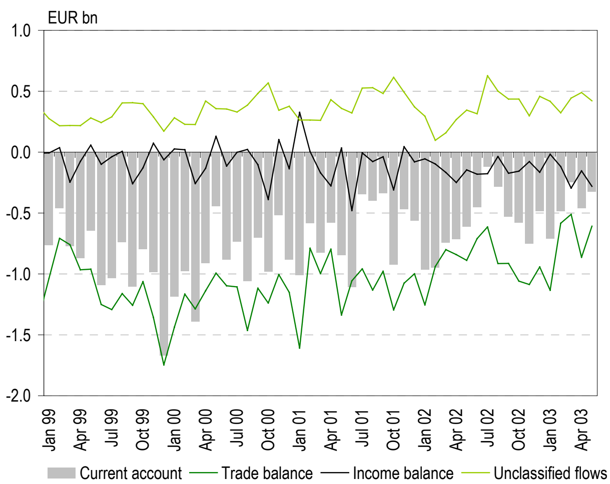


Source: NBP, BZ WBK

Trade gap reached €608m, down from €864m in the previous month and €889m in April last year. The decrease of trade gap mainly resulted from continuously strong exports. Its annual dynamics (in euro terms) accelerated to 8.0% from -2.3%YoY in the previous month. Thus, as we wrote previously, downturn of export growth rate in April was one-off phenomenon related to high base effect. Due to a considerable appreciation of the euro against the dollar, growth rate of exports expressed in US dollars was substantially higher, reaching as much as 36.3%YoY. Import dynamics in May was negative again (it amounted to -1.5%YoY against -1.2%YoY in April). This may suggest that economic recovery is driven to a large extent by net exports while domestic demand, although gradually accelerating, is still relatively weak. We expect that subsequent months will bring continuation of robust export performance and finally a pickup in import. In the last quarter of this year import dynamics should be already higher than those of exports, reflecting stronger and stronger improvement in domestic demand.

Unclassified flows' surplus in May reached €421m in May versus €489m in April and €345m in May 2002. This also shows that unofficial export is expanding, which improves the overall C/A figure. On the other hand, the current account of the balance of payments was negatively affected by higher than expected deficit on the income account. It reached €281m against €146m in the analogous period of last year. This was surprisingly weak result as there were no information about significant foreign debt interest payments in May. Perhaps this was related to earlier than usual transfers of annual profits to foreign investors from their operations in Poland.

Balance of payments, selected components



Source: NBP

There were no spectacular developments on the financial account of the balance of payments. FDI inflows remained at low level reaching only €139m in May against €286m in the same period of 2002. After two months of portfolio capital outflows May saw €385m inflow. These figures show that deficit on the current account in financed to a growing extent by short-term capital.

Deteriorating budget performance in May

After five months of this year budget deficit reached PLN23.2bn i.e. 60.0% of the whole year plan. Revenues amounted to PLN56.7bn or 36.4% of the plan. This was a consequence of lower tax revenues, both from income taxes and indirect taxes. PIT revenues in May were 7.8%YoY lower and in January-May period and their cumulative growth rate declined to 8.5%YoY from 12.1%YoY after April. According to finance ministry officials this was related to higher returns of excess tax payments. The highest annual fall was recorded in CIT revenues (-23.2%YoY in May). After five months of this year CIT revenues were 10.1%YoY lower than in the corresponding period of 2002 (in January-April period of this year the fall stood at 8.4%YoY and the annual plan is -4%). CIT revenues are hit by reduction of CIT rate by one percentage point to 27%. According to deputy finance minister Halina Wasilewska-Trenkner corporate tax inflows confirm the ongoing economic recovery and their low increase is caused by the fact that the companies allow for losses made in previous years, while their present earnings keep growing. Unfortunately, revenues from indirect taxes were also weak, falling by 1.2%YoY in May. In January-May period their growth rate diminished to 6.8%YoY from 8.9%YoY after April (the annual plan is 7.5%).

In line with expectations, spending remained in check in May. Total expenditures after May reached PLN79.9bn or 41.1% of the plan. Similarly to previous months the highest growth was observed in subsidies to the Labour Fund and to the Social Security Fund. Of course, the costs of servicing the public debt are much lower than assumed in the budget, amid much lower interest rates environment. The finance ministry's figures showed that budget deficit continued to be financed by increased issuance of treasury bonds and treasury bills (it exceeded 74.5% and 195.0% of the whole year plan, respectively) while privatisation revenues stood at only 15.8% of the plan (PLN1.17bn) in January-May period.

Central bank watch

- **Interest rates cut for the sixth time in a row**
- **...and we expect a holiday break**
- **Who (and when) will replace Janusz Krzyżewski?**
- **"Dovish faction" pushed for deeper cuts in 1Q03**

Just can't get enough

In June the Polish Monetary Policy Council cut all main interest rates for the sixth consecutive time this year by 25bps, reducing the reference rate to 5.25%, the lombard rate to 6.75% and the deposit rate to 3.75%. It was the 20th rate cut since the beginning of this monetary easing cycle, initiated in February 2001.

The MPC's official statement issued after the meeting and comments gave by NBP president Leszek Balcerowicz during press conference clearly showed that the main argument behind another interest rate reduction was still very positive inflation outlook. The MPC listed a group of factors reinforcing persistently low inflation in Poland and limiting inflation growth in future, including among others low core inflation, very low growth of wages, low dynamics of broad money and limited demand for loans in the banking sector, still low inflation expectations of households. At the same time the MPC recognised a number of factors limiting the scope for monetary easing, which included significant reinforcement of symptoms of economic recovery in Poland and an existence of potential sources of inflationary pressure (high uncertainty regarding fiscal policy, high growth of cash in circulation, risk of oil price hike). However, they were clearly not strong enough to counterbalance the optimistic inflation forecasts of the central bank. Especially, that the MPC included also another group of factors, which influenced the decision: recent developments affecting the zloty exchange rate in the medium term. What is interesting, Leszek Balcerowicz's comment during press conference strongly suggested that the latter was an important point in MPC's considerations last month. Despite two of those factors were unfavourable for the zloty (reduced outlook for Poland's rating by S&P's and turmoil on the Hungarian market), clearly the MPC was concerned about growing appreciation pressure on the zloty. Balcerowicz particularly emphasised the importance of successful accession referendum, being a critical step on the road towards EU accession and stressed that the MPC decision accounted for this factor in June.

One thing seems to be clear after June's meeting of the MPC – we will not see another interest rate reduction in July. The Council will hold its meeting on 17-18 July, i.e. before the release of most of the economic figures for June, which means that set of information available for the MPC will not differ much from what they knew in June. And – what is important – Leszek Balcerowicz nearly declared no rate cut in July in open text, reiterating at the very end of the press conference (without being asked) that the next MPC meeting would be held earlier than usually and there would be much less information available. However, it seems also clear that the cycle of interest rate reductions has not finished yet. Albeit even "dovish" MPC members are starting to talk that it is coming to an end, admitting that the central bank should consider holding back monetary easing policy amid strengthening symptoms of economic revival. Given the central bank's very optimistic inflation predictions we think that another 25bps rate cut might take place after summer holidays. And the subsequent decisions would probably depend on the government's actions regarding fiscal policy. In June the MPC focused lots of attention on the fiscal perspectives. Central bankers urged the government to cut budget spending rather than focusing on the revenue side and warned against severe consequences of high budget deficit not only for inflation but also for growth prospects. In fact this was nothing new, as the MPC's very critical stance concerning situation in public finance has been well known, which in practice does not seem to be a real problem in continuing a monetary easing process (example was given in June). However, it should be noted that interest rates have came down very substantially in recent quarters and taking into account that annual CPI growth could accelerate to 2-2.5% in course of the next 4-5 quarters, the scope for further rate cuts gets indeed much smaller. We would expect to see additional rate cuts, moving the reference rate below 5% this year only in a scenario when the budget draft for 2004 and a package of fiscal solutions include some steps towards constraining fiscal imbalance in the medium term by a reduction of public finance spending. Well, we think such changes are not very likely.

Who will replace Janusz Krzyżewski?

At the beginning of July, MPC member Janusz Krzyżewski died in a car crash. He was one out of three members appointed by the Lower House (together with Marek Dąbrowski and Jerzy Pruski). Now, according to the central bank charter, Sejm would have three months time for the election of a new member on the vacant place. The chosen person would stay in the office until the end of term of the original member (in this case – January 2004), however according to the NBP bill she/he could be re-elected for the next full six-years term if the replacement was not longer than three years (which would be the case).

The election of new MPC member would be important for the financial market. However, a potential impact on interest rate decisions this year would not be significant, as Krzyżewski was one of the doves and a new person would probably vote in a similar manner. A more important issue is that the election of new candidate for the MPC could shed more light on the shape of new Council that would emerge at the beginning of 2004. Media started to guess the possible candidate for the post in the MPC. According to senior SLD politicians quoted by PAP, Grzegorz Kołodko was a seriously considered nominee. We tend to believe he is rather unlikely to be appointed for the MPC member, mainly for two reasons. One is that he quit Leszek Miller's cabinet in the atmosphere that was quite distant from a friendship. Rumours say that he disappointed many politicians during his term of office as a finance minister (mainly those who hoped he would deliver fast and painless boost to the economy), and until the end of his mandate he earned many enemies, even within the SLD. Therefore he would not necessarily have a high support within the ruling party. Second issue is that Kołodko could be not interested with such proposal. Taking into account that it could be only a three-months job without a guarantee for the re-election (if deputies get disappointed again, they would choose someone else for the full term starting in January) he might not be willing to take a risk. In our opinion among more likely candidates for the MPC are Andrzej Sopoćko and Witold Koziński. Both are professors of economy at Warsaw University. Sopoćko is a former economic advisor to PM Leszek Miller and ex-deputy finance minister in Grzegorz Kołodko's ministry (he quit several days ago). Koziński was a deputy governor of the NBP responsible for monetary policy in late 1990s and now acts as a president of Bank Gospodarstwa Krajowego (BGK).

Anyway, until the appointment of new MPC member any interest rate cuts seem a bit less likely. In July we foresaw no rate cut anyway (signalled by president Leszek Balcerowicz), but the outcome of August MPC meeting might depend on whether a new candidate would join the Council until then. As we wrote above, the deadline for the Lower House to find a replacement is three months, but we guess the MPs would like to do it as soon as possible not to delay a potential monetary easing. According to Sejm speaker Marek Borowski, the Lower House could vote over the appointment of new MPC member not earlier than at the end of August, after a holiday break in the parliament. Therefore, it seems that only nine members of the Monetary Policy Council would decide about interest rates in August. In such case it seems a bit more likely that a rate cut decision would be postponed by one month, as the hawks' caucus would have the majority (5:4). However, one also cannot rule out a scenario when one or two of the usual hawks would support another monetary easing, being aware that the decision is to large extent justified by low inflationary pressure and the sooner it would be implemented the better (past record showed that Grabowski and Pruski used to vote for small interest rate cuts earlier this year). There is also another option possible: the Sejm's session starts on 27th August, so if the new MPC member would be appointed in the very first day and the Council meeting would be scheduled for 28-29 August (Thursday-Friday), then a new person could take part in decision making already in August.

