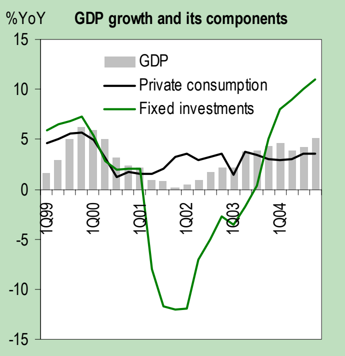
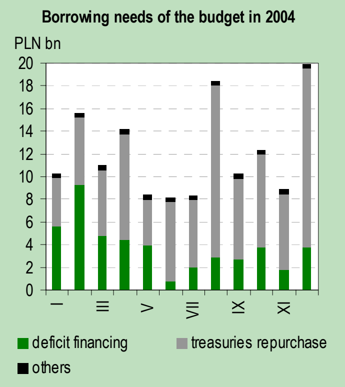
Bank Zachodni WBK

MACROscope

Polish Economy and Financial Markets

January 2004





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Year of growth

■ **The New Year will undoubtedly bring a continuation of GDP growth acceleration. Unfortunately, a "growth" refers also to the increase in the budget deficit as a result of a substantial increase in expenditures, which will cause the increase in the financial needs of the country and the increase in the public debt.** The biggest threat to a growth of the Polish economy will be represented by a high deficit in the public finance sector. Though the economic growth pace in 2004 will not depend on the rate at which changes are implemented, the effectiveness of the planned reforms will determine whether the revival can see its continuation going forward. In 2004 we also expect increase in investments. They started to grow already in 2003, companies' financial performance is much better and taxes for enterprises have been reduced. Certainly, given the high share of investment goods in the Polish imports, the growth in investments will drive down net exports' contribution to the GDP (despite continuing growth in exports).

■ **The acceleration of the economic growth is to take place parallel to deeper economic imbalance, although not in a scale, which could constitute a threat to the GDP growth over a longer period of time.** We expect growth of both current account deficit and inflation by about ca.1 percentage point. Despite the fact that the growth is also observed as regards inflationary expectations and (moderately) core inflation, it seems that inflationary perspectives are quite favourable (NBP inflation target is not in danger) and should not cause the new, more dovish, MPC members' headache at the beginning of their term of office.

■ **This month we also take a close look at the plan of the issue of treasury securities in 2004.** Difficulties with selling treasuries last year induced the Ministry of Finance to look for new instruments and ways of financing borrowing needs of the central budget. Private placement issues, reaching to foreign sources and new type of bonds with variable rate will allow to close financing of the budget expenditures in the first quarter, that we estimate at almost PLN37bn. However, in subsequent quarters high supply of treasures is likely to be sustained and in the two last quarters, the borrowing needs will even be higher.

■ **The parliament chose new members of the MPC.** The Sejm picked Jan Czekaj, Stanisław Nieckarz and Mirosław Pietrewicz while senators elected Marian Noga, Stanisław Owsiak and Halina Wasilewska-Trenkner. Although we still do not know candidates of the President, one can already state that the makeup of the new MPC will be quite balanced. Despite the new Council will be surely more dovish than the previous panel, one can expect that decision on interest rates and FX policy will be reasonable (continuation of "small steps approach" to rate cuts with the first move in March and no changes in foreign exchange regime).

Financial market on 31 December 2003

NBP deposit rate	3.75	WIBOR 3M	5.60	PLN/USD	3.7405
NBP reference rate	5.25	Yield on 52-week T-bills	5,75	PLN/EUR	4.7170
NBP lombard rate	6.75	Yield on 5-year T-bonds	6,65	EUR/USD	1.2611

This report is based on information available until 14.01.2004

Special focus

A year of ups in economy

2003 – good year, if it was not for the fiscal policy...

While looking at some economic indicators of last year, one could say that we witnessed a breakthrough year. After two, extremely lean years of 2001 and 2002, when the GDP growth totalled 1.2% on average, distinct acceleration was recorded (up to 3.6% according to our projections, though Central Statistical Office will quote the data only in March). Even though, the acceleration of the economic growth was anticipated, its scale was assumed to be smaller, as 12 months ago the GDP growth of 2.7% on average was projected (according to the survey run by *Gazeta Bankowa*), with our forecast of 3%. Moreover, such a scale of growth pace acceleration was expected with an assumption of the economic imbalance deepening - the current account deficit increasing to 4% of GDP, and the inflation rate up to 2.5%. In reality, however, the acceleration took place with a totally different structure of the economic growth than it was expected by, among others, finance minister Grzegorz Kołodko. It was not very helpful in generating the planned budget income. The main driver of the Polish economy was exports, the good results of which could primarily be attributed to favourable trends in the world currency market. It was thanks to the unexpected rise of the euro against the dollar up to 1.26 last year, that the zloty/euro exchange rate went up above 4.70. For a comparison, in the *Gazeta Bankowa* last year's survey these two variables were projected at 1.00 and 3.98. It is a fact, however, it was not only exports which drove the Polish economy, as with the inflation rate much lower than forecast 12 months ago, clear growth in individual consumption was witnessed. The subsequent records of low inflation also contributed to the continued cycle of reductions in interest rates (every month in 1H2003).

Certainly, in the upcoming years, the biggest threat to the Polish economy growth will be represented by a high deficit in the public finance sector, along with the rising public debt. The budget adopted for the past year was a continuation of excessively expansionary fiscal policy, in particular, when we consider the entire sector of public finance, and not only the central budget. Unfortunately, the 2004 budget is no breakthrough in this respect. Quite the opposite, the uncertainty as to the shape of the fiscal policy gave rise to impetuous reactions of the financial markets towards the end of the last year, and as a consequence, was the main reason for putting on hold the MPC interest rates cuts cycle. Of course, the anxiousness in the financial market was additionally fuelled by a bigger political risk, and the earlier replacement of the finance minister. In the first half of last year, a surprising phenomenon was the lack of an optimistic reaction of the Polish currency market to the positive outcome of the EU referendum.

A year ago, we wrote that the opportunity to take the first step in the public finance reform had been squandered. It is with great regret that we have to state the same again this year. There is no knowing, however, how many such opportunities we still have ahead of us, given the pace at which the public debt is growing (a detailed analysis of the current fiscal situation has been presented by us in the few past MACROscope issues, where we assessed the draft budget for 2004 and the medium-term strategy of public finance).

2004 – fastest growth in the world and strong euro

Last year, the Polish exports gained strength despite bad economic conditions of the key trade partners. This encouraged us to perform a quantity analysis of the demand for Polish exports (MACROscope, August 2003), which triggered a provoking thesis that economic stagnation in the European Union could trigger a change of parameters in our exports demand function (growth in the price flexibility, drop in income flexibility). Of course it does not mean that as a result of the change the demand for Polish goods will diminish upon the revival (even if only slight) in Europe, anticipated this year. Assuming that exporters have used the change in the exchange rate effectively, and not only have they survived, but, actually, strengthened their positions in the European markets, one can expect continued growth in exports. The more so, when the situation in the global currency market does not change, probably – the euro will still remain strong against the dollar, which, even when the zloty strengthens against the basket of both currencies, will allow to maintain high price competitiveness of Polish goods.

As for the pace at which the global economy develops, we are anticipating economic growth in the European Union and the United States at 2.0% and 4.8%, respectively. Both in the US and the Eurozone, the cycle of interest rate increases will most probably commence this year.

The state finance in the focus again

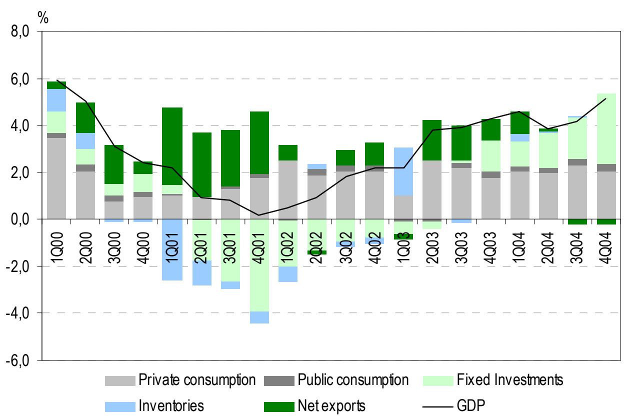
The issue of the public finance will remain the center of attention also this year. Though the economic growth pace in 2004 will not depend on the rate at which changes are implemented, the effectiveness of the planned reforms will determine whether the revival can see its continuation going forward. The impact of the fiscal situation, and primarily of the planned reform on the economic revival witnessed now and the economic growth prospects, was touched upon in one of the previous MACROscope issues (November 2003), where we emphasized the importance of the so-called non-Keynesian effects of fiscal adjustments.

The situation in the Polish financial market - fluctuations of the zloty exchange rate and the yield on the Polish bonds (referred to below) - will also significantly depend on the approval of Hausner's plan in the parliament.

Continuation of the revival not perceived by the society

In its first issue this year, *Gazeta Bankowa* presented a survey conducted among the analysts of the banking sector, including macroeconomic projections for the new year. The consensus emerging from the survey is quite optimistic. Everybody expects the GDP growth to accelerate, by 1pp. on average. Even though it is to take place parallel to deeper economic imbalance - the anticipated scale of growth both with regard to the current account deficit and inflation (also by about ca.1pp) - constitutes no threat to the GDP growth over a longer period of time. It should be emphasized, however, that the survey did not include projections of the deficit in the public finance sector which, along with the growing public debt, is sure to constitute the biggest threat to the further growth of the Polish economy in the upcoming years.

Quarterly structure of GDP growth



Source: BZ WBK, CSO

Quite common is also an expectation of a drop in the unemployment rate. The problem is, however, that the methodology of calculating the unemployment rate can change, and the percentage of the unemployed can grow as a result of reducing the denominator. It turned out as a result of the Statewide Census that the agricultural sector employs two times people less than the statistics have quoted so far. In such a case, it would be difficult to imagine the unemployment rate dropping to level anticipated by the economists in the survey of 17.5%. It would rather be higher by 2pp.

Macroeconomic projections for 2004 (%YoY)

	BZWBK	Exp. average	Exp. range
Economic growth[1]	4.5	4.3	3.5-5.0
Private consumption[1]	3.2	4.0	3.2-5.5
Investments[1]	9.9	6.6	3.5-10.0
C/A deficit (% of GDP)[2]	2.5	2.4	1.0-3.9
Inflation (year-end)[2]	2.5	2.7	2.2-3.3
Unemployment rate (year-end)[2]	17.2	17.5	16.5-19.0
Reference rate (year-end)[2]	4.50	4.90	4.50-5.75

Note: Unemployment rate according to current methodology
Source: BZ WBK, [1]Consensus Economics, [2]Gazeta Bankowa

The table above presents a market consensus (according to *Gazeta Bankowa* and *Consensus Economics*) with regard to the main macroeconomic projections for 2004 along with our expectations. As for the economic growth, just like last year, our forecast is above the average. And like last year, we have to admit that in our opinion the departure of the actual figure against our projections is more likely to be upwards than downwards. The range of expectations is very wide when we take into account the pace at which private consumption grows. It will certainly be limited by the incessantly high rate of unemployment and no distinct growth in employment (unfortunately again the revival will not be noticeable for the society) and effective increase in the tax burden for households. Though, on the other hand, most probably, part of the individual consumption is generated in the gray economy zone, which makes the projection of this figure difficult. Revival in investments is commonly anticipated. One is tempted to say “just like last year”. It seems, however, that are many more reasons here to be optimistic now – investments started to grow already in 2003, companies' financial performance is much better, taxes for enterprises have been reduced. Certainly, given the high share of investment goods in the Polish imports, the growth in investments will drive down net exports' contribution to the GDP (despite continuing growth in exports).

... and (unnoticeable?) inflation growth

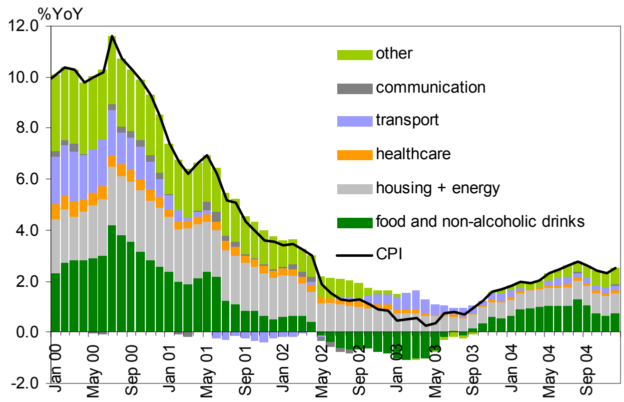
As we mentioned, despite significant acceleration of the economic growth last year, the CPI inflation did not rise significantly. At the end of the year, it will remain below this year's inflation target of the central bank (2% +/-1pp). The fact the inflation did not accelerate was related primarily to the economic growth structure other than the expected one and to higher contribution of net exports. On top of that, the inflation growth was primarily determined by the supply side rather than the demand side of the Polish economy. The net inflation (exclusive of the food and fuel prices), namely, dropped again to ca. 1.5% from 1.9% in December 2002. The food prices accelerated in fact in the last months of the year (from deflation of 3.6%YoY in February, inflation of food prices grew up to ca. 2% at the year-end). Thus, last year we witnessed subsequent records of low inflation (the lowest level: 0.3%YoY in April).

This year, we expect further acceleration of the inflation, within the limits of the inflation target set out by the central bank (as of this year, this is an ongoing target of 2.5% +/-1pp). One of the main elements driving this growth will continue to be food prices, representing ca. one-third of the consumer basket (we anticipate their acceleration up to 2.3%YoY), however, we will surely record a growth in net inflation and other core inflation measures. This means that along with the intensifying internal demand, stronger demand pressure on prices can arise. It will, however, be limited by still difficult conditions in the labour market (high unemployment rate, no excessive pressure on the salaries). Additionally, upon Poland's accession to the EU, there will be changes in some indirect tax rates (e.g. VAT on construction materials), which can give rise to the non-recurring growth in the inflation rate. Moreover, we are expecting the zloty to strengthen by a few percentage points. Through the impact on the price of imported goods, it can reduce inflation slightly. This effect will, however, be limited, as, for one thing, we did not see the opposite effect when the zloty weakened. According to the NBP studies, presented in one of the inflation reports, the long-term pass-through ratio (representing the impact of the nominal exchange rate on prices) dropped from 0.19 in Q2 2003 to 0.15 in Q3 2003.

We are projecting inflation at 2.5% in December 2004 against 1.7% at the end of 2003, with the average annual inflation of 2.3%. Over the year, we are expecting the inflation rate to accelerate up to 2% in 1Q04, to ca. 2.5% in 2Q04, and after it reaches the maximum level of 2.8% in August, to decline slightly at the year-end.

As for the other components of the inflation, the most distinct acceleration in the growth of prices is anticipated in categories "home furnishing and maintenance" (from 0.6% to 3.2%YoY). Category "housing and energy" has, apart from food, the biggest share in the inflation basket (ca. 20%), thus, the growth in the price of these goods anticipated by us (from 3.3% to 4.1%YoY) can also be instrumental in increasing the inflation. On the other hand, we are projecting that the deflation in "clothing and footwear" category will continue. We do not anticipate significant long-term fluctuations in the market of fuel prices – possible rises in the oil prices globally can be offset by the weaker dollar.

Structure of CPI growth



Source: BZ WBK, CSO

New Council in the New Year – rates slightly down

Though, a few members of the MPC will participate in the January meeting, the tenure of the Council has practically come to an end. Regardless of the scale of criticism that the monetary policy and the council members have been subject to in the past years, it surely deserves congratulations for fulfilling its main task, which is reducing inflation from a dozen to less than 2 percentage points. Words of recognition should also be expressed for the consistency with which the exchange rate policy has been run – along with the application of the strategy of the direct inflation target, the MPC moved gradually to the totally floating exchange rate of the Polish zloty. It is thanks to the good coordination of the exchange rate and interest rate policy, that we have avoided problems which were experienced in Hungary at the end of 2003.

It should be remembered, however, that the unquestionable success achieved by the MPC throughout its just finishing tenure does not mean that the monetary policy will be a piece of cake for the new members. With the anticipated economic revival and a big scale of fiscal policy expansion, the monetary policy will continue to be managed with a lot of uncertainty around. Especially that a few years during which the strategy of the direct inflation target has been applied have not brought much improvement in the precision of defining the mechanisms of monetary policy transmission.

The same applies to the inflation expectations, the manner of formulating them and possible translation of these expectations into the actual growth of consumer prices. This is important as part of the inevitable inflation growth anticipated in the upcoming quarters, will be determined by the supply factors. Even though, for this reason, (or because of increasing the indirect taxes, which the governor of the NBP has talked about quite recently), the inflation growth can be of incidental nature, nobody really knows how the economic life participants will treat this (consumers, companies, financial markets). The change in prices depends actually on them.

Perhaps, the main objective of the new MPC will be to make the society aware of the reasons for the growth in prices (it is actually an integral part of its main objective, i.e. maintaining the inflation at a low level). Then the inflation growth – even up to 3% for example – arising from reversible factors and existing in parallel with relatively stable inflation expectations, will not necessarily have to mean interest rate hikes.

The FRA market continues to indicate the possibility of interest rates rising. In our opinion, however, in the upcoming months, we should expect cuts rather than hikes. First of all, there is still no significant demand pressure on prices. What is more, there is no certainty (and there never will be), if following the approval of the so-called Hausner's plan, the stepping down MPC would decide to apply subtle reductions (most likely with an equal distribution of votes). An argument which makes the interest rate cut possible is also a change in the MPC composition. We wrote about it in detail in the previous issue of MACROscope (December 2002). The distribution of powers which is established in the MPC (details in the section *Central bank watch*), will undoubtedly be more conducive to the decision to reduce interest rates. Of course only if we are talking about the scenario of a moderately stable development of the situation in the financial markets, rather than the "crisis" option. Thus, we are expecting to see continued expansion of the monetary expansion, in the form of 2-3 reductions of the main NBP rate. We do not anticipate a departure from the policy of the so-called small steps (even if some candidates for membership in the MPC were of a different opinion), which means that each of them will total 25 bps.

