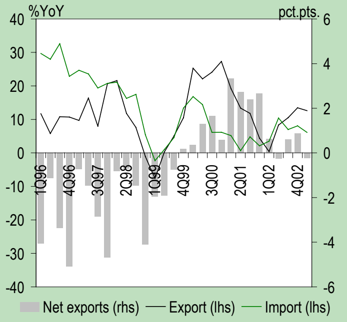
MACROscope

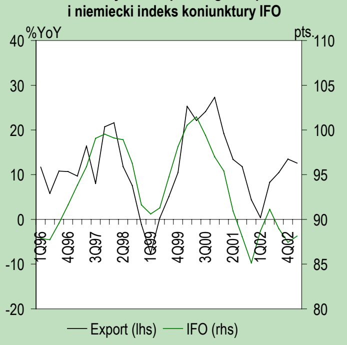
Polish Economy and Financial Markets

August 2003

Foreign trade turnover and net exports' contribution in GDP growth, const. prices



Realna dynamika polskiego eksportu i niemiecki indeks koniunktury IFO



Exciting export

■ **More and more distinct signals of economic revival, observed for the past few quarters, clearly indicate that exports play an important role in overcoming negative stagnation tendencies by our economy.** One could have an impression that for some time international trade has been a driver of the Polish economy without which it would remain stagnant. In order to shed a bit more light on the mechanisms determining Polish external trade, we have made an econometric research of the demand for Polish exports. Estimation results showed very high income elasticity and small price elasticity of export demand. It suggested that deep real depreciation of the zloty by over 15% within the past nine quarters with a concurrent slow-down in the development of the “fifteen” EU states (and recession in Germany) still does not fully explain high dynamics of the Polish exports’ turnover, growing regularly since the beginning of 2002. The negative dependence between the domestic demand in Poland and the Polish exports, which is confirmed statistically, can also be only a partial explanation. For a few quarters, we have been witnessing a regular increase in the dynamics of domestic demand. In such situation quite provocative thesis comes to mind that economic stagnation with our main trade partners could contribute to a change in the parameters of the demand function for our exports (growth in price elasticity, drop in income elasticity).

■ **Macroeconomic data for 2Q03 confirmed that a gradual recovery of the Polish economy, which we have been expecting for a long period of time, is materialising.** One can safely bet that GDP growth amounted to at least 3%YoY in 2Q03. It also seems that our GDP forecast for the whole year of 3%, which a year ago was perceived as overly optimistic, is very likely to materialise (or may be even exceeded). The economic recovery still does not transfer into higher labour demand and wage increase. As a result, June saw another fall of wage bill in the enterprise sector. Acceleration of the economy is also not reflected in monetary statistics. Inflation increased again in July but we expect that CPI in December will not exceed 1.5%YoY.

■ **In July, the Monetary Policy Council, for the first time this year, left all main interest rates on hold.** We expect that holiday break in monetary easing process will be continued in August. It will be decided by NBP governor Leszek Balcerowicz regardless whether new MPC member will attend August meeting or not (one of hawks will be absent). In the beginning of August, NBP governor warned (in our opinion excessively) that “one cannot exclude Argentinean scenario that the state will bankrupt”. Does central bank chief should cut interest rates in such situation?

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Financial market on 31 July 2003					
NBP deposit rate	3.75	WIBOR 3M	5.24	PLN/USD	3.8721
NBP reference rate	5.25	Yield on 52-week T-bills	4.90	PLN/EUR	4.3879
NBP lombard rate	6.75	Yield on 5-year T-bonds	5.46	EUR/USD	1.1332

This report is based on information available until 13.08.2003

Special focus

What drives export growth?

More and more distinct signals of economic revival, observed for the past few quarters, clearly indicate that exports play an important role in overcoming negative stagnation tendencies by our economy. Exporters constitute a group of entrepreneurs whose financial performance improves at the most rapid pace, their growth in new orders is the highest, their expectations of the future production and sales are the most optimistic; the highest industrial production growths are recorded in exports-oriented industries. One could have an impression that for some time international trade has been a driver of the Polish economy without which it would remain stagnant. Meanwhile, it seems logical to ask if, this is indeed a driver able to put the fast economic growth into long-term motion, or rather a life line, keeping Polish enterprises temporarily afloat in the period of slowing down domestic demand.

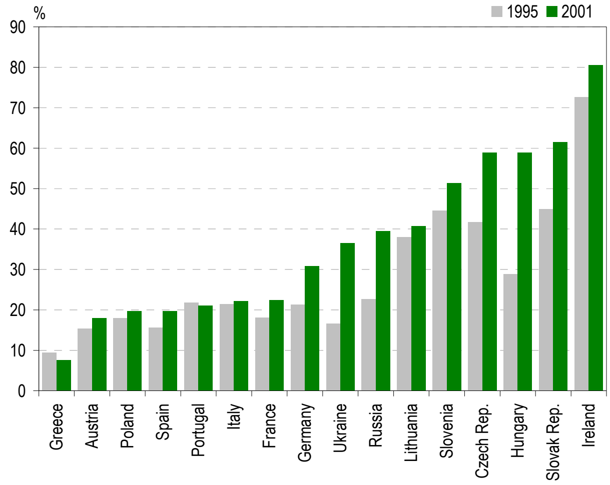
However, before we make this attempt to answer the question about prospects of the Polish exports and their potential translation into the economic growth dynamics, it is worth taking a closer look at its evolution over the past years as well as at the current situation.

Far away from the extra-class

We guess this is common knowledge that our country has no reputation of an exports power. Polish economy is characterized by a relatively low degree of openness to the foreign trade exchange. The annual ratio of exported goods totaling ca. 20% of the nominal GDP puts us at the end of the ranking list of OECD countries (although it is not much worse than most of big European economies). What is more, over the past years, we have not progressed significantly in this respect, contrasting to other developing countries of the region (see the adjacent graph).

On the one hand, this indicates a relatively small sensitivity of the domestic economy to the external demand shocks (which allowed our economy to overcome effects of the Russian crisis of 1998 relatively fast), but, on the other hand, it seems to limit potential benefits for the development pace which could become Poland's share in the aftermath of joining the EU and a single currency zone – unless we manage to boost our exports potential in the foreseeable future.

Exports / GDP, current prices



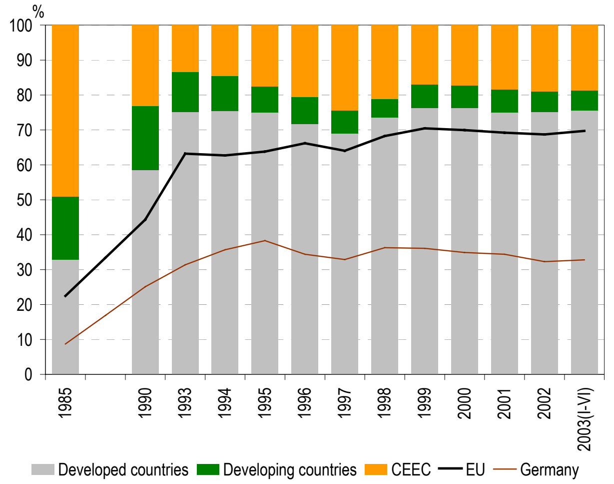
Source: CSO

Why does the scale of exports against the national income in Poland diverges so much from the corresponding ratios with our neighbors in Central-Eastern Europe? There are a few reasons for that. We have to remember, for example, that our economy is a few times bigger than the Czech or Hungarian one and a big internal market can constrict producers' penchant for foreign expansion. Such relationship can be observed among OECD countries, although it is not always binding (e.g. Germany with high share of foreign trade and Greece with tiny exports).

So far, unfavorable structure of industrial production (and consequently exports) has seemed to be one of the major barriers blocking demand for Polish goods It has been characterized by a small share of highly processed and technologically advanced products, able to compete in foreign markets with quality and not only price.

The structure of the Polish exports, similarly to other countries from Central-Eastern Europe, has been subject to thorough changes over the past dozen or so years of economic transformation. The biggest changes took place immediately after the shift in the social-economic system and establishment of free market – the trade with economically advanced countries, including primarily those of the EU has become very crucial. Its share in the Polish exports grew rapidly more than three times, to over 2/3 of total exports (see the graph). At the same time, a sudden drop was recorded in trade exchange with Central and Eastern European countries and former USSR.

Geography of the Polish exports, current prices



CEEC – Central and Eastern European Countries + former USSR
Source: CSO

The process, however, was related to a concurrent significant deterioration in the product structure of the Polish exports. While in the times of centrally planned economy, highly processed goods constituted a significant part of goods sold abroad (mainly to socialist countries), their share in exports after 1990 dropped suddenly, as they proved totally non-competitive in the market conditions. In the markets of Western Europe, in particular at the first stage of economic transformation, we were forced to compete mainly in terms of pricing, and not quality, exporting primarily all industrial goods with a relatively low degree of processing, raw materials and food.

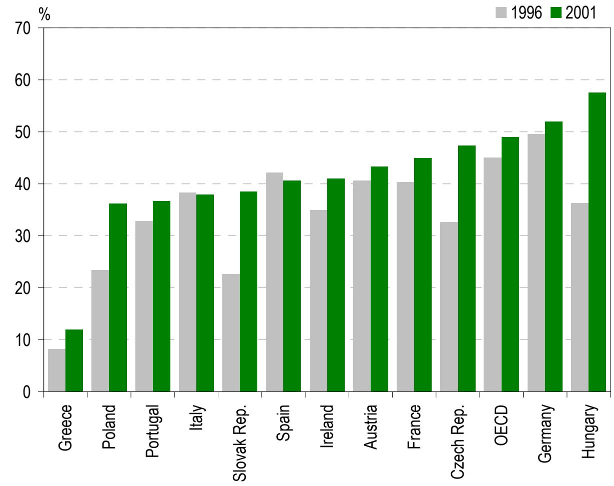
Polish exports – structure by SITC sections, current prices

	1985	1990	1995	2002	2003 (I-V)
Food and live animals	7.5	10.9	9.2	7.2	7.3
Beverages and tobacco	0.7	0.5	0.7	0.3	0.3
Crude materials inedible, except fuels	7.2	6.8	4.5	2.5	2.8
Mineral fuels, lubricants and related materials	15.7	10.7	8.2	5.0	5.0
Animal and vegetable oils, fat and waxes	0.2	0.2	0.2	0.0	0.0
Chemicals and related products	6.1	9.2	7.7	6.4	6.6
Manufactured goods classified chiefly by material	15.0	23.0	27.5	23.8	24.6
Machinery and transport equipment	*39.4*	*26.2*	*21.1*	*37.6*	*35.7*
Miscellaneous manufactured articles	6.8	7.5	20.9	17.2	17.6
Commodities and transactions not classified in SITC	1.4	5.0	0.0	0.0	0.0

Source: CSO

Fortunately, the situation in this area has been improving on a regular basis almost for the entire decade, in parallel with the development of Polish economy and improvement in the ability to use the comparative advantage. Particularly distinct (kicking off from a low level) has been a growth in the share of highly processed goods (machinery and devices) in exports to the EU. There is no doubt, however, that it is still difficult to describe Polish economy as innovative, and the technological standard of exported goods, though to a smaller degree than before, still lags behind comparable products available in the western markets. Despite a clear improvement over the past years, our share of machines, devices and transportation equipment in the total exports, still makes us one of the last countries in the list of OECD.

Share of machinery and transport equipment in total exports, current prices



Source: CSO

It could be concluded that since highly processed goods which could compete in international markets not only in terms of price but also quality, constitute a relatively small part of the Polish exports, the price flexibility of demand for the Polish exports should be relatively high, while the income elasticity should continue at a moderate level. The knowledge of the actual value of all these ratios should prove extremely useful not only in the effective projection of trends in the Polish exports but also in the right selection of actions and tools in the area of the state's economic policy. Thus, we have decided to run a wider empirical research with this regard. What is interesting, the outcome of this research points to the conclusions opposite to those driven by intuition – we will focus on it in more detail below.

What do the figures tell us?

Traditionally, the majority of export models are based on the equation for the demand for exports (in the form of log-linear function) where the key variables are: foreign demand and relative prices. The former is usually calculated using economic activity ratios of the key trade partners (GDP weighted with the share of the partners in the foreign trade), the latter is usually the real effective exchange rate. Our analysis is based on a similar approach, although we do realise it is not perfect. Limiting the analysis to demand only would be a major simplification, not always reflecting the reality. This is not only because it is based on the assumption of indefinite price elasticity of export supply (at least in long-term). The supply potential of exports may change significantly in a given economy as a result of structural and technological changes, economic integration, etc. which seems particularly important in the countries which are undergoing economic transformations and catching up with more developed countries. In order to take account of the changes on the supply side (e.g. the globalisation effect), at least partially, another variable was added to the analysed equation. The variable reflects the global "trade intensification": global exports / global GDP in the current prices (the solution has been drawn from empirical literature). Additionally, taking account of the large size of the Polish internal market, which for domestic producers represents a strong alternative to the foreign demand (especially when the external economic situation slumps), yet another variable was added – measuring the domestic demand in Poland as another factor taking account of the supply effect (as a result, we will also be able to test the hypothesis referring to "pushing out" the domestic production to the exports in the case of a slowdown in internal demand). As a result, the analysed exports equation is as follows:

$X = F(Y^*, d4REER, DD, T)$

where: X – represents aggregated Polish exports, Y* – economic activity (GDP) of the main trade partners; DD – Polish domestic demand; d4REER – annual changes in the real effective exchange rate; T – "intensification" of the international trade (all variables in the logarithms).

The results of the estimates along with a detail specification of variables are included in the "Technical appendix" pp. 7.

The statistical conclusions referring to the dependencies determining the shape of the Polish exports (similarly to the majority of other macroeconomic variables) has a limited potential due to several key factors. The first problem is, of course, the accessibility of comparative statistical data (time series) and the related relatively limited number of observations on which the calculations were based. In the discussed analysis, quarterly data was used covering the period from 1995Q1 to 2003Q1. An additional factor is the dynamic change in time of the structure and the force of dependencies to which the economic variables are subject. This is both due to the continued structural changes recorded in the Polish economy and the once-off events such as the Russian crisis (1998Q3). The latter was especially important for the Polish exports and its implications, e.g. for the geographical structure of the Polish foreign trade, are observed in Poland till this day.

However, what is interesting is that despite the above mentioned limitations, the results of the estimations made using three independent methods for two sub-periods (separately for the entire sample and exclusively for the post-Russian-crisis period) turned out to be statistically significant and very similar, which suggests that the dependencies between the variables are not accidental.

The signs of the estimated parameters match the intuition and economic theory – demand for exports is positively impacted by the economic activity (income) of the trade partners, and adversely impacted by the real effective exchange rate (appreciation of the currency drives the exports down). The force of the latter dependency (coefficient ca. 0.5) is much smaller than that of the former (well above 1). What also proved important was the reverse relation between the domestic demand and exports. This confirms the thesis referring to the phenomenon existing in the Polish economy and based on "pushing out" the home produce to exports if the internal economic climate deteriorates (which we are witnessing now). It also confirms the fact that businesses limit their export activity in the times of prosperity of domestic demand, as it is easy for them to sell the goods on the "hungry" domestic market. This effect is even stronger than the impact of the exchange rate.

These results are quite crucial in the process of projecting the Polish international trade's reaction to various economic stimuli. In particular, a small long-term price elasticity of demand for the Polish exports (i.e. sensitivity of demand for the changes in the relative prices of exports, measured by a change in the real effective exchange rate) and lack of a significant short-term dependency between the fluctuations in exports and changes in the real exchange rate imply that the (real) devaluation of the Polish zloty, strongly recommended by part of economists and a very numerous group of politicians as a panacea for revival of the Polish economy through stimulation of exports, would most probably, turn out a hardly effective tool. It can be assumed that the small value of coefficient in this part of the equation is a derivative, e.g. of a significant import-absorption of the Polish exports, which limits the effectiveness of pro-exports stimuli of exchange rate nature.

On the other hand, the high income flexibility of demand for exports allows us to hope that together with a speed up of economic growth with our major trade partners, the exports will play a role of a driver propelling economy also in our country and supporting long-term growth in GDP. But why, then – with such a high sensitivity of the Polish exports to the foreign demand within the past few (dozen) years – Polish exports failed to expand in a scale similar to our neighboring countries?

In fact, the income elasticity ratio was probably overestimated by the model for technical reasons which are discussed at more length in "Technical Annex". Additionally, it seems that the dynamic and long-term development of the Polish international trade was significantly constricted (and still is) by the supply side, not modeled in detail in this description. Apart from the mentioned earlier poor adjustment of the Polish exports structure (product range – low share of highly developed products) to the foreign demand (in particular, in highly developed countries), a number of structural factors (barriers) should be mentioned, as they are evidence of delays in the development of the Polish economy.

A long racetrack with hurdles

The high-paced modernization of industry in the Polish transformation, which would facilitate the adjustment of the Polish exports structure to the demand, was not aided by the structure of investment outlays, a big part of which is represented in Poland by traditional expenditure on passive production factors (buildings and constructions), and the fact that foreign direct investments (FDI) were mostly targeted at areas outside high processing sectors and in addition areas which do not generate strong positive effects for growth in exports. These investments were more targeted at internal market exploration. Majority of foreign investments went to financial intermediation, trade, transportation, food industry and construction (ca. 60% of total FDI).