MPC doves pushed for deeper rate cuts in 1Q03

According to MPC's *Inflation report* for 1Q03, the "dovish" faction within MPC sought after deeper interest rate cuts during two MPC meetings held on January and February. In January four members have supported the motion of 50bps interest rate reduction: Janusz Krzyżewski, Dariusz Rosati, Grzegorz Wójtowicz and Wiesława Ziółkowska. Meanwhile, in February only two of them (Rosati and Wójtowicz) voted for the cut of reference rate by 50bps and lombard rate by 100bps, while Krzyżewski was against such move and Mrs. Ziółkowska was absent. Clearly at the beginning of this year a part of the MPC consequently claimed that monetary policy could have been relaxed more sharply. And although already in March a motion of deeper than 25bps has not been submitted, it seems justified to believe that this "dovish" faction would still opt for quite substantial interest rate reduction (Wiesława Ziółkowska mentioned additional 100bps recently). Nevertheless we maintain our view on interest rate cut scenario this year. Especially, that the MPC would like to cut reserve requirement ratio later this year, which would also create an impulse relaxing monetary conditions. Bogusław Grabowski admitted that this issue is being discussed within the MPC, adding also that it is rather unlikely that it would be delivered already in July.

Comments of the MPC members and central bank representatives

Last month, many central bankers' statements concerned public finance stance (however, words were not followed by actions and a concern with effects of current fiscal policy was not reflected in the MPC decision in June). Budget assumptions triggered very sceptical reaction of MPC members. NBP governor Leszek Balcerowicz decisively protested against including revenues from NBP revaluation provisions to budget revenues. This confirms an opinion that there is a constrained scope for a compromise on that issue. Most likely, the NBP will decide to lend a part of FX reserves to the government for a repayment of foreign debt. MPC members were not enthusiastic about the change on the finance minister post either. Their comments suggested that they are mostly afraid of lesser fiscal discipline after economy minister Jerzy Hausner took over responsibility for co-ordination of the government's economic policy. Balcerowicz said that if the government would not reduce budget deficit it would be anti-growth action. Bogusław Grabowski from the MPC stressed that uncertainty regarding fiscal policy makes conducting monetary policy much more difficult. He is afraid of continuing monetary easing cycle in such a situation. He pointed out that monetary policy could be relaxed not only through interest rates cuts but also by lowering of reserve requirements.

MPC member Dariusz Rosati seemed to be much less concerned about risks from the fiscal policy side. In his opinion temporary increase in budget deficit could be accepted if it was accompanied by a credible plan of fiscal reform (including spending cuts) in the following years. Also, Rosati agreed with IMF suggestion that there is a room for additional monetary easing in Poland saying that the proposal is "very important" and he will surely take it into consideration. Well, it is to be seen whether the so-called "hawkish faction" will take it into account as well.

Recently MPC members very often expressed their concerns related to possible date of Poland's EMU entry. The official statement, saying that 2007 is the best date for euro adoption, is still maintained. However, it seems there is no doubt that it would be practically impossible because of very high budget deficit and a lack of political will to decrease it. Grzegorz Wójtowicz said that until recently he regarded 2008 as the most likely date, but latest developments in fiscal policy area increase a risk of delay. Wójtowicz's comment is consistent not only with our view but also with market consensus on the issue. In the newest PAP poll most of market analysts indicated 2009 as the most probably date of introducing the euro in Poland. Undoubtedly, there is a risk of even further delay, but as MPC member Grabowski rightly stated "telling about another concrete date before getting acquainted with public finance reform, that the government should prepare for spending side, […] is nothing but day-dreaming".

WHO. WHEN. WHERE	COMMENT
Leszek Balcerowicz, NBP governor; Financial Times, 26 Jun	It is the responsibility of the EU to worn accession countries [against high public finance deficit]. Economists who argue that deficits are acceptable in the short term to promote growth are wrong. In situation when local forces are so populists [like in Poland] we need more external advice. […] I think the European Commission and the ECB speak too little on the need for fiscal consolidation in the context of stability and growth in accession countries.
PAP, 25 Jun	The decision followed an analysis of four groups of factors attesting to a lasting low inflation, we have a visible fall of industrial production prices and stronger pay discipline in our economy, which proves stronger competitiveness. Repeated signs of economic revival are the limitation for reducing interest rate cuts. They signal demand revival. Significant uncertainty relates to a shape of fiscal policy in 2004 and 2005. Not reducing deficit from present level would be anti-development factor. I hope, that we will have to do with proposals and activities that will create a prospect of permanent limiting of spending as a result of reforms, as it is a key for acceleration in economy. If clear prospects of healing public finances are missing then it could not be excluded that a risk premium in bond yields would increase and, as a result, foreign debt servicing cost would increase. It would confirm a rise in long-term interest rates. I remind that in July MPC meeting will be held earlier, on 17 and 18 and there will be mush less information. I can't rule out inflation growth higher than 2.5% this year. This will depend on the scale of structural reforms that are to improve the state of public finances and firms. We do not anticipate consent to money printing. However, we have suggested recently other subject of discussions that could concern an aid in reducing foreign debt but a form and scale of this operation must be of the size that would not create a threat for price stability in our economy.
PAP, 18 Jun	I hope for good co-operation [with minister Raczko], which would respect the independence of Polish central bank.
PAP, 10 Jun	I see no relationship [between monetary policy and introducing flat rate tax]. The monetary policy must exercise its tasks, and as it is known the most important one is to give people stable prices, that has been done and it has to be maintained.
PAP, 6 Jun	Taking into account current conditions and two-year period within ERM2, the earliest possible date of Eurozone entry is 2007. […] At the moment, the European institutions' stance is not clear. From the point of view of current and future members and growth perspectives, a change or relaxation of fiscal criteria would be negative.
PAP, 5 Jun	The strategy of floating FX regime for the next few years was published and is still binding. We should be prepared for serious discussion next year, if we want to join the Eurozone in 2007. […] We should prepare different strategies and dates in the following months. The impact of the weakening of the forint on the zloty will be short-lived as the situation boils down to differences in the FX system with the Polish floating rate system enabling to avoid the complications that appeared in Hungary.
Bogusław Grabowski, MPC member; TVN24, 30 Jun	With 10% growth in industrial output, 10% growth in retail sales and 8% growth in exports it is absurd to talk about significant interest rate cut. [about a meeting with Mr. Hausner] We will present opinion on macroeconomic situation, we will tell about bad results of increasing the deficit and again we will tell why we will not release revaluation provisions.
PAP, 30 Jun	[the Eurozone] 2007 is absolutely unrealistic date but telling about another concrete date before getting acquainted with public finance reform, that the government should prepare for spending side, […] is nothing but day-dreaming.
PAP, 27 Jun	Lowering reserve requirements in a full range presently would lead to monetary easing. And one has to remember all interest rates cut made to date. If we reduced reserve requirements from 4.5% to 2%, we would inject the banking sector with around PLN8bn and that is 10% of monetary base. The MPC has already reduced reserve requirements twice: the first time from average level of 12% to 5% and late on to 4.5%. However, both of theses decision did not affected liquidity of the banking sector because the first one depended on purchase of NBP bonds by banks, which absorbed increased liquidity, while the second one, from 5% to 4.5%, was a substitute of excluding cash from reserve requirements calculation. There is possibility that we will discuss it [reduction of reserve requirements] at July's meeting.
PAP, 25 Jun	We do not know what will happen with public finance in 2004, what will be the deficit, what will be the scale of spending, whether there will be public finance reform. In such uncertainty we have to make a decision, which will influence developments in the economy next year. The economy is slightly accelerating, we have growing dynamics of industrial production, almost 10% growth rate of retail sales. We see some signs of rebound in investment activity. [...] However, one should remember that the accelerating economy, after gaining momentum, may come across too low level of interest rates and then we could have the same problem as recently was observed in Hungary when interest rates were significantly lowered but after three months they had to be rapidly increased. We would like interest rates to be at low level but in a stable, predictable way. Only if interest rates are low for a long period of time they are supportive for investment. [About government's decisions regarding PIT] These are not real changes in PIT. This is only a touch-up but it increases effective tax burden, particularly for the richest.

PAP, 18 Jun	I have concerns on how the fiscal policy in 2004 would look like; therefore monetary policy should be particularly cautious at the moment. If we see that we act in uncertain conditions, then the rule of vigilance should predominate. In such situation it is better to conduct cautious monetary policy, which does not assume deficit reduction, rather than to make such assumption which will not be fulfilled impacting inflation developments. The rule of caution should be applied in Poland because we are approaching the end of disinflation process. Letting inflation out of control would cost us too much. Neither former nor present finance minister talked about public finance reform based on reduction of budget spending. It is hard to say how the deficit in 2004 will look like, because approved assumptions are too optimistic. I do not know how foreign investors will accept such huge deficit and whether they would still like to finance it.
PAP, 13 June	The result of the confidence vote shows the opposition has no majority to change the government. Financial markets are in the uncertainty mood again and I doubt this might change in the near future, as there is no believe that necessary reforms would be accepted. Market will analyse minister Hausner's policy and statements and will react to such news.
Radio PIN, 11 June	All the economic picture implemented in the budget has little to do with what is going to happen in the reality. However, the worse thing is that it would be accompanied with rapid loosening in fiscal policy.
Reuters, 9 June	The Prime Minister says that economic policy will co-ordinated by the minister who does not care for public finance reform and lowering public finance deficit though he presents the program of supply changes. […] From the point of view of Polish economy, implementing this strategy will delay EMU accession, which is bad for Polish economy in long-term perspective.
ISB, 6 Jun	We can only dream of euro in 2007. [...] This means that fast convergence on markets in the whole region, strengthening local currencies is excessive. In my opinion, which is shared by most of the MPC members, when deciding about central parity [of the zloty against euro in ERM2 system] one would have to consider market exchange rate from the recent period.
Reuters, 4 Jun	Short-term volatility on the zloty, even on a large scale, is not a reason to worry or to adjust monetary policy - either through interest rates or foreign exchange interventions. But if political instability leads to a serious threat of irresponsible policies, high public finance deficit and markets would see it and react with long-term zloty depreciation, monetary policy will have to react to the depreciation and high deficit with higher rates. Market reaction after the referendum would reflect expectations of how responsibly the government will tackle public finance reform ahead of Poland's EU accession next year and euro adoption later this decade. Any longer term zloty weakness will show that financial markets expect political jitters to lead to a situation where macroeconomic policy is going to be irresponsible in the longer term.
Cezary Józefiak, MPC member; PAP, 11 June	[Finance minister's resignation] means that political turmoil continues and there is no clear conception of economic policy, while it is much needed at the moment […] I cannot exclude a possibility of zloty weakening. The market will be very careful, but rather with depreciation tendencies. Although after the referendum the trend should be positive, the market is nervous, especially as we do not know yet what is the economic policy of the cabinet. This budget draft is unacceptable, as there is no spending decrease and we see a idea of money printing. This is not consistent with the EU standards. I do not understand what does it mean if we have the government's acceptance for the programme, and its author is leaving the cabinet.
Janusz Krzyżewski, MPC member; PAP, 25 Jun	I think that one should not expect inflation threats in form of a sharp rise due to the erosion of the market by very high unemployment. Statements by my superior [NBP governor] suggest that we are standing by some kind of a wall, but I am more optimistic that something good is still ahead of us. There will be pleasant developments on the market. It is a fact that we have to start thinking about slowing down the tendency of monetary policy relaxation, and that we are beginning to have signs of growth. […] However, announcement of possible growth of public debt, vagueness in the fiscal policy may be a sign of unpleasant directions, which will have to be taken. Personally, I think there will be no causes for inflation to grow, apart from one - I am concerned whether the exchange rate will manage to cope with the situation.
PAP, 17 Jun	It would be difficult to go on with the trend [of interest rate cuts] every month. Majority [of MPC members] would have reservations about such extravagancies. Not every month such a step is possible. […] We must consider whether our steps are still necessary of not. We have to adjust our current instruments to the EU. Each one of us has own idea of the interest rates level at the end of our term. We would have to work it out together with a path of approaching optimal level of interest rates. Obviously, very cautious monetary policy, pursued in a way that prevents foreign currency crisis and market panic, has contributed to boosting credit action which in turn boosted production. Economic growth [in 2Q03] will be higher. We have exports growing, recently also imports kicked off. Import requires a credit, which is confirmed by industrial output figures.
Jerzy Pruski, MPC member; PAP, 25 Jun	The effects of high fiscal deficit will postpone a possibility of joining the Eurozone. Monetary criteria are fulfilled now and fiscal criteria are to be fulfilled. At the end of 2003 inflation should be within this year's brackets, most likely closer to the lower bracket, or some 2%. […] So far we cannot see a background for 5% GDP growth rate. We can talk about the growth of 4%.
Dariusz Rosati, MPC member; Reuters, 30 Jun	Without fiscal reforms adopting euro in 2008 or 2009 is unrealistic. A credibility of reforms should be proved with reduction of the deficit.
PAP, 27 Jun	The annual inflation indicator in June will slightly go up but it will not exceed 0.6 percent. Inflation is exceptionally favourable. So far results are good. There is no threat to inflation, which is confirmed by food prices. It is possible that at the end of the year inflation will be below 2 percent.
Radio Zet, 20 Jun	I can imagine temporary increase of budget deficit in 2004 because it is unusual, extraordinary year, but only under condition that the government presents a credible programme of public finance reform, including basically reform of the spending side. This would allow convincing the financial market and the NBP that this increase in the deficit is indeed short-term and would not cause unwinding a spiral of government spending. Deputy PM Hausner already mentioned that in his opinion one should not be afraid of higher deficit if it allows for growth acceleration. We are afraid of such thinking about budget deficit as a phenomenon that bears no negative effects. [...] If we made no changes at all, even those proposed by minister Kołodko, and maintained spending growing at the same pace as now, then in 2004 budget deficit would reach ca. PLN60-62bn and it would increase in the subsequent years. In one or two years we would breach the limits of public debt imposed by the law. That's what everyone wants to avoid. Every well-educated economist will tell that a flat tax rate is a good solution from the economic point of view, because it encourages for work and does not scrap the incentives and motivation. It also boosts savings in the economy, which is important because it allows reducing interest rates. I would opt for considering flat tax rate as soon as possible, however one has to be realistic. Perhaps it turns out that next year's budget deficit would grow to the size unbearable for the economy. But it is the issue to calculate. [IMF's warning against excessive caution in assessment of inflationary pressure] Yes, it is a critical remark, which I am going to take into consideration. But I would also recommend it to my colleagues from the MPC.