Financial markets are rather unlikely to stay calm

Among the economists taking part in New Year surveys, there are usually both optimists and pessimists. There are also those who are out of the main stream, even when it comes to the direction of changes in some economic ratios, e.g. anticipating an increase in the central bank's interest rates. The most interesting, however, are usually projections of market indicators.

Financial market projections for 2004 (end-year)

	BZWBK	Exp. average	Exp. range
Yield of 5-year bond (%)	6.5	6.9	5.8-8.1
Exchange rate EURPLN	4.50	4.50	4.10-4.79
Exchange rate USDPLN	3.60	3.68	3.36-4.30
Exchange rate EURUSD	1.25	1.23	1.07-1.32
Change of the zloty against basket of two currencies (minus=depreciation)	4.7%	3.6%	from -4.0% to +12.2%

Source: BZ WBK, Gazeta Bankowa

As the table above shows, the diversification in the projections of the exchange rates and yield on the government's bonds is (just like last year) quite considerable. Of course, the wide range of projections re. the relation between the zloty and the two most important currencies is in a big part a product of high range of projections regarding the euro/dollar rate in the international markets (in the survey: from 1.07 to 1.32). However, the surveyed economists display quite a big diversity of projections when it comes to the strength of the zloty against the basket of both currencies. The biggest optimists see the zloty ca. 12% stronger than the average level of December 2003, while the pessimists assume the zloty to be weaker by about ca. 4%. As it can be expected, a follow-up to the expectations as to the strength of the zloty are assumptions for the development in the debt securities market – for a 5-year bond the anticipated yields range from 5.8% to 8.1%. When looking at the average projections for the 2004-end zloty exchange rate against the basket of currencies and bonds' yield, one can conclude that not much will change in comparison to the end of last year, which does not mean of course that there will be no changes in the currency markets throughout the following 12 months.

With quite diverse market projections in the background, our expectations seem moderately optimistic. We are expecting the zloty to strengthen against the euro-dollar basket, while the debt market should see continuation of the positive sentiment, when it comes to the short end of the yield curve, owing to the forthcoming, (in our opinion) reductions in interest rates. Even though our projection re. 5-year bond's yield points to more or less the same level in December as now, it does not mean that the Polish debt market will remain stable. Quite the opposite, we can expect to see a traditional "budget cycle" in the financial market. Right before the first attempts at defining the next year's budget, which will surely take place in early summer (providing the finance minister does not change, which over the past few years took place in July), financial markets will start living the "public finance crisis" again. Since, as usual in Poland, planning the budget for next year is more difficult than a year ago, we should reckon with a temporary depreciation of the zloty and growth in yield in this period. However, similarly to what happened last year, higher yield levels and weaker zloty can induce investors to come back to the Polish market given high attractiveness of the Polish bonds in the region. Though certainly, this attractiveness and the overall situation in the debt securities market in 1H04, depends, primarily, on the approval of Hausner's plan by the government, the ruling coalition and the parliament. If this happens, another opportunity will arise to take advantage of the "convergence play". Otherwise, bond yields could once again go the levels seen in November last year. In our opinion, the first scenario is more likely, though we have to remember, that this year the market of bonds can be sensitive to the news from the parliament more than usual. This is because of very high borrowing needs of the state (we are writing about it in the second *Special Focus* of the month). In the context of unfavourable interplay of political-economic events, investors can demand a higher risk premium in the subsequent auctions, where a historically high supply of treasuries will be offered.

New Year's Greetings

Though the budget deficit will not start reducing earlier than in the next year, our first wish to the Minister of Finance is to successfully bridge the budget gap. This is important for all of us as otherwise there will be no faster economic growth in the long run. However, as we realise that we will not be able to avoid the shortage in the state's budget in the near future, another wish for the Ministry of Finance is to find the cheapest possible way of financing of what will not be mended with the reduction in expenses. As long as relevant steps are taken (Hausner's plan) with a view to reducing the deficit in the future, the sentiment of foreign investors may be quite good. The informational policy and communication with financial markets cannot be forgotten – may the issues be consistent with the debt management strategy, and may the currency exchange on the market be carried out in a transparent way.

The wish of transparency of actions can undoubtedly be addressed to most social / economic decision makers, including the central bank. May the medium-term inflation projections be published and may the information published after the MPC meetings not be limited to the summary of economic developments of the previous month. We wish the new Monetary Policy Council a stable currency and low inflation without the need to hike interest rates.

We also wish all the above institutions to be able to quickly work out a stance on Poland's entry into the Eurozone and may the successful macroeconomic policy make the Europe's common currency come to Poland as soon as possible (here also the implementation of the Hausner's plan is a prerequisite).

Entrepreneurs are sure to welcome the reduction of labour costs, those non salary-related, in particular. If we could add less bureaucracy and reduction in the number of bothersome officials to our wish list, businesses would start popping up as mushrooms after a rain and their financial performance would be quite good. If the non salary-related expenses are reduced, we will stand a bigger chance to reduce unemployment (permanent unemployment rather than seasonal). If thanks to consistent monetary policy inflation stops not consuming part of the income, consumers will be able to finally feel the economy revival in their pockets.

And we would also like to wish you much optimism and may at least some of the wishes come true.

Treasury papers AD 2004

At the onset of December last year, the Ministry of Finance consulted the market players and then published several documents outlining the plans of financing budget borrowing needs in 2004. Among others, there was a proposed schedule of tenders for T-bonds in 2004 and more detailed proposals for financing the deficit in the first quarter, namely possible ranges of supply for particular types of treasuries during subsequent tenders. It is the first time that Ministry of Finance has sent such documents for review. Previously, the Ministry published a ready schedule of T-bond issues through the year and at the beginning of the month specified supply within tenders envisaged for the papers in a particular month.

Timetable of treasury bond auctions in 2004

	Type of T-bonds				
month	*2Y*	*5Y*	*10Y*	*20Y*	*new**
January	✓				✓
February	✓				✓
March	✓	✓	✓		
April	✓	✓	✓		
May	✓	✓			✓
June	✓	✓			✓
July	✓		✓		
August	✓				✓
September	✓	✓		✓	
October	✓	✓	✓		
November	✓	✓			✓
December	✓				

* variable coupon

Source: Ministry of Finance

As it seems, the main reason for the Ministry's willingness to consult the issuance plan was the situation on the fixed income market where since the mid-2003 yields were growing and since September Polish T-bonds were witnessing falling interest on the part of investors, which affected in the first place papers with longer maturity terms. Till the end of the year their sales at the auctions were quite low, very often below supply and in September none of the five-year bonds were sold.

Hence, in order to adjust to the market situation, the Ministry of Finance have transferred the bulk of the supply in 1Q04 to the shorter end of the yield curve, while 5- and 10-year bonds will be issued only in March. Besides, the Ministry will issue a new type of bonds with variable interest and 3- and 7-year maturity (first auction of them was held on 14 January) and conduct bond issues in a private placement system with non-standard coupons (first operation of this type was carried in mid-December). Finally, a certain part of borrowing needs will be financed with loans from foreign institutions and eurobond issues, because in 1Q04 the Ministry intends to raise €4-5bn from these sources. A part of it will be earmarked for "supplement domestic financing in the first quarter of 2004 and for securing financing of borrowing needs of the central budget in the second quarter of 2004". Therefore as early as at the end of last year the Ministry drew loans from the European Investment Bank and exchanged €200m from them into the zloty. This money is to be used in 1Q04. It is worth noticing, that until now money from foreign sources have not been used for financing budget deficit but only for foreign debt repayment both before and on maturity.

According to the justification to 2004 budget draft, receipts from issuing treasury papers will amount to PLN144.4bn this year. Meanwhile, in the same document collecting PLN119bn is forecasted for last year while in the justification to 2003 budget act proceeds of PLN115.1bn were assumed. The difference in the forecasts of almost PLN4bn is certainly a result of lower than planned receipts from privatisation.

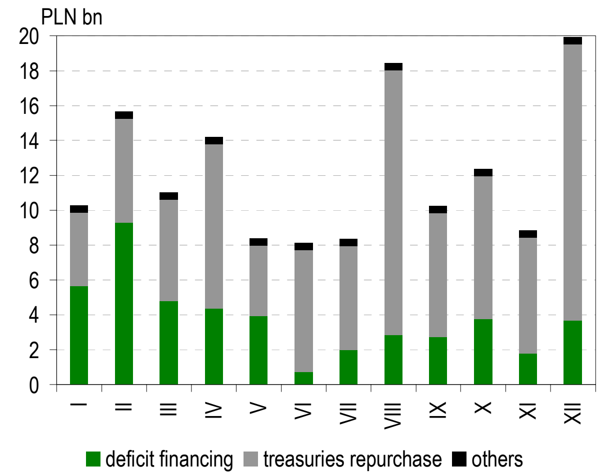
The size of the issue planned for this year is determined by the estimated borrowing needs of the state budget. The amount is primarily made up of the budget deficit of PLN45.5bn assumed in the government's draft budget and the nominal value of treasury securities to be redeemed (those issued in the previous years as well as 13- and 26-week T-bills, which will be sold still this year), which is estimated at some PLN95.5bn. The total amount, i.e. PLN 141bn, must be increased by the so-called negative balance of privatisation proceeds* of nearly PLN6bn and almost PLN4.5bn earmarked for pre-financing projects to be financed with EU grants. Finally, having deducted ca. PLN5.5bn, i.e. funds from the central budget accounts that are to finance the deficit, the result of our calculation is some PLN 146bn, which is close to the planned budget inflows.

The graph below illustrates our estimations of the central budget's borrowing needs in the consecutive months this year. While projecting the deficit execution we took into account the previous year's trends. The maturity profile of treasury securities was produced by us basing on data from the Ministry of Finance on the issued securities. The remaining amounts were equally spread over months, on the assumption that the majority of privatisation proceeds will emerge in second

* This phrase represents a deficit of proceedings from privatisation compared to expenditures that should be financed with these proceedings according to adequate acts

half of the year, which means that the shortage of these proceeds will be primarily financed in the first half, while the EU projects will be primarily pre-financed in the second half of the year in view in some delays in their preparations.

Borrowing needs of the budget in 2004



Source: Ministry of Finance, BZ WBK

The most difficult months for the Ministry will be February, April, August and December when substantial payments accumulation is evident. The high February amount is a result of high budget deficit, while the situation in the three remaining months is triggered by accumulation of payments related to the repurchase of treasury securities. However, based on the borrowing needs, one cannot directly project the size of the issue in individual months as the Ministry of Finance is always free to influence the supply of treasuries taking advantage of the funds accumulated in the government's accounts held with the NBP. In the months when needs are lower, the issue size will exceed the needs to ensure that the accumulated reserve can be utilised in more difficult months and that the supply is limited, as a result. Furthermore, as we mentioned above, this year the Ministry of Finance envisages support from foreign sources. This is why the quarterly, not monthly, forecast for supply of treasury securities is likely to be closer to reality. Our forecast for gross and net (reduced by repurchase of maturing securities) issue of treasuries is presented in the table.

Projected supply of treasury securities (PLN bn)

period	gross issue	net issue	repurchase
1Q2004	36.9	20.9	16.0
2Q2004	30.7	10.2	20.5
3Q2004	37.1	8.8	28.2
4Q2004	41.2	10.5	30.7
Total	145.9	50.5	95.4

Source: BZ WBK

The comparison of the gross issue of treasury papers projected by us for the first quarter with the supply of T-bills, 2-, 5- and 10-year T-bonds within a relatively wide range of PLN26-35.1bn as announced by the Ministry of Finance indicates that the Ministry will be able to close financing of the state budget expenditures in this quarter if the sales of treasuries are close to the upper end of the Ministry's plans. The current market conditions indicate that this is attainable. A shortage of a few billion zlotys will be covered with the already accumulated funds from private placement issue and the conversion of the EBI loan into zloty. Variable interest rate bonds should also play some role, however, it is still not known to what extent they will be accepted by the market.

High supply of treasury securities is likely to be sustained in the subsequent quarters. Only in the 2nd quarter, the budget borrowing needs will be significantly lower than in the first one, while in the two last quarters, the issue of treasuries will even be higher than in the first one. Certain part of the supply will surely be transferred to switching auctions, however the experience from the previous years shows this is usually the case with relatively low amounts.

What is more, if another year in a row does not yield the whole projected revenues from privatisation, then it may result in further increase in supply of treasury papers in the second half of the year.

Economic update

- **GDP growth accelerated to 3.9% in 3Q03**
- **Recovery in trade and industry also in 4Q03**
- **CPI and inflation expectations gradually picking up**
- **... together with money supply and its counterparts**

Economic figures published in the last month of 2003 confirmed that the Polish economy is on the path of recovery. GDP growth in 3Q03 amounted to 3.9%. Statistics of industrial output, retail sales, and foreign trade for November showed that positive trends were also maintained in the last quarter of 2003. We expect 4.3%YoY GDP growth in 4Q03, bringing the whole year growth to 3.6%. Together with improvement of business climate we saw information about rising core inflation and inflation expectations, however those facts should not cause the new MPC members' headache at the beginning of their term of office, as despite moderate upward trend both current and anticipated inflation remains at fairly low level.

GDP growth accelerates

According to the Central Statistical Office, the Polish economy expanded in the third quarter 2003 by 3.9%YoY following an increase of 2.2% and 3.8% in 1Q03 and 2Q03, correspondingly. This was exactly in line with market's forecasts, while we expected a moderate deceleration of growth to 3.7%. Figure below summarises information concerning the growth of GDP components in the third quarter.

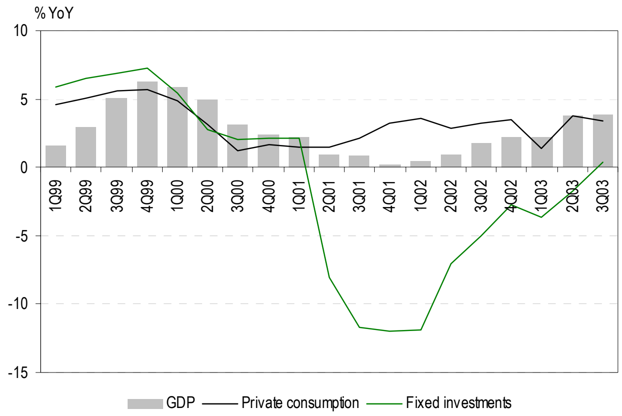
GDP and its components, %YoY

	1Q03	*2Q03*	*3Q03*	*4Q03**
GDP	**2.2**	**3.8**	**3.9**	**4.3**
Domestic demand	2.3	2.0	2.3	3.3
Total consumption	1.0	2.8	2.9	2.7
Private consumption	1.4	3.8	3.4	3.0
Public consumption*	-0.5	-0.6	1.1	1.5
Gross accumulation	12.7	-1.6	-0.3	4.9
Fixed Investments	-3.6	-1.7	0.4	5.0
Net exports contribution (in pp)*	-0.2	1.7	1.5	0.9

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

Domestic demand was the main factor contributing to the third quarter growth acceleration and it was driven purely by high total consumption growth of 2.9%YoY. Private consumption increased by 3.4% in comparison with average 2.6% in 1H03. It decelerated as compared to the second quarter (3.9%), but this should not be surprising given one-off factors, which were responsible by high growth of consumption in April-June period (earlier than usual indexation of social transfers and later Easter effect). The second, most important factor behind high GDP growth was net exports. It contributed to 1.5pp growth, which in line with our expectations was a bit lower than 1.7pp contribution in 2Q03. Of course, two features bring attention as concerns net exports – excellent export performance and relatively low imports amid low fixed investments. High export is not surprising if recent industrial production and export data are taken into account. However, we have been expecting slightly higher fixed investments. While we forecasted 2%YoY growth in investments, they recorded an increase by a mere 0.4%. Still, it is worth to notice this was the first fixed investment growth since 1Q01, which confirmed hopes that investment activity finally started to revitalise. However, growth of gross fixed capital formation was negative again (-0.3%YoY, close to zero contribution to GDP), as changes in inventories contributed negatively to GDP growth rate (by 0.1pp).

Contribution of components to GDP growth



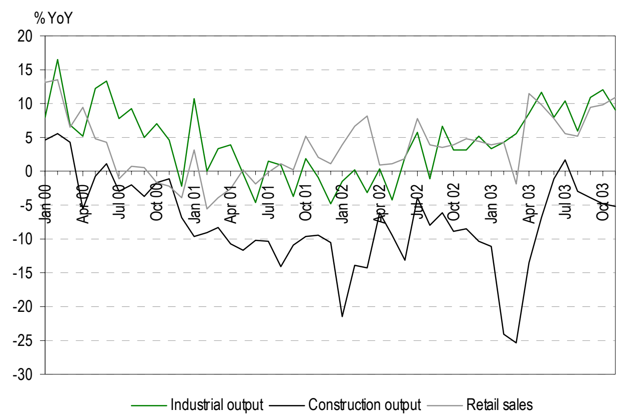
Source: CSO, own estimates

On the supply side, as usual in recent quarters industrial sector was the most important with value added rising by 8.2%YoY (8.3% in 2Q03). Value added in market services also maintained high growth rate (4.5%YoY vs. 5% in 2Q03). While construction sector recorded still negative contribution (drop by 2.0%YoY), its dynamics improved significantly as compared with decreases of 19.5% and 7.4% in two previous quarters, respectively. In the first two months of 4Q03, we observed output growth in the industrial sector of 12.1%YoY and 9.1%YoY respectively, and we forecast above 10% growth in December. This may lead to two-digit growth of gross value added in this sector. Therefore it seems that even a continuation of negative dynamics in construction should not be a barrier for achieving above 4% GDP growth in 4Q03 (assuming stable dynamics in market services). We expect that accelerating fixed investments, together with relatively stable dynamics of private consumption and still high export growth should contribute to accelerated GDP growth in the last quarter of 2003 and further in 2004. We forecast 4.3% GDP growth in 4Q03, which would translate into some 3.6% annual average growth in 2003. We maintain our GDP growth forecast of 4.5% in 2004.