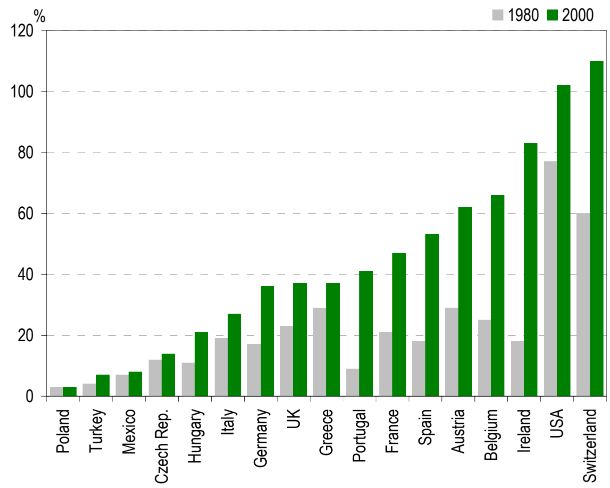
FDI in Poland – breakdown by sectors

	% of total
Financial intermediation	21.8%
Trade and repairs	12.3%
Transport, storage and communication	10.2%
Manufacturing: transport equipment	10.1%
Manufacturing: food, drinks & tobacco	9.7%
Construction	5.3%
Power, gas and water supply	3.7%
Manufacturing: chemicals and chemical products	3.1%
Community, social and personal services	3.0%
Manufacturing: pulp and paper, publishing and printing	2.8%
Manufacturing: electrical machinery and apparatus	2.7%
Other	15.1%

Source: PAIZ, as of 31.12.2002

Additionally, the factors which slow down the pace at which foreign investments reach Poland (still, without them it is hard to hope for the modernization of the Polish exports) are high labor costs in Poland (mostly non-wage costs), unstable tax system, slow-down of privatization. Another big barrier we cannot forget was and still is the infrastructure development, mainly transportation one. In those terms, Poland would have to be classified as a Third World country – according to the research conducted recently by the OECD, not only do we depart in terms of the transportation network from the world standards more than any other member of this organization, but we are also the only country (apart from Canada) where the development level of this area of infrastructure has not improved for the past twenty years!

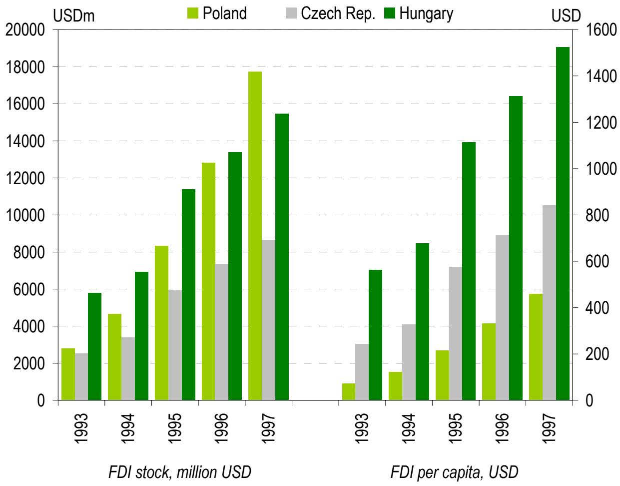
Composite index of transport infrastructure, USA 1995 = 100



Source: OECD (2003) Economics Dept Working Paper No. 359

It is no wonder then that the inflow of direct investments to Poland has so far been relatively small in comparison to the economic scale (though, in absolute figures we were the leader in the second half of the 90s), which most probably, has been highly instrumental in stifling the export potential of the Polish industry.

Foreign direct investments



Source: NBH (2000), Working Paper No. 2000/1

An additional element is the fact that intensive inflow of FDI into our country commenced a few years later than for example in Hungary, thus, potential positive effects of those investments for the modernization of economy and the exports performance could arise adequately later.

Where is the growth from?

All the above listed factors limiting the exports' prospects (and by no means is it a full list) are structural, long-term in nature. Hence, it is difficult to count on their quick withdrawal or disappearance. How then, in the light of those barriers and estimated outcome of empirical analysis, can we explain the regularly growing dynamics of exports over the past quarters, despite continuing stagnation in the EU's economy, and, in particular, with our main trade partner – Germany?

As a result of high income flexibility of demand for exports (even if it is partly overestimated), as well as low (particularly short-term) sensitivity to changes in relative prices, deep depreciation of the real PLN exchange rate by over 15% within the past nine quarters with a concurrent slow-down in the development of the "fifteen" EU states (and recession in Germany) still does not fully explain high dynamics of the Polish exports' turnover, growing regularly since the beginning of 2002. The negative dependence between the domestic demand in Poland and the Polish exports, which is confirmed statistically, can also be only a partial explanation. For a few quarters, we have been witnessing a regular increase in the dynamics of domestic demand.

A supplementary explanation for the latest trends in the Polish international trade can be a quite provocative thesis that economic stagnation with our main trade partners could contribute to a change in the parameters of the demand function for our exports (growth in price elasticity, drop in income elasticity). Intuitively, this phenomenon can be explained in the following way: in view of the budget constraints much stricter than in many years in the past, foreign consumers / companies have been forced to pay more attention than usual to price competitiveness of products, as a result of which, old habits (e.g, "I buy only Bosch wasching machines") gave way to choices based on new criteria. However, verification of this thesis in terms of its adequacy and quantity, will be feasible only after a sufficient time necessary to collect sufficient statistical data.

What is interesting, the analysis of the structure and dynamics of the Polish exports by industry branches, indicates that the factor which determines a significant growth in exports over the past dozen months have been price parameters – there has been, namely, a noticeable drop in the share and dynamics of highly processed goods for the benefit of products in the case of which the purchase depends more on the price rather than quality (raw materials, food, etc.).

Technical appendix

We have analysed long-term export demand function of the form:

$$X = F(Y^*, d4REER, DD, T)$$

where variables (all in logarithms) have been specified as follows:

Variable	Description	Time series used in the model
X	Polish aggregate export	Export of goods based on custom statistics, constant prices 1995=100, seasonally adjusted
Y*	GDP of main trading partners	EU-15 GDP, constant prices 1995=100, seasonally adjusted
DD	Polish domestic demand	Polish domestic demand, constant prices 1995=100, seasonally adjusted
REER	Real effective exchange rate	Real effective exchange rate of the zloty, 1995=100 (higher values = appreciation)
d4REER	= REER – REER(-4)	
T	"Intensity" of international trade	World exports / world GDP, US$ current prices; quarterly data series has been created by simple interpolation of available annual series

Results of Augmented Dickey-Fuller (ADF) tests showed that all the above-defined variables are non-stationary, integrated of the order I(1). Therefore, estimation of long-term equation by ordinary least squares method was inadequate, because of risk of obtaining biased estimates and finding spurious correlation between trended variables. To handle this problem, we have employed three alternative and independent estimation techniques when verifying long-term export demand equation: (1) ARDL approach to cointegration; (2) Phillip-Hansen's Fully Modified estimator; (3) Johansen's procedure of testing for cointegration. All three approaches allow for dealing with non-stationary data without yielding biased results. Econometric estimation was based on quarterly data from 1Q1995 – 1Q2003 period and used Microfit 4.1 software package.

If the number of I(1) variables in analysed long-term relation is higher than 2, it might tun out that there is more than one cointegrating vector. In such case univariate estimation techniques are not able to capture the true nature of long-term dependence, yielding misleading results. However, while the Johansen's tests for cointegration and the number of cointegrating vectors suggested the existence of only one cointegrating vector (with DD and T variables treated as exogenous in VECM model), then the two remaining estimation techniques have been considered as adequate.

The Russian crisis in 3Q1998 (in the middle of analysed sample) potentially might have caused a structural change of mechanisms determining behaviour of Polish exports. Therefore export demand equations have been separately estimated for the full sample period (1Q96-1Q03, while four quarters of 1995 were dropped because fourth difference of REER is used) and the period after the crisis (3Q98-1Q03). The results proved to be quite similar.

Following tables present the estimation results of long-term export demand equation.

Sample 1996Q1 : 2003Q1

	ARDL	FM estimator	Johansen
Y*	3.7780 (0.000)	3.2710 (0.000)	4.6656
d4REER	-0. 52759 (0.004)	-0.50700 (0.000)	-0.44162
DD	-0. 88312 (0.002)	-0.69662 (0.000)	-1.5497
T	2.6158 (0.000)	2.9946 (0.000)	3.3247
C	-16.6760 (0.000)	-16.4036 (0.000)	-19.9191

Sample 1998Q3 : 2003Q1

	ARDL	FM estimator	Johansen
Y*	4.7260 (0.000)	4.4806 (0.000)	4.8525
d4REER	-0.36207 (0.080)	-0.28984 (0.001)	-0.33462
DD	0.061297 (0.945)	-0.59179 (0.028)	-1.0689
T	1.5169 (0.095)	1.7409 (0.000)	3.8108
C	-22.3000 (0.000)	-18.6782 (0.000)	-24.7464

Notes: X is a dependent variable. C is an intercept. p-values are given in brackets, i.e. the probabilities of making mistake when rejecting null-hypothesis about statistical non-significance of a given coefficient.

After determining a long-term relation, a short-term model of export changes has been estimated with an error correction mechanism (ECM). The equation has been based on long-term relation from ARDL model (while the remaining two estimation methods gave similar results, other cases were not analysed). The equation has been estimated with an ordinary least squares (OLS) method for the full sample of 1Q96-1Q03.

Estimation results are presented in the following table.

Short-term ECM equation

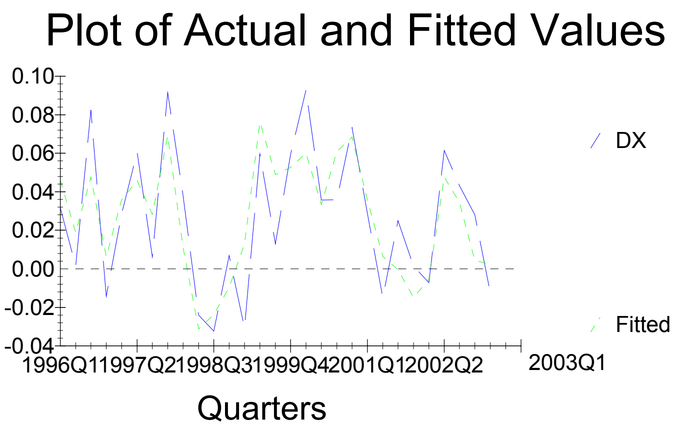
ΔYE15	3.1907	(0.038)
Δd4REER	-0.11521	(0.327)
ΔDD	-0.44606	(0.069)
ΔT	1.2141	(0.041)
C	-0.0047518	(0.600)
ECM(-1)	-0.82373	(0.000)

R^2 = 0.66581 DW = 2.1079

Notes: X is a dependent variable. C is an intercept. ECM(-1) represents residuals from the long-term equation, lagged one period. Symbol Δ represents first difference operator. p-values are given in brackets.

Short-term equation seems to be properly estimated, test statistics show no autocorrelation of residuals, lack of heteroscedascity and stability of regression. Signs of estimated coefficient are also consistent with expectations, although short-term impact of real exchange rate is clearly smaller than in the long run – the coefficient value is smaller and statistically insignificant.

The graph below presents actual and fitted values from the short-term equation.



PROBLEMS WITH ESTIMATED ELASTICITIES

Estimated income elasticity of export demand, fluctuating around suspiciously high levels of 3-4, at first glance raises concerns over the appropriateness of estimation technique. Although similarly high coefficients are not a rare phenomenon in an empirical literature, in most cases they were related to a use of inadequate econometric method, e.g. disregarding integration/cointegration of time series under analysis. Our approach (and in fact each of three independent methods) are believed to cope well with a problem of non-stationarity and cointegration. Therefore, high coefficient for foreign demand is probably resulting from something else. We have guessed two main potential reasons for such an outcome:

– Incomplete measure of foreign demand. Analyses like this most often use measures of economic activity abroad as a weighted averages of home country's main trading partners' GDP, with weights set according to the relevant shares in export volume. Due to problems with data availability, we have used aggregate EU-15 GDP value instead.
– The model focuses mainly on the demand side, while export fluctuations are also affected by the supply side developments. It is particularly important in case of transition and fast-developing countries, which might experience significant changes of export potential under the influence of various factors, like inflow of new technologies, modernisation of economy, abolition of legal and administrative restrictions, ongoing economic integration. The two variables included in our model (DD and T) that were supposed to capture at leas part of supply side dynamics, were most likely not sufficient.

In effect, this part of export's variability, which has not been explained by variables included in the model, might have caused excessively high estimates of YE15 coefficient. Therefore, a real income elasticity of demand for Polish exports is most likely lower than suggested by the results of our analysis.

Economic update

- **Strengthening of positive tendencies in real economy**
- **... while inflation pressure remains subdued**
- **There are still no signs of improvement on the labour market**
- **...and no significant change in monetary developments**

Macroeconomic data for 2Q03 confirmed that a gradual recovery of the Polish economy, which we have been expecting for a long period of time, is materialising. One can safely bet that GDP growth amounted to at least 3%YoY in 2Q03. It also seems that our GDP forecast for the whole year of 3%, which a year ago was perceived as overly optimistic, is very likely to materialise (or may be even exceeded).

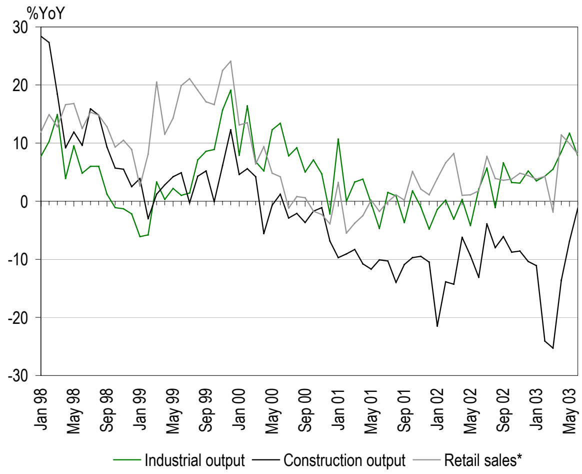
CPI inflation increased again and it was connected mainly with a low base effect in case of food prices. We think that this factor will continue to push annual inflation up in the remainder of this year. On the other hand, demand factors should remain subdued and this will constrain prices growth rate. We expect that CPI in December will not exceed 1.5%YoY. Lack of demand pressure in the economy is related to bad situation on the labour market. The economic recovery still does not transfer into higher labour demand and wage increase. As a result, June saw another fall of wage bill in the enterprise sector. Acceleration of the economy is also not reflected in monetary statistics. NBP data for June showed that credit activity is limited. However, there are several signals that there is a change for the better in the Polish economy. Among them it is worth noticing above all growing consumers' optimism and better results of business climate surveys.

The real economy is going really strong

According to CSO data sold industrial production dipped by 0.5%MoM and grew by 7.8%YoY in June. The figures were almost exactly in line with our forecast of 7.9%YoY. As in previous months production in manufacturing was the strongest (up 9.6%YoY) while output in mining and utilities fell by 5.8%YoY and 1.7%YoY, respectively. Seasonally adjusted industrial production advanced by 0.7%MoM and by 7.3%YoY. The only negative was lower than in the previous month number of branches, which recorded growth in production (20 out of 29 against 22 in May). However, this stemmed from the fact that data for May were exceptionally good due to an effect of the higher number of working days in comparison with May 2002. Looking at the whole second quarter of this year, industrial production increased by 9.3%YoY against 4.4%YoY in January-March period (seasonally adjusted figure by 8%YoY against 4% in 1Q03). Continued improvement in industry confirms that the economy accelerates and GDP growth in 2Q03 should be higher than in 1Q03.

Positive outlook for the economic growth was also confirmed by data on construction output. In June, this sector experienced sharp seasonal rise in output amounting to 15.9%MoM and its annual dynamics improved again to -1.2% from -6.9% in May. In the whole second quarter, construction output dropped by 7.2%YoY versus as much as 20.2%YoY in the three first months of the year. The structure of construction production shows that output in building installation and building construction (civil engineering) sections fell in annual terms, while sections preparing new construction investments and finalising them showed sharp increase (by 100% and 65%, respectively). Of course, one should remember that the figures for the first and second quarter of this year are deformed to some degree by one-off factor, i.e. severe weather conditions at the beginning of the year, which caused a shift in construction activity for subsequent months. However, the data for construction sector indicates that it is bringing out from the slump observed since 2000, which suggests a rebound in ainvestment activity.

Real activity indicators



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

Data on retail sales and unemployment rate brought little surprises. Retail sales in June were more than 2% lower than in May, however in annual terms it maintained a reasonably fast pace of growth of 8.1%YoY (against 9.7%YoY in May and 11%YoY in April). The fastest growth was recorded in case of food, drinks and tobacco, which sales increased by 17%YoY (up from 10.1%YoY in May). However, as expected, retail sales growth was also contributed heavily by purchase of motor vehicles (8.9%YoY), fuels (10.9%YoY) and clothing and footwear (7.2%YoY). Strong retail sales growth was confirmed by car sales, which increased by 13.3%YoY in 1H03 and was driven by imported car sales (growth of 33.4%).

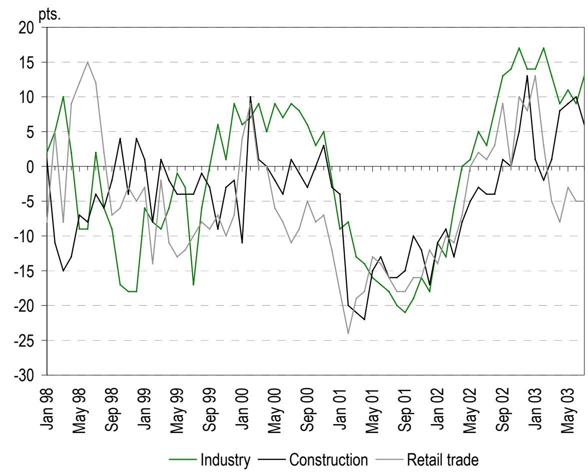
In the second quarter as a whole retail sales increased on average by 9.6%YoY in nominal terms, while real growth was not very much lower and could be estimated at ca. 9%YoY. This shows a significant improvement after a mere 1.2%YoY real growth of retail sales recorded in 1Q03 and it would be the best result since the beginning of 2000. It confirms that we should observe a substantial pick up of private consumption demand in 2Q03, following its deceleration to 1.4%YoY in the first quarter.

All in all, considering real economy data for a couple of previous months, one can conclude that a gradual recovery of the Polish economy, which we have been expecting for a long period of time, is materialising. Until recently we have been maintaining our GDP forecast for 2Q03 at 2.8% (produced a year ago, while during this period the others' estimations were gradually moving into our direction). Now we have a full set of data from the real sphere of the economy for the 2Q03 and one can safely bet that GDP growth in 2Q03 amounted to at least 3%YoY. It also seems that our GDP forecast for the whole year of 3%, which a year ago was perceived as extremely optimistic, is very likely to materialise (or may be even exceeded).