Gazeta Wyborcza, 17 Jun	The cause of chronic budget imbalances is spending side and none of the ministers paid enough attention to it, treating it as a hot potato. We need to change the way of thinking about social policy by socialdemocrats. Differentiating of tax rates should not necessarily be the best social policy. [...] It is better to conduct social policy on the spending side – to achieve similar scale of money redistribution.
Reuters, 10 June	[about budget assumptions] Economic growth forecast is optimistic. Inflation is optimistic, budget deficit very optimistic and one must see if it is consistent. […] High growth rate requires similarly high growth in investment. If nobody says about removal of barriers for investment than there are doubts if it will be made real. If it is than the question appears if inflation will accelerate.
PAP, 9 June	The introduction of a flat tax can be surely considered, this is surely a pro-development move that is worth being considered by the government.
Gazeta Wyborcza, 6 Jun	[about using revaluation provision] I can imagine that the idea of printing PLN9-10bn could be accepted with new Prime Minister and new MPC members. The government would show that the deficit was lowered artificially. If the MPC thought that the amount of money on the market is too small, the MPC would cut rates and would increase the supply. I think that it was possible –we have different opinion within the Council in this respect. [about Eurozone entry] 2008 is realistic under the condition that we have +/-15% band and that medium-term public finance reform is realised. We have to lower budget deficit to 3% of GDP in 2006 and then the EU could assess it in April-May 2007. After the positive assessment we could enter the Eurozone in 2008.
PAP, 3 Jun	We still estimate that year-end inflation will be between 1-1.5% and there is a huge margin here. [about increase in wheat prices] This impact will not be significant, since a share of cereals in total CPI basket is relatively little. Moreover, everything suggests that this rise is not permanent, I mean either it will reverse or it will disappear, so the influence will be once-off. We have expected increase in inflation in May or June. We are not worried with it. In May inflation will probably at 0.6-0.7%. […] I believe that this episode with cereal prices is not a result of any catastrophe or permanent trends. This is small, one off factor, without permanent impact on inflation. Even if bread and other cereal products' prices increase by 10-15%, overall price index may increase by 0.2-0.6 pp, but this should be closer to 0.2pp. I think that CPI inflation may increase in June amid very low statistical base of June 2002 (deflation). We do not know much about fruits and vegetables' prices in June, and they will be the most important for June CPI. […] This would around 0.8-0.9% and then we'll see a stabilisation in summer and a moderate increase in autumn. Next year, we can see different scenarios. Crops may be worse, especially as we had two years of excellent harvest. All forecasts suggest that the situation may be worse in comparison with previous years, but still better than long-term average. […] We will witness convergence play after the EU accession. After the period of zloty weakening against the euro, we should see a stabilisation of exchange rate in 2H03 and a return to appreciation trend. We expect CPI inflation to increase to 2.0-2.5% in 2004.
Grzegorz Wójtowicz, MPC member; PAP, 30 Jun	We have a record again, imbalance for the past 12 months is lower and the deficit fell to 2.8% of GDP from 2.9% of GDP a month ago. It seems that the deficit will be below 3.5% at the end of the year. There are no surprises in the data, but it is visible that export sector performs well despite bad world's business climate. […] We have economic revival mainly owing to export sectors. Also at import side it is visible that the economy revives and GDP growth in 2Q03 will be higher than in 1Q03 is highly probable.
PAP, 26 Jun	I expect a slight rise in food prices which will cause an insignificant inflation rebound to 0.6% from 0.4% in May. So far I was 20% convinced that it will be 2007, 50% that we will join the Eurozone in 2008 and 30% that it will be 2009. The earliest possible date is 2008 and the likelihood that it will be later increases. […] Taking into account the state of public finances, no delay is recommended.
PAP, 9 June	[about flat tax rate] As economist, I support such idea, but on the other hand I live here and now and I wonder is it realistic. Politicians must decide. Monetary policy cannot be linked with some elements of fiscal policy e.g. with taxes or with situation abroad, as it concerns the economy as a whole. That is why there is no direct link between one solution in terms of taxes and monetary policy.
Gazeta Wyborcza, 5 Jun	What happened in Hungary can influence the zloty but only in a short-term. The situation in there is a little different than in Poland as managed rate is implemented, so the parity could be changed. In Poland it is impossible, since the rate is determined by the market and no by administrative decisions.
Reuters, 4 Jun	Financial markets in Poland and Hungary are correlated. Even if today's decision [forint devaluation] brought the uncertainty, this would be rather short-lived. Hungarian authorities' decision showed how difficult is to maintain stable exchange rate if the economy is open, as the Polish or Hungarian economies. I would not perceive this decision in competitiveness categories. This is not a classic devaluation, this is rather technical decision, while the market rate will be still important. Managed exchange rate regime is a bit artificial assuming free movement of capital, but on the other hand Hungarians know that that all new EU members will have to go through ERM2 system.
Rzeczpospolita, 3 Jun	It is difficult to assess the impact of the world economy on the Polish economy, but I would not treat possible import prices' decrease as a threat. [...] Talking about deflation risk is much more too early. […] Deflation movements, similar to those observed last year, when we had four months of falling food prices, are possible. […] Despite low food prices, other important elements of demand are showing rising tendencies. […] World experience with deflation and conclusions from this experience would cause that one can avoid this.
Wiesława Ziółkowska, MPC member; PAP, 17 Jun	One may expect that GDP growth in 2Q03 will be slightly higher than in 1Q03 and will amount to some 2.5%. [upward trend in output] It is maintained, which should be perceived very positively especially given the fact that the environment, mainly in Germany, was not favourable. The [production] data will surely have influence on the monetary policy, but it will depend on an option, which is represented by particular member of the MPC.
PAP, 11 June	Minister Hausner is undoubtedly well educated, competent economist. But he will be assessed based on his budget draft and his economic programme. I believe that we will see one coherent economic plan and that this uncertainty among entrepreneurs, citizens, investors, would disappear. I do not know well Mr Raczko, but I think it is possible he would co-operate well with minister Hausner.
PAP, 6 Jun	The cut of interest rates this year by at least 100 base points will pose no threat to the implementation of the inflation target in 2004. Making decisions the RPP is guided by the likelihood of achieving the target. In May inflation will rise to 0.6-0.7% and at the end of the year it may be between 0.6-1.2%. Inflation is more likely to be closer to the level of 0.6% than to the level of 1.2%. Crude oil prices pose no threat but drought impact on food prices remains unknown. Only drastic surge of food prices caused by draught could push inflation up to 1.2% at the end of this year.

Government and politics

- **Prime Minister strikes back**
- **...resulting in a change of economic policy**
- **Fiscal expansion unavoidable**

Prime Minister declares boosting economic growth

A consequence of Prime Minister's counter-strike and winning of a confidence vote, which we described last month, was Leszek Miller's re-election for a leader of the SLD. During the party's convention he said that the government's top priority must be to boost domestic demand (both private consumption and investments), and that the best and the fastest ways to achieve it is lowering tax burden. He also recalled the idea of flat rate tax and suggested it might be introduced in Poland in 2005 (if estimates and analysis show it would be beneficial for GDP growth and unemployment). Miller suggested also that a problem of fiscal imbalances is not on the top of government's list, saying that although public finance reform was necessary, it would be possible only amid sharp acceleration of economic growth. PM declared a will to co-operate with the MPC and the NBP, at the same time calling the central bank to cut interest rates more decisively.

More detailed economic plans of the government were presented by deputy PM, economy and labour minister Jerzy Hausner. The Ministry of Economy prepared a special package of solutions aimed at stimulating supply side of the economy. The "Plan of pro-growth measures for 2003-2004", which was accepted by the government, consists of a number of legal changes substantially eliminating impediments for entrepreneurship and facilitating running business in Poland, mostly by reduction of bureaucracy. Of course such measures are desirable and should support medium- and long-term growth prospects. However, they can by no means be a substitute for a reform of the public finance. And in the area of fiscal policy we do not expect to see any revelations – it seems quite likely that the course adopted by the government might drive Poland aside from the path of quick euro adoption, as the government prefers to boost growth first. Let's hope it would not be too late.

To save the economy without public finance reform

Jerzy Hausner confirmed declarations of PM Leszek Miller, stressing that the government would give high priority to economic growth, suggesting that a reform of public finances would be less important. Hausner said that he was going to increase budget deficit "temporarily" in the next two years due to costs of the EU accession. Later on, in 2006 and 2007 the deficit should be reduced in order to meet Maastricht criteria in 2007. Such way of public finance management would enable, in his opinion, joining the Eurozone in 2008 or 2009. Hausner said he wanted to introduce flat rate tax (but only if trade unions accept such solution), accelerate privatisation (he announced the government will decide on Gdańska refinery and steel group PHS privatisation projects) and rationalise social spending. Economy and labour minister aims at achieving 5% GDP growth in 2004 and stabilisation of the economic growth at this high level in the following years.

In our view Hausner's plans earned a critical review. There are no reasons to believe that the growth in the budget deficit in the years 2004-05 will only be "temporary" in nature what the government wishes for. Quite contrary, the main reasons for their increase suggested by Mr. Hausner – the costs related to EU accession – would remain, and in fact would be even higher in the following years. Once increased, such high fiscal imbalances would be impossible to reduce without deep reform of the spending side of public finance, while it shows clearly that the government lacks determination to carry out necessary reforms in course of the next two years. Hausner's opinion that higher budget deficits in 2004-05 might still allow for Eurozone entry in 2007-08 seems completely implausible. We have argued many times in the past that 2007 would be the earliest possible date of euro adoption only if fiscal imbalances would be reduced below 3% of GDP in 2005. Meanwhile, government's strategy implies that we will end up 2005 with fiscal deficit well above 6% of GDP. Even if fiscal tightening would start right in the following year, the date of EMU entry seems to be moving away at least until 2009.