Industrial sector kept expanding also in 4Q03

In November industrial output fell 8.1% in relation to previous month and increased 9.1%YoY. Even though the result was slightly weaker than expected (market forecasts pointed to ca. 11%YoY), the fact is that it represented a continuation of strong expansion of industrial sector again. Similarly as in previous months it was fuelled mostly by excellent performance of manufacturing sector, where production surged by 10.7%YoY. And within this sector the best results were attained in industries producing goods mainly for exports – e.g. motor vehicles (40.5%YoY), furniture and other goods (25.6%YoY), machinery and tools (21.7%YoY), electrical appliance (18.8%YoY). Industrial output corrected for seasonal factors increased 8.7%YoY, which was well below October's 11.8%YoY, however slightly exceeded average growth rate of seasonally adjusted output recorded in the second and third quarters (8.5%). In general, even though the data were not as strong as forecasted, they were positive for economic growth prospects and did not give any reason to doubt in continuation of recovery process in the Polish industry.

Economic activity indices, real growth



Source: CSO, own estimates

Much worse information came from construction sector, where output fell by 5.1%YoY and after seasonal adjustment a contraction was even deeper (by 6.9%YoY). This suggests that improvement of investment activity showed recently by CSO data is not broad-based, or perhaps concentrates in fixed investments in machinery and tools rather than buildings (which would be actually a positive phenomenon). Still, negative performance of construction sector counterbalanced good results of manufacturing. But fortunately this would not be enough to prevent gradual acceleration of GDP growth in subsequent quarters.

... and so did retail trade

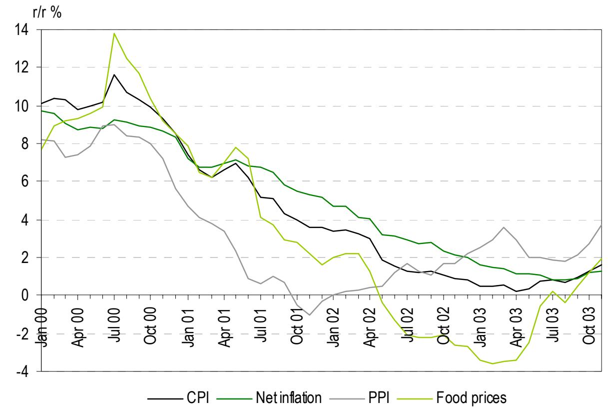
Retail sales grew by 11.4%YoY in November after falling by 4.1% in relation to previous month. The result was higher than market consensus of 9.4% and our forecast of 10.6%. A breakdown of retail sales growth was very similar to what was observed in the last couple of months. The highest annual growth was recorded in "the remaining retail sales in non-specialised shops" (67%) and in sales of food, beverages and tobacco (16%). Relatively high growth was still observed in the sectors of "motor vehicles" (14.8%), "fuels" (12.3%), "textiles, clothing, shoes" (7%), and in "cosmetics and pharmaceuticals" (6.8%). High dynamics of retail sales across the branches suggests that private consumption growth may be maintained at the level of around 3%YoY, despite the fact that retailers in small companies perceive economic situation very negatively and despite consumer confidence records very low level.

Inflation steadily picking up

In November consumer prices increased 0.3%MoM and their annual growth rate accelerated to 1.6%YoY from 1.3% in the previous month. The result exactly matched our forecast as well as market consensus, and the structure of price increase was also consistent with expectations. The biggest inflationary impulse came from the food market, where prices grew 0.8%MoM in November. Whilst in the corresponding month of 2002 food prices recorded unexpected fall of -0.3%MoM, such quite significant increase in 2003 pushed annual dynamics in food and non-alcoholic beverages sharply up – from 1.2% to 2.1%YoY – being a significant factor behind the acceleration of overall CPI growth. Very similar story repeated on the fuel market, which also increased 0.8%MoM against 0.3%MoM drop recorded in November 2002. It fed into the 0.4%MoM increase of transport prices, accelerating annual its dynamics from 2.3% to 3.0%YoY. Other goods and services displayed rather moderate price increases.

CPI figures confirmed that upward inflation trend comes almost exclusively from supply-side factors, which in 2H03 turned from positive into unsupportive. Food and fuels are pushing inflation up, but price growth in other categories remains stable or even decelerating. Besides, medium-term inflation outlook still looks positive, as CPI growth should be around the middle of NBP's inflation target in 12 months time. It seems that this still leaves some room for slight monetary easing this year after the new crew of dovish economists would take over control over the level of interest rates.

Measures of inflation



Source: CSO, own estimates

The CSO informed also that producer prices surged stronger than expected, accelerating from 2.7%YoY to 3.7%YoY in November, after 0.4%MoM increase in relation to previous month. A combination of two effects contributed to such sharp hike of PPI growth: very low base effect (producer prices fell 0.5%MoM in November 2002) and rapidly growing prices of raw materials (metals, coal, crude oil) strengthened by weak zloty exchange rate. The highest increase was recorded in mining (1.9%MoM, 7.1%YoY), however manufacturing also saw accelerating dynamics of prices, from 2.4%YoY to 3.7%YoY. Sharp increase in PPI growth may create some pressure on CPI inflation in the medium term, but we do not think this effect will be excessively important. Especially, that on the other hand there are still significant factors that would constraint consumer price growth (e.g. high unemployment). So in effect we believe the perspectives of inflation are still reasonably safe in 2004, and it should not be a real headache for monetary policymakers in the coming months.

Inflation measures, %YoY

	PPI	*CPI*	*Net inflation*	*15% trimmed mean*
End-2001	-0.3	3.55	5.15	3.70
End-2002	2.2	0.84	2.02	1.19
Mid-2003	2.0	0.75	1.07	0.91
September 2003	2.1	0.93	0.86	1.19
October 2003	2.7	1.26	1.20	1.20
November 2003	3.7	1.59	1.26	1.39

Source: CSO, NBP

In line with expectations all core inflation figures for November showed increases as compared to the previous month. Net inflation (CPI excluding food and fuel prices) increased by a moderate 0.06pp to 1.26%YoY from 1.20% in October, confirming that supply side factors were to a large extent responsible for CPI inflation rise last month. Another very important measure, i.e. 15%-trimmed mean, rose by 0.2pp to 1.39%YoY in November, which was the seventh consecutive increase of this annual index. CPI excluding controlled prices recorded the most significant growth (to 1.37%YoY up by 0.34pp), CPI excluding the most volatile prices accelerated to 0.7%YoY (up 0.4pp) and CPI excluding the most volatile prices and fuel prices rose to 0.98%YoY (from 0.7%). All core inflation measures increased together with November's CPI inflation increase from 1.3% to 1.6%YoY. However, it is worth noticing that an average growth of all core inflation measures was lower than CPI rebound in November (0.22 pp vs. 0.33), which was also the case in previous two months (see figures on the left). All core inflation measures remain below the headline inflation figure and below the central bank inflation target of 2.5% +/- 1pp.

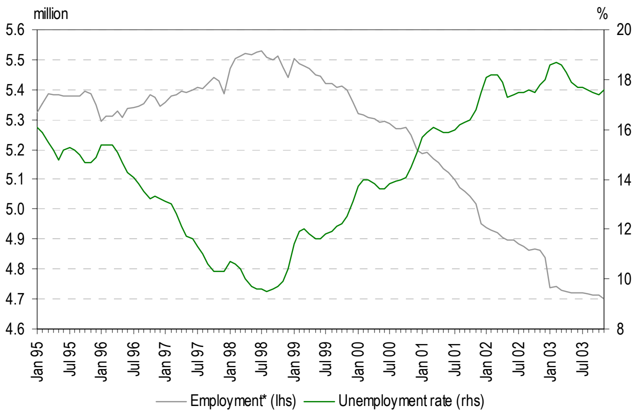
... and inflation expectations are growing too

Households' inflation expectations rose sharply in December. According to data published by the NBP, average inflation rate expected by private individuals in 12 months time increased to 1.6%YoY from 0.9% in November, which was the most significant rise since late 2000. One has to notice that part of this sizeable hike resulted from the increase of current inflation rate. (due to central bank's methodology of measuring inflation expectations). However, the rise in expected CPI (0.7 pp), was higher than rise in actual CPI (0.4 pp), which suggests that households indeed got more pessimistic as regards consumer price movements in the future. While this might be an argument calling for caution in future monetary policy decisions, its significance would depend heavily on the persistence of this trend. Meanwhile, we expect that even though the growth of inflation expectations would continue amid climbing CPI, the pace of their growth would be quite limited and should not frighten the new members of the MPC, at least at the beginning of their term of office.

Unemployment rate also higher

Registered unemployment rate in November increased to 17.6% from 17.4% recorded in the previous month, which was in line with market consensus and our forecast. This reflected a typical seasonal hike, which will be most likely continued in the following months (we forecast unemployment rate in December at 18%). It is worth noticing that registered unemployment rate fell by 0.2 pp in relation to the corresponding period of previous year, although one should also remember that unemployment rate according to the Labour Force Survey is much higher and amounted to 19.4% in 3Q03.

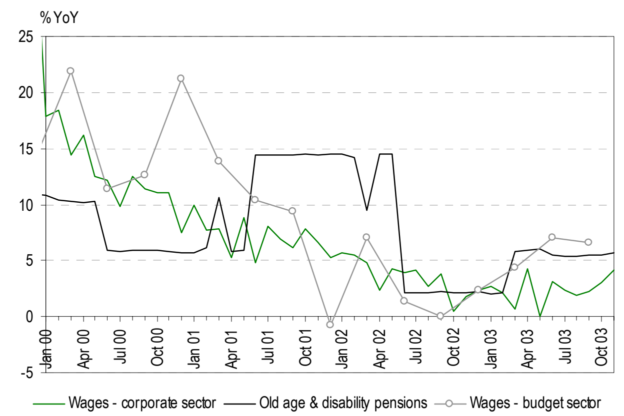
Average employment and unemployment rate



* employment growth in comparable terms, adjusted by changes in CSO methodology
Source: CSO, own estimates

Employment in the enterprise sector fell 0.3%MoM in November taking the annual dynamics down to -3.3% from -3.2%YoY in the previous month. The number of employed reached 4.701m – the historical low. This indicates that better and better results of the real economy do not go hand in hand with indicators of the situation on the labour market. As we have written many times in the past this stems from deep restructuring process in Polish firms and growing labour productivity, which allows enterprises to expand their activity without increasing labour demand in the short run.

Average wages and social benefits



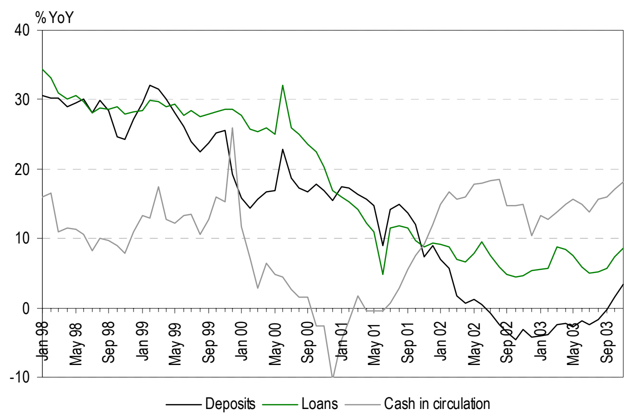
Source: CSO, own estimates

While employment is still falling, dynamics of wages is gradually increasing. In November wages grew by as much as 4.7% on a monthly basis driving the annual growth rate to 4.1%, up from 3.0%YoY in the previous month. As a result average growth rate of wages in January-November period amounted to 2.4%YoY versus 2.2% after October. High wages growth in November offset fall in employment and nominal wage bill in the enterprise sector grew by 0.7%YoY. However, it did not offset also accelerating pace of prices growth and wage bill in real terms fell by 0.9%YoY.

Money supply growth keeps accelerating

Reviving activity in industry and gradually picking up prices go in line with acceleration of money growth. In November broad money supply M3 remained unchanged on a monthly basis but rose 5.7% in annual terms against 4.7%YoY increase in October. This resulted not only from continued acceleration of cash in circulation (up 1.2%MoM and 18.2%YoY) but also from further improvement of deposits dynamics. Overall deposits inched up by 0.5%MoM and 3.4%YoY. This was the second consecutive month of annual growth in deposits following earlier 15-months period of falls. What's important, November saw a deceleration of decrease in households' deposits as they dropped by only 3.2%YoY versus 5.1% decline in the previous month and 6.2% average drop in January-October period. Apart from rising money demand (see below) this may be a consequence of the fact that profitability of alternative forms of saving, mostly mutual funds investing in debt instruments, drastically worsened recently (both in terms of current and expected rate of returns) and their relative advantage over traditional banking deposits declined. At the same time, corporate deposits were still growing at very fast pace (25.1%YoY), reflecting considerably improved financial results and liquidity of Polish companies.

Loans, deposits, and cash in circulation



Source: NBP

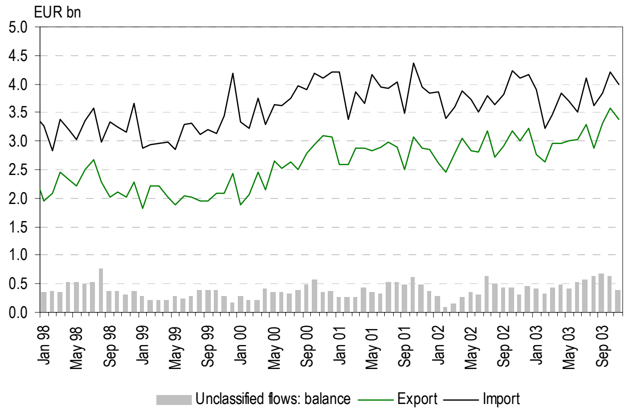
The fundamental reason for money supply growth is rising money demand. Overall credits grew by 1.4%MoM and 8.5%YoY against 7.2%YoY increase in the previous month and 6.5% growth in January-October period. As in previous months, this resulted mainly from accelerating dynamic of households' borrowing (mainly mortgages) – it rose 13.6%YoY after 12.2%YoY growth in October and average 8.8%YoY increase in first ten months of the year. Meanwhile, growth rate of corporate loans is still sluggish and was only 3.6%YoY in November against 3.1%YoY in the previous month and 3.5%YoY on average in January-October period. However, this does not have to necessarily mean that enterprises do not expand investment activity as the main source of financing investment outlays used to be companies' own resources (retained profit), not banking loans.

Current account in red again

In November Polish current account recorded deficit of €286m, which followed two months of surpluses (€58m in September and €198m in October). Deficit was higher than our forecast and market consensus of around €100. However, it was not trade balance that forced such change, because trade deficit was actually even lower than in October, reaching €633m (against €644 in previous month). Trends in foreign trade payments continued and were consistent with our predictions. Export maintained its excellent growth, which remained at October's level 12.1%YoY (when expressed in euros), confirming that offshore markets remained the main target of intensified industrial output growth recorded in Poland in recent months. At the same time import performed weakly again, falling 2.2%YoY (in euro terms), which is the deepest drop since March 2003. It does not seem to suggest significant revival in domestic demand, and especially in investment demand. However, such results might reflect some changes in domestic demand structure, namely a shift from imported goods into domestic substitutes amid their greatly improved price competitiveness. It would be positive for long-term growth prospects of the economy, however we believe that such effect would not be long-lasting and we will finally see revived import growth in 2004 after domestic demand gets real boost.

While registered trade balance showed positive results, the unclassified flows balance did worse, and its surplus fell to €385m in November from €640-680m range recorded in three previous months. It is too early to explain this phenomenon, as weak zloty exchange rate was continuously supporting lively cross-border unregistered trade, which is a large component of unclassified flows. Perhaps the effect of introducing visas for our Eastern neighbours appeared with a lag, or Poles stopped exchanging their euro-denominated assets into zlotys despite still attractive exchange rate.

Foreign trade turnover



Source: NBP (payments-based figures)

Apart from unclassified flows, other factors also contributed to weaker current account in November as compared to previous month. First, services balance turned into red again (-€23m) after recording unprecedented surplus of €65m in the previous month. Second, surplus in current transfers decreased by nearly a half after very good results in September-October period. Third, income balance was much more negative (-€155m) than usually in November (-€78m in 2002 and surpluses in previous years) amid both relatively high income outflow and low income inflow.

In general, current account data for November were positive, confirming strength of Polish export sector and showing that the economy's external imbalance keeps shrinking. The cumulative 12-month C/A deficit fell to 1.8% of GDP from 2% in the previous month. We expect a continuation of these trends in December's data.

No surprises in quarterly balance of payments data

Also the NBP's balance of payments data on a transactions basis for 3Q03 did not bring surprises, confirming trends showed by monthly statistics for that period revealed earlier (payments-based data from the NBP and customs-based figures from the CSO). The table below depicts main elements of the balance of payments on a transactions basis in comparison with payments-based statistics.