Continuously improving business climate

Positive outlook for the Polish economy is reflected in results of business climate surveys. In July, in line with our expectations, business climate in industry and construction remained positive, showing a continuation of positive trends recorded in previous months. Further improvement was recorded in industry, where business climate index reached 7 pts and was 13 points higher than in corresponding period of last year. Companies signalled a minor increase of new orders on the domestic market and a contraction of foreign orders. Nevertheless forecasted levels of new orders and production were assessed positively and were higher than in previous months. Inventories of finished goods are seen as only marginally exceeding an optimal level, entrepreneurs expected an improvement of their financial condition in future and planned continuing staff reduction at a scale similar to this observed in June. In construction the overall climate index was lower than in June, but still positive (15 pts) and much higher than in corresponding month of last two years. Entrepreneurs recorded a continuing inflow of new orders but they expressed concerns over its level in the upcoming months. They also planned a continuation of labour shedding process at broadly the same pace as in past. The worse situation was reported in retail trade. Business climate index was negative and lower than in July 2002. Companies signalled growing impediments for the level of sales, intensifying financial troubles and planned contraction of the sales level. Layoffs are expected to continue, but at slower pace than previously. As expected, the worst assessment was presented by the smallest trade companies, employing up to 9 people. However, negative business climate was maintained also in other groups of trade companies.

Business climate, YoY change



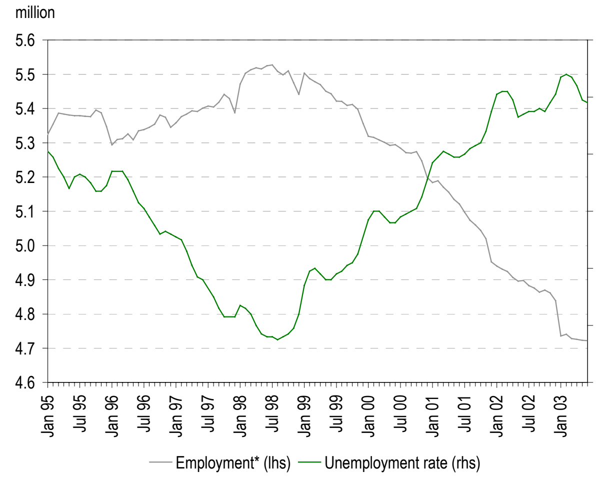
Source: CSO

Results of business climate survey suggest that positive trends in construction and industrial output should be continued in next months. Meanwhile, an impressing growth of retail sales observed in 2Q03 still does not find confirmation in assessment presented by retail trade companies.

Still badly on the labour market

The CSO data on employment in the enterprise sector brought a continuation of trends observed since several months. There was no change in employment on a monthly basis and in annual terms labour demand shrunk by 3.6% (we forecasted 3.5%YoY). The fall was deeper than last month and such developments in labour demand confirm our view presented many times in the past that gradual recovery of the Polish economy observed recently would be not accompanied by a visible improvement of the situation on the labour market.

Corporate employment and the unemployment rate



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

The unemployment rate in June matched our forecast declining to 17.8% from 17.9% in previous month. It still represented only a seasonal drop of unemployment rather than a permanent improvement on the labour market. The number of unemployed was still growing in relation to corresponding month of last year, however at slightly reduced pace. Now we expect the unemployment rate to stabilise for the next three to four months and it should return to ca. 18% by the end of the year.

Wages dynamics is very volatile in recent months. After no change in annual terms in May wages grew by 2.1%MoM and by 3.1%YoY in June. This was above our prediction of 1.5%YoY and consensus forecast standing at 1.6%YoY. Such acceleration of wages dynamics does not mean that we experience emergence of wage pressure. Looking at average growth rate of wages in a longer period of time, there is no need to worry about inflation. In January-June period, wages increased by 2.1%YoY, which is only slightly higher than 1.9% recorded after five months of the year. Higher than expected wage growth did not offset continuously deep fall of employment and in June wage bill in the enterprise sector dropped by 0.6%YoY in nominal terms and by 1.4%YoY in real terms. This shows that one should not expect strengthening of consumption demand in the nearest time and no significant inflationary pressure should be expected from this side.

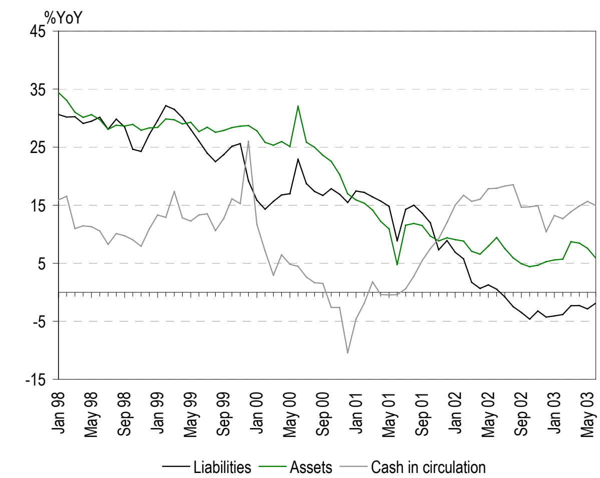
... but households are quite optimistic

Despite pessimistic statistical data from the labour market, results of a consumer optimism survey performed by Ipsos-Demoskop institute at the beginning of July showed another improvement. Monthly changes of optimism indicators were not impressive, as they remained roughly stable. However, the annual changes brought much more optimism - the overall optimism index (WOK) increased by 9.3%YoY, propensity to consume was up 3.5%YoY, and a general assessment of the economic climate showed the most significant improvement rising sharply by 18.6%. Authors of the survey concluded that households' declarations and level of their optimism are signs of economic recovery. Of course, as usual, households pointed to some impediments of economic growth, which included fear of unemployment, bad political climate and a lack of government's economic policy plan.

Money supply growth accelerates although credits activity weakens

Economic recovery is still not seen in monetary statistics. The NBP said that the broadest measure of money, aggregate M3, grew by 0.9%MoM and 1.3%YoY in June. The figures were above market consensus of 0.8% and our forecast amounting to 0.9%YoY. Acceleration of broad money supply was accompanied by an improvement in deposits' dynamics. Drop of overall deposits decelerated to 1.9%YoY from 2.9%YoY observed in the previous month. The improvement was a result of considerable acceleration of corporate deposits growth (from 9.1%YoY in May to 16.3%YoY) while households deposits kept falling (by 6.7%YoY against 7.1%YoY drop in May). Despite a decrease of total deposits, money growth was possible thanks to a continuation of sharp increase of cash in circulation (up 14.9%YoY) and other items of M3.

Banking system's assets and liabilities



Source: NBP

Developments on the credit side were weaker than in previous months, which stemmed from slow growth of corporate credits (3.0%YoY versus 6.1%YoY in the previous month). Total loans grew by only 5.9%YoY against 7.6%YoY increase in May. Consumer borrowing growth rate remained roughly stable amounting to 8.4%YoY versus 7.9%YoY in the previous month. However, one should remember that zloty-denominated value of households' credits in June would be lower if not the zloty depreciation during that month. Therefore, last month showed that credit activity in the Polish economy is weakening despite stronger signs of economic revival. The most likely explanation of this phenomenon is banks' risk aversion intensified by relatively restrictive regulations concerning risk provisions. However, we expect that this should change when the economy gains higher momentum and situation of creditors improves more visibly.

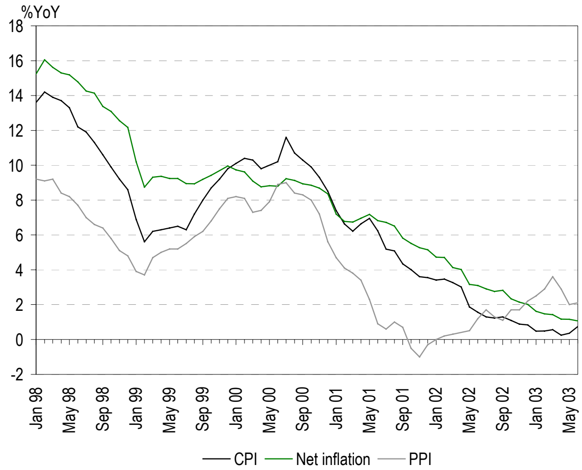
CPI accelerated to 0.8%YoY in June

Inflation in June increased to 0.8%YoY from 0.4%YoY in May. As expected, food prices were the main reason of CPI acceleration in June. Their dynamics was even higher than it was indicated by preliminary CSO data (-0.2%MoM) and amounted to 0.0%MoM. Taking into account very low base in 2002 it caused a significant acceleration of annual growth rate of food prices (from -2.5%YoY in May to only -0.6%YoY in June) and consequently the overall price level. On the other hand, fuel prices were lower than expected falling by as much as 2.7%MoM (preliminary data suggested stable prices). Therefore, growth of transport prices (3.7%YoY) was lower than in previous months and its negative impact on inflation diminished. Housing and energy prices were unchanged on a monthly basis and rose 3.3%YoY. Prices of other components of CPI basket were roughly stable and had little impact on 12-month inflation. All in all, June's inflation data confirmed our expectations for gradual acceleration of CPI during this year as an effect of reversal of downward trend in food prices. On the other hand, however, demand factors should remain subdued and this will constrain prices growth rate in the remainder of the year.

...and PPI stabilised around 2%YoY

Producer prices in June increased by 0.4% on a monthly basis and grew by 2.1%YoY (exactly matching our forecast) against revised 2.0%YoY rise in May. The most striking element of the data was growth of prices in the manufacturing of refined petroleum products sector, which amounted to 2.7%MoM. This contradicted CPI data for June pointing to a dip in fuel prices. A possible explanation of that phenomenon is the fact that there is a lag with which producer prices transfer into retail prices. Besides, stabilisation of PPI inflation around 2%YoY resulted from weakening of the zloty in the first half of this year. Finally, similarly to previous months, relatively high annual dynamics of producer prices (compared to CPI) stems from very low base effect last year. All things considered, we think that the data do not signal any change of low inflation environment in the Polish economy at the moment. Excluding low base effect, supply shock on the oil market and exchange rate impact, growth rate of producer prices would be much lower, showing no domestic demand pressure on prices.

Measures of inflation



Source: CSO, NBP

... while core inflation starts growing

According to the NBP four out of five measures of core inflation increased in June, confirming our expectations that a downward trend of those indices concluded together with a reversal of CPI drift. Only one measure: net inflation (i.e. inflation excluding food and fuels from the CPI) was slightly lower than in the previous month (1.1%YoY against 1.2% in May), indicating that an acceleration of price growth in June was caused by a worsening on the supply side. The sharpest increase (from -0.3% to 0.4%YoY) was recorded in case of CPI excluding administered prices, but this was driven mainly by the effect of low statistical base (index was stable on a monthly basis in June this year, while in June 2002 it fell by 0.5%MoM). Nevertheless, all the measures of core inflation remained relatively low after six months of this year, with two indices (CPI excluding most volatile prices and CPI excluding most volatile prices plus fuels) still below zero and all but one (net inflation) well below 1%YoY. The most informative, in our opinion, measure (15% trimmed mean) increased from 0.8% to 0.9%YoY. This suggests that no strong inflationary pressure is looming in the medium term in Poland, giving the MPC no sound reasons to concern over inflation growth in 2003 and most of 2004.

Lower crops will affect inflation (in 2004)

We have written for a few months that inflation scenario for 2H03 and in particular for 2004 will heavily depend on the situation on the food market. Let us recall that foodstuffs are the main component of the CPI basket in Poland, making up for almost 30% of average consumer spending. In 2001-02, agricultural production benefited much from exceptionally good weather conditions, which led to high output and significant fall in food prices. This in turn strongly pushed down CPI. This year was expected to be less favourable for farmers.

Information from the first half of this year suggesting that agricultural production will be considerably lower in 2003 than in the two previous years due to severe winter and following drought in summer (experienced not only in Poland but also in other European countries) was verified by the CSO data. Poland's grain harvest, excluding maize, is expected to fall to 21.7-22.7 million tones against 24.8 million tones produced last year, which means that this year's harvest will be lower than the 1997-2001 average. The output data implies that domestic grain production might not be able to meet demand needs, although agriculture officials say that duty-free imports allowed under an agreement with the EU should be sufficient to cover the shortfall. Moreover, contrary to grain output, production of vegetables and most of fruits would be higher than last year.

Preliminary estimates of agricultural output in 2003

	2002=100
Basic grain	87-91
Vegetables	102.4
Fruits (trees)	103-111
Fruits (shrubs)	97.7

Source: CSO

Given the fact that fruits and vegetables have similar share in CPI as cereal products, CSO data mean that although we will see a reversal of positive supply shock on the food market due to deep shortfall of grain production, it should be offset to some extent by relatively good results in case of fruits and vegetables. One should expect that shortfalls on the food market will transfer into consumer prices gradually, not immediately and the majority of this effect will be visible in 2004.

Continued reduction of external imbalance

In 1H03 Poland's trade gap considerably narrowed, as the difference between exports and imports reached €6.22bn against €7.64bn in the corresponding period of last year. This means that deficit in foreign trade decreased by 18.7%YoY in the first half of this year. In dollar terms the fall in deficit was much smaller and amounted to only 0.2%YoY as a result of movements in EURUSD rate. Trade gap denominated in zloty dropped by 5.2%YoY. Reduction of the deficit in the country's foreign trade stems from fast increase in exports and a contraction in imports. The table below shows foreign trade dynamics both according to CSO customs statistics and NBP figures on a payment basis.

Foreign trade in 1H03

	EUR	USD	PLN
Exports (%YoY)	3.3 (5.1)	26.9 (29.4)	20.5 (22.6)
Imports (%YoY)	-2.0 (-1.5)	20.4 (21.2)	14.3 (14.7)
Trade gap (bn)	6.22 (4.26)	6.82 (4.67)	26.44 (18.06)

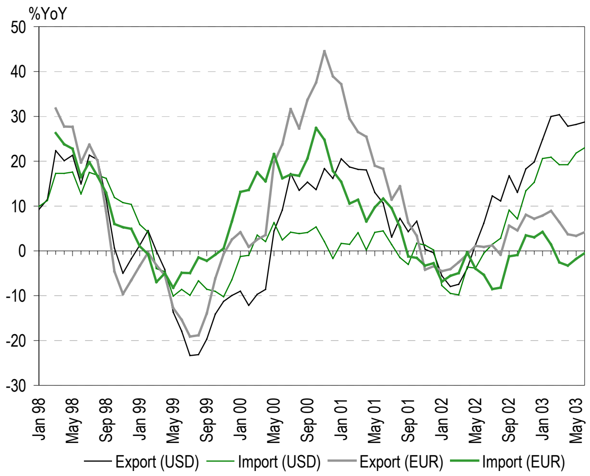
Note: NBP figures in parentheses
Source: CSO, NBP

The above data confirm that net exports were one of the main drivers of the economic growth in Poland in the second quarter of this year. One can be concerned, however, about slip in the euro-denominated value of imports as it may reflect prolonged stagnation in investment activity. Although it has to be stressed that imports dynamics improved in 2Q03 as compared with 1Q03, which means that one may count on some rebound of domestic demand in GDP figures.

The CSO figures showed little changes in the structure of Poland's foreign trade. Germany has still dominant share in Polish exports, amounting to 32.8% after the first half of this year, the same as in the analogous period of last year, which means that despite economic stagnation in the largest European economy Polish firms are able to increase sales on that market. Germany has also the biggest share in imports, which stood at 24.5% in January-June period.

Also NBP data on a payment basis indicated that reduction of external imbalance in the Polish economy is continued. Current account deficit dropped to only €83m in June from €411m in May and €451 a year earlier (100m below our forecast, leave alone market consensus). According to our estimates 12-month cumulative C/A gap reached 2.6% of GDP, down from 2.8% after the previous month. Trade gap amounted to €487m versus €681m last month and €711m in the analogous period of last year. Exports remained strong growing by 8.4%YoY after 6.4%YoY increase in May. Although we expected slightly better result, the data show that foreign demand for Polish goods is still growing despite prolonged economic stagnation in Poland's main trading partners. We expect that positive trend in export will maintain in the remainder of this year. At the same time imports should accelerate reflecting gradual strengthening of domestic demand. For the time being, imports recorded a mere 0.3%YoY growth in June after four consecutive months of annual falls.

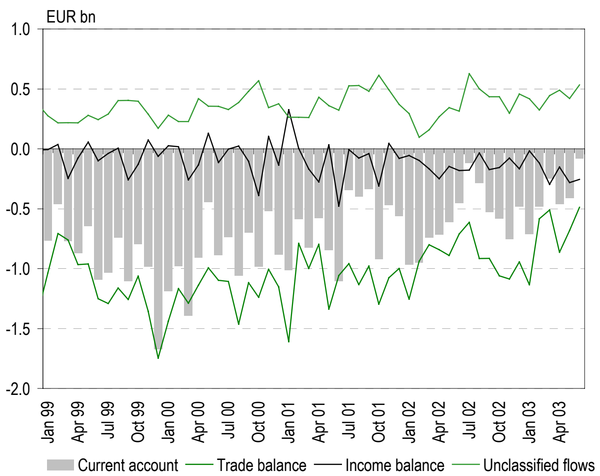
Foreign trade turnover (3-month moving average)



Source: NBP, BZ WBK

Apart from relatively low trade gap, drop of C/A deficit was a result of high surplus of unclassified flows. It reached €534m, up from €421m in May and €315m in June 2002. This stemmed probably from high shuttle trade turnover, but additionally from the fact that weaker zloty could induce households to sell foreign currencies.

Balance of payments, selected components



Source: NBP

Other elements of the current account had little impact on the amount of the deficit - services balance amounted to -€67m, income balance totalled -€255m and transfers balance reached €192m surplus. On the financial account we saw again very low inflow of FDI (only €87m) and outflow of portfolio capital from the fixed income market of €434m (we are likely to see a continuation of this effect in July data).

Budget deficit reached 61.5% after 1H03

Budget gap in January-June period reached PLN23.8bn or 61.5% of the annual plan. In comparison, at the halfway point in 2002, the deficit had reached 63.4% but this was without the central bank's profit, which was transferred to the budget this year in June (in the amount of PLN4.7bn) and in 2002 in July.