Budget 2004 – still a great unknown

The first few meetings of the government with new finance minister Andrzej Raczko and new deputy PM Jerzy Hausner did not bring new details as regards main assumptions of the next year budget, although the government accepted a few budget accompanying bills. It was officially confirmed that CIT rate would fall next year to 19% from 27% in 2003. Of course this is positive news from the point of view of GDP growth perspective, as it might bring additional fixed investments in the economy. However, one should remember that a lot of SME pay taxes according to PIT scheme and some of them use other simplified taxation rules, which remained unchanged (although changes in this regard are planned for 2005). Three existing tax rates remained unchanged at 19%, 30% and 40%, however the tax-free income was raised by ca. 13.5%, as the government declared it wanted to lower tax burden for the poorest. According to finance minister Andrzej Raczko, this change should leave ca. PLN1.5bn income "in taxpayers' pockets" in 2004, which would help in stimulating domestic demand. The cabinet also decided to cancel some of the existing tax write-offs and allowances, increasing budget revenues next year by PLN320m. Additionally, capital gains from the stock exchange would be a subject to flat 19% tax since 2004. Deputy PM Jerzy Hausner declared that broader changes of tax system could take place in 2005, and the government's full proposal would be known in September.

One should expect that budget assumptions for 2004 would be a subject of further discussion and changes. However, we have to wait the end of July, as the government plans to accept it on 29th July (unless "an unexpected delay" takes place again). Changes would especially concern revaluation provisions, which were treated as budgetary revenues by Grzegorz Kołodko. Of course, budget deficit would be higher as a result.

Meeting between deputy PM Jerzy Hausner, finance minister Andrzej Raczko and NBP governor Leszek Balcerowicz did not bring any decisions. However, it apparently brought about a visible change in government's stance as regards a use of revaluation provision and co-operation with the central bank in general. In a short communiqué published after the meeting there was only information that talks were devoted to the issue of using a part of the FX reserves for earlier repayment of a part of foreign debt. It was agreed that possible solutions of this issue will be analysed and the discussion will be continued. Finance minister said after the meeting that budget assumptions for next year will be most likely changed and they will be based on an agreement with the central bank regarding use of the FX reserves. He was quite optimistic as regards the agreement saying, "the way of thinking of both sides is convergent." What is important, Raczko did not talk about revaluation provisions at all, calling it a "secondary" issue. What is more, deputy PM Jerzy Hausner explicitly backed off from the idea of using revaluation provision in the budget, saying in public TV interview that he believes it is impossible to get this money, as the idea has no legal foundation and the NBP would not agree. Surely the NBP president must have been very convincing during the meeting.

We still think that the government and the central bank will reach a compromise and the government will be allowed to borrow a part of FX reserves for paying off the most costly part of foreign debt. Deputy finance minister Ryszard Michalski said the NBP could lend US$1-1.5bn. Such solution would slightly decrease costs of servicing debt and a part of revaluation provisions (much smaller part) would be freed in the central bank and transferred to the budget.

In terms of other budgetary assumptions, nothing has changed since our latest MACROscope edition, in which we wrote that budget 2004 is a great unknown. We do not know planned spending, revenues or budget deficit. In one of interviews Jerzy Hausner declared the package of solutions they would propose would contain also a reform of spending side of the budget, including restructuring of pension system for farmers, cuts of social spending on disability pensions etc. Well, we have written before that declarations are far too little and Polish economy needs real decisions in the area of public finance. It remains to be seen how much weight the government would attach to the reform of budget spending, however we would not expect any radical moves, as at the same time Hausner declared in open text that he would opt for increasing budget deficit in 2004-05, hoping that it would allow for boosting economic growth sufficiently to stimulate growth of budget revenues in subsequent years. Therefore, one should be prepared for expansionary fiscal policy.

What budget financing needs in 2004?

Although a detailed information about major budget assumptions still remains unknown, during a meeting in the parliament deputy PM Jerzy Hausner and finance minister Andrzej Raczko tried to talk down concerns about next year's budget and government fiscal policy in the medium term. Jerzy Hausner assured that budget deficit in 2004 will not exceed PLN47.1bn and could be even lower, however the extent to which it can be reduced depends on the parliament's will to accept necessary spending cuts.

However, in fact it is even not clear how the government defined budget gap of PLN47.1bn mentioned above, whether this includes or excludes some sorts of expenditures (like transfers to private pension funds). However, it looks like financing needs in the draft prepared by Hausner and Raczko would be some PLN14bn higher than those suggested by Kołodko's budget assumptions (because of no PLN9bn revenue from revaluation provision and privatisation receipts lower by ca. PLN5bn). Still, it seems that the market has been already prepared for such a figure after examining the draft presented by Grzegorz Kołodko (as assumptions concerning revenues from revaluation provisions and as much as PLN12bn revenues from privatisation were perceived as unrealistic). Therefore, now one should not expect a negative surprise unless the next year's privatisation plan of PLN7bn would not materialise. What is more, any news signalling that budget gap in 2004 could be a bit lower than initially announced PLN47.1bn would be probably perceived positively.

Planned budget deficit and real financing needs of the budget

	Kołodko's assumptions	*Hausner and Raczko's plan*
Budget deficit (PLNbn)	33.1*	47.1**
Financing needs (PLNbn)	47.1	47.1

* PLN9bn revenues from NBP revaluation provisions and PLN12bn privatisation revenues
** no revenues from NBP revaluation provisions and PLN7bn privatisation revenues
Source: Ministry of Finance, Hausner and Raczko's statements

S&P's issued a warning for the government

International rating agency Standard & Poor's revised the rating outlook for Poland from stable to negative, at the same time confirming their ratings for Polish foreign and domestic debt. The S&P justified the decision by "deterioration of medium-term fiscal policy prospects, in view of increased fiscal pressures going forward and political difficulties facing key fiscal reforms". Although the timing of such a change of outlook was not widely expected, the decision itself could be in fact anticipated after recent developments on Polish political scene. S&P's explanation seems to fully reflect our view – please recall that we have written many times earlier that recent change of control over government's economic policy most likely implies a negative scenario for the fiscal policy: higher pressure on maintaining large budget deficits and focus on short-term economic stimulus rather than on long-term sustainable and balanced economic growth. This of course might result in a delay of possible euro adoption, which is not an optimistic scenario for the financial market.

While the change of outlook is only a warning for Polish authorities to undertake proper policies in a proper time and does not necessarily mean that the ratings will be downgraded in future, Polish financial market reacted quite nervously to this announcement. The zloty exchange rate dropped by more than 1% and yield curve moved up by several basis points in the second half of the day. Perhaps investors begin to seriously doubt whether the government is able to improve substantially the quality of its economic policy. In such case adverse market reactions might repeat quite often hereafter, especially if it turned out that the reform of public finance delays and/or its scope was much smaller than planned. Other major rating agencies (Fitch, Moody's) are probably also going to update their sovereign ratings in a short time, so it remains to be seen whether the concerns over long-term fiscal stability in Poland finds its echo in their assessments too.

Comments of the government members and politicians

The majority of comments of the government members and politicians were described in the section above. They concerned mainly government's economic policy, flat tax rate proposal (which does not seem to be supported by the ruling coalition), perspective of co-operation between the central bank and the government. Until recently, former finance minister Grzegorz Kołodko's statements were the most important to follow, but his quotes are not included in the table below. The situation has changed at the beginning of June and new deputy PM statements should be analysed to find a hint on future macroeconomic policy of the government.

WHO, WHEN, WHERE	COMMENT
Aleksander Kwaśniewski, President; PAP, 10 June	If it turns out that the government has majority, than these are parliamentary rules. Majority is a majority. […] I believe that elections before 1 May 2004 would be fatal idea no matter if they are held because of government failure or not passing the budget. Only combining these two elements, i.e. serious and deep program to fight with poverty and unemployment and possible implementing flat rate tax can be a basis for further talks.
PR3, 9 June	I think the idea of earlier elections is good. The latest possible date was proposed by Leszek Miller and it is spring 2005. There is also different plan of earlier elections together with European parliament elections in spring 2004. The question is whether it would not be too risky to join these events as one of them could have minor importance.
TVP1, 6 Jun	There is an issue of 2004 budget and a majority for this budget. Personal issues are perhaps the most interesting for the public, however they must be discussed in the end.
Marek Borowski, Sejm speaker; PAP, 4 Jun	This money [for next year's EU contribution] must be found. In my opinion increasing budget deficit will be necessary. It would be risky, as now the deficit reaches as much as 5% of GDP. But it would pay, because it would bring higher growth rate.
Leszek Miller, Prime Minister; Reuters, 29 VI	The government and we all must take actions aimed at stimulation of consumption demand, and especially investment demand. The simplest and the quickest way to achieve this objective is a reduction of fiscal burden, which should concern both personal income tax and corporate income tax. [...] One should account for rationalisation of budget spending and directing larger part of the spending for pro-growth objectives, including absorption of EU funds. The reform of public finance is needed, however it is possible only on the path of economic expansion and high economic growth. The programme of public finance reform cannot be scaled down to the issue of required level of budget deficit and public debt. If after estimates and consultations it turns out that the uniform (flat) tax rate creates such a chance [for GDP growth acceleration and reduction of unemployment] then it could be introduced in 2005. In such case it [flat tax] cannot be treated as an ideological superstition. The opinion of Entrepreneurhip Council submitted to the government puts emphasis on the reduction of interest rates, reduction of NBP's reserves and reorientation of policy concerning setting of inflation targets. Surely those postulates deserve support and their fulfilment would allow for substantial reduction of tax burden.
Reuters, 26 Jun	I am somehow astonished at Mr. Balcerowicz's comments. I believe there is a room for lowering interest rates. So does the IMF. The inflation is low and kept under control, not threatening with repeated outbreak.
PAP, 17 Jun	The Council of Ministers accepted lowering CIT to 19% starting from 2004. It is important step and it results from conviction that the reduction of the tax burden would have good effects as regards modernisation of companies and improvement of their competitiveness. A downward trend in the unemployment rate would be strengthened. It will also cause increase in investment. […] Polish economy must receive a very strong pro-growth stimulus, the situation on the labour market must change, Poland must become a friendly country for foreign investors. The negotiations [about using NBP reserves] will be conducted, ministers Hausner and Raczko have been authorised for it. […] Talks are necessary; we expect that our decision to cut CIT will be noticed and treated as an opportunity for serious dialogue.
PAP, 11 June	[about entering the Eurozone] I can't tell the date but I think it should be as soon as possible but we have to meet Maastricht criteria. […] It may be in 2007 or 2008 or whenever it will be possible.
PAP, TVP1, Reuters, 9 June	We should consider the introduction of a flat tax rate but this should be accompanied by a change in a monetary policy (lower rates, lower reserves, inflation target modification). Such solution would not decrease budgetary revenues and would not be negative for the poorest. I would like to change the structure of control over government's economic policies shifting the power into the hands of economy minister rather than finance minister. I want to return to the earlier plan of the election in the spring of 2005. It's no use reading tea leaves to find out whether the government enjoys public support or not, so I will propose the Parliament to hold a vote of confidence in the government during the next session. [if confidence vote is negative] Then the PM will have no choice but to file a motion with the president, requesting dismissal. Ii is interesting whether the MPC will react on our proposals. If not, we will have the new MPC next year and it might be easier to co-operate with new, more elastic Council.
Jerzy Hausner, deputy PM, economy and labour minister; PAP, 30 Jun	The budget deficit in 2004 and 2005 should be higher in view of the EU accession. This should however serve as a path to lower the deficit in 2006 and 2007 so as to meet the Maastricht criteria in 2007, without exceeding a limit of 55% by debt-GDP ratio. […] If the Maastricht criteria are met in 2007 Poland could join the Eurozone in 2008 or no later than 2009. Pro-growth activities must be one of priorities of economic policy. 5% GDP growth next year is our aim so that it would be permanent trend. […] In 2003 we have a realistic chance to reverse upward trend in unemployment and in 2004 and 2005 for a fall in it. 19% tax rate for all enterprises is a possible option, as well as higher tax-free rate in PIT, but only under the condition of an agreement with the central bank and with the Three-Party Committee, as these agreements would allow to create a safe budget. Tax flat rate is possible only when trade unions agree. We have very low inflation, indexation is good only in the high inflation environment. We would like to cancel this mechanism, excluding pensions and disability pensions, In September we will present detailed proposals and we will realise them. The reform of public finance sector is necessary element of the strategy.
PAP, 27 Jun	Q. Will Poland join the euro zone in 2007? A. It is difficult to answer this question, it is certainly not that the government has set such a target. Poland should join the euro zone as quickly as possible, but will it be 2007, it should not be excluded, today this is not a target. Certain depreciation of the zloty that has occurred is favourable for exporters, so in that way helpful for the economy. […] It is all speculative flows and can change within a week or two.