Main elements of balance of payments (EUR)

	1Q03	2Q03	3Q03
Export %YoY	7.7 (6.4)	5.1 (3.9)	9.0 (7.1)
Import %YoY	3.0 (-2.5)	-2.5 (-0.6)	7.2 (2.7)
C/A deficit (bn)	1.58 (1.44)	0.90 (0.97)	0.46 (0.29)

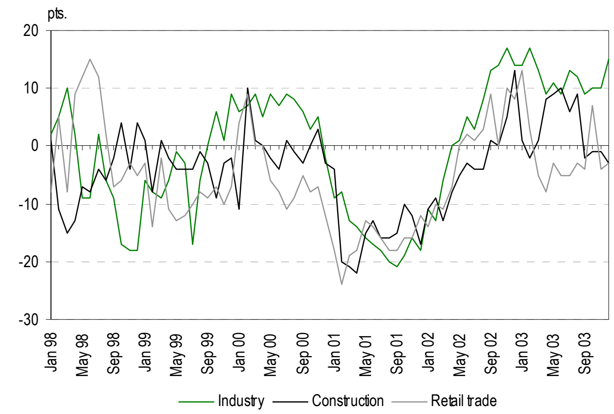
Note: in parentheses data on a payment basis
Source: NBP, BZ WBK

As shown above, according to quarterly data on a transactions basis, tendencies in Poland's foreign trade in 3Q03 were the same (despite quite large discrepancies in dynamics) as indicated by the central bank's payments-based statistics published earlier. Export continued excellent performance even accelerating in comparison with previous quarters, benefiting additionally from the zloty depreciation. At the same time import moderately recovered from a slump in the first half of the year indicating gradual rebound of domestic demand. Tendencies in foreign trade led to narrowing of trade gap and were the main reason for lowering of current account deficit. Developments on financial account of the balance of payments were also similar to those seen in payments-based data. 3Q03 saw fall in FDI inflow and outflow of portfolio investments in debt instruments.

Excellent business climate in industry

Business climate indicators for November brought a confirmation of excellent export performance. Economic leading indicator for the industrial sector recorded another sharp increase by 15 pts as compared to December 2002, which was driven mainly by positive expectations as regards future orders and future production. What is interesting, however, at the same time entrepreneurs are sceptical about current orders (domestic and foreign), which resulted, in their opinion, in reduction in current production. Well, this phenomenon is not visible in recent data, as industrial production expanded by close to 10%YoY in November and it is also expected to grow by two-digit level in December. Positive results of business climate are very diverse among different branches in industrial sector. Similarly as it was the case in production output, economic climate was positively affected by exporting sectors (furniture and other goods, electrical appliance), although it was negative in motor vehicles. We still believe high export growth will contribute to high dynamics of industrial production in the following months.

Business climate



Source: CSO

Leading indicators are still negative in two other sectors – indices of construction and retail sales recorded decreases on annual basis by 3 pts. In the construction sector only 13% of enterprises expect an improvement of the economic situation, while 38% assess prospects of their business negatively. This is mostly due to low orders, poor financial stance and falling prices. Majority of construction firms perceive production capacity as excessive and they plan to reduce employment. Entrepreneurs in the retail sector are also far from positive about economic climate. However, this is affected mainly by enterprises employing less than 9 people, while bring retailers are much more optimistic. This explains why we still see very high growth of retail sales, as the data are reported for big enterprises only. One important feature, which was observed also in the industrial sector, is that polled enterprises expect prices increase (sometimes significant) in the following months.

Deteriorating consumers' optimism

December's result of consumer's confidence performed by Ipsos-Demoskop institute showed second consecutive month of relatively poor results. The overall optimism index (WOK) fell by 3 pts as compared to November, which represents a decrease by 2.6%YoY. The fall was driven by lower propensity to consume (down by 2 pts on monthly basis and no change as compared to December 2002). A general assessment of economic climate fell significantly on monthly and annual basis – by 5 pts and 5%YoY, respectively. Households indicated they expect prices increase and they declared higher propensity to buy durable goods (financed by commercial credits). The results may be perceived as a confirmation of forecasts showing that high growth of private consumption observed in 2Q03 (3.9%YoY) is not likely to be repeated in the following quarters.

Central budget 2003 under control

Budget deficit after eleven months of 2003 proved to be even smaller than announced earlier by the FinMin officials. The gap totalled PLN35.55bn, i.e. 91.8% of the annual plan. This means that in November alone the deficit was very low, reaching merely PLN0.7bn against more than PLN3bn in the corresponding period of two previous years. Nevertheless, as we have expected, such result did not stem from any significant acceleration of revenue growth, but rather from cuts in budget expenditure. And likewise in the preceding month, large part of the cuts was concentrated in subsidies to various funds – labour fund, which realised its planned subsidy already in August, and social security fund, which hit the ceiling level in November. This means that even though the deficit of the central budget in December will not breach its maximum level of PLN38.7 written down in the Budget Act, the actual deficit of the public finance will be higher than planned in 2003. What is important, budget data not only confirmed there was no threat of exceeding planned budget deficit, but also showed that the Ministry of Finance should not have significant problems with liquidity at the turn of the year. FinMin's liquidity cushion increased again, reaching PLN13.1bn at the end of November against PLN8.5bn last month and merely PLN1.1bn in September.

The Ministry of Finance also presented updated economic forecasts. The ministry estimates that GDP growth should accelerate to 4.4% in 4Q03. Growth in the whole 2003 should top 3.6% and is forecasted at 5% for 2004. FinMin's inflation forecast for December 2003 pointed to 1.8%YoY, while in 2004 it should reach on average 2%YoY.

Public debt slightly up in 3Q03

According to the Ministry of Finance the debt of Poland's public sector totalled PLN39.8bn at the end of 3Q03. It means that the third quarter saw only moderate increase of the public debt by 0.2% of GDP (PLN5.8bn) to 49.7% of GDP, much below the expansion recorded in two first quarters of 2003, namely by PLN25.7bn (2.9% GDP) in 1Q03 and by PLN10.7bn (0.8%GDP) in 2Q03. Nevertheless, the measure of public debt used in Poland's public finance law – i.e. the ratio of public debt augmented by the predicted pay offs of state guarantees – which was reported at 47.6% of GDP at the end of 2002, has surely already exceeded the first safety threshold of 50%, and would be clearly above this level at the end of 2003. This is not a revelation and was expected by both the government and the market.

Foreign debt steady in 3Q03

According to the National Bank of Poland, Polish external debt at the end of 3Q03 reached US$93.27bn, which was equivalent to €79.94bn. In general, its fluctuations in this period were largely connected with sharp exchange rate movements (especially dollar depreciation against euro). While the debt expressed in US dollars increased both in relation to previous quarter and to 3Q02 (by 1%QoQ and 16%YoY, respectively), the corresponding values in euros fell at the same time (-1%QoQ and -2.2%YoY). The table below gives more detailed breakdown of Poland's foreign debt in both currencies. We argue that in terms of debt level there was nothing especially worrying going on in the third quarter of last year. However, one should notice a continuation of worrisome trend as regards the term structure of Poland's external liabilities. The short-term debt is constantly rising it terms of both ratio of total foreign debt (17.6% in 3Q03) and ratio of foreign exchange reserves (50% in 3Q03) – they reached the highest level for at least couple of years. While this is still to early to say it is a dangerous situation, the tendency has to be tracked with caution in the following quarters, as it increases Poland's vulnerability to any disturbances on the FX market.

Foreign debt (in billions)

	end-2002		Q3 2003	
	USD	EUR	USD	EUR
Central bank debt	0.1	0.1	1.1	1.0
Public sector debt	35.7	34.1	38.6	33.1
Banking sector debt	7.6	7.2	8.4	7.2
Other (enterprises') debt	40.9	39.1	45.2	38.8
Total foreign debt	**84.3**	**80.5**	**93.3**	**79.9**
- short-term debt	13.6	13.0	16.4	14.1
- long-term debt	70.7	67.5	76.8	65.8

Source: NBP

Polish short-term debt against FX reserves

Date	Ratio of short term foreign debt to official reserve assets
1Q01	35.65
2Q01	38.79
3Q01	37.44
4Q01	41.66
1Q02	40.78
2Q02	41.24
3Q02	39.53
4Q02	45.59
1Q03	46.44
2Q03	48.42
3Q03	49.97

Source: NBP, BZ WBK calculations

Central bank watch

- **The outgoing MPC ends term without changes in monetary policy**
- **The parliament picked new members of the MPC**

No changes in monetary policy at the end of 2003

The Monetary Policy Council did not surprise at the end of its term. The last meeting in 2003 (and in fact also the last one in the 'old' makeup) concluded with no change in monetary policy parameters. Main interest rate of the central bank remained at 5.25% and the MPC maintained neutral bias in monetary policy. As always, the statement released after the meeting listed arguments that influenced the decision. The list of factors supportive for maintaining low inflation in future included: still strong wage discipline in companies (sharp acceleration of wage growth in November has been explained by the low base effect); moderate dynamics of money (despite its clear upward trend); low growth of credit. The Council admitted that strengthening growth trends in the economy increase inflationary pressure, however not to the extent that could threaten inflation target. The statement also clearly suggested that one of the main arguments against monetary easing in November was still uncertainty regarding current and future situation of the public finance, which in the MPC's opinion was responsible for high yields of the bonds and weak zloty exchange rate. What is interesting NBP president stressed that additional uncertainty on the FX and fixed income market might appear after the Ministry of Finance changed the strategy of public debt management (shortening average maturity of treasuries). As a potential sources of inflationary pressure the MPC listed also (as usually): high and accelerating dynamics of money in circulation, possible hike of oil prices, forecasted increase of food prices in 2004.

As said above, neither the decision nor the statement of the MPC was a surprise. The conclusions from last meeting confirmed what we have written many times in the past – even the MPC leaving the office would be probably keen to cut interest rates by 25bps if the turmoil surrounding public finance reform would have disappeared. And considering that in 2004 the monetary policy decisions would be in the hands of more dovish economists, the likelihood that we will see more interest rate reductions is still high. On the other hand, one should not expect too deep reductions, as acceleration of economic growth and inflation is apparent and even the most dogmatic doves in the MPC would not risk more rate cuts when GDP flourishes by 4-5%YoY and inflation rate moves towards 3%.

The MPC made also decision on changing the NBP accounting rules. As expected, the changes (adjustments to EU regulations) make it more difficult for the government to print money in the central bank for financing budget deficit. They are working since January 1, 2004. The revaluation provisions of the central bank, held as a reserve against exchange rate fluctuations, has been transformed into revaluation account, which is consistent with ECB's guidelines. The conditions of releasing money from the revaluation account have been strictly defined and – according to MPC's Bogusław Grabowski – introduced changes would in fact make it more difficult for the new MPC to decide about dissolving part of those funds, because any changes to the revaluation account would have to be initiated by the NBP governor.

Sejm and Senate chose new members of the MPC

On January 8, the Sejm chose three members of the new MPC. As expected the Sejm elected Jan Czekaj, Stanisław Nieckarz and Mirosław Pietrewicz (we presented their profiles in the past), in line with deal between SLD, UP and PSL. Jan Czekaj was appointed for the second term (in August 2003 he replaced Janusz Krzyżewski who died in car crash), Mirosław Pietrewicz replaced Jerzy Pruski whose term ended on January 7, and Stanisław Nieckarz will start working in the central bank after Marek Dąbrowski's term of office ends on February 6.

The outcome of the vote in the Senate was prejudged to much lesser extent. Shortly before the vote a few candidates-parliamentarians gave up, including radical dove Stanisław Stec (under the pretext that parliamentarians should not give up their seats in favour of job in the central bank). Finally, senators decided to support a trio, which would compromise between parliament and other centres of power. Thus, senators elected Marian Noga (the only parliamentarian, who stayed in the race for seat in the MPC), Stanisław Owsiak (professor of the Economics University in Krakow, specialist in public finance, supported by senators as well as deputy PM Jerzy Hausner and President Aleksander Kwaśniewski) and Halina Wasilewska-Trenkner (deputy finance minister of long standing, specialist in creating state budget, who received very strong support from finance minister

Andrzej Raczko and deputy PM Hausner). Just a few weeks ago both Wasilewska-Trenkner and Owsiak were not mentioned among potential candidates for the rate-setting panel.

The choice made by senators is positive news for Polish economy and the financial market, because the worst scenario (when the MPC would be dominated by strong and radical doves) has not materialised. We still officially do not know the names of the presidential members (they will be announced at the beginning of February), however it is very likely that professors Edmund Pietrzak and Andrzej Wojtyna would get those nominations. More uncertain is the third president's pick; however our suggestion is that it could be a person from the central bank, having deep experience in monetary policymaking and functioning of the financial market. We think that Andrzej Sławiński, professor at Warsaw School of Economy and experienced NBP researcher, could appear as the right choice.

Even though some names are still uncertain, we could conclude that the composition of the new MPC would be quite balanced. Of course, we maintain our view expressed in our December's Macroscope that the new Council would be on average more dovish than the previous one. Nevertheless, the majority of members would probably present weighted and pragmatic approach to monetary policy, which should allow for deliberate decisions as regards interest rate movements and exchange rate developments. We still believe that the MPC would return to the interest rate reduction cycle, continuing a "small steps approach" adopted by the previous panel. A room for some cautious monetary easing was clearly indicated by nearly all six new MPC members that have been already elected (we present their statement on next pages).

The first 25bps rate cut should be expected already in 1Q04, most likely in March, and until the end of 1H04 main reference rate may drop to 4.5%. The next MPC meeting has been scheduled for January 20-21, i.e. the last two days before the expiry of three MPC members' term of office (Bogusław Grabowski, Cezary Józefiak and Paweł Łączkowski). This means that at this month's meeting the composition of the MPC would not differ much from its previous makeup. There will be only one new nominee in the panel – Mirosław Pietrewicz will replace Jerzy Pruski on January 7. This way, a possibility of interest rate cut in January is in practice excluded.

One of new members of the MPC suggested recently that interest rate cut would not be made also at the first meeting of the Council in the new makeup, in February – "the MPC members have to know each other and set rules of co-operation".

Comments of the MPC members and central bank representatives

The majority of statements presented below are comments of new members and candidates for the MPC. As regards statements of outgoing MPC members, we present only those, which shed light on likely monetary policy decisions of the new Council. In general, the most important conclusion from recent statements of new MPC members is that although they think that monetary policy should support the economic growth to a larger extent than in the past, at the same time they are against radical changes in monetary policy. It concerns not only possible rate cuts but also the exchange rate policy or the issue of revaluation provision (as regards the latter issue, new MPC members will not be able to do much taking into account changes done by the previous MPC in December). However, opinions of new MPC members indicate that one can count on restart of cautious monetary easing in the first half of this year. Besides, stating that the zloty exchange rate should remain free-floating until Poland's entry to the euro zone, new MPC members allow for a possibility of FX interventions of the central bank in order to prevent the exchange rate from undesirable, excessive fluctuations (with emphasis on unwelcome zloty appreciation).

WHO. WHEN. WHERE	COMMENT
Leszek Balcerowicz, NBP chairman; PAP, 14 Jan	Aiming at the fastest possible date of EMU entry is the best strategy, because it mobilises the candidates to undertake structural reforms and to stop debt [increase] in order to meet Maastricht criteria. It also shortens transitory period, when some turbulences could take place, resulting from flows of short-term portfolio capital.
PAP, 6 Jan	The [old] council faced a much more difficult task: to bring high inflation down. At the same time the aim of central banks in developed countries was to maintain stability of prices. A new Monetary Policy Council will face such a task. [...] It is my hope that new MPC members will respect any attempts to keep the economy growing and more, strengthen this newly-built foundation of sound development. If not, they could not be effective. If the government plan in an unabridged version, or best in an extended version, is not implemented swiftly, the persistence of an accelerating growth would be impossible. It is possible that Poland's economy will grow by 4-5% in 2004 but if the plan was not implemented, you can most likely say that the growth will not be persistent. It should have to fall in a next period and in 2004 various unpleasant disturbances on the financial markets would most likely appear in 2004. Yields of bonds would have to rise.
Polish Radio 1, 6 Jan	In December 2003 inflation will most probably amount to 1.7%, anyway at any rate much below 2%. Inflation forecasts we have put inflation at between 2% and 3% in 2004 or it will be slightly higher than last year. Actual price increases contribute to a part of this inflation rise. Most of the price increases follows moves of indirect taxes, and they in turn are related with adjusting to the European Union and the situation of the budget.
PAP, 17 Dec	We have now price stability, it is one of few fields thanks to which we are in Europe, it has to be kept, it cannot be wasted because that would threaten a stable growth. Some additional uncertainty regarding the zloty FX rate could stem from abandoning previously announced strategy of public debt management in 2004-2006 and particularly from shortening average maturity and planning higher issues on foreign markets. Majority of forecasts suggest this year's GDP growth at 3.5% or more. […] The acceleration is a real fact. The point is it must not be short-lasting. It demands a few quick steps that will result permanent restoring our public finance. Certainly, Hausner's plan goes towards desirable direction. All the fundamental changes are necessary. The only thing that could be postulated is to widen the plan. ECB regulations do not allow for issuing the money in order to increase budget revenues in artificial way. […] I cannot imagine that we could put a price stability at risk in this way.
Jerzy Stopyra, deputy NBP governor; PAP, 9 Dec	It is a typical operation the ministry carries out if it needs to switch a foreign currency into a local one or vice versa, and is conducting it on the FX market. It is a well-timed operation but I do not treat it as intervention. The ministry, as a market participant, should have been visible on the market for a longer time, and it is good that it is materialising at last. […] I neither treat is as an intervention nor a special event but the fact that it is carried out outside the central bank makes it more transparent. If NBP carried it out on behalf of the ministry, then markets would have doubts whether it is an intervention or just an operation the central bank is conducting on behalf of the government. The MPC has held a few discussions with the hope that the Council will soon adopt new regulations on accounting and on creating revaluation reserve. […] Mr. Balcerowicz said a few months ago that NBP is ready to repeat the so-called Brazil operation, and it will be connected with the volume of the revaluation reserve. At a time when Poland joins the Eurozone, the mandatory reserve rate should be at Eurozone's levels but as conditions favouring the rate at an earlier date may arise, if excess liquidity further decreased, then reasons may emerge in 2004 what will make the MPC to cut it at an earlier date. […] A new MPC will made the cut decision. We predict that NBP's profits for 2003 will be PLN4.1bn, of which almost PLN4bn will go to the central budget, that is slightly less than in the draft budget but the difference is insignificant.
Jan Czekaj, MPC member; Gazeta Wyborcza, 12 Jan	The MPC would have to maintain stable prices, and the new and very important issue would be Poland's entry to the euro zone. When it comes to co-operation with the government, first of all there should be no conflicts, although some differences of opinions would probably appear. Let's hope they would not transform into hostility [...]. There are several things to discuss, e.g. use of FX reserves, but not the revaluation provisions. We cannot frighten investors by reckless decisions, they are financing our deficit. [...] I do not rule out interest rate movements, but I would not expect a radical change in monetary policy.
PAP, Reuters, 9 Jan	It seems that there is no intensification [of inflationary pressure]. There was some increase of prices at the end of last year, resulting among other from increase in food and fuel prices. Data on wages show that there is not wage pressure. We still have high unemployment. The most important factor for inflation is under control. I do not see any threats in this field, but it does not mean they will not appear in future. We do not know what happens to fixed investment but it does not seem that there is any threat to inflation from this side. I do not foresee rapid [interest rate] movements in neither directions but some changes are not excluded.
PAP, Reuters, 8 Jan	I have no fears there will be any disturbances in the monetary policy. I do not think any major changes could take place. A new MPC will have to set its strategy and decisions on interest rate cuts or no cuts will result from it. Accounting standards have been set by the outgoing MPC. Of course, the new MPC will be able to deal with it once again. For sure we do not manage [to adopt euro] until 2007. In my opinion this will take place closer to 2009-2010.
PAP, 17 Dec	This almost 10% increase [in November's production] proves that upward trends are strengthening. This is positive. […] it should be reflected in the monetary policymaking.
PAP, 15 Dec	We are still within the limits of inflation target and there are no threats of any kind. It matches expectations, we have rising food and fuel prices, which translate into inflation. Also economic revival contributes to it. However we still cannot see any threats on inflation side. [...] Apart from economic recovery, also EU accession will result in inflation rise. We do not know what price growth will result from adjustment to EU level.