Total budget revenues after six months amounted to PLN71.9bn or 46.2% of the annual plan. Revenues from indirect taxes, which are the budget's biggest source of income, were weak in June falling by -14%YoY. As a result, their growth rate after six months of the year decelerated to 2.5%YoY from 6.8%YoY after May (against 7.5%YoY planned for the whole 2003). Flows from CIT were also low plummeting by as much as 55.5%YoY in June alone and by 14.3%YoY in January-June period against 10.1%YoY drop in the first five months of this year and -4%YoY planned for the whole year. Weakening revenues from VAT and CIT are difficult to explain taking into account improvement of firm's financial stance and high dynamics of retail sales. Although the latter could be to some extent justified by the phenomenon revealed recently by deputy finance minister Hailna Wasilewska-Trenkner – many companies that made losses in last two years now pay low (or no) income taxes because they account for past deficits, even though their present earnings are growing. Still, low proceeds from indirect taxes seem to be at odds with recently observed sharp upturn in economic activity. Revenues from PIT grew by 15.9%YoY in June and by 9.5%YoY after half of the year versus 8.5%YoY in January-May period. This suggests that despite wages in corporate sector increase at very slow pace, other components of households' registered income perform much better.

Total budget expenditures after June reached PLN95.7bn or 49.2% of the annual plan. Likewise in previous months of this year, the fastest rise of expenditures was recorded in case of subsidies to the Labour Fund and to the Social Security Fund. As regards financing of the deficit, there were no changes in its structure after June. Revenues from privatisation after June were unchanged from the end of May and reached only PLN1.17bn or 15.8% of the annual plan. Therefore, budget gap was financed through increased issuance of treasury bonds and treasury bills. All in all, although budget performance after the first half of this year was slightly disappointing, there is no reason to expect problems with budget execution in 2003.

Central bank watch

- **Interest rates unchanged in July**
- **We expect another rate cut in September**
- **Jan Czekaj in the Monetary Policy Council**
- **... but this will be important only in September**

No change in monetary policy parameters

In July, the Monetary Policy Council, for the first time this year, left all main interest rates on hold, breaking the series of cuts initiated in January. The reference rate will continue to be at 5.25%, the lombard rate at 6.75% and the deposit rate at 3.75%. Such a decision was in line with expectations.

The MPC's official statement issued after the meeting and comments gave by NBP governor Leszek Balcerowicz during the press conference showed that the main argument behind leaving interest rate unchanged was an improvement in real sphere of the economy and a threat of widening of budget deficit in coming years, though inflation outlook was still positive. As in previous months, the MPC listed a group of factors reinforcing persistently low inflation in Poland and curbing inflation in the future, including, among others, low core inflation, low growth of wages, low dynamics of broad money and limited demand for loans in the banking sector, and still low inflation expectations of households. On the other hand, the MPC said that reinforcement of symptoms of economic recovery in Poland and prospect of an increase in budget deficit could be potential sources of inflationary pressure in mid-term perspective and therefore were limiting the scope for monetary easing. In particular, the MPC pointed that industrial output dynamics (7.8%YoY increase in June) confirms upward trend of output volumes, situation in construction improves and business climate in construction output and manufacturing significantly warmed up. Also, the MPC said it took into account the scale of up-to-date interest rate cuts that would have delayed influence on the growth of domestic demand in 2H03 and in 2004.

Central bankers paid a lot of attention to perspectives of fiscal policy. According to MPC estimates the economic deficit reached 5.2% of GDP in 2003 against 5.0% in 2002 r. NBP governor said that budget deficit in 2004 at PLN45bn does not mean tightening of fiscal policy but "disclose worrying shortages". MPC member Marek Dąbrowski noticed that in comparable methodology deficit at PLN45bn means in fact over PLN50bn. It is a consequence of the fact that in budget for 2004 transfers to open pension funds will not be included in current expenditures as it was done this year. The MPC said that a perspective of economic deficit growth in 2003 and 2004 is a potential source of inflationary pressure. At the same time, central bankers stressed that expansionary fiscal policy is especially dangerous when economic growth is accelerating.

The MPC decision and latest statements of particular MPC members show that the Council becomes more and more hawkish. Although there is no threat for this year's inflation target, accelerating economic growth and expansionary fiscal policy limit the scope for further monetary easing. It seems that in the nearest months the MPC would be waiting for clarifying of the situation in public finances (a complete shape of budget draft and medium-term fiscal plan at the beginning of September) and would be closely watching the pace of economic revival. We think that the cycle of interest rate reductions has not finished yet, but scale for possible monetary easing is relatively small (at least during this term of the MPC). In current circumstances next decisions of monetary policy are likely to be focused on gradual adjustment of interest rates level to the scale of inflation acceleration and the strength of the economic recovery. MPC member Dariusz Rosati said that further cuts would be possible if inflation stayed low and economic recovery remained moderate. Decision about interest rates reductions will depend on NBP president's, Leszek Balcerowicz, view and we think that another 25bps rate cut would take place in September.

The MPC confirmed that it started a discussion about lowering obligatory reserves. However, as we expected, no decision was made. The discussion will be continued during the nearest meeting of the MPC scheduled for 26-27 August, however, as NBP deputy president Andrzej Bratkowski said no decision should be expected this month either. As we have written many times in the past, reduction of reserve requirement ratio would be another factor limiting the scope for further interest rate cuts this year.

SLD picked candidate for the MPC

The presidium of the ruling party SLD chose deputy finance minister Jan Czekaj to fill a vacating post in the MPC. Czekaj began his work in the ministry when Grzegorz Kołodko was minister of finance and he has been responsible for tax policy, accounting and public finance discipline. He also participated in recent meetings between government officials and central bankers on ways to use the bank's foreign currency reserves to buy back a part of Poland's foreign debt.

Czekaj, professor at Cracow school of economics, is seen as a dove and his appointment should restore the balance within the MPC between hawkish and dovish faction of the rate setting panel. This would mean that, similarly to a few previous months before MPC Janusz Krzyżewski's death, central bank chief Leszek Balcerowicz will have a decisive vote on possible rate cuts. Czekaj used to strongly advocate deeper interest rates reductions, which is confirmed by his statements from recent months presented below:

- *Inflation has been so far falling much faster than the MPC's own forecasts, which implies that monetary policy had been too tight. If the inflation goal is not overshot, there is no basis to tighten policy. Past monetary policy had been too restrictive and there had been more room to lower interest rates.* **Reuters, 6 August**
- *I reiterate my opinion that to-date MPC's policy was too restrictive. Possible interest rate decisions will depend on the economic situation, that is inflation, unemployment and economic growth rate.* **PAP, 30 July**
- *The finance ministry has long been saying that interest rates are too high. This, of course, means that we will see the need for cutting them. However, we would like to see the interest rates cuts to be bolder than what we have seen so far. This, next to lower taxes, would be an important economic growth stimulus.* **www.mf.gov.pl, 24 April 2003**
- *There is no possibility of stimulating GDP growth by radical decrease of taxes. Spending is less sensitive on GDP growth. The necessity of indexation means that spending cannot adjust to the revenue side of the budget. The main burden of public finance reform is on the spending side. The liquidation of valorisation mechanism is necessary, as there is no other possibility to decrease deficit, as via lower share of fixed spending in the budget.* **PAP, 20 March 2003**
- *If the MPC keeps high real interest rates, the economic strategy of the government would be uncertain. (...) Higher fixed investments outlays would not be possible without lowering real interest rates to below 5%.* **Gazeta Wyborcza, 13 March 2002**

Parliament is expected to vote on the appointment of the new member of the MPC after the summer break (the first parliamentary session after holiday starts on 26 August - just when the MPC starts its monthly meeting). SLD candidate actually seems to find relatively broad support in the parliament (of PSL and a few other minor parties) and he is expected to win the vote, although MPs will also vote on other candidates, including professor Jan Winiecki proposed by the Civic Platform. According to the Polish law, Jan Czekaj could be also appointed for the next full term in the office, and Jerzy Jaskiernia confirmed such scenario.

It is not important when Czekaj joins the Council

It is not certain when the new MPC member will join the Council and whether it is possible that he might participate in the August meeting. According to advisor to NBP governor Łukasz Kwiecień, if the Lower House of the parliament would appoint new member of the MPC on 26 August, he would be able to take part in the MPC meeting scheduled for 26-27 August. The problem is that the parliamentary public finance committee has to prepare official opinions about all proposed candidates for the post, which will take them a few days. Of course, if despite of the above-mentioned factors, Jan Czekaj could join the Council for August meeting, he would undoubtedly reinforce the dovish faction. However, this would not increase chances for another interest rate cut already this month, as most likely ultra-hawk Marek Dąbrowski would miss the nearest voting due to his holidays plans. In such a situation, casting vote of NBP president Leszek Balcerowicz would be crucial. The issue whether the new member of the MPC would join the panel already in August would be important only if Marek Dąbrowski could attend the meeting There is only one scenario when Balcerowicz's vote will not decide about the cut – Dąbrowski is present, new member is absent.

In our opinion one should not expect Balcerowicz to support rate cut in August. His recent statements suggest that he does not see a need to reduce rates, at least until we will get know Hausner's plan of changes to budget spending in coming years, which is to be presented on 9 September. Although Balcerowicz stressed risks on the side of fiscal policy many times in the past and at the same time he voted for interest rate cuts, we believe that now he will want to prove that he means what he says. What is more, at the beginning of August he warned "one cannot exclude Argentinean scenario that the state will bankrupt". Well, central bank president should not cut interest rates in such situation.

Comments of the MPC members and central bank representatives

Last month central bank representatives' comments were focused on three issues: fiscal policy, perspective of joining ERM-2 system and the Eurozone, and agreement between the NBP and the government as concerns revaluation provisions and FX reserves. NBP officials remain consistently sceptical about the government's fiscal policy. NBP president (giving a speech in the parliament reviewing monetary policy in 2002) as well as NBP deputy governor gave a number of comments on this issue, saying that high fiscal deficit could constraint a scale of monetary easing. Andrzej Bratkowski said also that any loan or purchase of hard currencies by the government from the FX reserves cannot be much higher than ca. US$1bn. Also NBP president Leszek Balcerowicz ruled out a big transaction, which could reduce FX reserves substantially. However, Dariusz Rosati hinted that MPC is divided on how much of the FX reserves can be lent to the government for premature buy back of Poland's foreign debt, as in his opinion it could be ca. USD3-4bn (the MPC did not consider large amounts e.g. 10bn).

Other statements confirmed that internal splits in the Council are not limited to the reserves management issue. MPC members saw stronger and more numerous signs of economic revival. The hawks (Grabowski, Józefiak) argued that there is no more room for monetary easing, while the doves (Rosati) still saw a chance for interest rate reductions. Also, we saw contradictory comments of MPC members after food prices release. While for Wiesława Ziółkowska their indicated that there is still scope for rate cuts, other MPC member Bogusław Grabowski said that the data confirm that positive shock on the food market is reversing, which will transfer into acceleration of overall inflation indicator. Meanwhile, SLD's candidate for the MPC member Jan Czekaj gave an early taste of views he would represent in the Council (there is no doubt about which faction he would join), saying that past monetary policy was overly restrictive, and suggesting that central bank's decisions should account for GDP growth and unemployment rather than focusing only on inflation. He said also that it is difficult to fight weather conditions with interest rates, if weak harvest in agriculture would result in higher inflation. This confirms that there is still an appetite for more interest rate reduction amongst the MPC doves (current and future member). However the fact that Ziółkowska (and recently also Rosati) put some conditions, which are necessary to reduce rates more, might suggest that the scope for rate cuts is indeed very limited. Especially, as Ziółkowska said that GDP growth may reach above 3% in 2003 and 5% in 2004. Of course, the members from the hawkish faction have different opinions. While Cezary Józefiak said that risk of inflation increase does not exist at the moment, in his opinion further depreciation of the zloty could be a potential driver of prices' increase. He added that that GDP growth acceleration is still uncertain, as investment growth is still not visible.

While NBP governor was still arguing that Poland should enter Eurozone already in 2007, other MPC members were very sceptical whether this was a realistic date. According to Dariusz Rosati even 2009 does not seem to be plausible without fiscal reforms. NBP deputy governor Andrzej Bratkowski said that not only Eurozone entry, but also ERM-2 admission should depend on the chances to meet all Maastricht criteria. He believes zloty should stay within ERM-2 as shortly as possible, so if euro adoption was to be delayed because of fiscal policy stance, one should not hurry up with introducing ERM-2 system in Poland.

It seems that most of the MPC sees a need for lowering reserve requirement, however the time has not came yet – according to Dariusz Rosati such operation could take place in 4Q03 or 1Q04. Andrzej Bratkowski ruled out such decision in August.

WHO. WHEN. WHERE	COMMENT
Leszek Balcerowicz NBP governor Parkiet, Reuters, 31 Jul	One cannot rule out that economic growth would reach 5% [in 2004]. However, the main problem is not GDP growth in 2004, but in the long run. In market economy we have business cycles, there comes recovery after a period of stagnation. However, it would not last long if the fiscal conditions do not improve. It is all about permanent deficit reduction by spending reform. In line with earlier proposals, the NBP and FinMin are discussing to what extent the central bank could support the government in early buy-back of foreign debt. I underscore that the scale of such operation cannot be high, because the level of FX reserves is crucial for our economy.
PAP, 24 VII	Our mission is maintaining low level of inflation. (...) I would like to leave no doubts that monetary policy will be focused at what we have achieved that is price stability. I stress that one has to look at enormous scale of interest rates reductions, which has been done so far: from 10.0% in February 2001 to 5.25% presently that is by almost 14 pp compared to only 1.5% reduction in Hungary and 3% in Slovak Republic. We said that one could consider some version of operation that was done two years ago, when we lend money to the government for an earlier payback of Poland's debt to Brazil. I would not like to determine whether it would be loan or other form of operation. We conduct working talks but I can say that we will not decide on anything that could undermine stability of our currency.
Reuters, 23 VII	These examples [of the other countries] indicate how important for sustainability of low inflation is keeping cautious monetary policy. Adverse proceeding most often results in higher costs and brings in nothing to economic growth. Room for manoeuvre in monetary policy was strongly narrowed due to a situation in public finances. High budget deficit increases threat of higher inflation. […] Permanently sick public finances not only increase a risk of higher inflation but also in other ways hurt long-term development. Limiting the deficit, which is necessary for fast and sustainable development, does not have to lead to a temporary slowdown in growth. On the contrary, it may cause its immediate acceleration. A credible plan of cutting excessive public spending would enable people to expect taxes to fall in the future and that their disposable income would increase.
PAP, 18 Jul	The signals of recovery are becoming stronger and stronger. Those signals are repeating and building up. Industrial output is growing robustly. The situation in construction sector is improving. [...] Those data are encouraging and show strengthening of recovery. Its persistence depends on the structural reforms. Factors limiting future inflation growth also persist. Inflationary expectations are low. Wage discipline strengthens in companies, money supply growth remains low. [Budget deficit at PLN45bn] does not show any deficit reduction in relation to previously proposed level. It is rather revealing troublesome shortcomings.
PAP, 15 Jul	With sufficient political determination, Poland can enter the euro zone in 2007. […] This chiefly depends on a decision on Poland's public finances' reform. Thanks to it we could lower public finance deficit to below 3% of GDP. […] This is a last condition that we should fulfil for our interest in order to have a European currency. It pays Poland to carry on such a policy that restoration of public finance would not be delayed, strengthening economic growth in that way. It would create conditions to adopt the euro. We will certainly start discussions about it [lowering mandatory reserve rate]. It is not a secret that the reserve rate is higher in Poland than it is in the EU. We should gradually lower this burden.
Rzeczpospolita, 8 Jul	No central bank governor would announce a retreat from lower inflation. But one cannot acknowledge something that one reached as given forever. Low inflation must be cultivated. The most important factor, which has to be taken into account when forecasting interest rate cuts in Poland, is the fact that we have made a gigantic cut from 19% to 5.25%. […] We have made enormous interest cuts. At the same time signals of gradual acceleration of the economy are stronger. This says something about the so- called room for further rate cuts.One cannot assume that future MPC members will want to put low inflation at risk. Decisions must be taken with the best will, on a basis of accessible information and forecasts.