PAP, 24 Jun, after government meeting	[About flat rate tax] We do not close the way for public debate and an agreement on this issue. In September, there will be assumptions (regarding changes to tax system in 2005] and until the end of the year there will be bills. Since 2005 we plan uniform tax on business activity regardless of its legal form.
PAP, 24 Jun, before government meeting	If the budget deficit in 2004 would be temporarily higher than in 2002-03, and at the same time the economy would be protected against the crossing over of the 55% public debt-GDP relation, than in my opinion it would be a rationally permissible solution under condition that it would lead to taking advantage of structural funds and to boosting development and thus decreasing the budget deficit. […] Public debt-GDP relation is a strong restriction and we must not lead such a policy that it would exceed the level of 55%. However, it is important to keep budget deficit under control in the middle term […]. […] If PLN50bn led us to lower budget deficit in 2006-2007, under condition of maintaining debt-GDP relation at 55%, than I would not dramatise. Let's remember we have certain expenditures that were absent before, e.g. spending on co-financing EU funds. I am not saying their financing should be made by means of spending growth; to the contrary I believe that it should be attained by reduction of some redundant expenditure for the sake of pro-growth expenditures. If present forecasts say that we can expect, in unchanged conditions, a 3% GDP growth in 2003 and for example a 4% next year, than I am asking - can I, within an affordable risk, try without artificial encouragement on the part of the economic policy push the economy to a higher trajectory of growth. If it succeeded I would imagine easier solution of problems, balancing budget in the middle term and fleeing from 50% debt-GDP limit. Than I would imagine easier reducing expenditures. Fiscal tightening based mostly on expenditure cut [...] could be employed by the government but only within a broader programme, consisting of: economic policy as a pro-growth vehicle, control over macroeconomic stability and the relation of debt to GDP, healing of public finances i.e. rationality of fiscal spending and limiting irrational spending, and finally long-term concept of EU membership after 2006 with full access to EU funds. After the first half of June the unemployment level is lower by 0.1% [than at the end of May] and at the end of the month it will be probably lower by 0.2-0.3%. There are reasons for maintaining the [monetary] policy of small steps forward, I see no reasons to change it, and I hope it will be continued. [using revaluation provision] This potentially tempting solution can be characterised as one-off doping. I am obliged with government stance, it is a starting point, but I do not persist in it and I see some objections, as well. […] An argument, that PLN9bn is one-off factor improving a situation but making dependant, because afterwards there won't be PLN9bn again, is in my opinion relevant argument. So, let's find another solution, as I do not persist in it. But it can not be that way that no solution would be proposed to me.
ISB, 18 Jun	I do not believe that we would be able to absorb 100% of the EU funds. So far, no country has managed to do it. If we were able to use some 70-80% of the funds in the first two years, which seems to be a real target, we would be successful. The former government, as well as local governments, has already put much effort to prepare for the absorption of the EU funds. We still have 10 months to prepare and we will not fail.
PR1, 12 June	I do not think that we will have a radical change of macroeconomic assumptions in the budget draft, although undoubtedly there will be a change of a few parameters. In budgetary assumption there is a suggestion to use a part of revaluation provisions. We will talk with the central bank.
PAP, Reuters, 11 June	A government programme is to stimulate economic growth to 5% of GDP, boost the entrepreneurship and create new jobs. [budget assumptions] They are obliging, as I would like to discuss the guidelines with the partners from finance ministry. The repair of the public finances is the third priority. We will concentrate on budget spending side. […] I will fight for removing barriers that make spending stiff. […] This are desindexation and removal of automatic valorisation, gradual reducing social transfers, gradual introducing fiscal measures in agriculture. […] Many elements of widening of basis and making expenditures less stiff will appear, but the indexation of old age and disability pensions will remain. [using PLN9bn from revaluation provision] This is a proposal that we maintain. I would like to meet with NBP governor relatively soon. Even if we do not agree to the way that the government have proposed we will be able to discuss the other way to use the reserves in the way that would allow reducing public debt and would make it easier to work out a budget for 2004 and next years.
PAP, 6 Jun	Q. Could the FinMin propose a deficit exceeding PLN50bn? A. It is a question of coming to understanding with the NBP. […] Otherwise it might happen.
Marek Pol deputy PM PAP, 15 June	The Labour union will not support the idea of the flat tax rate
Andrzej Raczko, finance minister; PAP, 30 Jun	My predecessor included a use of the revaluation reserve was in the budget. I did not support the solution but I support co-operation with the NBP and I am an advocate of an agreement under which some NBP assets can be used for the benefit of the country. What I mean is foreign debt. I believe that the finance minister should not comment a decision of the independent central bank. More important is, by what criteria the bank is guided, […] all these factors should be taken into consideration by the MPC, which they do, and they make a final decision. Poland should join the Eurozone as soon as possible but we must meet the Maastricht criteria. A part of them has been met, already. The criterion connected with the budget deficit is remaining and from this point of view not only a prospect of 2004 budget building is important, but also in the nearest future. […] If we meet the criteria, we will think about joining the ERM2 system and the Eurozone.
PR1, 25 Jun	In my opinion appropriate steps should be made bit by bit, one should preserve some sequence of actions. [...] PM Hausner signalled whole series of steps aiming at rationalisation of spending side. We will want to achieve it gradually. [...] I don't believe in hyper-revolution in public finances. I believe in consequent actions, step by step, yielding positive effects.
PAP, 24 Jun	More than PLN1.5bn will remain in taxpayers' pocket [after PIT changes in 2004], creating a significant impulse allowing for increase of consumption expenditure. The aim of tax changes is triggering a demand effect in a form of consumption growth and an impulse for investments. We do not resign from taxing farmers. We intend to do this since 2005.
PAP, 17 Jun	I am responsible for the budget deficit. Taking up the post I had to accept the existing budget assumptions. […] I understand that the assumptions would be subject to revision […], in particular the NBP-connected amount and I understand that this question is open. […] The finance ministry intends to hold tough discussions with the central bank governor after which it will be possible to speak about details. An assumption relating to economic growth [5% in 2004] has been adopted which is a bold assumption and we will be watching it.

PR1, 17 Jun	As far as the tax rates are concerned, we will not introduce an additional tax rate in order to make the system more intelligible and not more troublesome. But we will want to low the fiscal burden by adjusting a tax-free amount accordingly. […] We treat this as a very serious instrument of boosting demand and bolstering the economy. I have inherited the Ministry of Finance together with budget assumptions [for 2004]. But we would have to look at the budget assumptions once again, even considering recent government's discussions as regards tax system. It is obvious for me that revaluation provision is a kind of income gained by the NBP. […] The key is in what way the economy may benefit from NBP's income, which undoubtedly is a state income. I understand the point of view of the NBP, that is should be used in such a way that it will not produce an inflationary impulse. Undoubtedly, the money should work bringing profits for Polish economy. […] Decisions should be taken in compliance with law. We have an independent bank, which is regulated in proper way in the constitution, we have the rules of NBP's accounting and we have a control instrument in the hands of a finance minister, who is in a way an auditor of the central bank. So obviously all steps must be taken in line with legal regulations.
PAP, 16 Jun	The number one issue is the budget. It would be difficult to accomplish because it will be the first year of EU membership and a budget where we make very brave steps in cutting tax burden. Another issue is public finance reform concerning not only tax system, but most of all budget spending. Third issue is that we will construct this budget in order to achieve pro-growth results. But as a finance minister I am an advocate of macroeconomic stabilisation. Fourth issue is that the success depends on the co-operation with the central bank. Polish central bank has both “National” and “Polish” in its name, which is binding, especially at this very special moment of EU entry. I see only one solution, very hard dialogue and agreement between both sides.
Jan Czekaj deputy finance minister; PAP, 28 VI	According to preliminary estimates GDP growth exceeded 3% in 2Q03. In the whole year GDP should grow by 3.5%.
Ryszard Michalski; deputy finance minister; PAP, 13 Jun	The situation on the market is very favourable; the yields are very low. We expect that this situation will maintain within next few years. In 2H03 we plan to issue floating 3-5 years bonds worth €300-500m The central bank proposes to use a part of FX reserves to repay Polish foreign debt It is very tempting because we would like to close the chapter called “Polish Brady bonds“ this year. We, as the ministry, are interested in the conditions of payments towards the NBP. What kind of bonds the NBP expects? What is the coupon? NBP chief agreed to lend US$1-2bn, we would like to borrow higher amount. A few hundreds of millions would be used for Brady bonds, and the rest would be spent for Paris Club debt repayment.
PAP, 6 Jun	Q. Is the zloty too weak now? Would Mr. Kołodko like NBP to intervene to restore PLN4.35 against euro? A. No way. Please note that NBP intervention would have monetary effects and knowing central bank's approach one could be afraid of excessive monetary tightening. Q. Do you expect turmoil in the autumn, when budget for 2004 would be presented and what would be market reaction to the results of referendum? A. I hope that in both cases nothing extraordinary would happen. To the contrary – there would be some strengthening of the zloty. In case of budget presentation it would be an effect of higher confidence for the government's abilities. When it comes to referendum, one should expect increased interest of foreign investors [...] also resulting in zloty appreciation. There are talks going on [about the loan from the central bank for early repayment of Poland's debt]. FinMin wants the size of this transaction to be large and conditions of interest payments to be as good as possible.
Halina Wasilewska-Trenkner, deputy finmin; PAP, 25 Jun	I am glad that the MPC cut interest rates but I do not know if they will cut further. There is a room for further cuts at present level of the inflation but I understand that the MPC can take into account a recent zloty depreciation and from this point of view different actions can be considered.
PAP, 23 Jun	Reducing spending is difficult because one cannot expect spectacular effects of such action. Budget expenditures are very inflexible. (...) However, we have to find PLN7.5bn for payment of Poland's contribution to the EU budget. (...) Significant amounts are needed to co-finance EU projects. They can be either included in the deficit or obtained from limiting expenditures. Presently, public debt level stands at around 50% of GDP. Thus, we are close to the critical level. (...) The first (way out) is to introduce public-private partnership. The second one is to use inactive capital resources, for instance open pension funds assets. They should be used for investment projects, which are necessary for the economy.
Jacek Krzyślak, Head of FinMin Research Dept.; PAP, 9 Jun	We are estimating that prices will not go up in June in comparison to May but as deflation in June 2002 was 0.4% we are expecting the annual inflation to go up in June 2003 to 1.1%. In our opinion the average annual inflation will be 1% this year.
Danuta Huebner, European affairs minister; Reuters, 23 Jun	Solbes' proposal [of ERM-2 conditions] is impossible to fulfil. [...] First years after EU entry could be unstable due to huge structural reforms in Poland and capital inflow, including portfolio capital. [EU politicians] do not want us in the Eurozone, because they have their own problems and are afraid of having new ones. Poland should try to undermine Solbes' proposal in talks with EU member states, on which the ultimate decision on the conditions of Eurozone enlargement is heavily dependent. We would fulfil the criteria of Eurozone membership in 2006 at earliest, and then one more year would be required for their assessment.
Mieczysław Czerniawski, head of Public Finance Committee, SLD; PAP, 12 Jun	It is out of the question for the finance minister to add PLN9bn of the NBP revaluation provisions to budget revenues, knowing that the present Monetary Policy Council would not agree. When Mr. Raczko was the deputy finance minister a co-operation with the NBP was possible, which resulted in decline in our debt. However we could talk only about using FX reserves and not revaluation provisions.
Witold Orłowski, President's chief economic advisor; PAP, 25 Jun	With a present structure of the budget, certainly we will exceed 55% limit of public debt. I do not believe that we would avoid breaking the limit of 55%. If the most radical activities were not undertaken there would be high probability of exceeding 60% limit. If Poland reached 60% limit and if caution mechanisms that prohibit budget deficits were set going one would have to say: it would be a budget of social catastrophe if it turned out that the deficit must be reduced from 6% of GDP to zero. The budget should already be a red light that orders to implement radical steps in a very near future in order to prevent social and economic troubles.
PR3, 11 Jun	Only the NBP can decide abut revaluation provisions. As long as the NBP disagrees, the government cannot include this in the budget. I think there is a room for discussion between the two institutions, but the amount should be much lower than PLN9bn. 5% [GDP growth in 2004] it is quite optimistic assumptions, although realistic in my opinion under the assumption that everything is fine.
PAP, Reuters, 10 Jun	Shifting economic policy management to Economy Ministry is quite risky because it is finance minister who has the most significant role in economic policy. Treating ministry of finance only as an accountant is in my opinion underestimating his role in economic policy. My definition of public finance reform is: deep structural changes in public sector, control of budget deficit and public debt. I cannot see such activity.