Bogusław Grabowski, MPC member; PAP, Reuters, 17 Dec	New accounting rules will cause that every transaction carried out by the NBP will have exactly the same financial result as if we haven't change the rules . […] The change in the way of book-keeping will cause that any changes to the revaluation account would have to be initiated by the NBP governor
Dariusz Rosati, MPC member; PR3, 6 Jan	We have already achieved relatively low level of interest rates. […] We should remember that developments on the financial market does not depend so much any more on NBP interest rates, but above all on public finance stance. […] Because the government plans quite significant debt issues due to high deficit this and next year, interest rates on the market will remain at quite high level. Thus, the new MPC will not have much room for further rate cuts. Nevertheless, I do not exclude that such possibility may appear when situation in public finance clears up.
Grzegorz Wójtowicz, MPC member; PAP, 17 Dec	A piece of advice from us for the new MPC: euro is the target.
Stanisław Nieckarz, new MPC member; Gazeta Wyborcza, 12 Jan	This is not about supporting government's policy. Inflation and exchange rate should be stabilised amid strong economic fundamentals. One cannot disregard economic reality in monetary policymaking. Overcoming stagnation in investments is the most important thing. [...] In the first half of this year inflation could increase by 1-1.5% due to hike of VAT and excise tax. But they would be supply-side factors, which are independent on the MPC.
PAP, Reuters, 9 Jan	One should not take sharp turnings at high speeds. A change of policy should be flexible and take into account certain tendencies and economic conditions. We have a floating rate at present and there is no departing from it. Doctrinally I would not be bound with the inflationary target. One should have a pragmatic attitude towards it. Life shows that there are so many changing factors that the target later proves not to fit to reality. One has to optimise a few factors – does not let to increase inflation without a reason, but also to support creation of stronger fundamentals of the economy, which would preserve low level of inflation.
PAP, Reuters, 6 Jan	The goal of the MPC should be to care about fundamentals of the economy, which decide about strength of the currency. [...] The goal is to reach the EU interest rate level in real terms in a year or year and half time. It is around 1 pp. [...] Until 2010 Poland should adopt the euro. (…) The aim is not a date of the entry to the euro zone. It has to be preceded with improvement of the economy's fundamentals and achievement of the economy's balance. I do not imagine entering the euro zone with the unemployment rate at 20%. [...] The problem of reduction of credit interest rates is related to elimination of the overliquidity in the banking sector, but it cannot be done amid high interest rates, one of the highest in Europe. [...] The NBP does not does not achieve the main goal, because it does not support the government's economic policy maintaining such high interest rates. [...] The problem of revaluation provision stemmed partly from lowered payments of NBP profit to the budget. This is very complicated issue and it has to be carefully investigated. Possible revenues from the provision cannot goes to the budget. It can be used for reduction of public debt.
PAP, 9 Dec	At present, with low inflation and lower interest rates, we should have a floating exchange rate. It is best for the exchange rate to be set by the market. […] I criticised the present Monetary Policy Council for floating the zloty too early. One does not fully float a currency if one has the biggest real-term interest rates in Europe. [...] One should always speak about a real interest rate which is at more than 4% at present. In the European Union countries it is practically at 0%. […] There is a big room for interest rate lowering. For me […] it is important to overcome the situation in investments. Without investments there will be no economic development, and investment processes in companies cannot be activated by tax lowering alone. [...] We have missed a transmission of monetary policy [of present Council] to microeconomic process. I believe that the Council should take real economic process into account despite its independence. […] Obviously, they should be cautious so that no inflationary process was triggered. Inflation can be reduced to zero very fast but destroying the economy by the way. [...] The provision against a risk of exchange rate changes is very high. Some solution should be found to use a part of it. We should join the monetary union as early as possible but first we must lower the unemployment radically, to some 10-11%. It is also important to have balanced foreign trade balance and rising investment before entering the Eurozone. […] I don't think the date should be the aim itself but I believe that joining the Eurozone in 2008 would be possible. One could enter the ERM2 and meet all the criteria but it would not support the whole economy. There is no problem to lower the deficit below 3% of GDP within 3-4 years time. If we maintain growth rate at around 5%, no budget revenues will leak-off and social spending will rise a few percentage points below the real GDP growth rate there will not be any problem with it.
Marian Noga, new MPC member; PAP, 14 Jan	If inflation rate is currently at 2%, and reference rate at 5.25%, the difference is 3.25 pts. and it is the space where we can move around. I strongly confirm I am an advocate of gentle changes in economy. Stabilisation of prices is surely the most important, as a statutory goal, however also [important is] such shaping of monetary policy to stimulate economic growth. The main objective, i.e. maintaining low inflation does not imply that MPC should not stimulate economic growth with monetary policy. It is all about real co-operation between the government and the MPC. Even significant reduction of interest rates does not have to lead to economic growth. Zloty appreciation is always bad, overvaluation is bad for the economy and one should intervene, regardless of whether this is now or in future. I am for maintaining free floating exchange rate. [...] I would leave reserve requirement ratio unchanged for three years, because those funds would be directed for the fund of EU warranties. The revaluation provision could be dismantled only as a loan to the government in order to service Poland's external debt.
Reuters, 7 Jan	The principal goal of the MPC will be to keep inflation below 2%. I believe both annual and end-2004 CPI inflation will be below 2%, but there are some risks. [...] Certainly, I am an advocate of very small reductions (25bps) spread over time. Cuts cannot be too deep during one year. In 2004 it could be a maximum of 100bps. The first cut may be ordered in February or March. [...] I am an advocate of a narrower band [in ERM2 system]: ±10%. There is nothing better for a Polish entrepreneur than a predictable economic situation, when a producer or exporter knows volatility will not be too high. [...] The central bank could lend the government some foreign currency to finance debt servicing, but I am strongly against allowing it to be put into circulation as this would increase inflationary pressures.
Gazeta Wyborcza, 23 Dec	I do not think that in present situation we should consider a possibility of intervention of central bank in defence of the zloty – intervention always means interference in the market and therefore the reasons to it must be carefully analysed. As yet, I do not see such strong reasons to this steps. We do not have rapid changes in the zloty, the market is moderate and there is no reason to worry.
PAP, 3 Dec	Current reference rate of the central bank is still too high, the MPC still has work to do and there is more room for interest rate cuts. Perhaps not at once, perhaps [in steps] by 25bps, but a 100bps rate cut is still possible. I have always repeated that interest rate setting must be like a plane landing, however it could go down faster sometimes. I review current MPC's behaviour as passive. In crisis time the Council should fight against the crisis while at good business climate they should prevent the crisis. Too low investment is our Achilles' heel. We have to encourage for investments in the country and it requires adequate interest rate. [...] Inflation is likely it to be at 1.5% at the end of 2003. Next year it could amount to 2.2-2.5% since entering the Eurozone will be connected with adjustment in prices which will be reflected in inflation. […] I absolutely agree with the MPC's adopted inflation target. I also accept the strategy of direct inflation target.[...] I am not for using revaluation provisions, but we could discuss

	whether it should be at present level. For sure the Council will work on it. However, calling for transferring the provisions to the budget is not responsible. [...] I am in favour of entering the Eurozone as soon as possible, we should do everything for it. Convergence criteria are quite clear, government's program is prepared in the way that allows joining the zone in 2008 […]. I would even be for joining in 2006, but we would not meet all the convergences criteria till 2006, e.g. deficit criterion. Therefore the most likely date is probably 2008. [...] Such a high FX rate of the euro is not justified and it must combined with turmoil on the bond market. Weaker FX rate favours exporters, but only in short-term. In long-run terms, competitiveness influences the exports to more significant extent than the FX rate itself. [...] Budget deficit is justified only when it supports economic growth. I would not squash budget deficit at all costs, because it would be squeezing domestic demand, which is a rescue for us. [...] The central bank has its objective set by the Constitution, i.e. reinforcement of domestic currency and preventing inflation processes. But at the same time the central bank cannot be deaf to the economic climate. I would asses the policy of present MPC at weak 'four' in five-mark scale.
Stanisław Owsiak, new MPC member; PAP, Reuters, 14 Jan	I do not expect any surprising decision at February's meeting. Council members must get to know each other. An interest rate cut should not be expected in February, all depends on what will happen with the FX rate and inflation at the start of the year. The major task will be to monitor inflation. There are some tax reduction-related inflationary impulses. Radical changes of basic parameters of monetary policy would be highly disadvantageous.
PAP, 7 Jan	I will try to improve relationship between the central bank and the government. It is possible to achieve consensus bringing economic growth. Monetary authorities may be helpful in finding a solution as regards domestic and foreign debt. Lowering inflation was a success of the NBP, but there is still an open question whether costs were not too high.
Mirosław Pietrewicz, new MPC member; Gazeta Wyborcza, 12 Jan	The policy of the new MPC should be cautious. It is not certain whether the [economic] growth is persistent. [...] The scope for lowering interest rates would depend on economic figures for 4Q03, namely GDP growth rate and investment growth.
Reuters, 9 Jan	The zloty is undervalued against the euro considering the current economic growth and the lack of unexpected turbulence on financial markets. By the end of the year it should appreciate. [...] Still, I am not a proponent of too strong a zloty. The question is what the equilibrium rate is – but this is a difficult question.
Reuters, PAP, 8 Jan	It is possible that there will be necessity to cut interest rates by 50bps in the first quarter of this year. The most important is to decide to what extent we should lower interest rates and this would depend on results of 4Q03 as regards GDP growth and fixed investment dynamics. It is very important whether pace of growth will be rising or stabilised. If it is stable at the level of 3.9% recorded in 3Q03, it would mean that there is still possibility to stimulate the economy, particularly through stimulation of fixed investment, i.e. through lowering of interest rates. It is not possible to consider this issue before February's meeting of the Council. FX reserve should as large so that it secure foreign exchange operations of the NBP. It seems that it is too high presently and that part of it could be used, but not for current spending or increase of budget revenues. It should be used for reduction of our foreign debt. It is important issue and it should be treated as an urgent one.
Reuters, PAP, 6 Jan	There is a chance to reduce interest rates in 2004. This will depend on the development of the economy, mainly of investments in the fourth quarter [2003]. If it turns out that investments in the fourth quarter are still low, then we should consider boosting investment through lowering the cost of money, or interest rate cuts. Rate cut should not be of more than 50bps at a time. The thing is not to race against time, but the thing is that the Polish economy should be prepared to the EMU entry. Too early date of entry could bring more costs than benefits. The revaluation provision is currently too high and one should use it for foreign debt repayment. One should lead to proper mix of monetary and fiscal policies in order to ensure achievement of the supreme goal in the form of stable economic growth.
Gazeta Wyborcza, 23 Dec	The process of euro appreciation against the zloty supports Polish manufacturers and should be tolerated by both the NBP and the MPC if it is not sudden. If zloty depreciation accelerates suddenly, intervention should be considered seriously, otherwise there would be a threat of crisis. In my opinion, at present there is no need of intervention on the FX markets or reasons to worry that it will be necessary soon.
Reuters, 8 Dec, PAP, 9 Dec	Poland should join the Eurozone as soon as possible but this process should not be artificially accelerated. The euro should be adopted when it is the most beneficial for the economy. Too high zloty level would be unfavourable from price competitiveness point of view. The zloty should remain in free-float FX regime until it joins the ERM2 system, which should not take place before 2007. The zloty should stay in the ERM2 system for as short as possible and Poland should also defend wide +/-15% bands within the system. I would not be a supporter of very quick nor very slow euro adoption process. Current zloty level if good for exporters, too weak for importers. Possible the zloty is too weak form fundamental point of view and therefore it is likely to appreciate. It is too early to talk about a possibility of one sharp reduction of interest rates. But in 2004 there would not be a reason to hike rates for sure. In line with the Constitution, the central bank should focus on price stability, but it is extremely important to cooperate with other institutions to achieve higher economic growth. Monetary policy should also focus on this target, even at the cost of higher inflation. Inflation target adopted by the current MPC seems reasonable. MPC conducted over restrictive monetary policy until spring 2000, and therefore was responsible for GDP growth deceleration. It is possible to use a part of revaluation provision earlier foreign debt repayment. I support lowering budget deficit, but not at any cost. It is necessary to achieve primary balance in the budget Q: Is it necessary to lower the deficit as proposed by Hausner? A: I do not think it is necessary.
Edmund Pietrzak, candidate for MPC member; PAP, 14 Jan	Introducing fluctuation band of ±2,25% in ERM2 is preparing currency crisis. We must negotiate ±15% band. Poland should join the ERM2 as late as possible.
PAP, 7 Jan	New MPC will have much more difficult target, as it will have to lead Poland to the Eurozone. […] We should join ERM-2 mechanism as late as possible, to enter it only for two-years period and to join the Eurozone after we meet necessary criteria.
Reuters, ISB, 22 Dec	Current level of interest rates poses no threat to growth. It does not muffle economic activity. Nothing will happen in regards to interest rate level till the end of February. I could see room for two small cuts of 25-bps each in the first year-half, if Hausner's public-finance reform is implemented and deficit in 2004 budget will not be bigger than government target. […] In theory, another 25-bp reduction is possible in the second half of next year. But if any of these fiscal conditions are not met, a slight rate increase is more probable. Inflation is already picking up and it will continue to rise slightly over the next 12 months as the economy accelerates, but I do not think it will top the central bank's target. […] Progress in public finance reform and government's fiscal policy are the other important factors influencing inflation next year. Possible zloty depreciation resulting from market uncertainty could also result in higher inflation.