Rzeczpospolita, 8 Jul	It does not pay us to be there [in ERM2] for longer than two years. This system is not better than the one we have at present. So we have to experience the ERM2 only because it is required. This is the road to the euro. We have to wait for a concrete plan. [...] If an increase of budget deficit by minister Hausner would be just an adjustment for the elements, which were unrealistic [revaluation provisions, too high privatisation revenues], this would be positive news. The other issue is the amount of budget deficit and its influence on economic stability and development. It is very important to implement such changes, which would ensure lowering budget deficit. The effects if such policy should be reliably estimated, to present a clear perspective of Polish public finance sector.
DPA, PAP, 1 Jul	Starting from 2007 we should be there [in the Eurozone]. It is important that we should meet the criteria of Stability Pact. […] We have already met inflation criterion and the rest of them we will meet soon. I reiterate, if possible we should meet criteria of the monetary union already today and not ease them. Referring to current problems of bigger countries does not help Poland.
Andrzej Bratkowski, deputy NBP governor; Reuters, 31 Jul	A cut in the mandatory reserve rate is August is unlikely. Slightly more likely would be September, when the central bank will decide whether to cut in one or more moves. The figure is better than one could expect. By the end of the year the CA deficit can widen to around 3% of GDP along with slight zloty appreciation. […] We had very strong exports in the first half of the year, supported by a weaker zloty. We have to do with stabilisation in imports with revival in production.
PAP, 29 Jul	The probability of further interest rate cuts is systematically falling, although cuts cannot be ruled out. But the probability is now lower than a month ago, when there was still hope the government would propose more credible budget plans, with a lower deficit and more restrictive fiscal policy. These plans are worrying and signal fiscal loosening. Based on comparable methodology, the budget deficit in 2004 would exceed PLN60bn. […] Next year's budget plans, without presenting spending reforms, threaten to deepen macroeconomic imbalances and may put in danger Poland's fulfilment of the inflation criterion in 2005; it may mean increase in debt servicing costs. The remaining question is if the present government is able to show a concrete program of reform on expenditure side. The first possible date to enter the Eurozone is 2007, but this target is now seriously threatened. A more likely date is 2008, and that is realistic only if there is a plan for fiscal consolidation and with hard efforts of the government. […] But if we fail to join in 2007-2008, then we will not join before 2012, as the budgetary crisis will not disappear in the following years, but will gain in force instead. The NBP will not agree to ERM-2 entry if there is no certainty that the fiscal convergence criterion will be met in the first year of that stay, since it would be dangerous for macroeconomic balance. […] In present conditions it [the parity in ERM-2] could stand at PLN4.30-4.50 per EUR1, but still everything can change. When fixing the parity we should take into consideration the exchange rate in two preceding years and analyse the reasons of changes in it. After recent data, e.g. on industrial output growth, one cannot exclude completely that the economic growth will exceed 3% this year, although there are still many threats. It seems that present revival is to large extent caused by good performance of foreign trade. We don't know yet whether we will lend or sell the hard currency to the government [for repayment of foreign debt], but if it was to be a one-off operation the amount should not be much higher than $1bn. Also if there were to be a few such transactions, their cumulative value should not be significantly higher than $1bn. We can make efforts to help in earlier repayment of foreign debt. However, one should remember that using FX reserves for foreign debt repayment is one-off operation while balancing budget requires permanent balancing of revenues and expenditures. The scale of any operations should be curbed by the need to maintain stable currency reserves, which we will need after entering ERM-2 and which will be an anchor stabilising economy, particularly in the context of fiscal loosening. Such an operation [selling hard currencies at a preferential rate] would be dangerous, also for the government as it could undermine confidence in economic policy and lower transfers to the budget in following years.
PAP, 9 Jul	We are estimating the inflation at the end of this year at 1.5-2.0% If Poland meets the Maastricht criteria at the end of 2007 we could join the euro zone not earlier than in 2008, but there are fears that due to the procedure of convergence criteria assessment this may take place in 2009. We are waiting for consultations with ECB [on setting the parity], to take place in August. We want to find out what the ECB thinks. Further cuts in interest rates cannot be ruled out. But they depend on information that will be appearing, if it would confirm revival in the pace of economic growth and on that pointing to inflation threats. [3.5% GDP growth] I think it is an optimistic forecast but we do not exclude it. There is a chance for reducing mandatory reserves this year.
PAP, 2 Jul	The government said that budget deficit criterion may be met in 2007-08 and we would like to see it as soon as possible. I understand that the government would like to adopt zloty by euro as early as possible as well and that is why we are waiting for more precise plans in this regard. The condition of further negotiations [with EU about ERM2 entry] is an agreement between the Polish government and the NBP. We have to have a very credible plan to meet all required criteria one year before EMU entry. The government has to prepare itself for it; pure declarations are not sufficient. At the end of the year, inflation will probably reach the lower end of the target, although we cannot exclude a possibility of inflation falling below 2%. It would depend on short-term factors outside of our control - zloty exchange rate, the scale of economic recovery in 2H03 and on supply factors development. [...] Our today's policy is targeted on next year inflation target. Export allows domestic firms to survive despite a fall of domestic demand connected with a temporarily lower investment activity. Quarterly estimation of GDP is biased and we are not sure about the level of GDP growth in 1Q03. However, 2Q03 should be better than 1Q03, we will see whether it is possible to enter 3% growth level. NBP should concentrate on its main tasks, maintaining low inflation above all. This does not exclude a possibility of co-operation with the government as regards early foreign debt repayment. […] Agreement between MinFin and NBP is important if it is positive for the economy. News about co-operation and no conflict between the two institutions could be positive for the market in the short-run. However, the budgetary reforms on the spending side will be of crucial importance for the Polish public finance situation. This would allow a reform on the revenues (taxes) side. And this will be the most important for the exchange rate in the longer-run.
Marek Dąbrowski MPC member; PAP, 18 VII	The government changes methodology of calculating the deficit. In comparable methodology deficit at PLN45bn means in fact over PLN50bn. It is a consequence of the fact that in budget for 2004 transfers to open pension funds will not be included in current expenditures as it was done this year.
Bogusław Grabowski, MPC member; PAP, 31 Jul	An upward trend in exports will be the most probably continued in coming months amid improved competitiveness of Polish companies and favourable FX rate. The trends observed for many months still continue, i.e. high growth rate of exports that considerably exceeds growth rate of imports. […] It is also seen that we have a big surplus in unregistered turnover in balance of payments, bigger than a year ago. It also diminishes the deficit in balance of payments. It results probably from intensive near-border trade and sales of currencies by the Polish who work abroad.

PAP, 30 Jul	I have been reiterating for many months that food prices will slowly accelerate growth rate of consumer prices. […] We know that interventions of the Agricultural Market Agency are sometimes efficient and sometimes are not. Its operations often increase price fluctuations, so they are pro-cyclic. […] By the year-end and by the beginning of next year at the latest, surplus of meat that resulted from big animal production caused by big vegetal production in 2001-2002 will have started to decrease. For a number of recent months we have had to do with food price deflation reaching as much as 3.5%YoY in April. Starting from now this factor which have been lowering total CPI is turning back and it will accelerate the CPI growth. We will see the impact of food prices on inflation in the nearest months but it will be the strongest on the year-turn and in 1Q04.
PAP, 25 Jul	Current indicators do not reflect trends, which can be visible in coming months. Worse crops of cereal and some vegetables this year may cause increase in food prices in the nearest months. Friday CSO data confirm analysts' expectations that food prices will run different than last year. Such data may lead to verification of a scenario of macroeconomic developments in a dozen or so number of months. This scenario in turn may affect monetary policy decisions.
Reuters, 17 Jul	Another meeting [with the government] should take place after the holidays. During today's discussion there were no detailed considerations or negotiations. MPC members and government officials presented their views. We have presented arguments for the soonest possible euro adoption.
PAP, Reuters, 15 Jul	So far we have many imprecise comments. Apparently there are problems with determining, what a stable exchange rate means in practice for candidate countries. We have two groups of such countries: one, which perfectly meet exchange rate stability criteria, because they run currency board regimes for a number of years and the second group consists of countries with floating exchange rates. This latter group is doomed for appreciation, unless they do not make mistakes in fiscal policy. Therefore, it is hard to require from them proving exchange rate stability within ERM2. [...] The MPC will meet on Thursday with Mr. Hausner for the first time. We want to ask the deputy PM about public finances in 2004-2005 and in the next years. We have heard dangerous signals about plans to accelerate growth through demand and thus we want to present macro threats, which this move could bring. This will not be a meeting on a loan from reserves.
Reuters, 14 Jul	At the year-end inflation will slightly exceed 2%, will stand at 2-2.2%. Inflation will increase on the back of a revival in demand as well as in fuel and food prices and the effect of depreciation on prices of goods and services. The process of disinflation is reaching its end. Let's stop thinking about a further easing of monetary policy. […] Nearest future should be a period of observation, and not decisions, if these new trends are really taking place. Slight changes would be possible only if turned out that the process of economic revival and domestic demand acceleration is slower then we expect. One should take into account reversing inflationary trends, a rise in domestic demand and the economy is slowly leaving stagnation, with the Polish one faster than the global. I estimate that GDP growth will amount to 2.5-3% this year.
PAP, 11 VII	At a time of a visible economic recovery, a reversal of the favourable food or fuel price supply factors, a visible depreciation of the zloty in past several months, that will surely translate into a price rise, at a time of forecasted relaxation of the fiscal policy, a continuation of the loosening of the monetary policy is very dangerous, it is like playing with fire. Increasing deficit up to PLN54bn is very bad news, because then it is very likely that in 2004 a 55% threshold of public debt to GDP would be exceeded, which requires taking necessary drastic measures with their full impact on the economy in 2005. Estimates of budget deficit presented by Jerzy Hausner are wrong and introduce a methodological chaos. Privatisation revenues are important only for the financing of budget deficit, while they are not the element of budget revenues. No matter what their level is, they have no impact on the size of budget deficit. By adding PLN33bn deficit and PLN9bn from revaluation provision and PLN5bn from lower privatisation inflows Hausner introduces a total chaos. According to methodology used this year, budget deficit next year would reach PLN54bn [...] New and worrying information is that we cannot count on PLN12bn privatisation revenues in 2004, but rather on PLN6-7bn. It shows the scale of necessary financing on the fixed income market, which is very bad news for this market. Additionally, the finance minister said we would adjust GDP growth forecasts in line with most of economists' predictions, which would result in lower revenues, and increasing budget deficit over PLN54bn. Minister Raczko said also that in budget assumptions there are underestimated budget expenditures related to the EU accession, which would additionally increase the deficit. Financial markets should not pay attention to any single figure on budget deficit given by deputy PM Hausner until he sorts out methodology of estimations and presents it in public.
PR1, 2 Jul	To what extent investors will be able to invest in this public finance deficit? Will they be willing to buy the debt, annual debt increase of PLN54bn considering worse prospects of Polish economy? They could do that but at higher interest rates. We will have a capital inflow, appreciation and […] competitiveness of companies will deteriorate. One thing is certain: if you introduce new expenditures in fiscal policy or you do not counteract their growth then such a state tends to become permanent. If actions limiting expenditures permanently and institutionally are not introduced immediately I do not see any possibility, that in to years time – as Mr. Hausner says – the expenditures would start falling and deficit would start declining. This process becomes permanent and this is why it is so difficult to conduct public finance reform in order to change it. It is not easy. Now we hear from finance minister about a new idea – using FX reserves for earlier repayment of foreign debt. It is somehow like the government – additionally persuading such a trade to central bank – would say: "We have legal restrictions for easing fiscal policy, as the Constitution forces us not to exceed some limits. We should try with the central bank to evade these regulations, so that we could deteriorate public finance further. The whole problem is that if the government does not limit public finance deficit we will quickly reach a constitutional limit of unbreakable level of public finance deficit at 60% of the GDP. […] Please imagine that we breached this limit last year or this year than in next year's budget it would be legal requirement to balance public finance. If such a criterion would dominate in selection of new members of the MPC – that the Council should be obedient to government's expectations, that it would execute their intentions – then it would be bad.
Cezary Józefiak, MPC member; PAP, 21 Jul	At present there are no inflationary threats but if for any reason (domestic of foreign) zloty depreciation accelerated it would result in rapid acceleration in inflation. I think that the role of monetary policy is stabilising prices. There are opinions, represented for example by Mrs. Schadler, that it should stimulate the economic growth. In mid-1990s the economic growth in Poland was excessively high not due to monetary policy. Following economic slowdown was also not a result of monetary policy. These factors [rise in exports and improvement in business climate in construction] may prove of the beginning of economic growth but they don't have to. Increase in investment is the most important for the economic growth and it has not been observed, yet. Much depends on world's business climate but these are factors independent from us. What depends on us has not been started properly, yet. One could talk rather about intentions and not achievements.
PAP, 17 Jul	NBP stance [related to a date of Poland's entering Eurozone] has been known for long time, it was expressed in the Strategy of monetary policy. Nothing has changed in this regard.

PAP, Reuters, 14 Jul	I think that nominal interest rates are now close to the equilibrium level and one would need strong arguments to change their level. […] Let's remember what has happened in Hungary. I share the view that the process of easing-up of the monetary policy in the form of cutting interest rates has ended. However, I cannot rule out up/down moves depending on developments in the world and in Poland. The balance level [of interest rates] is not fixed, but this is the level around which fluctuations are observed. Although we do not now what the balance level is, as it is difficult to calculate it, but we are close to it. I believe that the situation will not be like in Hungary that we would have to raise rates, but now everything is possible. June inflation was widely predicted, we are in the moderate growing trend, at least by the end of the year (I hope not too long), when inflation may reach about 2%, maybe a bit higher. […] Meanwhile it is a low inflation, the lower end of this year's NBP target. Upward inflationary trend can be influenced by maintaining zloty depreciation, which has not been reflected in the prices entirely, yet. […] Besides, clear revival in industrial production is observed. It affects PPI, which is higher than CPI and will affect towards CPI acceleration. […] Food should not support fall in inflation as it was up to now. A rise in average wage is more or less balanced with a fall in employment so probably there will not be any influence from this side.
Jerzy Pruski, MPC member; PAP, 21 Jul	This year, economic growth is conformable to the phase of the business cycle. It is roughly natural catching up after slowed down GDP growth in last two years, especially slowed down investment growth. The economy enters the phase of economic revival in natural way.
Dariusz Rosati, MPC member; Reuters, 18 VII	I cannot exclude further rate cuts If inflation is under control and economic recovery is anaemic.
Reuters, 16 Jul	We have almost 20% unemployment, GDP growth stands at 2.5%, though it may be slightly better, and inflation below 1%. […] Producer prices slowed down already, and monetary aggregates are under control […], and interest rates are three times as high as in the Euroland. […] I watch monetary and real conditions and basing on them I put together for myself a vision where the rates are. If we agree with the government on a credible, mid-term fiscal strategy […] we could join ERM2 on January 1, 2005. […] It would be best for Poland to scrap the ERM2 obligation, but the EU is unlikely to agree […] The ERM2 system is good for countries like Denmark or Sweden, in which currency swings would reflect bad economic policies. In our countries, volatility may stem from economic catching up, productivity gains and capital inflow. The EU will want the zloty to be fixed strong against the euro while we will be keen on having a weaker zloty. We will probably meet each other half-way. […] We will naturally fight for a weaker rate [than 3.92 based on historical levels]. We would lilke to see the 2004 budget on the table and a package of laws which will remove structural sources of budget deficit growth. Polish economy might suffer if the zloty weakens above PLN4.50 per euro. [about loan from the FX reserves to government] We are not discussing large figures such as US$10bn. It will depend on finally agreed amount, but if it were to be, say, US$3-4bn that would lower the public debt to GDP ratio to EU standards, and subsequently release a part of the revaluation reserve to the budget. […] Nobody knows what is the so called safe level of reserves […] but I believe that this few billions would not cause any problem, as we have free floating rate and the NBP does not intervene on the market. But there is no unanimous opinion within the MPC on how much could be used. […] The government might borrow hard currency from the bank in exchange for bonds priced at market levels, which it could then pay back with inflows from privatisation. There is no question about the move to lower the rate [of mandatory reserve], it's just a question of timing. We want to do it before Poland joins the EU, and the best moment to do so will probably be the fourth quarter this year or the first quarter of 2004. […] This extra liquidity will have to be lifted off the market through open market operations. We would like to time that operation when the government's borrowing needs are smaller so that we don't have to compete with each other. We do not plan new instruments for the time being. I think that extra liquidity can be easily mopped up with our bills, although we do have an option to issue longer-dated instruments.
PAP, 14 Jul	This is no surprise. I have expected inflation of 0.8-0.9%. The market expected slightly less, 0.7% YoY, so there is certain cooling down here. […] It only proves that we have lower seasonal deflation this year compared to last year. It is still observed but it is very slight. Everybody has expected that because prices of food and especially seasonal articles did not fall that fast, especially in case of fruits and vegetables. It influences June's figures. It matches our expectations and does not mean any new information. We expect stable prices. It is hard to say something about food prices, probably this downward trend will be slowed down and we count for slight rise in inflation rate in July. […] At the year-end I expect inflation around 1.5%. The data are no surprise and do not bring in a new element [for conducting monetary policy].
PAP, 11 VII	The amount of PLN1-1.5bn results from the value of outstanding Brady bonds at the moment. It is the part of [foreign] debt that could be bought back quite easily. If the government wanted to make a bigger operation, it would have to reduce debt against the Paris Club, but this is far more complicated, because it requires negotiating with all 30 countries, which are creditors in the Paris Club. If the government succeeded in this and there was such a chance, then we could think about higher amount, however not much higher because the NBP believes that present level of FX reserves should not be reduced substantially. If the conditions proved to be exceptionally good, then it could be slightly more money, because it would pay in such case. But if the agreement would not be very attractive, the NBP would prefer to remain restrained.
Grzegorz Wójtowicz, MPC member; PAP, 14 Jul	This year one should expect lower deflation MoM in summer period, therefore twelve-month rate will be rising month after month. At the end of the year it will stand at around 1.5% I have expected that [in June] a hike in inflation rate from month to month will not be that high. One should remember that last year, there was a four-month deflation in summer period with quite deep price falls. As a result present increases in annual inflation rate should not be a surprise. I also believe that in months to come one should expect further increase caused with quite deep, seasonal price falls last year. […] The level of deflation will mainly depend on what vegetable and fruit prices will shape seasonally. So one should not pay to much attention to a hike in inflation rate in summer period. One year vegetables and fruits become cheap more, the other less. These are usual seasonal price fluctuations.
Radio PiN, 8 Jul	Various candidatures will appear. I believe that one should have expected, that Grzegorz Kołodko would be one among them. Without any doubts, this would be a good candidate from the point of view of competence. However, I would warn of comments before anything happens if someone is very dovish or very hawkish.
Reuters, 7 Jul	I expect deflation of 0.2% in June, which will mean an increase in the annual CPI to 0.6%. From June, a gradual upward trend in the index is expected. At the end of the year inflation should be around 1.5%.

Wiesława Ziółkowska, MPC member; Reuters, 25 Jul	Today's food price figures demonstrate that there is room for 50 basis points in rate cuts this year. I envisage that year-on-year inflation would be 0.8% in July, unchanged from June, and rise to 1.5 percent in December. The scale of interest rates reduction will also depend on the strength of the economic growth impact on inflation as well as on fuel prices and money supply. Although one cannot rule out a rate cut in August, the reduction is more probable in September.
PAP, 21 Jul	If there is no inflationary pressure from increase in wages and food prices and conditions in agriculture do not lead to rise in risk, further monetary easing through interest rate cut is possible. I estimate that GDP growth should stand above 3% [this year]. If this forecast proved to be true the growth at 5% next year seems likely.
Reuters, 7 Jul	Food prices data show that there are still no inflationary or demand pressures, which creates room for rate reductions this year. When making a rate decision, the MPC must remember that its effects will be visible in six to nine months and has to take into account next year's inflation. Year-end inflation could stand at around one percent. There are some uncertainties concerning oil prices and effects of drought.
Łukasz Kwiecień, NBP governor's advisor; Reuters, 30 Jul	A new MPC member can start his work immediately after appointment and swearing-in, which means the possibility for him to participate in the nearest MPC meeting if he is appointed and swore by the Sejm in Tuesday's morning.