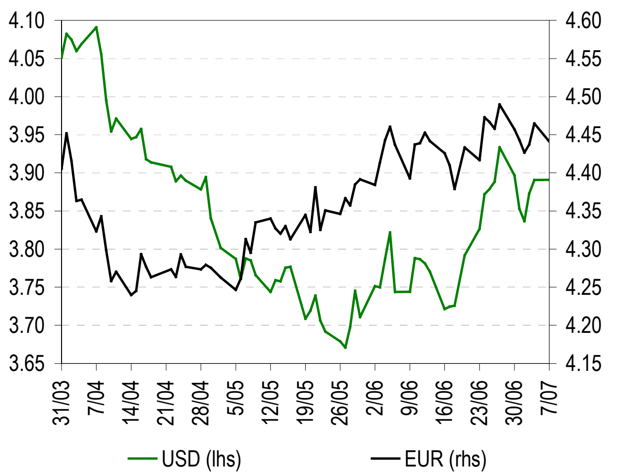
Market monitor

- **Weak zloty despite victorious accession referendum**
- **Upward move of the yield curve**

Hot month on the FX market

In June a considerable nervousness and large volatility in rates were observed on the Polish FX market. Uncertainty on the political scene and continued turmoil in Hungary were of greater importance than victorious accession referendum and influenced the zloty in a negative way. However, on the other hand, following the periods of worse sentiment, the Polish currency was strengthening back, which means that despite many negative factors investors stay on the Polish market. At the end of June, the zloty was weaker by nearly 3% against the currency basket as compared to the end of May. It lost more against the dollar, as the EURUSD rate fell in the second half June after the period of continuos rise since the beginning of this year.

Zloty FX rate in recent 3 months

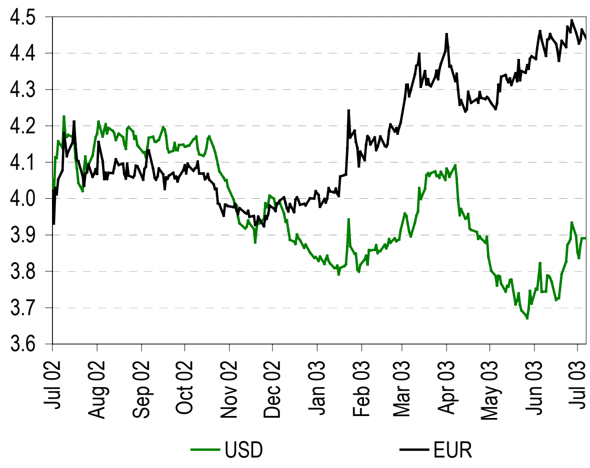


Source: NBP

According to the NBP fixings, in June the dollar was traded between PLN3.7213 (16 June) and PLN3.9336 (on 27 June) and PLN3.7991 on average (against PLN3.7414 in May). The euro traded from PLN4.3790 (18 June) to PLN4.4896 (27 June) with the average at PLN4.4355 (PLN4.3020 in May). The average rates were quite close to our forecasts presented in the previous MACROscope (3.76 and 4.42, respectively).

First half of June was a really hot period, with daily rate changes usually exceeding 1%. At first, before the accession referendum the zloty weakened because uncertainty concerning its result was accompanied by the turmoil on the Hungarian market after forint devaluation. On Monday after the voting, the zloty gained 1% at the opening, however during the day a deep depreciation occurred given the developments on the political scene. Announcement of the confidence vote for the government and of changes in economic policy the market perceived negatively. Finance minister's dismissal two days later resulted in merely small and short-living weakening. An appointment of minister Raczko was a little disappointment, as the market positively perceived rumours on Dariusz Rosati's candidature. All in all the market was waiting calmly for the confidence vote.

Zloty FX rate in recent 12 months

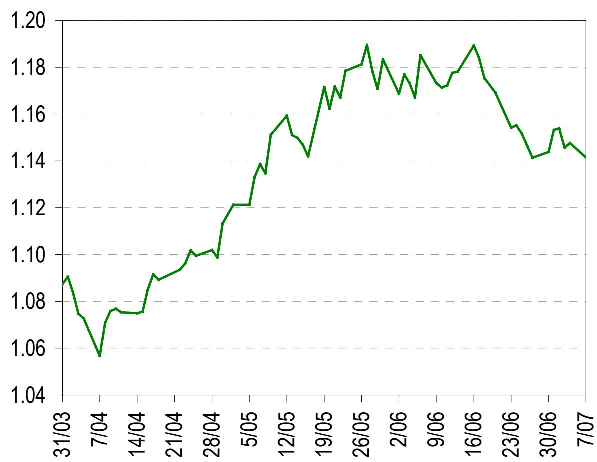


Source: NBP

After the positive result of the vote the market was calm, especially that the week with long weekend started. At the beginning of the next week information on downgrading the outlook of Poland's rating occurred and at its end the sentiment on the market deteriorated given next turmoil in Hungary. As a result around at the end of weekend the zloty reached the weakest levels of the month, when the euro approached PLN4.5.

In the first week of July the zloty appreciated temporarily as a result of very large buy order.

EUR/USD FX rate

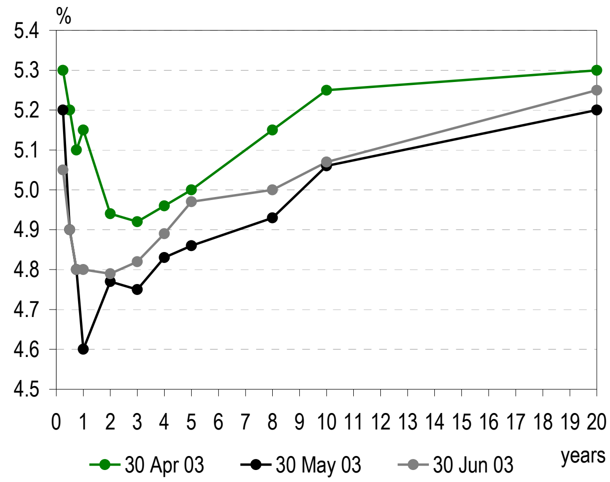


Source: NBP, BZ WBK

Fluctuations on the T-bond market

Also on the T-bond market significant fluctuations in prices were observed in the whole month. Majority of events on the political scene and on Hungarian market resulted in rises in yields. Downgrading the outlook of Poland's rating caused a rise as well, but rather moderate. On the other hand the yields fell after interest rate cuts in the Eurozone and in Poland, after the confidence vote and moderately after Grzegorz Kołodko's dismissal. Also, changes in prices were observed after releases of data on inflation, industrial output and balance of payments. Considerable influence on trading on the domestic market was exerted by the German market. All in all, the yield curve recorded an upward move.

Yield curve



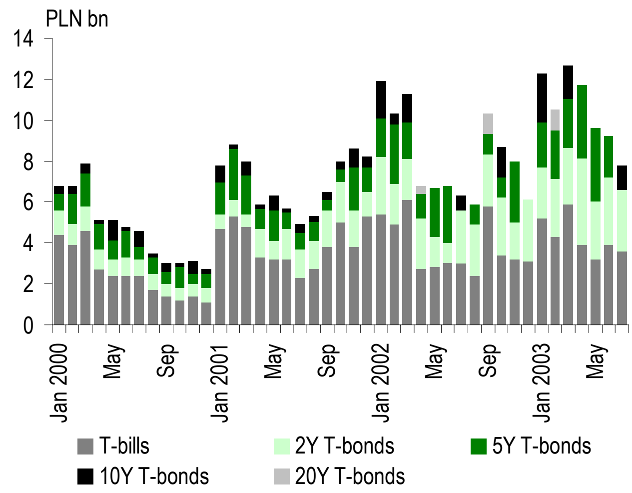
Source: BZ WBK

At the auction held on 18 June all offered 5-year bonds (PS0608) totalling PLN2bn were sold, with a demand at the level of PLN4.4bn, which was more than two times bigger than supply. Average yield fell to 4.851% from 4.861% a month earlier and it was close to expectations and current market level.

On Wednesday, 2 July, the fourth auction of a 2-year benchmark (OK0405) was held. Bonds totalling PLN2.5bn were offered and this time the demand was also high (PLN6.6bn), nearly three times as high as the supply. Obviously, all the offered bonds were sold but the average yield rose to 4.807% from 4.741% at the auction in June, being slightly above expectations but in line with current market level. At a supplementary auction demand was below supply and it was accepted in total.

At the auction on 9 July the whole offer of 10-year bonds (DS1013) totalling PLN1bn was sold, with a surprisingly high demand at PLN3bn. Average yield fell to 5.169% from 5.489% at the previous auction of the papers in March, reaching the lower end of a range of expectations. At the supplementary auction PLN200m worth of the papers were sold with demand of PLN1.7bn.