	The [MPC's] decision virtually bars releasing the revaluation provision through actions other than sale of foreign currencies or lending funds from FX reserves. […] The central bank may lend the government up to $5bn to ease the foreign debt burden. But no more that this because the larger the reserves the better our defence in the event of speculative attacks.
Gazeta Wyborcza, 12 Dec	One of the best things in course of economic transformation was FX policy leading to free floating FX regime. Some elements of flexibility could have been introduce earlier, but the effect is very good. […] Free floating rate is a fine measure in macroeconomic policy. It should be changed only when we will really have to do it, as late as possible. And we all agree about it – me, the central bank, president's advisors and the president himself.
PAP, 5 Dec	Assuming that nothing extraordinary will happen, there is a chance for rate cuts but at the earliest in March. However, interest rate hike is a little more probable. […] Within 2004 it could amount to no more than 50-75bps. […] It will be realistic if budget deficit for 2004 is not assumed higher than PLN45.5bn and Hausner's plan is accepted. If these to things succeed the room for interest rate cuts will be created. […] However I do not expect that interest rates in the nearest months, in December, January or February. On the other hand there are some factors that will not ease interest rate cut. They are just the opposite and can result in necessity to hike the rates. Economy is accelerating and it will exert pressure on increase in prices. If fiscal policy brings worse performance than assumed it will lead to the sell-off of the bonds and zloty depreciation. […] The depreciation that have not resulted in increase in prices, yet, can result in it finally. If inflation accelerates clearly not only there will not be rate cuts but the new council will have to decide to hike the rates. Inflation will keep growing. November's CPI may be 1.5-1.6%, may double throughout the year, will likely amount to 2.5% and even to 3%. […] That does not mean the necessity to revise the inflation target. The MPC was learning from its own mistakes. In course of time they acted better. Interest rate hikes in past are partially responsible for economic slowdown in 2001-2002. […] The policy of the new Council will not differ significantly from the policy of the new Council. It does not have to be more dovish, but certainly it will be better amid experience of the present Council. […] Not only the monetary policy but also joining the Eurozone will be the main occupation of the new Council. The Council's attention will be focused on monetary union matters. […] In the Council there should be not only experts of macroeconomics but also of international finance, financial markets, FX market and monetary union. 2009 is the first possible date of euro adoption, but 2010 seems more realistic if all procedural requirements are taken into account. [...] It is not late. I forecasted this date in 1997 during NBP conference. If medium-term fiscal plan is not accepted, we would not meet Maastricht criteria and euro adoption would be postponed, which would not be positive. It is impossible to adopt euro in 2008 because of technical and procedural reasons - data on budget deficit as % of GDP for 2007 will known only in May 2008. […] What is more, the final decision is take by the Commission, which analyses the situation of candidate countries each two years. The Commission will meet in March 2008 and if a positive decision would be taken, we could join in 2009. Poland should stay as short as possible in the ERM2 system (with +/-15% band) to avoid speculative attacks. We should meet Maastricht criteria during the second year of ERM2 participation. The fixed parity against euro cannot hamper Poland's competitiveness. If we enter ERM2 in 2007 this parity could be at PLN4.4-4.6. I do not think all candidate countries will adopt euro at the same time. This process will take place in 2007-12. If public finance reform is accepted, the zloty would depreciate only slightly until EU accession, although we may see a factor, which was not visible recently - FDI inflow. After the accession the zloty should be roughly stable against the basket of two currencies, or may slightly appreciate. If there is a political turmoil or Hausner's plan is rejected, we could see even a currency crisis, but probability of such event is very low.
Halina Wasilewska-Trenkner, candidate for MPC member; PAP, 7 Jan	I would like to encourage the MPC to hold a debate, to go beyond theoretical considerations. If we enter recovery period price stabilisation cannot be maintained at such a low level, and a new MPC should not react with too radical rate increases or with other decisions on monetary aggregates. Sometimes you have the impression that NBP's reserves are owned by the NBP but they are state money, they are funds that should be used in an extremely cautious way to solve the major financial problems. […] NBP should conduct a policy of stable prices and support government's policy, though these are usually contentious issues.
PAP, 18 Dec	I agree [for standing for the MPC]. This a kind of adventure that you would not refuse, too. Let's wait for Senate's decision.
PAP, 16 Dec	Revaluation provisions will not be written down into the budget, at least not at present. A few changes, including MPC decision, are required so that it could be put in the budget. With no change in decisions regarding NBP's accounting system and no actions regarding reserves nothing can happen with NBP's reserves. Therefore these figures are not reflected in the budget, at least now.
Andrzej Wojtyna, candidate for MPC member; PAP, 7 Jan	Many mistakes of current MPC concerned not monetary policy conducting, but rather their communication. Many things could have been clarified much better. What would be wrong if finance ministry representative participates in the council's meeting. [...] Why the MPC should not set inflation target together with the government? [setting inflation target] does not consist in surprising the market nor in being defeated by the market.
Reuters, 6 Jan	Monetary policy will again become more difficult when we will be in a managed float regime. With one instrument, interest rates, we will have to reach two goals – an inflation target and an exchange rate target. Finding a parity will be tough. Looking at EURUSD rate swings it seems there is no good theory on how to find an equilibrium rate at which we should fix the zloty in ERM-2. [...] [after joining the EU] The new Council will have to explain that these are not price increases which suggest a return to higher inflationary pressure, but one-off shocks which can be absorbed by policy and will not influence the inflationary process. This will be an interesting test, not only what the new Council does with interest rates but also how it communicates.
Gazeta Bankowa, 22 Dec	For sure the new Council should work on this strategy [of MPC's policy in 2004] already at the first meetings. […] I think that the end of present MPC's term of office is a good chance for the Parliament to discuss present and first of all future policy that certainly will not be easier. Initial period of new MPC's term will be intently watched by financial markets and therefore it is important that they will be sure there will be a continuation. Even if to certain extent high budget deficit contributed to economic revival one cannot say that relaxation in fiscal policy was intentional. Partially it resulted from wrong diagnosis, omitting certain factors that as it turned out later led to higher deficit. However, I do not suppose it was strong impulse. One should also remember that higher deficit does not always mean relaxation in policy. It is not too low consumption that is our problem but rather low savings. We must improve supply side of the economy, i.e. efficiency of using production factors. Demand stimulation will not bring benefits because if potential GDP growth is exceeded inflationary pressure will appear soon. And history of economy tells that high saving rate was a very important factor allowing to catch up the richer in many countries. Limiting budget deficit is the most certain way to increase savings.

There is also a third solution [if public debt exceeds legal safety thresholds] – creative budget accounting. For example Portugal used it when there were problems with meeting requirements from Growth and Stability Pact. I do not allow for the possibility of constitution amendment.
If we were forced to meet this criterion [of narrow fluctuation band in ERM2 – ±2.25%] our joining ERM2 would be postponed *ad calendas grecas*. In my opinion it would also mean a fundamental change in rules of the game in course of it. Therefore I hope it was only a test.
FX policy will become even more difficult after joining the ERM2 system. A so called trilemma of monetary policy in open economy will return. It will have to achieve direct inflation target matching Maastricht criterion and at the same time maintain the FX rate within ±15% band with fully free capital flows. Therefore nothing points that the new Council will have easy mission.

PAP, 3 Dec

On one hand there are arguments for soonest possible euro adoption, however it might appear that slight delay of this process might be beneficial. [...] Entering the Eurozone before 2009 will not be easy, especially looking at the government's calendar and the path of deficit and debt reduction. But 2009 is realistic.
Now we should be concerned about meeting the criteria, it is in our hand. […] It would be dishonest change the rules after the referendum […] and narrow the fluctuation band. If narrow fluctuation band was imposed it would mean that regardless sacrifices we would not meet requirements and would not join the EMU at all in foreseeable prospect.
I am against reaching for [revaluation] reserves when there is economic revival. Particularly in the period when decisions on spending rationalisation are to be taken. […] I would rather reach for it if it shows up that e.g. in two years time exchange rate plummets as a result of unfavourable external shocks and public debt surges despite government's effort and society's sacrifice. Then there would be a reason for using [revaluation] provisions. They should be used in case of crisis. However, spending part of the reserve for foreign debt reduction could be a sign of good will and cooperation between FinMin and the MPC.
I do not understand such proposal [of early pegging zloty to euro]. […] Change of FX regime is out of the question, it would unnecessarily complicate accession to the EMU
I hope that investors' confidence will return. Hungary that have worse economic situation are perceived better than us, as more stable country. Many indicators suggest that the FX rate should appreciate, but finally it is difficult to forecast
The economy is expanding, thus we cannot rule out some acceleration of inflation. For now there are no sufficient preconditions for interest rate reduction. Additionally, the new Council would have to send a balanced, smart signal to the market. It is crucial to avoid giving fake signal, especially in the initial period when a character of the new Council will be shaped. […] Amid uncertainty concerning selection of the new MPC, continuity of policy is crucial, at least in the initial period of new MPC's functioning.
There is a risk of appearing inflationary pressure, but if it is fuelled by short-lived and self-reversing shocks, it should not be a reason for interest rate hike.
It is more and more often underscored that monetary policymaking is like crisis management […]. Thus basing the policy on some fixed rules becomes difficult. Therefore explaining motives of their decisions by the MPC members is even more important. […] For example, missing annual inflation target is not a big problem itself. However, one has to be able to show, which disturbances are dependent on monetary policy and which are not. One has to explain what is influenced by interest rates.
There is a problem of democratic supervisory, which does not restrict the central bank independence. For example, central bank's president may be obliged to send a letter to the government and to the parliament in a case of under- or overshooting of the CPI target, to explain such situation. There would not be any sanctions.
The present MPC did not make any significant mistakes in making decisions about interest rates. […] The Council was cautious. […] Its weakness was communication with the market, and most of all with the government and the parliament.

Government and politics

- **Parliament's work on 2004 budget is drawing to an end**
- **…but they did not bring any significant changes**
- **…and risk related to fiscal policy is still high**

Sejm passed budget bill for 2004

On December 19 the Sejm (Lower House of Polish parliament) passed the budget bill for 2004 with the deficit totalling PLN45.3bn (i.e. 5.3% of GDP). The public finance committee recommended to reduce planned budget gap by PLN369.7m in relation to government's proposal, however later during the debate committee's chairman Mieczysław Czerniawski withdrew one of the amendments responsible for PLN169m deficit reduction. What's more, the MPs decided (regardless of negative stance of the government and public finance committee) to transfer total PLN700m from the 'special funds' for supporting Warsaw metro (PLN150m) and regional railway transport (PLN550m). According to both economy minister Jerzy Hausner and finance minister Andrzej Raczko, this donation was very harmful for functioning of certain state institutions financed from the 'special funds' and they appealed to the Senate to cancel the amendment. All in all, deputies increased central budget spending planned for 2004 from PLN198.25bn to PLN199.84bn. This represented 4.8%YoY increase as compared to 2003, but if we include transfers to open pension funds, the annual rate of growth would be as high as 10.7%. Is it a budget of savings? Revenues were increased by the same amount, but it was partly achieved by higher tax collection – a very doubtful assumption.

…and Senate introduced minor changes to the bill

As expected, the Senate did not introduced significant changes to the budget bill for 2004 approved earlier by the Sejm. In line with expectations, senators reduced the amount of so-called 'special funds' transferred to the budget by various ministries and institutions from 40% (set by the Sejm) back to 15% (proposed by deputy PM Jerzy Hausner). This enforced reduction of next year's budget subsidies for Warsaw metro construction and regional railway transport. However, the Upper House denied supporting government's motion of reducing budget deficit by additional PLN100m and the planned budget gap remained at PLN45.3bn. Instead the amount of PLN100m has been directed to the National Healthcare Fund. Now the bill goes back to the Lower House of the parliament, which will vote over Senate's amendments. Final approval of the budget bill by the parliament is planned for the session on January 20-23.

All in all, the modifications made to the budget in the parliament were cosmetic and did not affect overall assessment of fiscal policy plans for 2004. In particular, they did not reduce even by fraction a risk that the threshold 55% of public debt against GDP would be breached this year, implying that uncertainty regarding fiscal policy perspectives remains high.

First failure in implementation of Hausner's plan

After the government's meeting on January 13, deputy PM Jerzy Hausner said that this year there would be no change of indexation scheme of old-age and disability pensions. However, he added the government did not resign from the idea of changing this system, but postponed the changes until the next year. Hausner said that it would not imply reduction of total savings in public spending in the coming years. He believes that all PLN32bn of savings must be attained. Later modification of indexation implies that a promise of the government to lower this year's budget deficit (by PLN1.3-1.4bn) became very doubtful. Hausner pledged the savings would be found elsewhere, but he did not give any details. Instead deputy PM Hausner presented a schedule of further work on the savings plan. On January 20 the cabinet will discuss modifications to the programme and on January 27 the plan will be discussed by the SLD National Council. Until the end of March all bills are planned to be submitted to the parliament.

The day after the government's sitting, a meeting within a three-party committee was held, during which Hausner's plan received very critical reaction of trade unions. Hausner assured that despite the criticism he is determined to implement planned reforms and said they would be supported by the government and SLD. He only feared of support in the parliament (the government has not majority in the Lower House). Well, government's decision to delay changes in pensions' indexation scheme shows that even in the government the support for the Hausner's plan is not sure.

Comments of the government members and politicians

In recent weeks, statements of the government's members and politicians concerned mainly fiscal plans, financing of the budget's borrowing needs and choice of new MPC members. Deputy PM Jerzy Hausner reacted to the weakening on the financial market caused by the government's decision to delay change of pension indexation scheme for 2005. He tried to convince market participants that delay in implementation of the new system stems from procedural considerations, not from lack of political support for proposed changes. At the same time, he assured that alternative solutions will be proposed to achieve assumed amount of savings in 2004. In Hausner's opinion one cannot talk about resignation from the whole or even part of the reform plan. According to him, SLD will give political support for his propositions. Finance minister and his subordinates talked about financing budget's borrowing needs this year. In line with earlier announcements the ministry plans higher issuances on foreign markets and change of term profile of domestic debt as well as introduction of new instruments on the domestic market. President Aleksander Kwaśniewski announced that he would choose his candidates at the beginning of February, adding that they would be recognised experts, not connected with political activity. Minister in Presidents' Chancellery Dariusz Szymczycha said that talks with potential candidates were began at the beginning January and suggested that sights should be set on President's economic advisors. This confirms expectations that appointments will be received by Edmund Pietrzak and Andrzej Wojtyna. However, there is still uncertainty regarding the third's name.

WHO, WHEN, WHERE	COMMENT
Aleksander Kwaśniewski, President; PAP, 6 Jan	I have been and I am of the opinion that the firm principle of the independence of the central bank cannot be changed.
Reuters, 23 Dec	I will choose my three candidates in early February. They will be unquestioned experts, not previously associated with political activities.
Dariusz Szymczycha, minister in President's Chancellery; PAP, 18 XII	Mr. President will hold talks [with candidates to the MPC] in early January. [looking for candidates] One should carefully examine the list of president's team of economic advisors.
Jerzy Hausner, deputy PM, economy and labour minister; PAP, 14 Jan	I will surely not sign something, which even when implemented, will not yield significant effects. That does make sense, and is a waste of time. […] I am determined to carry out, jointly with the government and the ruling coalition, what has been designed in the plan, with minor changes proposed during the public debate. The results of the work of the teams are a sensible extension of the programme even if it means its slight softening. That's a decision making process. At stake is doing what must be done and not forcing own ideas. That, which if it is not done, will lead to a disaster. [...] I am convinced that the outcome of the debate [within SLD on the austerity programme] will be positive, however I do not treat it as read, because the discussion is still ahead of us. Public finance reform is now associated with this plan. If there are signals suggesting trouble, the markets respond very nervously, and the anxiety will persist until January 27; I believe I can make calm comments and do my job, I cannot do more. [...] Every signal is subject to interpretations, and that is a reason for certain anxiety connected with the evaluation of the feasibility of the plan. No signal should be interpreted as intention to resign from a part of the programme and definitely as intention to give up the whole programme. [...] It is a completely hypothetical situation from the point of view of public finances and financial markets. I had better not comment hypothetical situations as hypothetical situations tend to materialise. I do not expect the zloty to weaken.
PAP, 13 Jan	There is still scope for lowering rates but the rates are not the most important problem today. The rates should have been cut eighteen or twenty four months ago, placing Poland in a different stage of economic development now. I will not say how much the MPC should cut rates since it is not for me to decide. [...] However if interest rates were cut in January I believe it would not be dangerous. My aim is to act in the way that the MPC had no argument to raise rates. It would be destructive for our economy. [...] I do not agree with Mr. Nieckarz neither on the need for cutting interest rates to the EU level in a year or 1,5, nor in any other issue. [...] It would be misunderstanding if the new MPC pushed for sharp interest rate reduction. It would be unfortunate. Foreseen savings [in public spending] of PLN32bn will be realised. [...] I believe this is minimal level of savings. [...] This year pension indexation will take place, because it is written down in the budget bill. It means that savings that are projected for 2004 must be found elsewhere. Pension indexation according to new rules will be postponed. We have not closed this issue, but we will do on January 27, together with the full package. [...] I do not intend to withdraw the changes of indexation system. Undoubtedly there is a delay.
PAP, 12 Jan	I will present my appraisal of the public discussion at the cabinet meeting next week. I will recommend the implementation of the modified plan that will however retain all major thrusts of changes. I will propose to accept such changes that will not spoil the essence of the plan, consisting in bringing the public finances to equilibrium, but will ease some of the solutions.
Reuters, 12 Jan	I wish there was much lower tension between the government and the new MPC. There are sound premises for that. Issues that were crucial two years ago, e.g. reduction of interest rates, now lost their importance and there are no subjects for disagreement.
PAP, 8 Jan	Deputy Minister Wasilewska is a very good candidate [for MPC member]. I think the candidatures [for MPC members] of Professor Owsiak, Edmund Pietrzak, Andrzej Wojtyna and Halina Wasilewska-Trenkner are good. Calculating with the current methodology I would like to end the year 2004 with unemployment below 17%. I believe that we will make it but I am also sure that it will be difficult. I am not afraid whether the plan [of spending cuts] will be politically approved because the bodies that are to accept the scheme, that is the government and the national council of SLD, will say "yes". [...] I would like to see all bills, connected with the plan of spending rationalisation, in the parliament by end of March, or until end of April as regards additional bills. […] the bills should be approved until parliamentary holidays, which means May-June.
PAP, 6 Jan	The president said that MPC's independence had been confirmed as a systemic and economic value. I would like to repeat a statement of governor Balcerowicz that Poland needs higher economic growth which should be gained without undermining the foundation, that means price stability. The independence of the central bank consists, among others, on the fact that the government should not formulate assessments or voice expectations as to concrete rates level.
PAP, Reuters, 5 Jan	It is obvious that when the economy is picking up, inflation will be slightly higher, the more so that in 2003 it was at it is record low, but there is no danger of a stronger-than-forecast rise of CPI because that would mean either a revision of the monetary policy or an uncontrolled rise of wages, which is hampered by a very high level of joblessness. I will present a report on social debate as regards spending rationalisation plan during cabinet's meeting scheduled for 20th January. On 24th we will have a meeting of the SLD National Council […] I see no risks (for the plan) during the process on the government's and party's level, but parliamentary support is the key factor. I have concerns over the situation in parliament due to pass appropriate bills.