Government and politics

- **Next year budget assumptions accepted**
- **... with deficit of PLN45.5bn or lower**
- **... but if measured in line with this years' methodology it is above PLN60bn**
- **... which means higher financing needs**

Higher deficit, higher financing needs

The government approved modified guidelines for 2004 budget. General macroeconomic assumptions did not change much as compared with Kołodko's plan - GDP growth in 2004 was assumed to reach 5%, and average inflation was forecasted at 2.2%. Next year's budget gap was set at PLN45.5bn with the revenues at PLN152.7bn and total spending at PLN198.2bn. Public debt is expected to reach 50.7-50.8% of GDP in 2003 and might exceed 55% threshold in 2004 – as said in the official communiqué. This means the government easily agreed to balance on the line of 55% debt to GDP ratio, which would require substantial cuts in expenditures in 2005. One could only guess how likely are spending cuts in the year of general elections, but deputy PM promised to deliver such information on 9 September, when the plan of budget spending rationalisation would be presented. The same the government is expected to pass the budget for 2004 on together with a medium-term fiscal strategy, which would allow for meeting Maastricht criteria of fiscal convergence already in 2007. As Jerzy Hausner said: "the years 2004-2007 are the years to create conditions for Poland's future entrance to the Eurozone, the main task of this government is to ensure that Poland fulfils the entry criteria, but it will be up to a future government to decide on the timing". Well, it is hard to find positive elements in the next year's fiscal plan presented so far. Possibly, one such a factor might be a fact that politicians become more and more afraid of breaching constitutional limit for public debt level, which might be a factor constraining loosening of fiscal policy by the current government.

Deputy PM Jerzy Hausner and finance minister Andrzej Raczko ensured the deficit will not exceed PLN45.5bn and it could even be lower by PLN2-3bn under positive circumstances. This additional reduction would be really a moderate change if the scale of fiscal expansion is taken into account. The problem is that the deficit in 2004 computed the same way as this year is much higher, which means that financing needs would increase substantially. This means also that Raczko's budget is even more relaxed than Kołodko's (with ca. PLN54bn gap in comparable terms). The budget deficit is planned at PLN45.5bn, but all transfers to private pension funds (OFE) of PLN11.9bn should increase this amount, as they are excluded from budget spending. Also, some payments related to EU accession on top of transfers to OFE has been put "under the line" (PLN3.6bn). this gives total deficit of PLN61bn or 7% of GDP. If the above-mentioned elements were taken into account, budgetary spending would increase by almost 10% (unless, even more items were put below the line).

Privatisation revenues were believed to reach PLN7.1bn, however minister Raczko admitted he has no official privatisation plans from Treasury Ministry yet (they might be higher in the final version). But the government will have to finance compensation for lack of wages indexation in the budgetary sector in the past (PLN1.5bn). This means that total financing needs on the market (both domestic and international) of the government will increase to PLN55.4bn (as compared with PLN36bn in 2003). Deputy finance minister said recently that PLN15bn will be placed on the international market, which means that domestic issuance would be slightly higher than PLN30bn. Well, such a scenario is not a surprise for the financial market. Recent increase of long-term yields was driven by the negative mood on the debt market around the world rather than by higher risk premium in Poland (details in *Market Monitor* section). However, the fact is that problems of Polish public finances will not be solved but postponed by one year again.

Deputy PM Hausner announced that he invented a new, important rule, which holds that "every PLN1bn of deficit above PLN40bn in 2004 implies a need to cut deficit by PLN2bn below PLN40bn in 2005". Well, if this rule were supposed to be binding, we would suggest boosting the deficit even to PLN60bn in 2004, as this would imply balanced budget in 2005. But speaking more seriously, everyone knows how credible are budget rules invented by this government. The examples are Belka's and Kołodko's rules of budget expenditure growth rate, which did not work in practice any single year. Please note that Hausner's rule implies that if budget deficit were set to PLN45.5bn in 2004 (in practice, this means much deficit as some items were put below the line), spending cuts in the following year would have to reach PLN16bn. It seems that all ministers responsible for economic policy in the government want to propose something new as regards fiscal policy conducting. In practice, however, we see higher and higher fiscal deficits and financing needs.

Comments of the government members and politicians

Government officials were very active in media last month. As one could have expected, after Grzegorz Kołodko's (it seems he will not return to *Watch* section even as MPC mmeber) dismissal deputy PM Jerzy Hausner became an unquestioned leader and – despite he gave hardly any ulttimate details regarding 2004 budget – he made plenty of comments as regards fiscal and economic policy. Jerzy Hausner seems to be getting more and more radical every day (at least with his statements), formulating new rules of fiscal policy conducting. What is interesting, during his speech in the parliament, he turned into a role of fiscal discipline advocate and urged for a maximum reduction of budget deficit in 2004. Actually, majority of comments of government officials concerned mainly guidelines to the next year's budget and the issue of possible early buy-back of Poland's foreign debt with use of FX reserves. The fact is that despite numerous quotes and statements about a will to lower the deficit and to increase fiscal discipline, we will see the deficit higher by PLN20bn (according to this year's methodology).

WHO, WHEN, WHERE	COMMENT
Marek Borowski, Sejm's speaker; PAP, 8 Jul	In order to start a formal procedure for expiration of mandate of Sejm's representative in the MPC I must obtain a formal information from the MPC head. Then Sejm's speaker could acknowledge the mandate has expired, then there are 21 days for a submission of candidates and then 7 days more are required before Sejm could handle the issue. All in all, this voting could take place during the first session after the summer break.
Leszek Miller, Prime Minister PAP, 24 Jul	Yes, I think that this is a good idea [flat 19% tax rate for all entrepreneurs paying PIT]. I will do everything in order to accept this idea proposed a few weeks ago by deputy PM Hausner.
Reuters, 17 Jul	I still believe there is large scope for lower interest rates. Poland is not threatened by inflation and this is what Minister Hausner will be discussing today with the Council. I would like to reach an agreement on co-operation in economic and monetary policy matters. This is what the meeting will be devoted to.
Polish Radio I, 1 Jul	My government will focus on these three matters. First: economic growth, second: economic growth and third: economic growth.
Jerzy Hausner, deputy PM, economy and labour minister; PAP, 29 Jul	[Jan Czekaj] This is a professional candidate. The man who has all necessary qualifications and is an expert. The candidate who will ease dialogue with the NBP. The [next year's] budget deficit has been made real. The government assumed that PLN45.5bn is the maximum deficit level. The finance minister believes it can be financed. We will look for ways to reduce the deficit by PLN2-3bn. […] A credible and bright privatisation plan is very important in this context and treasury minister must present it to the government together with the budget bill. If the state treasury minister estimates the privatisation revenue at PLN7.1bn, then the discussion is not over yet. The problem is not to force a bigger amount but to ask the Treasury Ministry to show such privatisation plans that can generate bigger revenue. […] You need to look for higher revenues in the so-called grey zone, and there is also the issue of spending limits. These are three things I am interested in. […] I sit down with the finance minister and we analyse every item how to lower the deficit. There is high likelihood, close to certainty, that Poland will exceed the first debt threshold of 50% of GDP in 2003, will near the 55% mark or might cross the line in 2004. In 2005 we will get closer to the third safety threshold. […] Unless we start reforms that have to begun yet in 2003 we will exceed the 60% mark in 2006. If the third threshold is exceeded […] following year's budget must be balanced. If it happened in 2003 there would have to be zero deficit instead of PLN45.5bn projected at present [for 2004]. This would mean radical cuts in expenditures and rapid rise in taxes. […] This would result in stopped development and drawing back by a few years. One cannot allow for this. The years 2004-2007 are the years to create conditions for Poland's future entrance to the Eurozone. […] The main task of this government is to ensure that Poland fulfils the Eurozone entry criteria, but it will be up to a future government to decide on the timing. We have assumed lowering interest rates and reducing debt servicing costs in guidelines to the budget bill. If we do not take up efficient actions aimed at keeping budget under restraint then the assumption that debt servicing costs and interest rates will fall will fail. In this case the budget will be threatened. If foreign investors flee, the zloty's value tumbles and it's worth remembering that if the zloty depreciates by PLN0.1 the foreign debt burden grows by PLN3.5bn. [in 2Q02] Long-expected economic revival occurred, we have overcome economic stagnation. […] If investment acceleration takes place, and I am convinced it will take place in the second year-half, we must take into account deterioration in external balance, increase in imports and deterioration in current account balance.
PAP, Reuters, 25 Jul	This solution [flat 19% tax rate for all entrepreneurs paying PIT] would mean that the budget would lose PLN2.2bn. Thus, introducing flat tax rate for entrepreneurs depends on an agreement within three-party committee concerning possible cuts in spending in order to offset the loss in the budget. The deficit level of 45.5 billion is a maximum level that is not to be exceeded. We will seek additional revenue and ways to curb state spending, which if successful will result in a lower deficit level. Just now the work on 2004 budget begins. If there will be a pressure on increasing the deficit, there will be only one answer: no. It's too late now, it's past the point of no return. During further work on 2004 budget we will try to find some ways of constraining spending. The plan of their rationalisation will be presented in September.
PAP, Reuters, 22 Jul	We have agreed [with finance minister] that medium-term strategy of public finances for 2004-07, assuming that Maastricht criteria will be met in 2007, will be presented together with 2004 budget draft [on 9th Sep.]. We are on the right track. The track leads to 5% of GDP growth in the next year but we have to take care of macroeconomic stability so as not to disrupt the growth. Whether it [euro adoption] will happen in 2008 or in 2009 will depend on the next government. Our strategy aims at creating such conditions that would enable such decision. July has always been the month that saw unemployment rise, just as last year. We expect then a neutral result, or a slightly negative one, at 17.8-17.9%. [18% unemployment rate at the year-end] This is still possible, as we do not know how the economic revival would affect the labour market.
PAP, Reuters, 18 Jul	Today we sent guidelines to the budget law for next year. In line with yesterday's settlements reached with the finance minister at this stage we see the budget deficit at the level of PLN45bn so it is considerably lower in relation to what we thought it would be. […] These are the guidelines. A draft budget law, to be dealt with by the government on September 9, will finally specify it but the deficit should not be higher than in the guidelines. I would be very pleased if we manage to lower it further Stagnation in the economy is over and this [output data] is not one-month hike, but permanent trend month on month and quarter on quarter, which means that 5% GDP growth in 2004 is now fully realistic. […] This is a stable tendency which tells us that with a reasonable economic policy we will be able to achieve our goals […] i.e. a 5% economic growth in 2004, lower unemployment rate and faster economic development and good entrance to the EU.

PAP, Reuters, TVP1, 17 Jul	The most important thing is that we want to develop these contacts continuously, to continue the discussion in order to co-ordinate the government and the NBP actions aimed at introducing Poland into the Eurozone, on public debt management and the functioning of the bank sector. […] We preserve our respective powers at his fields but co-ordination of actions will be favourable for the Polish economy. We did not talk about interest rates reductions. We, as the government, hope for further cuts. We have also discussed how to decrease the reserves requirements ratio. EU entry causes that budget 2004 is incomparable with budget 2004. It is impossible to construct budget for 2004 at the level of 2003. I think that a bit higher deficit is justified, to lower the level of public debt in the future. We have to create a mechanism of technical, working meetings between NBP and FinMin, as well as meetings with my participation, which would allow for co-ordination. I think next meetings would be aimed at find solutions to a concrete problems, to show elements of co-ordination. We will prepare more concrete proposals in several aspects. We have confirmed that respecting institutional roles is crucial in our contacts, to create an environment for co-operation visible for the society. Our path as regards economic growth was as follows: 1% in 2002, 3% in 2003 and 5% in 2004. I can confirm this and add: 6% in 2005 and 7% in 2006.
PAP, 15 Jul	I think that we will talk about new MPC member candidature. I could not imagine that my opinion would not be taken into account. I would like to talk with minister of finance and then we both will talk with Prime Minister. The work is in progress, not only talks; we will also talk [with the NBP] about it [lowering mandatory reserve rate] on Thursday. The most important thing will be harmonising monetary policy with fiscal policy.
PAP, 14 Jul	I understand that minister Raczko confirms that next year budget would be constructed with an assumption of CPI inflation at 2.2%. Possibly, the FinMin will revise forecast after new data releases.
ISB, 11 Jul	I would like the budget deficit to be as close as possible to PLN40bn next year, as the level of PLN 47.1bn was definitely too high. The real budget gap envisaged for 2004 is at PLN46-47bn and not PLN33.1bn as presented in the budget guidelines by the former Finance Minister Grzegorz Kolodko.
PAP, Reuters, 10 Jul	I estimate that unemployment fell in June to 17.7-17.8%. The unemployment fell by 25,000 people. At present there is 5% [GDP growth forecast for 2004]. I do not know where other estimates come from. We will not propose drastic cuts in expenditures but we will make efforts to change their structure. […] If we want a deficit below PLN40bn in 2005 we must make adequate decisions still in 2003, because e.g. there is something like acquired rights. […] Cancelling valorisation mechanisms would bring PLN1bn savings. […] We must review various expenditures and cancel those that could be cancelled. In 2004 the deficit will exceed PLN40bn […] However PLN47bn is definitely too high deficit, which would translate into drastic cuts in expenditure in 2005. It would be unacceptably high. […] I defined a simple rule according to that each PLN1bn above PLN40bn deficit in 2004 brings about a necessity to lower the deficit by PLN2bn below PLN40bn in 2005. This comes as an effect of increasing the public debt. We must stick to the safe level of the debt, which is 55% of GDP. The Finance Ministry believes that next year's GDP growth may stand at 4.5-5%. The question of including the growth forecast in the assumptions is in charge of the Finance Ministry. […] But the target of government's economic policy is to reach 5% growth. Such forecast is surely optimistic but one must face ambitious goals.
PAP, 7 Jul	Looking honestly at what Kołodko has proposed in his budget assumptions, it is not PLN33bn but rather PLN46-47bn. [...] In budget assumptions deficit is very low and amounts to PLN33bn, but if there is no PLN9bn, which was a virtual item since the very beginning, then we have PLN42bn. Additionally, Kołodko assumed PLN12bn revenues from privatisation, while it would be a great success if privatisation inflows reach PLN6bn this year. It is better to present problems with budget deficit in an honest way than to risk opinions that one more time something is brushed under the carpet. I say it in open text that the deficit is in fact higher, [...] it is honest. I would like the MPC and market analysts to give us a chance. I would prefer there is no scream about rising deficit, because it translates into the assessment of our country by rating agencies, I believe it creates a vicious circle.
Andrzej Raczko, finance minister; PAP, 25 Jul	The Council of Ministers has accepted budget deficit level at PLN45.5bn. We will try to reduce it during further works by decisions on the spending side. We assumed PLN7.1bn [of privatisation revenues] in 2004. This outflow [of portfolio capital from Polish fixed income market] has been caused by global switch from bonds to stocks and worries over the size of the deficit next year. But the scale (of the deficit) has been set and we have clearly said we will seek to lower it.
PAP, 23 Jul	Public debt will clearly exceed 50% and it will not breach 55% only if the zloty exchange rate will be very stable. Depreciation of the zloty would mean that we exceed 55% and that is why I did not agreed for a war with the NBP. [Exceeding public debt level of 50% of GDP] means in practice that there is no possibility of tax reform, which would be neutral for the budget. We will do some conversion of the debt. He [NBP governor Leszek Balcerowicz] will have lower FX reserves but I will have lower public debt. However, in order to avoid turmoil we will do it gradually. By year-end inflation will fluctuate around 1%YoY. In 2004 inflation will accelerate due to acceleration of the economic growth and we forecast that CPI will reach some 2%YoY but it will be still fully acceptable.
PAP, 22 Jul	I assumed for calculations that budget deficit would stand at PLN45.5bn [in 2004]. […] Contributions [to pension funds] will be financed from privatisation revenues. If it's not possible then they will be financed from bonds issuance. Up-to-date figures show clear signs of economic revival. There is only a question of its pace. We are sure of a 3% GDP growth this year, it can only be much better. […] The economic revival has been taking place in favourable macroeconomic conditions. We see a clear acceleration in a pace of export growth compared to imports. We are not threatened with a significant deterioration in a deficit on current account, which means that one of key parameters will be at good level […]. Inflation is at a very low level. Inflationary expectations have been reduced and inflation will be at a very low level. Domestic income growth will take place in healthy environment. The implementation of the budget is fully controlled. We are ver pleased with privatisation revenues. Important fact is that we control the level of expenditures.
PAP, 17 Jul	The talk [with the NBP] is very essential. They consider on macroeconomic issues and policy. We also discuss the budget. We discuss Poland's economic development from a broader perspective and I think that it is one of first good steps in contacts between the government side and the MPC.
Rzeczpospolita, 17 Jul	I am close to the answer that in Polish conditions one should not expect quick, pro-development effect of flat tax rate introduction.
PAP, 15 Jul	From out point of view, possibilities of flat tax rate introduction are limited. What is more, tax free income level, which we proposed would cost the budget PLN1.5bn and we see no room for other tax changes in budget 2004.