Supply of Treasuries



Source: Finance Ministry, BZ WBK

Treasury bill auctions (PLN m)

	OFFER / SALE		
Date of auction	**13-week**	**52-week**	**Total**
02.06.2003	-	700 / 700	700 / 700
09.06.2003	-	700 / 700	700 / 700
16.06.2003	-	800 / 595.49	800 / 595.49
23.06.2003	-	800 / 800	800 / 800
30.06.2003	100/ 100	800 / 800	900 / 900
June total	**100 / 100**	**3,800 (3,595.49)**	**3,900 (3,695.49)**
07.07.2003	100	800	900
14.07.2003	100	800	900
24.07.2003	100	800	900
28.07.2003	-		900
July total	**300**	**3,800**	**3,900**

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	2,400	2,400	22.01	PS0608	2,200	1,959.1
February	05.02	OK1204	2,800	2,114.3	12.02	WS0922	1,000	0	19.02*	PS0608	2,400	2,000
March	05.03*	OK1204	2,750	2,750	12.03	DS1013	1,600	1,600	19.03	PS0608	2,400	2,236.8
April	02.04*	OK0405	4,200	4,200	16.04*	PS0608	3,600	3,600	-	-	-	-
May	07.05	OK0405	2,800	2,800	21.05*	PS0608	3,600	3,555	-	-	-	-
June	04.06*	OK0405	3,300	2,852,2	18.06	PS0608	2,000	2,000	-	-	-	-
July	02.07*	OK0405	3,000	2,836.0	9.07*	DS1013	1,200	1,200	-	-	-	-
August	06.08	OK0805	-	-	-	-	-	-	-	-	-	-
September	03.09	OK0805	-	-	10.09	WS0922	-	-	17.09	5Y	-	-
October	01.10	OK0805	-	-	08.10	DS1013	-	-	15.10	5Y	-	-
November	05.11	OK0805	-	-	19.11	5Y	-	-	-	-	-	-
December	03.12	OK1205	-	-	-	-	-	-	-	-	-	-

Source: Finance Ministry * with supplementary auction

International review

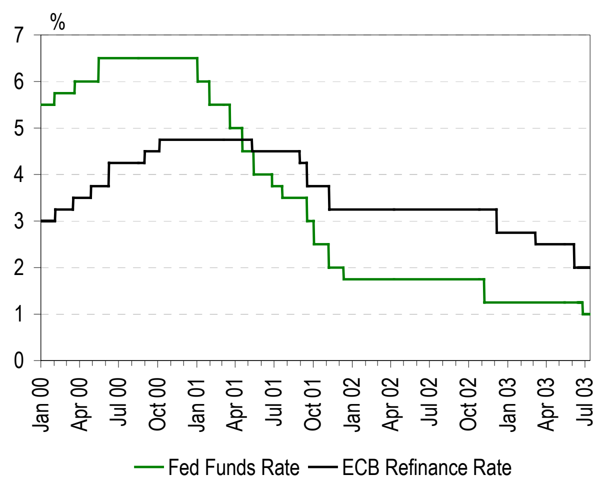
- **Interest rate cut by the Fed**
- **Stable consumer prices in June**
- **GDP grew in the Eurozone in the 1st quarter**
- **Record high unemployment in the USA**

In June rates down in the Eurozone and the USA

In line with analysts' expectations, the Council of the European Central Bank did not change interest rates at the meeting on Thursday 10 July. After the decision to lower interest rates by 50 bps made on 5 June main Eurozone's interest rate – refinance rate – stands at 2.0%, which is the lowest level since introducing the euro and the beginning of conducting monetary policy by the ECB. Eurozone's M3 money supply growth rate amounted to 8.5%YoY in May decelerating from 8.7% recorded in April, while analysts expected a deeper slowdown in a pace of growth to 8.3%.

After two-day meeting on 24-25 June Federal Open Market Committee decided to cut US interest rates by 25 bps. Federal funds rate stands at 1.00%, the lowest level since 1958. Fed's decision matched expectations of majority of analysts, though some of them forecasted 50 bps cut. In the report Fed stated that the risk of deflation was still higher than a threat of increase in inflation and that American economy had not shown the signs of stable economic growth, yet. They expressed their hope that expansive monetary policy would lead to growth revival.

Interest rates in the USA and Eurozone



Source: Reuters

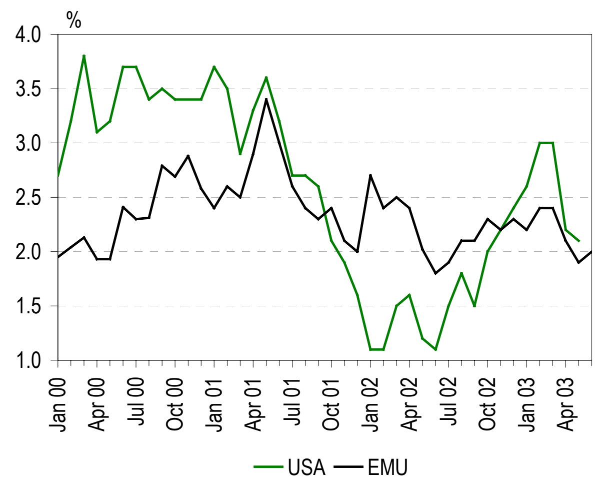
Inflation under control

According to final data, in May consumer prices in the Eurozone remained unchanged as compared to April. In annual terms inflation rate declined to 1.9% from 2.1% recorded in April, which exactly matched preliminary estimations and analysts' expectations. Moreover, according to preliminary estimations, in June Eurozone's annual inflation rate increased to 2.0%, which also exactly matched forecasts. Inflation stood at the level of target ceiling imposed by the ECB, as an indicator of mid-term price stability. In May, producer prices decreased by 0.4%MoM, slightly faster than a fall of 0.3% forecasted by analysts. Annual growth rate of prices declined to 1.3% from 1.7% a month earlier, which was also below forecast at 1.4%.

Preliminary estimations point that in Italy consumer prices increased by 0.1%MoM in June and annual inflation rate amounted to 2.6%, down from 2.7% in May. In France prices increased by 0.2%, which translated into acceleration in annual inflation rate to 2.0% from 1.8%.

In the United States consumer prices did not change on monthly basis in May, compared to analysts' forecasts at the level of -0.1%, which translated into small decrease in annual inflation rate to 2.1% from 2.2% recorded in April. Also, data on producer prices were very close to forecasts. The prices declined by 0.3%MoM in May, following very deep fall of 1.9% in April, while expectations pointed to a decline in prices of 0.2%. Annual rate of producer inflation recorded acceleration to 2.5% from 2.4% recorded in April.

Inflation YoY



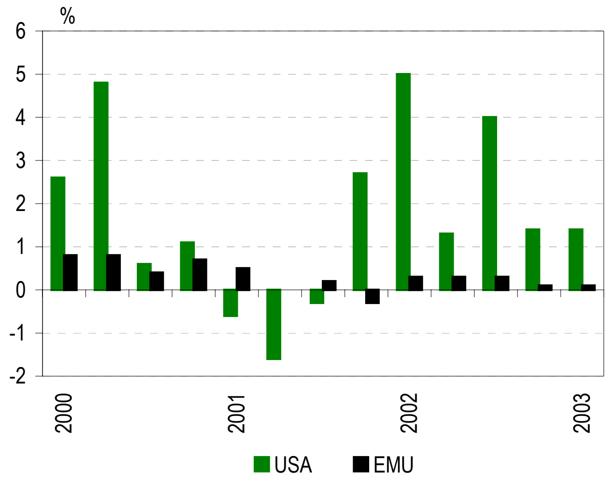
Source: Reuters

Downward revision in growth in the United States

Data on Eurozone's economic growth in 1Q03 were revised upward in the second release. According to latest estimation, Eurozone's GDP increased by 0.1%QoQ and 0.8%YoY in this period against preliminary released 0.0%QoQ and 0.8%YoY. Analysts expected a confirmation of earlier estimations. Moreover, the European Commission confirmed growth forecasts for second and third quarter this year, both at the level of 0.0-0.4%QoQ.

According to final data on economic growth in the United States, in the first quarter this year GDP increased by 1.4%QoQ, which was the same pace as in fourth quarter 2002 but significantly slower than the rate released in preliminary information a month ago, when the growth was estimated at 1.9%. The revised data were much weaker than analysts' expectations of 1.8%.

GDP growth QoQ



Note: growth rates for the USA are annualised
Source: Reuters

Industrial output in the Eurozone increased by 0.4%MoM in April after a fall of 0.7% in March. In annual terms the growth reached 0.8%. The figures were much better than analysts expectations pointing to falls in output of 0.4%MoM and of 0.6%YoY. Also, Eurozone's retail sales figures were significantly stronger than expectations. In April, the sales increased by 1.5%MoM and 2.2%YoY, compared to forecasts at 0.6% and 1.2%, respectively.

In the United States data on industrial production were very close to forecasts. The production rose by 0.1%MoM in May, following a fall of 0.5% in April, while a 0.0% was expected. Also, retail sales recorded a figure close to forecasts. In May it increased by 0.1%MoM, while analysts expected it to remain unchanged, following the fall of 0.3% (revised from -0.1%) in April. For a second month in a row low growth rate of sales resulted mainly from decline in retail fuel prices.

Record high unemployment in the USA

The unemployment rate amounted to 8.8% in May, unchanged from April and the figure exactly matched analysts' expectations.

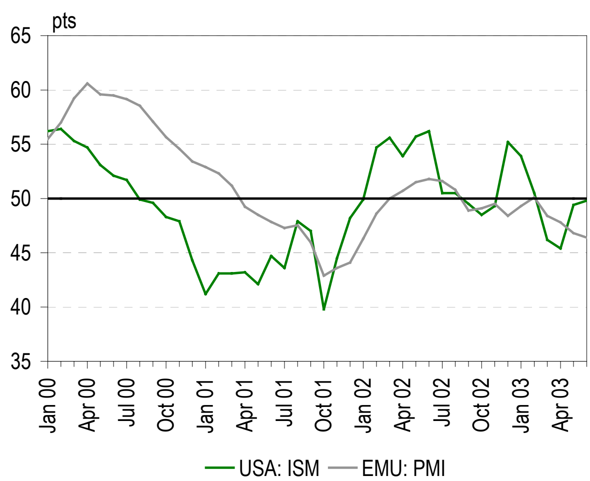
On the contrary, data on unemployment in the United States were worse than expected by analysts. The unemployment rate increased to 6.4% in June from 6.1% in May, while 6.2% was expected. It was the highest rate in last nine years.

Does IFO point to a revival in Germany?

Major business climate indicator for the German economy - index of entrepreneurs' sentiment IFO recorded a stronger than expected by analysts rise, reaching 88.8 pts in June versus 87.6 pts in May, while forecasts pointed to its slight increase to 88.0 pts only. Chief of the IFO institute said that the data pointed to rising chances for a revival in the German economy in second half this year.

In June economic activity in the Eurozone's industry was falling at faster pace than in May, while analysts expected slower pace of deterioration in activity compared to May. Reuters PMI index decreased to 46.4 pts from 46.8 pts, while an increase to 47.4 pts was forecasted. Meanwhile, in the United States economic activity in the industry recorded a fall at slower pace than in May, though analysts forecasted improvement in activity. ISM index reached 49.8 pts in June against 49.4 pts in May and 51.0 pts expected. The level of 50 pts is for both the indices a limit between improvement and deterioration in activity.