Reuters, 22 Dec	We want to trim next year's budget by three billion zlotys, but this would require changes in the indexation of pensions and disability benefits. I am determined to achieve this goal. [...] Referring to work on 2004 budget I can say that my expectations regarding reduction of the deficit were not higher than ca. PLN600m. Earlier I proposed to cut special reserve funds by 15% and thus reduce budget expenditures. [...] The proposal accepted by the Sejm, increasing expenditures by above PLN1.4bn is irresponsible, but I think that the government and I personally would not propose to constrain all decisions concerning changes in special reserve funds.
Gazeta Wyborcza, 10 Dec	We have never declared meeting Maastricht criteria to be the main aim. […] I believe we will be ready in 2008-2009. I assume that in course of parliamentary works on the budget the deficit will be declined by some PLN600m. This is not much but this is important signal that we give to the markets. We plan legal changes that will allow to shift the expenditures from 2004 to next years or to lower them. […] We will try to make the deficit lower by PLN3bn compared with the budget assumptions. [...] From my point of view, certain zloty appreciation would be beneficiary. It would not cause difficulties for exporters and facilitate public finance situation. PLN4.35 per EUR1 assumed by the government seems to be rational and likely to be reached.
PAP, 2 Dec	If I am not wrong the GDP will rise by 4.5% in 4Q, and then a 3.7% rise is possible for the full year . I expect no disturbances on financial markets because I expect the candidates fielded and approved […] to be professional, competent and guarantee the good performance by the MPC of its constitutional and statutory roles. […] I do not expect at all that any accidental persons without proper merit-based competences related with macroeconomic issues and public finance to join the body. […] I will try to convince the politicians that all the persons, regardless the names, must have excellent expertise, since our common safety is involved. As for the scale of a necessary fiscal consolidation the one proposed by the government is not the scale that can be lowered because no goal will be achieved. But a for the structure of actions and its timetable it is possible to revise and modify the original proposals. […] The government has surely no plans to withdraw from the action it plans.
PAP, 1 Dec	For sure, the unemployment rate will increase [in November], it is inevitable. I hope it will rise of 0.1% against October, to 17.5%. […] I assume that unemployment will rise in the coming 3-4 months but from March we will see a significant improvement. Unemployment was falling for eight consecutive months this year and I am convinced that we will see the same but a much stronger trend next year. I realise that from the point of view of budget financing first quarter will be the hardest, because of what are financial flows related to central budget. It is the most difficult for the finance minister to solve the problems in 1Q as there are relatively the lowest revenues, and on the other hand the highest spending.
Andrzej Raczko, finance minister; PAP, 14 Jan	Financial markets' job is to shape prices. But I see the sound foundations of the economy, and that's good news, but any speculation is always a speculative bubble, which is the additional effect of the functioning of markets There will be record high issue of public debt in 1Q04. Recently we have completed the issue of €1.5bn – the biggest in Poland's history. Therefore we cannot allow for spoiling the sentiment, which we are building abroad in order to secure budget financing in 2Q04. If we fail, then we will not guarantee budget liquidity, which is a basic task for every finance minister.
PAP, 13 Jan	This is a question of negotiating a good exchange rate which will be suitable for a stable development. The zloty should move in the widest possible band of fluctuations, at least in the first stage, and then it could be narrowed. Bigger budget deficit is the price Poland is paying for the EU membership. We want to fulfil convergence criteria as this is good for the economy. Last year's economic growth stemmed from exports that were increasing faster than imports. Investment that so far has not contributed to the growth should increase to the level of 2002.
PAP, 8 Jan	Foreign issues in 1Q2004 are being analysed. We haven't made up our mind whether it will the United States, if so it will be a bigger amount, or whether it will be a yen issue. It is not been resolved but we are taking into account that we will conduct another issue at the end of 1Q04 but on a non-European market. We are satisfied with our plans of public debt management, which we are realising. I think that change in the structure of instruments in 1Q04 positively affected market's opinion as regards yields and supply of papers.
PAP, 7 Jan	A row between the two sides of Swietokrzyska street [the FinMin and the central bank] will be much more acute at such low inflation than today. When inflation is brought down to a very low level, a visible room opens for the MPC to back the government's pro-growth economic policy. […] If we asked who the Finance Minister thinks is a permanent bridge between the two sides of Swietokrzyska street, that it is Ms. Halina Wasilewska-Trenkner. Recommendation is clear. We have taken a series of actions to persuade the markets of our new strategy, such as offering new variable interest instruments, announcing foreign issue plans. […] I think that all the factors and an eventual rise of foreign investors' investment in zloty paper produced a positive outcome of the auction. I think that is will be a permanent trend.
PAP, gazeta.pl, 6 Jan	We presented a strategy for ministers and this will be a subject of further discussion. Significant reduction of tax rates depends on support for Hausner's plan (sharp reduction of deficit).
PAP, 18 Dec	[about issues in private placement] The ministry does not exclude either domestic or foreign market. There is no broad plan for next year.
PAP, 16 Dec	Boosting budget incomes [in 2004 budget draft] by almost PLN500m in tax incomes increases the risk of not meeting the budget revenues plan.
PAP, Reuters, 15 Dec	We have a possibility to receive EUR4.5-5bn in 1Q04. However it doesn't mean at all that we will issue such an amount of the bonds […] Less than a half of this amount will relate to debt issuance. One should remember that the FinMin obtains money basing on agreements with banks. These are mainly international financial institutions. We have some agreements regarding revolving credits and can use this option. We can also conduct issues on the foreign market. Obviously we will plan such an issue in 1Q. […] Conditions of this issue – if we go to dollar or euro market or maybe another solution – will be discussed with investment banks as well, that will make some proposals for us. [...] We have asked dealers, what these papers [floating rate bonds] should be. We will work on the plan of issue in 1Q after receiving the answers. In the whole 2003 the GDP may grow not only 3.5% but there is a chance for 3.6%. This is good news. In 3Q the GDP will grow 4.1% in 4Q by 4.4%. Next year's economic growth is to amount to 5%. [...] It seems that we will see inflation rebound but it will remain under control. Inflation level below 3% is the most likely. This level will be acceptable from the point of view of macroeconomic stability and thus for the chance of reaching high pace of economic growth and its durability. [...] The highest level of registered unemployment is behind us. [unemployment forecasts: 17.8% at the end of 2003 and 17.7% at the end of 2004.]
PAP, 12 Dec	I will do everything that the meeting [of a team set up by the Finance Ministry and the National Bank of Poland to work out a strategy of entering the EU] takes place as quickly as possible.

PAP, 11 Dec	What is crucial is that the Polish budget, under a budget law, represents a limit of spending, therefore if during the budget year it turns out that there are statutory circumstances allowing to spend less money than it was assumed, this is an admissible solution. [...] If we succeed in lowering spending and reducing the deficit, it will create conditions for lowering tax burdens. […] We accepted it as one of basic conditions that a good tax system should support economic development and therefore should not be aimed at increasing tax burdens. That is why we accepted the assumption that the simplest measure will be a tax-GDP ratio - this ratio should not be increasing but it possibly should be decreasing.
Halina Wasilewska-Trenkner, deputy finance minister; PAP, 13 Jan	Under current calculations [...] there is the risk that NBP will transfer PLN300m less because the last weeks of 2003 were unfavourable due exchange rate and interest rate moves. [...] You can say that the amount of PLN100m is small in comparison with the budget bill where the deficit is set at PLN45.5bn but I can assure you that it is much. With such a deficit it is necessary to contract a credit and then incur costs of its servicing. […] By cutting the gap by PLN100m the Senate protected in the banking system money that private investors can gain. [...] The 2003 annual CIT revenues' plan was PLN14.3bn, the available data show they are PLN14.5bn.
Reuters, 6 Jan	There is no threat of budget insolvency in the first quarter but this will be a very difficult quarter.
Ryszard Michalski, deputy finance minister; PAP, Reuters, 6 Jan	I hope that there will be no price falls and freak moves on the [fixed income] market as in late 2003. […] For this year we assume stabilisation of even certain zloty appreciation. We do not want to resign from our strategy of public debt management, because it brings positive results. The structure of instruments is favourable and it allows for lowering costs of public debt servicing. We would like to sell more long-term bonds, when demand improves, which is visible already. I hope two-year bonds auction will be an example of improving sentiment. A privatisation plan was not meet for the second time in 2003. Let's hope that after two lean years privatisation will succeed will generate PLN8.8bn for the budget. The odds are that privatisation will finance the deficit more than in the past two years. […] The situation on the bourse is improving and sale of minority stakes may also be a success. There will be major privatisation deals. The budget will receive money from sale of the remaining components slated for privatisation.
Reuters, 31 Dec	We exchanged most of the loan from EIB. […] Market capacity turned out to be bigger than expected. […] We executed exactly our plan of year-end liquidity. Liquidity cushion at the end of the year will amount to at least PLN7bn.
PAP, 18 Dec	I can see no reasons now for the early buyback of the debt at the London and Paris Clubs but if such market conditions appear, the operation may be carried out. […] The FinMin is not planning at present any foreign currency funding or early repayment of foreign debt, which does not mean that we will not use such opportunity if favourable market conditions appear, provided that the move has been agreed with the central bank. We will be doing it [exchanging the currency from EIB loan] in a few steps. I think it will not have a big influence on the market, and even if it will, it marks certain stabilisation, the strengthening of the zloty. We do not want a big shock. If the whole amount was to shake the exchange rate, it should not be done.
Elżbieta Mucha, deputy finance minister; gazeta.pl, 6 Jan	[In the tax strategy] there are no figures. This is a philosophy, a conception, a material for further discussion.
Jacek Krzyślak, head of FinMin's research dept.; PAP, 15 Jan	This year's average annual CPI will be 2%, as stated in the budget, the 12-month index path will be quite interesting: it early 2004 we may expect 1.4-1.9% to 2.0% in June, in December 2004 it may reach 2.5%. Prices will grow till summer, stabilize at around 2.0-2.5%.
PAP, 7 Jan	We leave month-on-month inflation [forecast for December] at 0.2%, year-on-year yields 1.6-1.7 pct.
Jacek Tomorowicz, head of MinFin's foreign policy dept.; PAP, 22 Dec	We are planning a benchmark issue of at least €1bn. We want to conduct it in early 2004. It will be a fixed interest issue of five-year bonds. Its maturity will be in 2009. […] Five-year eurobond issue is our priority at present. […] Work are at an operation stage. [...] We are planning an issue in Swiss franks. It is designed to build a new market. The value of the issue will amount to around CHF300m. [...] A yen-denominated issue is being mulled over. It will be much larger than the previous one. […] Amid the end of financial year in Japan we must either hurry and conduct it in the first quarter or – what is more likely – wait till the second quarter. We have two credits from EIB that can be used for financing budget needs, both of EUR500m. First of them is designed for refinancing investment expenditures form the budget. Second is related with co-financing of EU structural funds. […] In case of the former we have already drawn EUR260m and next part, EUR240m, can be used in 1Q04. In the first quarter we will be also able to draw a first part – some EUR100m – from the latter one. Besides, we have a few projects with the World Bank, which should close a planned amount of €500m. The FinMin will exchange the hard currencies into the zloty on the market depending on profitability of this operation and budget needs. It will not be the FX intervention. We have been in talks with the Paris Club for a long time. The result of the negotiations is permission for an early buyback but we need technical talks on its evaluation. We have to think about how to carry out the operation and how to raise funds for it. […] Even the whole debt could be bought back although it cannot be a one-off operation. On Brazilian debt buyback we lent money from the NBP. Recently, there have been comments from NBP's representatives that the central bank is ready to repeat such operation. I suppose that the transaction would be possible with NBP's assistance, but I do not want to comment on details. However, we would expect from the NBP better conditions than previously. An early buyback of remaining Brady's bonds depends on profitability of such an operation. We estimate that present market value of these bonds is too high. Therefore, at present we do not plan conducting such operation.
PAP, 8 Dec	The ministry is prepared to conduct two-way operations: to buy or to sell currencies on the market. We have released information about the first transaction of this type. There is no programme for undertaking such actions in the future. [...] In case of this operation [selling €250m], what was at issue was to acquire zlotys. In this case the market situation was neutral. If the market conditions are unfavourable, such an operation will not be carried out. Instead of acquiring the money from the NBP, for some reasons it could be more profitable to do it on the market. But this will not have a character of market interventions.

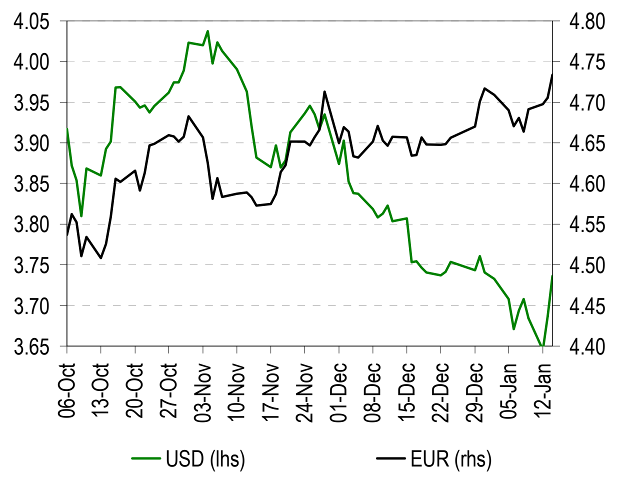
Market monitor

- **Zloty and bonds strong in December and January**
- **… until fears around Hausner's plan**
- **Successful sales of bonds and eurobonds**

Swinging moods on the FX market

After turmoil at the end of November, triggered by unforeseen interest rate hike in Hungary, at the beginning of December the trading on Polish FX market calmed down and the zloty appreciated. Improvement in moods was aided by good current account figures for October. In the following two weeks the zloty stabilised against dollar-euro basket, but it was strengthening against the dollar and depreciating against the euro amid increase in EURUSD rate. Just before Christmas Polish currency gained against both currencies, which probably resulted from transactions of currency conversion, just initiated then by the Ministry of Finance. During the Christmas time market activity remained subdued and comments made by FinMin's officials about ongoing sale of foreign currencies had only limited impact on the market prices. Meanwhile, EURUSD rate hit another record highs (above USD1.25 on December 29). At the end of December the zloty was ca. 2% stronger against the currency basket than at the end of November, however this appreciation was almost entirely transferred into USDPLN rate.

Zloty FX rate in recent 3 months

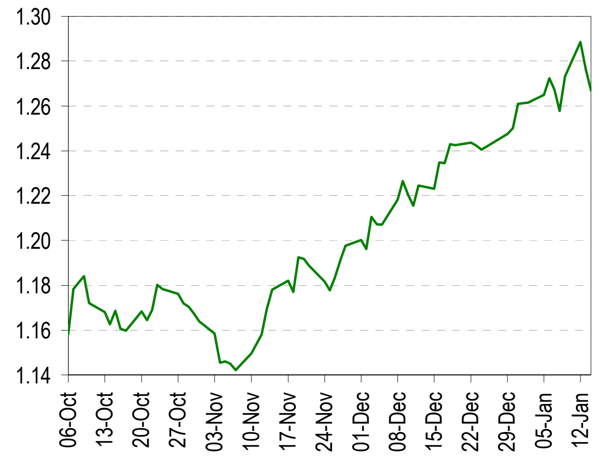


Source: NBP

In December, according to the NBP fixings, the dollar ranged from PLN3.7373 (on 22 Dec) to PLN3.9030 (2 Dec) with the average at PLN3.7928 (against PLN 3.9443 in November). The euro ranged from PLN 4.6318 (5 Dec) to PLN4.7170 (31 Dec) with the average of PLN4.6570 (PLN4.6194 in November). Compared to projections from the previous MACROscope (3.84 and 4.65, respectively) a noticeable difference is observed in case of the dollar, which resulted primarily from larger depreciation of this currency than expected.

At the beginning of this year the trade revitalised. Appreciation trend formed amid positive sentiment and sizeable activity of foreign investors. Still, the zloty was gaining more against the dollar than the euro, because EURUSD rate was continuing its growth and on January 12 it reached another record high level of nearly 1.29. In mid-January the moods on the market deteriorated amid uncertainty regarding implementation of Hausner's plan. The zloty plummeted to the weakest level against euro in its history, namely PLN4.76.

EUR/USD rate



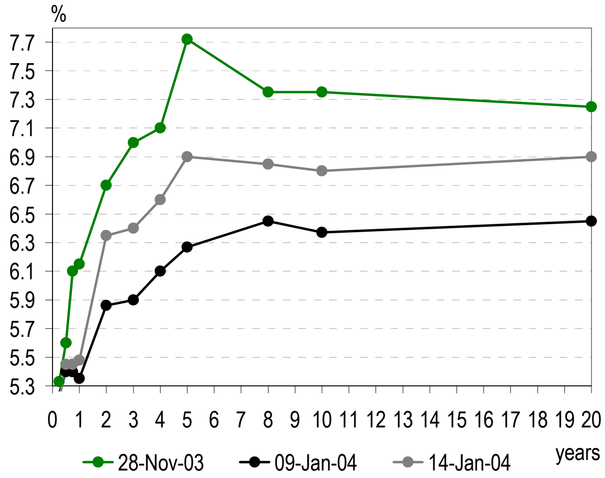
Source: NBP

Since early December another wave of dollar fall against euro has been continued. Even though the perspectives of European economy were perceived worse than America's outlook, lower interest rates in the US and its engagement in Iraqis war contributed to weakening of the dollar.

... and on the bond market

In December the yield curve was continuously moving down until Christmas. Initially, after the release of information about delay of long-term bonds supply on the primary market until March, it applied mainly to the long end of the curve, from 5 years onwards. Later it concerned more the short end, after the fears of interest rate hike diminished and good news about privatisation revenues appeared. During holiday period the yield curve fluctuated very little. In the first half of January, likewise on the FX market, initially the mood was very positive. Sizeable demand from foreign institutions and successful placement of 2-year bond during the first auctions fed into significant drops of yields. However, the turmoil around Hausner's plan triggered another hike - the yields went up by 40-50bps in just two days.