PAP, 10 Jul	Works over budget also include tuning macroeconomic assumptions. We are analysing growth indices. The economy is accelerating and the likelihood of reaching 3% of GDP [in 2003] is very high; I believe that we would be able even to exceed it. There is an issue of plausibility of budget construction [for 2004] under the assumption of 5% GDP growth. We assume for our estimates that 4.5% is very likely. 5% is an optimistic assumption, however it could be also taken into consideration. When it comes to inflation forecasts, we maintain 2.2-2.5%, because if we have economic recovery then we have inflation acceleration also. But it would be still on safe level.
PAP, 8 Jul	I have declared I would not tell NBP how by much it could reduce FX reserves, because it up to them to define how much it would be – without a threat for exchange rate, stability of Polish currency and future in the ERM-2. Now it has to be discussed, we have to work out a mechanism, do it in a safe and most efficient way, buying out the most expensive part of the foreign debt. We have to build a transparent tax system first and then introduce flat tax rate in appropriate moment, which would conclude a tax reform. If a flat tax rate was to be neutral for the budget, the rate would have to reach 20-30%, which implies that in practice the tax rate would have to rise. If we decide for introducing a flat tax rate, then we have to accept lowering tax revenues and therefore find compensating sources on the spending side.
PAP, Reuters, 3 Jul	We have discussed many issues with NBP governor; a use of NBP's revaluation provision was also raised during the discussion but it was rather a technical matter. […] We have identified the costliest part of the foreign debt. It is first of all Brady bonds although this could be elaborated. We discussed with NBP how we could speed up debt repayment. We have also discussed two key issues, that is NBP's hard currency reserves and the country's debt. We have spoken about the technical concept connected with the optimalisation of the two elements. […] Both the sides have shown understanding of each other's positions but it is hard to say that we have worked out a solution that will require further consultations. The approaches the sides take converge.
Piotr Czyżewski, state treasury minister; TVN24, 30 Jul	[gaining PLN7.1bn of planned privatisation revenues in 2004] This task is not easy because it is becoming more difficult to work out budget incomes. We have more and more uncertain projects. I believe that we will be able to raise these funds via privatisation deals, and I think it is realistic. […] We have more projects today and the amount that can be raised is higher than PLN7bn but easy and fast privatisation deals are gone.
Ryszard Michalski, deputy finance minister; Reuters, 29 Jul	Poland is already the largest issuer among future EU member states and is starting to be perceived as a large international player, and thus has to ensure a sufficient level of liquidity of its sovereign debt. In September we are going to issue at least €0.5bn worth of three-year floaters. In autumn we will decide if we will top up the €2.3bn of 10-year fixed-rate eurobonds, possibly to €3bn. We estimate preliminarily that we will want to gain some PLN15bn from foreign issues next year. Obviously, final level of the issue will depend on market situation. The Swiss franc is very strong right now and it is becoming a good time to tap this attractive but also demanding market. In February 2004 we plan to issue bonds worth the equivalent of US$200-300m. Probably these will be papers with 10-year maturity. It would be a good idea to revisit the US markets, probably just after EU entry in May. We need to educate American investors who still tend to perceive Poland as a typical emerging market. We want to come to the market less often but with larger placements. In case of the US market the value of the placement would have to be at least $1bn.
PAP, 24 Jul	We are buying foreign currencies in the NBP according to a scheme. Now, when a possibility for co-operation appears, we would be able to buy USD1-1.5bn on top of the scheme. It depends on the mutual agreement. It allows for buying foreign exchange at good conditions, if it turns out that buying back Brady bonds is profitable. I must pay in zloty and I will return extra money in exchange. It is a question whether it pays more to borrow abroad [...] or to buy foreign currencies in the NBP. Polish entities will be able to buy bonds directed so far only to foreign investors. This purchase could be made via foreign intermediary. It would be available for private investors and companies, but mostly for big investors.
PAP, 23 Jul	Poland may exercise a call option to buy back early around $400 million worth of its outstanding Brady DCB bond series in October. Everything depends on market conditions. At the moment, the most favourable would be buying back DCBs worth $400 million. We are co-operating with the National Bank on this issue. The whole operation would be spread over two to three years - for the moment we are aiming at that, because we still need to work this out with all members of the Paris Club.
ISB, 4 Jul	I think that the economic growth will amount to 3.5% this year. I can even bet on it. (...) In 2004 the economic growth is likely to accelerate to 5% without stimulation via higher budget deficit. Higher budget deficit is not needed anymore as the economy has already entered a path of healthy economic growth. We have started to talk about rise in budget deficit and all negative consequences of this fact. That what is acceptable in case of Hungary or Czech Republic, given their good media policy, is not accepted in case of Poland. Such phenomenon is visible in change of S&P's change of outlook for Poland's rating because all comparisons with those countries are favourable for Poland. Political instability and uncertain perspectives of fiscal policy are doing the Polish economy good because they weaken the zloty exchange rate and thus help exports. At the same time the zloty exchange rate is under control and does not threaten servicing costs of foreign debt. The EU side is afraid of new members in the Eurozone. Therefore, there appeared an idea of dividing accession countries into two groups – big (i.e. Wyszechrad countries) and small countries. It is supposed that small countries would join the Eurozone first. Even if Poland met all formal requirements (Maastricht criteria), the EU side, i.e. the European Commission and the ECB, could prolong negotiations because one cannot see enthusiasm on their side to enlarge the Eurozone. If we rely mainly on domestic demand as a source of the economic growth, we should consider some delay in the Eurozone entry. It will be a simple balance of benefits and possible costs. However, I think that it is better to enter [the Eurozone] earlier than later.
Jacek Tomorowicz, head of foreign policy dept. at finance ministry; PAP, 23 Jul	The situation on the markets is rather dynamic. At present bond yields are rising on international markets. This trend involves also our paper, including Brady bonds, but to a small degree. We believe that the full buyback of these bonds would not be effective, particularly in a call option. […] The scale of refinancing is already very high today. However, the market is very absorbent, there is a demand for our bonds. Risk premium is close to the countries, which are already in the EU, e.g. Greece. Our costs are not much higher. We are already perceived as EU-member. It allows believing that the needs we will face could be easily met when it comes to refinancing foreign debt. Most likely we will want to borrow €1bn more this year. I will not resolve now on which market we will place this issue. Maturities of these new papers must exceed 2008 because of high liabilities against Paris Club. [...] This is not a tradable debt. While in case of Brady bonds there are theoretically no obstacles for repurchasing them, then Paris Club is a special liability. [...] Negotiations on the potential buy back must be in practice made simultaneously with all creditors. According to 1991 accord the creditors cannot be treated separately, buying back only the most expensive part of the debt. The offer must apply to everyone. We predict quite a significant rise of budget loans and budget guarantees in coming years. EBI gives away loans on favourable conditions.

Halina Wasilewska-Trenkner, deputy finance minister; PAP, 1 Jul	If industrial output growth will be sustained from quarter to quarter than GDP growth will exceed 3%. […] April's and May's data were very good and June's ones should not be bad, which is suggested by tax revenues from companies. There is a signal suggesting that the situation may be better than it seemed to be. Enterprises, that recorded losses in previous years, are allowed to account for them this year. It seems that that is what they do. If they account for losses it means they have profits. She thinks they do so which means that they achieve profits presently.
PAP, 10 Jul	The recent estimates show that the GDP growth [in 2004] could be lower than the planned one and would stand at 4.5%.
Jacek Krzyślak, Head of Research Dept. in FinMin; PAP, Reuters, 1 Jul	Our [inflation] forecast for December 2003 stands now at 1.5%YoY. […] A month ago we assumed average annual inflation at 1.0% in this year. However, at present we have lowered the forecast of average annual inflation to 0.8% in 2003, given 0.2%MoM deflation in June expected by us. We have maintained the forecast of average annual inflation for 2004 at 2.2%. We assume that this year's corn harvest will be worse as compared to last year, though it is difficult to estimate their final influence on inflation. In assumptions for 2004 we stated that GDP growth in 2003 would amount to 3.0% and we maintain it.
Ludwik Kotecki wicedyr. dep. analiz MF Reuters, 18 VII	After industrial production data, we estimate that GDP growth accelerated to 3.3 in 2Q03%.
Elżbieta Suchocka-Roguska, head of Budget Dept. in FinMin; PAP, Reuters, 16 Jul	I believe the budget deficit after July will be around 70-75% of the plan. This follows from our schedule worked out in February. In June the deficit was lower due to inflow from NBP's profit, in July it will be much higher.
Mieczysław Czerniawski, head of public finance committee; Reuters, 31 Jul	In my opinion there is no chance that the person who will be chosen as the new MPC member can attend the August Council's meeting. […] First the public finance committee has to issue a formal evaluation of each candidate that will be sent to Sejm speaker. The deputies will have one day to get acquaint with it. The next sitting of the committee is planned for 26 August.
PAP, 7 Jul	[Grzegorz Kołodko] He would be a good candidate [for MPC member]
Jerzy Jaskiernia, head of SLD caucus; PAP, 28 Jul	Having examined the candidacies for the MPC member, the presidium of the SLD caucus resolved to back the present deputy finance minister Jan Czekaj. […] We are sure he has adequate qualifications. We've been looking for a person who is perceived positively by the public and does not cause controversies.
PAP, 21 Jul	If we will propose somebody now, we will recommend him once again later [for the next term of the MPC].
Stanisław Stec, SLD deputy; PAP, 7 Jul	We are going to look for the person who would satisfy expectations of economic policy and of entrepreneurs so that it would not be a tough economic policy. […] I imagine this person as the member of the refreshed or new Council and therefore it must be a person with stable opinion.
Janusz Lisak, head of UP caucus; PAP, 28 Jul	Mr. Czekaj has necessary qualifications for this post and his candidacy would serve well to monetary policy if it was accepted by the Sejm. However the Labour Union (UP) has not taken any decisions concerning support for this candidacy. We will work on it on Wednesday's meeting of the caucus.
Zbigniew Kuźmiuk, head of PSL caucus; ISB, 16 Jul	We are currently pondering whether to put forward a candidate, who would remain in the MPC four months, till January of 2004, when the term of the current Council expires. Decision on this issue and on a potential support for Kołodko will be taken at one of the caucus' sittings till July 31. It is well known that SLD has majority in the Parliament and I understand that it would present such a candidate who not only would bring new view to the MPC, but also could be appointed for another term of the MPC in January 2004. We hope that it will be a man with completely different view on the FX policy.
PAP, 7 Jul	We want to talk with SLD, as we want that a member with different opinion than present would come to the Council. Therefore we will look for a support for very different view. I doubt that Kołodko would gain SLD's support, since he feels a bit offended. For SLD he is probably to controversial candidate, for us he is less controversial. This should be a person who would be strong enough to force own arguments at a meeting. The thing is to propagate different than present view on monetary policy and FX rate.
Anonymous source in Three-party Committee; PAP, 16 Jul	Renouncing from wages indexation is the one of two opportunities giving savings. The indexation of old-age and disability pensions should remain. This may bring around PLN1bn in savings. And probably such a proposal will be presented to the parliament […] Cutting spending for home roads would bring another 1bn.
Witold Orłowski, president's chief economic advisor; PR1, 18 Jul	Indirectly, improvement of the situation in construction sector and high industrial production growth within last three months, suggest that investments increased. This factor is the most important for the Polish economy, and if we see rising investments we could say that the economy is expanding for sure. I think there are fundamental reasons to talk about GDP growth acceleration, although to not significantly more than 4-5%

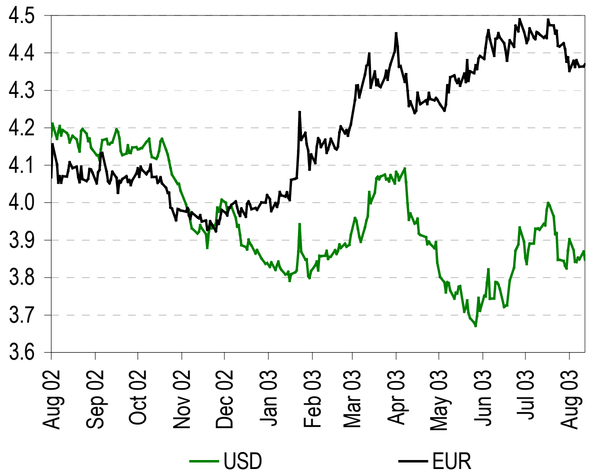
Market monitor

- **Relatively calm month on the FX market**
- **Weakening on the fixed income markets world-wide**

Holiday calming down on the FX market

In July a situation on the domestic FX market calmed down following a weakening of the zloty that occurred at the end of June. At the very beginning of July the Polish currency was supported by very good data on May balance of payments. However, the appreciation proved to be temporary and next days the zloty was traded at the weak levels from the end of June and in mid-July it experienced even deeper temporary depreciation. The situation reversed in the middle of the month when the zloty started to catch up for the losses. As a result, at the end of July, an average rate of the zloty against the dollar and the euro was stronger by 1.1% as compared to the end of June. Given appreciation of the dollar against the euro the zloty strengthened less against the dollar than against the euro. Turnover was low over the whole discussed period, due to holiday time and as a result lower activity of many market participants.

Zloty FX rate in recent 12 months



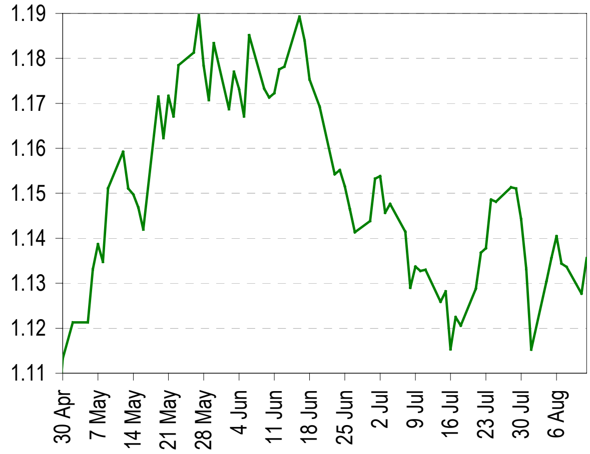
Source: NBP

According to the NBP fixings, in July the dollar was traded between PLN3.8248 (on 30 July) and PLN3.9988 (on 17 July) and at PLN3.9036 on average (against PLN3.7991 in June). The euro fluctuated in a range from PLN4.3765 (on 30 Jul) to PLN4.4885 (17 Jul) with the average at PLN4.4398 (PLN4.4355 in June). The average rates were very close to our forecasts presented in the previous MACROscope (3.92 and 4.43, respectively).

In the first two weeks of August the Polish FX market was very stable. Activity of the market was very low and the zloty rate was maintaining on the same level against the basket of the two main currencies. In the first two weeks of August the rates of the zloty against the dollar and the euro was following changes in the EURUSD rate.

In the remaining part of August the situation on the Polish market should be like at the beginning of the month. Given a lack of important macroeconomic and political events the zloty should remain under the influence of changes in the EURUSD rate, while a relation of the zloty against the basket of both the main currencies should fluctuate in relatively narrow range.

EUR/USD FX rate



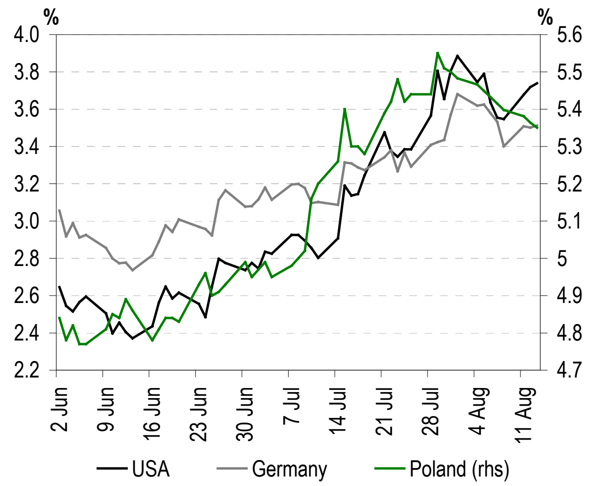
Source: NBP, BZ WBK

Significant weakening on T-bond market

At the beginning of July Polish fixed income market was very stable with moderate activity of investors. However, in mid-July the T-bond market recorded very large weakening, the most significant at a long-end of the yield curve. Deep fall in prices resulted from the same changes on the international markets that perceived negatively Fed's Chairman Alan Greenspan's testimony before the Congress. Also in next weeks of July the T-bond market was under influence of a weakening on the international market and the prices of Polish T-bonds were falling (and yields were rising) as a result.

The fact that upward move of the Polish yield curve was not caused by domestic factors only (diminishing expectations for further interest rate cuts and deteriorating prospects of fiscal policy), but it was mainly related with worsening sentiment on the fixed income markets in the EU (Germany) and the US is very well illustrated with a graph below. It proves that one should not draw a conclusion about increasing risk premium in case of the Polish fixed income market, as the rates on interest rates swaps in Poland were following the ones on the international markets and a spread between Polish and foreign rates was relatively stable.

5-year IRS rates

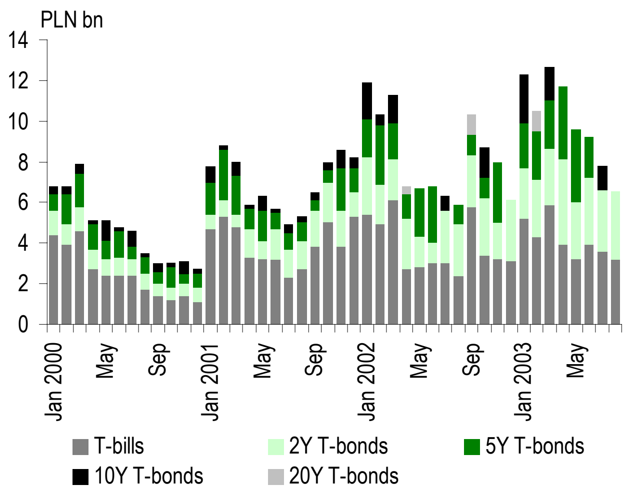


Source: Bloomberg, BZ WBK

At the beginning of August the situation reversed and a clear rise in prices (fall in yields) was observed. It was caused mainly by improving investors' sentiment on the main foreign markets. Moreover, the Polish market was supported by optimistic expectations for the first auction of a new two-year benchmark. When it turned out that the auction was successful indeed, increase in bond prices was continued. It also resulted from very positive sentiment on the international debt markets following a few successful auctions in other countries (both in the United States and Germany as well as in the region, like in Hungary). Additionally, at the beginning of August the Polish market was supported by better than expected data on food prices.

As expected, the debut auction of new 2-year benchmark (OK0805) worth of PLN2.8bn attracted a considerable interest of investors and demand amounted to PLN6.97bn (the bid-to-cover ratio reached 2.5 against 2.7 at the July's auction). The average yield of 2-year T-bond rose to 4.894% from 4.807% at the previous auction in July. However, the result was below market expectations ranging between 4.90% and 4.95% and below secondary market quotations of the previous two-year benchmark (OK0405) of 4.95-4.97%. At supplementary auction the Ministry of Finance sold all offered PLN560bn of 2-year bonds. Demand was much higher than supply and amounted to PLN3.3bn.