Activity indicators



Source: Reuters

What's hot this month

Monday	Tuesday	Wednesday	Thursday	Friday
30 June POL: Balance of payment (May) POL: T-bill auction *ITA: Inflation preliminary (Jun)* *EMU: Inflation preliminary (Jun)* *EMU: Money supply (May)*	**1 July** *EMU: Unemployment (May)* *EMU: PMI (Jun)* *USA: ISM (Jun)*	**2** POL: T-bond auction OK0405 *EMU: Producer prices (May)* *USA: Factory orders (May)*	**3** *EMU: Retail sales (Apr)* *USA: Unemployment (Jun)*	**4**
7 POL: Food prices (2H Jun) POL: T-bill auction	**8** *GER: Unemployment (Jun)* *GER: Industrial output (May)*	**9** POL: T-bond auction DS1013	**10** *GER: Inflation final (Jun)* *EMU: ECB meeting* *EMU: GDP (1Q)*	**11** *FRA: Inflation preliminary (Jun)* *FRA: Industrial output (May)* *USA: Producer prices (Jun)* *USA: Foreign trade (May)*
14 POL: Inflation (Jun) POL: Money supply (Jun) POL: Wages & employment (Jun) POL: T-bill auction *ITA: Industrial output (May)*	**15** *ITA: Inflation final (Jun)* *USA: Retail sales (Jun)*	**16** *EMU: Inflation final (Jun)* *USA: Inflation (Jun)* *USA: Industrial output (Jun)*	**17** POL: Industrial output (Jun) POL: Producer prices (Jun) POL: MPC meeting (first day) *EMU: Industrial output (May)*	**18** POL: MPC meeting (decision)
21 POL: Retail sales (Jun) POL: Unemployment (Jun) POL: T-bill auction *EMU: Foreign trade (May)*	**22** POL: Core inflation (Jun) POL: Business climate (Jul) *FRA: Inflation final (Jun)*	**23**	**24**	**25** POL: Food prices (1H Jul)
28 POL: T-bill auction *GER: IFO (Jul)* *EMU: Money supply (Jun)*	**29** *EMU: Balance of payment (May)*	**30**	**31** POL: Balance of payment (Jun)	**1 August** *EMU: PMI (Jul)* *USA: ISM (Jul)* *USA: Unemployment (Jul)*
4 POL: T-bill auction *EMU: Producer prices (Jun)*	**5** *EMU: Unemployment (Jun)* *EMU: Retail sales (May)*	**6**	**7** POL: Food prices (2H Jul) *EMU: GDP (1Q)*	**8**

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	25-26	23-24	27-28	24-25	17-18	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
Retail sales	22	21	21	22	22	24	21	22	19	21	24	19
Gross wages, employment	15	14	14	14	16	13	14	14	12	14	18	12
Unemployment	22	21	21	22	22	24	21	22	19	21	24	19
Foreign trade	about 50 working days after reported period											
Balance of payments	31	28	31	30	30	30	31	29	30	31	-	-
Money supply	14	14	14	14	14	13	14	14	12	14	-	-
NBP balance sheet	7	7	7	7	7	6	7	7	5	7	-	-
Business climate indices	22	21	21	23	22	24	22	22	22	22	21	22
Food prices, 1-15	-	7[d], 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

		Jun 02	Jul 02	Aug 02	Sep 02	Oct 02	Nov 02	Dec 02	Jan 03	Feb 03	Mar 03	Apr 03	May 03	Jun 03	Jul 03
GDP	%YoY	0.9	x	x	1.8	x	x	2.2	x	x	2.2	x	x	2.8	x
Industrial production	%YoY	2.1	5.7	-1.1	6.6	3.2	3.1	5.2	3.5	4.3	5.5	8.5	11.7	7.9	7.6
Retail sales ***	%YoY	2.5	8.6	5.1	4.7	5.1	5.9	4.9	4.1	4.2	-1.7	11.0	9.7	9.6	7.0
Unemployment rate	%	17.4	17.5	17.5	17.6	17.5	17.8	18.1	18.7	18.8	18.7	18.4	17.9	17.8	17.8
Gross wages ** ***	%YoY	3.9	4.1	2.8	3.8	0.5	1.8	2.4	2.7	2.1	0.7	4.2	0.0	1.5	1.9
Export (acc. to NBP)	EURm	2.797	3.177	2.727	2.912	3.182	3.004	3.223	2.761	2.635	2.957	2.969	3.060	3.121	3.246
Import (acc. to NBP)	EURm	3.508	3.791	3.642	3.826	4.241	4.090	4.166	3.895	3.219	3.467	3.833	3.668	3.668	3.851
Trade balance (acc.to NBP)	EURm	-711	-614	-915	-914	-1.059	-1.086	-943	-1.134	-584	-510	-864	-608	-547	-605
Current account balance	EURm	-451	-119	-284	-529	-580	-753	-484	-711	-483	-248	-460	-327	-177	-155
Budget deficit (cumulative)	PLNbn	-25.0	-25.7	-27.3	-29.8	-34.0	-37.1	-39.4	-4.1	-11.7	-15.5	-18.0	-23.2	-24.0	-26.3
CPI	%YoY	1.6	1.3	1.2	1.3	1.1	0.9	0.8	0.5	0.5	0.6	0.3	0.4	0.9	1.0
PPI	%YoY	1.2	1.7	1.3	1.1	1.7	1.7	2.2	2.5	2.9	3.6	2.9	2.1	2.1	1.4
Broad money (M3)	%YoY	2.5	1.3	-0.2	-1.5	-2.5	-1.0	-2.1	-1.4	-1.2	0.5	0.8	0.3	0.9	1.2
Deposits	%YoY	0.5	-0.8	-2.5	-3.5	-4.6	-3.2	-4.3	-4.1	-3.8	-2.3	-2.3	-2.9	-2.2	-1.9
Credits	%YoY	9.4	7.5	5.9	4.9	4.4	4.6	5.3	5.5	5.7	8.7	8.5	7.6	7.0	7.0
USD/PLN	PLN	4.03	4.12	4.18	4.15	4.12	3.95	3.91	3.84	3.87	4.01	3.96	3.74	3.80	3.92
EUR/PLN	PLN	3.85	4.09	4.08	4.07	4.04	3.96	3.99	4.08	4.17	4.33	4.30	4.33	4.44	4.43
Reference rate *	%	8.50	8.50	8.00	7.50	7.00	6.75	6.75	6.50	6.25	6.00	5.75	5.50	5.25	5.25
WIBOR 3M	%	9.30	8.89	8.55	8.07	7.45	6.81	6.82	6.56	6.37	6.17	5.90	5.53	5.38	5.25
Lombard rate *	%	11.50	11.50	10.50	10.00	9.00	8.75	8.75	8.50	8.00	7.75	7.25	7.00	6.75	6.75
Yield on 52-week T-bills	%	8.54	8.35	7.86	7.25	6.77	5.88	5.78	5.74	5.83	5.67	5.43	4.75	4.66	4.80
Yield on 2-year T-bonds	%	8.27	8.12	7.60	7.16	6.62	5.78	5.75	5.55	5.66	5.52	5.16	4.78	4.79	4.80
Yield on 5-year T-bonds	%	8.17	8.11	7.62	7.07	6.57	5.91	5.67	5.57	5.58	5.36	5.15	4.88	4.90	5.00
Yield on 10-year T-bonds	%	7.55	7.63	7.29	6.79	6.22	5.89	5.69	5.62	5.67	5.52	5.41	5.13	5.03	5.15

Source: CSO, NBP, BZ WBK
* at the end of period ** in corporate sector *** in nominal terms

Quarterly and annual economic indicators

		2000	2001	2002	2003	1Q02	2Q02	3Q02	4Q02	1Q03	2Q03	3Q03	4Q03
GDP	PLNbn	712.3	750.8	772.2	801.1	178.6	189.5	191.2	213.0	184.5	196.6	197.9	222.1
GDP	%YoY	4.0	1.0	1.4	3.0	0.5	0.9	1.8	2.2	2.2	2.8	3.0	3.8
Total consumption	%YoY	2.4	1.8	2.9	2.2	2.8	2.6	2.8	3.2	1.0	2.9	2.5	2.5
- Private consumption	%YoY	2.6	2.1	3.3	2.5	3.5	2.9	3.1	3.5	1.4	3.4	2.7	2.6
Fixed investments	%YoY	2.7	-10.2	-6.7	3.5	-12.8	-7.9	-5.9	-3.6	-3.6	1.6	5.0	7.0
Industrial production	%YoY	6.7	0.6	1.5	6.7	-1.6	-0.4	3.3	4.6	4.4	9.4	6.3	6.6
Retail sales (real terms)	%YoY	1.0	0.2	3.3	4.8	5.8	0.7	3.9	2.6	1.2	9.5	4.5	4.0
Unemployment rate *	%	15.1	17.5	18.1	18.2	18.2	17.4	17.6	18.1	18.7	17.8	17.8	18.2
Gross wages (real terms)	%YoY	1.3	1.6	1.5	0.9	1.9	1.4	2.3	0.3	1.4	1.4	0.6	0.3
Export (acc. to NBP)	EURm	28.255	33.823	34.746	36.403	7.853	8.668	8.816	9.409	8.353	9.150	9.200	9.700
Import (acc. to NBP)	EURm	41.423	46.848	45.712	46.450	10.847	11.109	11.259	12.497	10.581	11.169	11.700	13.000
Trade balance (acc.to NBP)	EURm	-13.168	-13.025	-10.966	-10.047	-2.994	-2.441	-2.443	-3.088	-2.228	-2.019	-2.500	-3.300
Current account balance	EURm	-9.952	-7.992	-7.188	-6.124	-2.659	-1.780	-932	-1.817	-1.442	-964	-1.375	-2.343
Current account balance	% GDP	-5.6	-3.9	-3.6	-3.3	-4.0	-3.6	-3.6	-3.6	-3.1	-2.7	-3.0	-3.3
Budget deficit (cumulative)*	PLNbn	-15.4	-32.6	-39.4	-38.7	-16.4	-25.0	-29.8	-39.4	-15.5	-24.0	-31.0	-38.7
Budget deficit (cumulative)*	% GDP	-2.2	-4.3	-5.1	-4.8	-9.2	-13.2	-2.5	-4.5	-4.9	-4.9	-5.1	-4.8
CPI	%YoY	10.1	5.5	1.9	0.9	3.4	2.1	1.3	0.9	0.5	0.5	1.1	1.3
CPI*	%YoY	8.5	3.6	0.8	1.5	3.3	1.6	1.3	0.8	0.6	0.9	1.1	1.5
PPI	%YoY	7.8	1.6	1.0	2.0	0.3	1.0	1.4	1.9	3.0	2.4	1.2	1.6
Broad money (M3)	%YoY	11.9	9.2	-2.1	3.8	3.2	2.5	-1.5	-2.1	0.5	0.9	3.0	3.8
Deposits	%YoY	15.5	8.9	-4.3	1.0	1.7	0.5	-3.5	-4.3	-2.3	-2.2	-0.2	1.0
Credits	%YoY	16.9	9.3	5.3	9.1	7.1	9.4	4.9	5.3	8.7	7.0	7.4	9.1
USD/PLN	PLN	4.35	4.09	4.09	3.85	4.16	4.06	4.15	3.99	3.90	3.83	3.86	3.82
EUR/PLN	PLN	4.01	3.67	3.88	4.29	3.63	3.81	4.08	4.00	4.19	4.36	4.36	4.26
Reference rate *	%	19.00	11.50	6.75	5.00	10.00	8.50	7.50	6.75	6.00	5.25	5.00	5.00
WIBOR 3M	%	18.78	16.10	9.09	5.58	11.02	9.80	8.50	7.03	6.37	5.60	5.23	5.10
Lombard rate *	%	23.00	15.50	8.75	6.50	13.50	11.50	10.00	8.75	7.75	6.75	6.50	6.50
Yield on 52-week T-bills	%	17.77	14.77	8.18	5.02	9.64	9.11	7.82	6.14	5.75	4.94	4.70	4.70
Yield on 2-year T-bonds	%	17.37	13.97	7.94	5.02	9.27	8.84	7.63	6.05	5.58	4.91	4.80	4.80
Yield on 5-year T-bonds	%	14.00	12.59	7.86	5.07	9.09	8.69	7.60	6.05	5.50	4.98	4.90	4.90
Yield on 10-year T-bonds	%	11.79	10.74	7.34	5.20	8.28	7.92	7.24	5.93	5.60	5.19	5.00	5.00

Source: GUS, NBP, BZ WBK

* at the end of period

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