Supply of Treasuries



Source: Finance Ministry, BZ WBK

Treasury bill auctions (PLN m)

	OFFER / SALE		
Date of auction	*13-week*	*52-week*	*Total*
07.07.2003	100 /100	800 / 800	900 / 900
14.07.2003	100 /100	800 / 800	900 / 900
24.07.2003	100 /100	800 / 800	900 / 900
28.07.2003	-	900 / 900	900 / 900
July total	**300 / 300**	**3,300 / 3,300**	**3,600 / 3,600**
04.08.2003	-	700	700
11.08.2003	-	600	600
18.08.2003	-	900	900
25.08.2003	-	1,000	1,000
August total	**-**	**3,200**	**3,200**

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	3,360	3,360	-	-	-	-	-	-	-	-
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

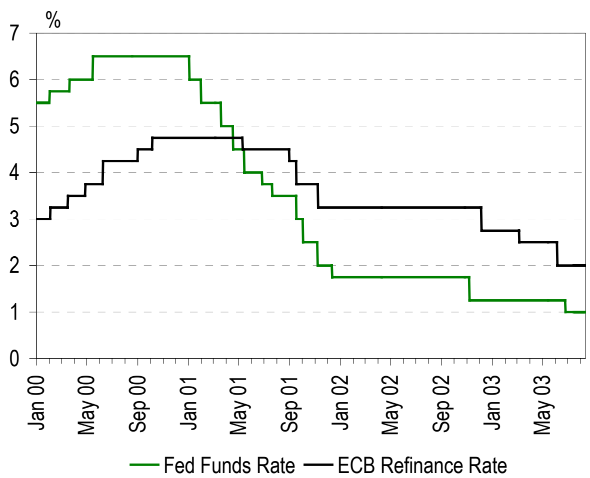
- **Interest rate unchanged in the US and the Eurozone**
- **Slight rises in consumer inflation**
- **Europe far from economic revival**
- **… contrary to the United States**

Only Czech Republic cut rates during holidays

In line with analysts' expectations, the Council of the European Central Bank did not change interest rates at the meeting on 31 July. The main Eurozone's rate – refinance rate – stands at 2.0%, after it was lowered by 50bps in June and remained unchanged on 10 July. This is the lowest level since introduction of the euro and the beginning of conducting monetary policy by the ECB. Also, the Council adopted an opinion on the appointment of a new ECB President and accepted the proposed candidate, Jean-Claude Trichet. This decision opened the procedure of nomination that should end in October and Mr. Trichet should enter the post since on 1 November this year.

Also, there was no surprise after the meeting of Federal Open Market Committee on 12 August. No rate cut was widely anticipated by the markets. From a point of view of monetary policy Greenspan's comments and Fed's statement were much more important. They expressed a belief that an accommodative stance of monetary policy, coupled with still-robust underlying growth in productivity, is providing important ongoing support to economic activity. However, at the same time Fed saw a bit higher risk of an unwelcome inflation fall than of a rise from the already low level. Consequently, the Committee suggested that it was likely to keep interest rates low for a considerable period, even with stronger signs of economic activity.

Interest rates in the USA and Eurozone



Source: Reuters

Nevertheless, there were changes in parameters of monetary policy in other countries. Quite unexpectedly the Czech Central Bank cut interests rates by 25 bps and starting from 1 August the main repo rate stands at 2.0%, i.e. Eurozone level.

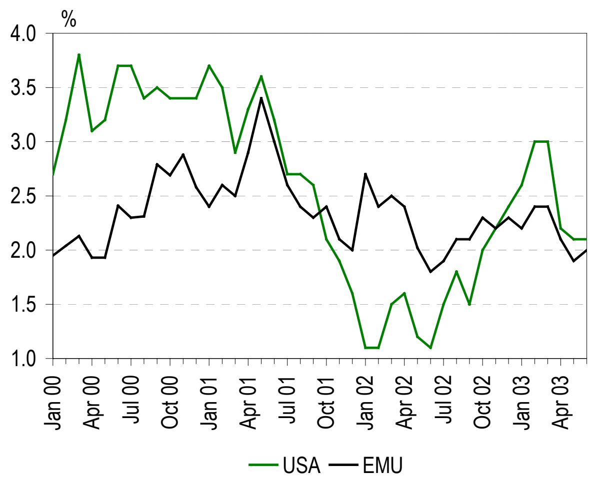
Slight rises in consumer inflation in June

Eurozone's M3 money supply growth rate amounted to 8.3%YoY in June decelerating from 8.5% recorded in May, while analysts expected a less deep slowdown in a pace of growth to 8.4%.

In June consumer prices in the Eurozone increased by 0.1%MoM. As a result annual inflation rate rose to 2.0% from 1.9% recorded in May, which exactly matched preliminary estimations and analysts' expectations. In June producer prices declined by 0.1%MoM and grew by 1.4%YoY, the same as in May (revision from 1.3%YoY). The figures were exactly in line with market expectations assuming that growth in energy prices prevented a larger drop in producer prices. Most countries experienced a drop in prices. Only the Netherlands and Luxembourg reported an increase while prices in France were unchanged.

Also, data from the United States on inflation were in line with the consensus forecast. In June consumer prices increased by 0.2%MoM, which translated into annual inflation rate at 2.1% - unchanged as compared to previous month. On contrary, figures of producer prices from the United States were higher than forecasted, increasing by 0.5%MoM in June, following falls in May and April, while expectations pointed to a rise in prices of 0.2%. Annual rate of producer inflation recorded acceleration to 2.9% in June from 2.5% in May.

Inflation YoY



Source: Reuters

Still quite far from economic revival in Europe

The index of Eurozone's economic sentiment calculated by the European Commission fell to 98.0 pts in July from 98.1 pts (revised from 98.2 pts) in June, which resulted from deterioration in business sentiment.

In July economic activity in the Eurozone's industry, measured with Reuters PMI index, was falling at slower pace than in June. The index increased to 48.0 pts from 46.4 pts in June, while 47.0 pts was forecasted. Moreover, PMI indices for main EU12 countries were higher than expected as well. Even better sentiment was observed in the service sector, since the Reuters Services index exceeded 50-pts threshold for the first time since Dec 2002. The index grew to 50.2 pts from 48.2 pts, signalling slight increase in the sector activity.

Nevertheless, remaining data from a real sphere of economy were not too optimistic. Eurozone's retail sales increased by 0.4%YoY in May while expectations were at 0.6%YoY. Also, data on industrial output in the Eurozone were clearly weaker than forecasts – in May production declined by 0.9%MoM and annual growth rate slowed down to -1.3% from 0.7% recorded in April. Major business climate indicator for the German economy – index of entrepreneurs' sentiment IFO rose less than expected by analysts, reaching 89.2 pts in July versus 88.8 pts in June, while forecasts pointed to its increase even to 89.7 pts. Head of the IFO institute reminded that three consecutive months of rising IFO index is usually a signal of approaching economic revival. We think it is too early for such conclusion. Also, data on industrial production in Italy were very weak – a 4.4%YoY fall.

The unemployment rate in the Eurozone remained steady at 8.9% in June from May as an estimated 12.5m people were jobless. The figure was slightly above market forecast of 8.8%. A year ago the unemployment rate stood at 8.4%. Spain continued to post the highest unemployment rate at 11.4%, while the lowest rate was registered in Luxembourg with 3.7%. In Germany the unemployment rate remained unchanged at 10.6% in July, as seasonally adjusted number of unemployed rose to 4.408m. The Federal Labour Office said that the unemployment rise was kept relatively moderate because of recent measures aimed at getting people back into work, rather than any improvement in the economy. The figures backed economists' warnings that despite a recent improvement in German sentiments' indicators suggesting a recovery is on the way, the fundamentals remain quite weak.

… while it is closer and closer in the US

Meanwhile, in the United States economic activity in the industry recorded a rise, as in line with forecasts it exceeded the level of 50 pts, i.e. a limit between improvement and deterioration in activity. The Institute of Supply Management (ISM) index reached 51.8 pts in July against 49.8 pts in June. Also, non-manufacturing or services sector index rose to as much as 65.1 pts in July from 60.6 pts in June, reaching its highest level since the index was started in July 1997. The index of new orders rose to 66.9 pts from 57.5 pts in June, while the employment index inched up to 50.7 pts from 50.3 pts in the previous month. Positive ISM results was offset by a report from job placement firm Challenger, Gray & Christmas with information that the number of job cuts announced by employers in the US economy surged by 43% in July after a two-month decline. The unemployment rate in the US fell to 6.2% in July from 6.4% recorded in June, while 6.3% was expected. It was the first fall in the rate for more than a year, however at the same time the number of jobs in economy decreased by 44,000, which suggests that lower unemployment rate resulted from the fact that many people discontinued actively looking for a job.

More and more data point that activity of industrial sector in the United States that was stifled for a long time is reviving. Factory orders for US manufactured goods rose by 1.7%MoM in June after an increase of only 0.3%MoM in the previous month, which was the fastest growth since March. New orders for durable goods in the United States grew by 2.1%MoM in June driven by a surge in demand for cars and aircraft.

According to advanced information, GDP growth in the United States amounted to 2.4%QoQ in 2Q03. The data were significantly stronger than analysts' expectations of 1.5% and also much better than 1Q03 figure of 1.4%. Such a strong performance resulted from stronger than expected growth in domestic final sales. In July American consumer sentiment indicator by the University of Michigan recorded a slightly stronger than expected rise to 90.9 pts from 89.7 pts in June.

What's hot this month

Monday	Tuesday	Wednesday	Thursday	Friday
28 July 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** POL: T-bond auction OK0805 *EMU: GDP (1Q)*	**7** POL: Food prices (2H Jul)	**8**
11 POL: T-bill auction *ITA: Inflation final (Jul)*	**12** *FRA: Inflation preliminary (Jul)* *FRA: Industrial output (Jun)* *USA: Fed meeting (decision)*	**13** *USA: Retail sales (Jul)*	**14** POL: Inflation (Jul) POL: Money supply (Jul) POL: Wages & employment (Jul) *GER: GDP preliminary (2Q)* *EMU: GDP preliminary (2Q)* *USA: Producer prices (Jul)* *USA: Foreign trade (Jun)*	**15** **POL: Public holiday** *USA: Inflation (Jul)* *USA: Industrial output (Jul)* *USA: Capacity utilisation (Jul)*
18 POL: T-bill auction *EMU: Foreign trade (Jun)*	**19** *EMU: Inflation final (Jul)*	**20** POL: Industrial output (Jul) POL: Producer prices (Jul) POL: Financial results of companies (2Q) *FRA: GDP preliminary (2Q)*	**21** *GER: GDP final (2Q)* *GER: Inflation preliminary (Aug)* *ITA:12-city inflation (Aug)*	**22** POL: Retail sales (Jul) POL: Unemployment (Jul) POL: Business climate (Aug) *FRA: Inflation final (Jul)*
25 POL: Core inflation (Jul) POL: T-bill auction	**26** POL: MPC meeting (first day) *GER: IFO (Aug)*	**27** POL: MPC meeting (decision) POL: Food prices (1H Aug)	**28** *EMU: Money supply (Jul)* *ITA: Producer prices (Jul)*	**29** POL: Balance of payment (Jul) *ITA: Inflation preliminary (Aug)* *EMU: Inflation preliminary (Aug)*
1 September POL: T-bill auction *GER: Retail sales (Jul)* *EMU: PMI manufacturing (Aug)*	**2** *EMU: Producer prices (Jul)* *EMU: Unemployment (Jul)* *USA: ISM manufacturing (Aug)*	**3** POL: T-bond auction OK0805 *EMU: PMI services (Aug)* *EMU: Retail sales (Jul)*	**4** *GER: Unemployment (Aug)* *EMU: ECB meeting* *USA: ISM services (Aug)*	**5** POL: Food prices (2H Aug) *GER: Industrial output (Jul)* *USA: Unemployment (Aug)*

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	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

		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	Aug 03
GDP	%YoY	x	x	1.8	x	x	2.2	x	x	2.2	x	x	3.1	x	x
Industrial production	%YoY	5.7	-1.1	6.6	3.2	3.1	5.2	3.5	4.3	5.5	8.5	11.7	7.8	7.2	4.4
Retail sales ***	%YoY	8.6	5.1	4.7	5.1	5.9	4.9	4.1	4.2	-1.7	11.0	9.7	8.1	5.8	7.3
Unemployment rate	%	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	17.8
Gross wages ** ***	%YoY	4.1	2.8	3.8	0.5	1.8	2.4	2.7	2.1	0.7	4.2	0.0	3.1	1.5	2.1
Export (acc. to NBP)	EURm	3 177	2 727	2 912	3 182	3 004	3 223	2 761	2 635	2 957	2 969	3 015	3 032	3 153	3 000
Import (acc. to NBP)	EURm	3 791	3 642	3 826	4 241	4 090	4 166	3 895	3 219	3 467	3 833	3 696	3 519	3 695	3 700
Trade balance (acc.to NBP)	EURm	-614	-915	-914	-1 059	-1 086	-943	-1 134	-584	-510	-864	-681	-487	-542	-700
Current account balance	EURm	-119	-284	-529	-580	-753	-484	-711	-483	-248	-460	-411	-83	-92	-100
Budget deficit (cumulative)	PLNbn	-25.7	-27.3	-29.8	-34.0	-37.1	-39.4	-4.1	-11.7	-15.5	-18.0	-23.2	-23.8	-27.7	-29.4
CPI	%YoY	1.3	1.2	1.3	1.1	0.9	0.8	0.5	0.5	0.6	0.3	0.4	0.8	0.9	0.9
PPI	%YoY	1.7	1.3	1.1	1.7	1.7	2.2	2.5	2.9	3.6	2.9	2.0	2.2	1.5	1.3
Broad money (M3)	%YoY	1.3	-0.2	-1.5	-2.5	-1.0	-2.1	-1.4	-1.2	0.5	0.8	0.3	1.3	1.2	1.8
Deposits	%YoY	-0.8	-2.5	-3.5	-4.6	-3.2	-4.3	-4.1	-3.8	-2.3	-2.3	-2.9	-1.9	-2.5	-1.5
Credits	%YoY	7.5	5.9	4.9	4.4	4.6	5.3	5.5	5.7	8.7	8.5	7.6	5.9	5.0	5.6
USD/PLN	PLN	4.12	4.18	4.15	4.12	3.95	3.91	3.84	3.87	4.01	3.96	3.74	3.80	3.90	3.85
EUR/PLN	PLN	4.09	4.08	4.07	4.04	3.96	3.99	4.08	4.17	4.33	4.30	4.33	4.44	4.44	4.35
Reference rate *	%	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	5.25
WIBOR 3M	%	8.89	8.55	8.07	7.45	6.81	6.82	6.56	6.37	6.17	5.90	5.53	5.38	5.26	5.25
Lombard rate *	%	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	6.75
Yield on 52-week T-bills	%	8.35	7.86	7.25	6.77	5.88	5.78	5.74	5.83	5.67	5.43	4.75	4.66	4.85	4.90
Yield on 2-year T-bonds	%	8.12	7.60	7.16	6.62	5.78	5.75	5.55	5.66	5.52	5.16	4.78	4.79	4.89	4.90
Yield on 5-year T-bonds	%	8.11	7.62	7.07	6.57	5.91	5.67	5.57	5.58	5.36	5.15	4.88	4.90	5.17	5.30
Yield on 10-year T-bonds	%	7.63	7.29	6.79	6.22	5.89	5.69	5.62	5.67	5.52	5.41	5.13	5.03	5.37	5.50

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	803.7	178.6	189.5	191.2	213.0	184.5	197.8	199.1	222.3
GDP	%YoY	4.0	1.0	1.4	3.1	0.5	0.9	1.8	2.2	2.2	3.1	3.1	3.9
Total consumption	%YoY	2.4	1.8	2.9	2.3	2.8	2.6	2.8	3.2	1.0	2.9	2.6	2.6
- Private consumption	%YoY	2.6	2.1	3.3	2.6	3.5	2.9	3.1	3.5	1.4	3.4	2.8	2.8
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	6.4	-1.6	-0.4	3.3	4.6	4.4	9.0	6.0	6.3
Retail sales (real terms)	%YoY	1.0	0.2	3.3	4.9	5.8	0.7	3.9	2.6	1.2	9.8	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	1.4	1.9	1.4	2.3	0.3	1.4	2.0	1.2	0.9
Export (acc. to NBP)	EURm	30 768	33 823	34 746	36 269	7 853	8 668	8 816	9 409	8 353	9 016	9 200	9 700
Import (acc. to NBP)	EURm	44 970	46 848	45 712	46 329	10 847	11 109	11 259	12 497	10 581	11 048	11 700	13 000
Trade balance (acc.to NBP)	EURm	-14 202	-13 025	-10 966	-10 060	-2 994	-2 441	-2 443	-3 088	-2 228	-2 032	-2 500	-3 300
Current account balance	EURm	-10 672	-7 992	-7 188	-5 235	-2 659	-1 780	-932	-1 817	-1 442	-954	-925	-1 914
Current account balance	% GDP	-6.0	-3.9	-3.6	-2.8	-3.9	-3.6	-3.6	-3.6	-3.1	-2.7	-2.7	-2.8
Budget deficit (cumulative)*	PLNbn	-15.4	-32.6	-39.4	-38.7	-16.4	-25.0	-29.8	-39.4	-15.5	-23.8	-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	0.7	3.4	2.1	1.3	0.9	0.5	0.5	0.9	1.1
CPI*	%YoY	8.5	3.6	0.8	1.3	3.3	1.6	1.3	0.8	0.6	0.8	0.9	1.3
PPI	%YoY	7.8	1.6	1.0	2.1	0.2	0.7	1.4	1.9	3.0	2.4	1.3	1.6
Broad money (M3)	%YoY	11.9	9.2	-2.1	3.8	3.2	2.5	-1.5	-2.1	0.5	1.3	3.0	3.8
Deposits	%YoY	15.5	8.9	-4.3	0.4	1.7	0.5	-3.5	-4.3	-2.3	-1.9	-0.5	0.4
Credits	%YoY	16.9	9.3	5.3	7.0	7.1	9.4	4.9	5.3	8.7	5.9	5.4	7.0
USD/PLN	PLN	4.35	4.09	4.08	3.85	4.13	4.04	4.15	3.99	3.90	3.83	3.85	3.82
EUR/PLN	PLN	4.01	3.67	3.85	4.29	3.62	3.72	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	%	18.48	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	5.05	9.64	9.11	7.82	6.14	5.75	4.94	4.80	4.70
Yield on 2-year T-bonds	%	17.37	13.97	7.94	5.06	9.27	8.84	7.63	6.05	5.58	4.91	4.86	4.90
Yield on 5-year T-bonds	%	14.00	12.59	7.86	5.20	9.09	8.69	7.60	6.05	5.50	4.98	5.12	5.20
Yield on 10-year T-bonds	%	11.79	10.74	7.34	5.35	8.28	7.92	7.24	5.93	5.60	5.19	5.30	5.30

Source: GUS, NBP, BZ WBK

* at the end of period

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