Yield curve

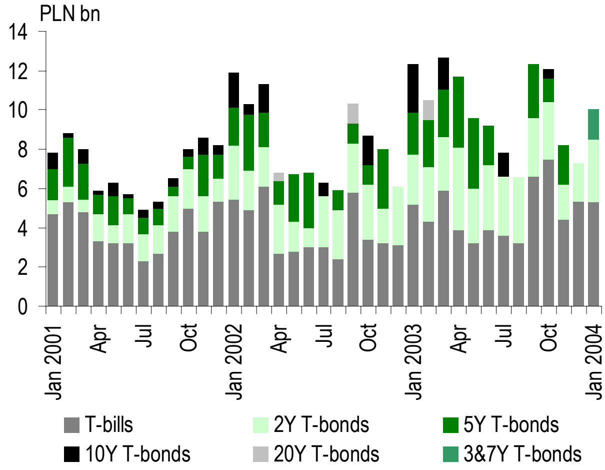


Source: BZ WBK

On Wednesday, 7 January the second auction of 2-year benchmark OK0406 was held. The bonds enjoyed great interest and declared demand (PLN9.1bn) was over three times bigger than supply. Previously such a significant surplus was recorded in April. All the offered papers were sold and average yield was lower by almost 1pp. than at December's auction and by some 10bps below quotations on the secondary market a day earlier. At the supplementary auction very high demand was declared and all the offered papers were sold. On 14 January the first auction of 3- and 7-year variable-rate bonds (WZ0307 and WZ0911, respectively) was held. The bonds of shorter maturity enjoyed greater interest from investors. Total declared demand was a few times higher than total supply, however the ministry rejected majority of the offers and sold less bonds than had offered.

On 8 January Poland sold €1.5bn worth of 5-year eurobonds at a yield of 32bps above the swap rate and 46bps above German bonds. The value of the issue was increased from €1bn initially planned. The Finance Minister said that the ministry is considering another issue on non-European market in 1Q04, however it is not decided whether these will be dollar or yen bonds.

Supply of Treasuries



Source: Finance Ministry, BZ WBK

Already in December the Ministry of Finance issued USD400m worth of bonds, in a private placement to Bank Pekao SA. The money from this operation (PLN1.5bn) was put on the government's account in the NBP and is to be used in 1Q04. This was the first issue of this type of the Polish government.

Treasury bill auctions (PLN m)

	OFFER / SALE			
Date of auction	*13-week.*	*16-week.*	*52-week*	*Total*
01.12.2003	-	-	1,100 / 1,100	1,100 / 1,100
08.12.2003	-	-	1,100 / 1,100	1,100 / 1,100
15.12.2003	100 / 100	-	1,500 / 1,500	1,600 / 1,600
22.12.2003	-	-	1,500 / 1,500	1,500 / 1,500
December total	**100 / 100**	**-**	**5,200 / 5,200**	**5,300 / 5,300**
05.01.2004	100	200	1,000	1,300
12.01.2004	100	200	1,000	1,300
19.01.2004	100	100	1,200	1,400
26.01.2004	-	100	1,200	1,300
January total	**300**	**600**	**4,400**	**5,300**

Source: Ministry of Finance

Short-term prospects for Polish financial market remain uncertain. After a short-lasting improvement at the beginning of the year sentiment deteriorated significantly when some doubts on implementation of the whole Hausner's plan appeared. Moreover, the market faces the pressure of enormous borrowing needs of the central budget (see *Special focus* section).

Treasury bond auctions in 2004(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	07.01*	OK0406	3,200	3,200	14.01	WZ0307/0911	1,500	1,407	-	-	-	-
February	04.02	OK0406	-	-	11.02	WZ0307/0911	-	-	-	-	-	-
March	03.03	OK0406	-	-	10.03	DS1013	-	-	17.03	5Y	-	-
April	07.04	OK0806	-	-	14.04	DS1013	-	-	21.04	5Y	-	-
May	05.05	OK0806	-	-	12.05	WZ0307/0911	-	-	19.05	5Y	-	-
June	02.06	OK0806	-	-	9.06	WZ0307/0911	-	-	16.06	5Y	-	-
July	07.07	OK0806	-	-	14.07	DS1013	-	-	-	-	-	-
August	04.08	OK0806	-	-	11.08	WZ0307/0911	-	-	-	-	-	-
September	01.09	OK0806	-	-	8.09	WS0922	-	-	15.09	5Y	-	-
October	06.10	OK1206	-	-	13.10	10Y	-	-	20.10	5Y	-	-
November	03.11	OK1206	-	-	10.11	WZ0307/0911	-	-	17.11	5Y	-	-
December	01.12	OK1206	-	-	-	-	-	-	-	-	-	-

Source: Ministry of Finance * with supplementary auction

International review

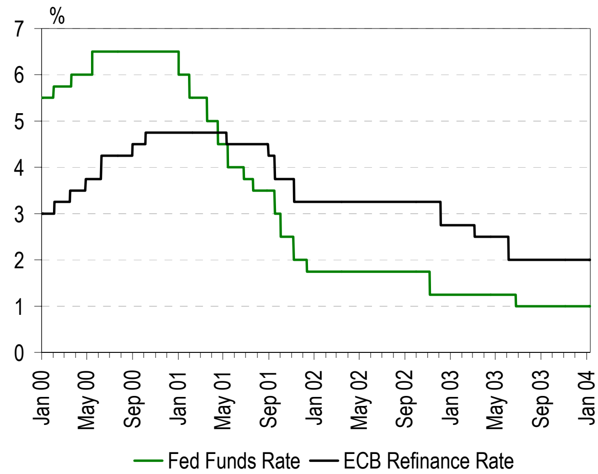
- **Interest rates still unchanged**
- **Eurozone's inflation above ECB's target**
- **… while prices fell in the US**
- **… and US GDP is growing at record pace**
- **Expected Eurozone's recovery around the corner**

Interest rates unchanged – as expected

In line with analysts' expectations, the Governing Council of the European Central Bank did not change interest rates at meeting on Thursday, 8 January. Since June 2003 the main Eurozone's rate – refinance rate – has stood at 2.0%. During the press conference the ECB president Jean-Claude Trichet stated that recent euro appreciation is unfavourable for exports from the Eurozone countries, but this effect can be partially offset by rising demand in world's economy. According to market expectations, interest rate will be raised only after the Fed decides to hike the rates in the United States.

Meanwhile, next, two-day meeting of the Federal Open Market Committee is planed for 27 and 28 January and no change in interest rates is expected, as well.

Interest rates in the US and the Eurozone



Source: Reuters

European Commission sues the Council of Ministers

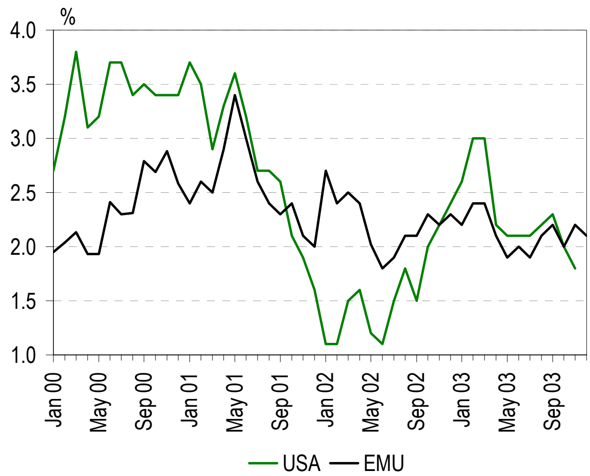
The European Commission filed a suit to the Court of Justice of the European Communities against the Council of Ministers. In November the Council decided not to punish Germany and France for the third consecutive exceeding of budget deficit convergence criterion. The Commission judged the decision as illegal due to procedural reasons and sued the Council.

Low core inflation in the US

According to final calculations, in November consumer prices in the Eurozone increased by 0.1%MoM and as the result annual inflation rate accelerated to 2.2% from 2.0% recorded in October. The data exactly matched preliminary estimations and analysts' expectations and in November inflation exceeded the level of ECB's inflation target at 2.0%. Moreover, according to preliminary estimations in December Eurozone's annual inflation rate decreased to 2.1%. Again, the data matched market consensus. Data on producer prices roughly matched market consensus. In November the prices increased by 0.1%MoM and annual growth rate amounted to 1.4%, up from 0.9% in October. Analysts' forecast was at 0.0% and 1.2%, respectively.

According to the ECB, Eurozone's M3 money supply growth rate amounted to 7.4%YoY in November, which means significant deceleration from 8.1% recorded in October and revised from 8.0%. A month earlier M3 growth saw unexpected acceleration from 7.6% that now proved to be one-off hike.

Consumer inflation YoY



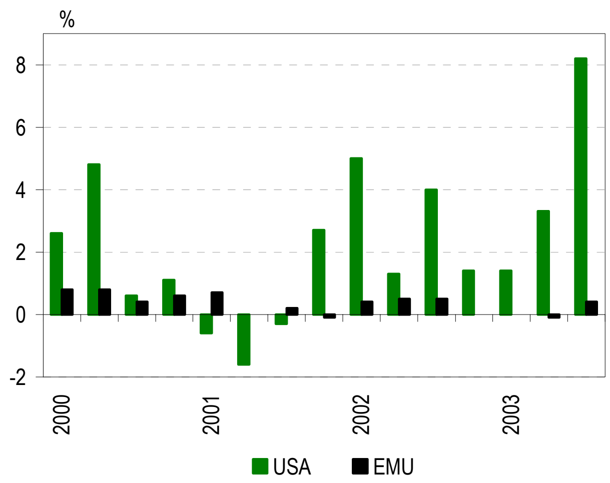
Source: Reuters

Data on inflation in the United States were much better than analysts' forecasts. In November consumer prices declined by 0.2%MoM, while 0.1% rise was expected by economists. This figure translated into a fall in annual inflation rate to 1.8% from 2.0% recorded in October. Annual core inflation rate fell to 1.1%, which is the lowest level since January 1966. Producer prices recorded an unexpected fall of 0.3%MoM in November, following a significant increase of 0.8%MoM in October. Market consensus for November stood at 0.0%. Annual rate of producer inflation remained unchanged at October's level of 3.4%.

Record high growth in the US

In the United States final data on economic growth were released. In the third quarter of last year, US GDP increased by 8.2%QoQ compared to 3.1% recorded in the second quarter 2003. The data meant a confirmation of preliminary estimations released a month ago and they matched analysts' forecasts. It was the highest pace of economic growth in almost twenty years. Analysts expect that in fourth quarter the GDP growth will decelerate, but it will be still relatively high at some 4%.

GDP growth QoQ



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

Data on industrial production in the United States were much stronger than market expectations. In November the output rose by 0.9%MoM, which was the biggest rise in four years, while 0.4% increase was forecasted. Also, data on retail sales were stronger than market consensus. In November the sales increased by 0.9%MoM, while 0.7% rise was forecasted.

In the United States the unemployment rate decreased to 5.7% in December from 5.9% recorded in November, while no change was expected. The number of jobs in the economy increased for a fifth time in a row, but this time only by 1,000, which was clearly below market expectations at 130,000 and these figure was negatively perceived by the market.

… and return into black in the Eurozone

Already in December, first release of detailed GDP figures for third quarter 2003 took place in the Eurozone. Preliminary estimations were confirmed, which also matched market expectations. In 3Q03 Eurozone's GDP increased by 0.4%QoQ after it had shrunk by 0.1% in 2Q03. In annual terms the Eurozone's economy grew by 0.3% in 3Q03. At the same time, the European Commission confirmed growth forecasts for 4Q03 and 1Q04 at the level of 0.2%-0.6%QoQ and 0.3-0.7%QoQ, respectively. Second release of 3Q03 data is planned soon.

Industrial production in the Eurozone increased by 1.1%MoM in October and annual growth rate amounted to 0.9%, compared to -1.3% recorded in September and revised from -1.8%. Meanwhile forecasts for October stood at 1.4% and 0.0%, respectively. On the contrary, data on retail sales roughly matched market consensus. In October Eurozone's retail sales increased by 0.5%MoM and remained unchanged in annual terms, compared to forecasts at 0.4% and -0.2%, respectively.

In the Eurozone the unemployment rate amounted to 8.8% in November, unchanged from October's level, which means a sixth consecutive month of stable unemployment rate. The figure matched analysts' expectations. The highest unemployment was recorded in Spain (11.3%).

IFO at the highest level in four years

Major business climate indicator for German economy – index IFO reflecting entrepreneurs' sentiment – recorded an eight consecutive rise, amounting to 96.8pts in December versus 95.7pts in November, while forecasts pointed to the increase only to 96.5pts. The index reached the highest level since January 2001. Head of the IFO institute commented this figure saying that it proves that economic recovery is a real fact and it is gaining momentum.

In December economic activity in the Eurozone's industry was rising for the fourth month in a row and it was accelerating at faster pace than in November but slower than expected by analysts. Reuters PMI index increased to 52.4pts, which was the highest level since January 2001, from 52.2pts in previous month, while 53.0pts was forecasted for December. For a fourth consecutive month it has remained above the level of 50pts, i.e. a limit between improvement and deterioration in activity. Meanwhile, in the United States the ISM index moved far away from this level, as economic activity in the industry was rising quickly and against expectations. The ISM index reached 66.2pts in December against 62.8pts in November and 61.0pts forecasted.

What's hot this month

Monday	Tuesday	Wednesday	Thursday	Friday
5 January POL: T-bill auction *ITA: Inflation preliminary (Dec)* *EMU: Inflation preliminary (Dec)*	**6** *FRA: GDP (3Q)* *USA: Factory orders (Nov)*	**7** POL: T-bond auction OK0406 POL: Food prices (2H Dec) *EMU: Economic sentiment; Business climate (Dec)*	**8** *GER: Unemployment (Dec)* *EMU: Producer prices (Nov)* *EMU: Unemployment (Nov)* *EMU: ECB meeting*	**9** *EMU: Retail sales (Oct)* *USA: Unemployment (Dec)*
12 POL: T-bill auction	**13** *FRA: Inflation preliminary (Dec)* *FRA: Industrial output (Nov)*	**14** POL: Money supply (Dec) POL: T-bond auction WZ0307 and WZ0911 *USA: Producer prices (Dec)* *USA: Foreign trade (Nov)*	**15** POL: Inflation (Dec) *ITA: Inflation final (Dec)* *EMU: GDP (3Q)* *USA: Inflation (Dec)* *USA: Retail sales (Dec)*	**16** POL: Wages & employment (Dec) *ITA: Industrial output (Nov)* *USA: Industrial output (Dec)*
19 POL: T-bill auction *EMU: Foreign trade (Nov)*	**20** POL: Industrial output (Dec) POL: Producer prices (Dec) POL: MPC meeting (1st day) *EMU: Industrial output (Nov)*	**21** POL: MPC meeting (decision) *FRA: Inflation final (Dec)* *EMU: Inflation final (Dec)*	**22** POL: Business climate (Jan)	**23** POL: Core inflation (Dec) POL: Retail sales (Dec) POL: Unemployment (Dec)
26 POL: T-bill auction	**27** *GER: IFO (Jan)* *USA: Fed meeting (1st day)*	**28** *USA: Fed meeting (decision)*	**29** *EMU: Money supply (Dec)*	**30** POL: Balance of payment (Dec) *EMU: Inflation preliminary (Jan)* *EMU: Economic sentiment; Business climate (Jan)* *EMU: Balance of payment (Nov)* *USA: GDP (4Q)*
2 February POL: T-bill auction *EMU: PMI (Jan)* *USA: ISM (Jan)*	**3** *EMU: Producer prices (Dec)* *EMU: Unemployment (Dec)*	**4** POL: T-bond auction OK0406 *ITA: Inflation preliminary (Jan)* *USA: Factory orders (Dec)*	**5** *GER: Unemployment (Jan)* *EMU: ECB meeting* *EMU: Retail sales (Nov)*	**6** *USA: Unemployment (Jan)*

Source: CSO, NBP, Finance Ministry, Reuters

Data release calendar for 2004

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
MPC meeting	20-21	-	-	-	-	-	-	-	-	-	-	-
GDP*	-	-	19	-	-	22	-	-	21	-	-	21
CPI	15	16[a]	15[b]	14	14	14	14	16	14	14	15	14
Core inflation	23	-	23[b]	23	24	22	23	24	22	22	23	22
PPI	20	18	17	20	20	18	19	18	17	19	19	17
Industrial output	20	18	17	20	20	18	19	18	17	19	19	17
Retail sales	23	20	19	22	24	23	21	20	21	21	24	21
Gross wages, employment	16	13	12	15	17	16	14	13	14	14	17	14
Unemployment	23	20	19	22	24	23	21	20	21	21	24	21
Foreign trade	about 50 working days after reported period											
Balance of payments*	2	-	31	-	-	-	-	-	-	-	-	-
Balance of payments	30	-	12[c]	13	-	-	-	-	-	-	-	-
Money supply	14	13	12	14	-	-	-	-	-	-	-	-
NBP balance sheet	7	6	5	7	-	-	-	-	-	-	-	-
Business climate indices	22	20	22	22	21	22	22	20	22	21	22	22
Food prices, 1-15	-	9[c], 25[d]	25	23	25	25	23	25	24	25	25	23

* quarterly data,
[a] preliminary data, January, [b] January and February, [c] January, [d] February

Source: CSO, NBP

Economic data and forecasts

Monthly economic indicators

		Dec 02	Jan 03	Feb 03	Mar 03	Apr 03	May 03	Jun 03	Jul 03	Aug 03	Sep 03	Oct 03	Nov 03	Dec 03	Jan 04
Industrial production	%YoY	5.2	3.3	4.3	5.5	8.5	11.7	7.9	10.3	5.9	10.9	12.1	9.1	15.5	5.9
Retail sales ***	%YoY	4.9	4.1	4.2	-1.7	11.0	9.7	8.1	5.4	5.5	9.7	10.3	11.4	12.8	11.4
Unemployment rate	%	18.0	18.6	18.7	18.6	18.3	17.9	17.7	17.7	17.6	17.5	17.4	17.6	18.0	18.4
Gross wages ** ***	%YoY	2.4	2.7	2.1	0.7	4.2	0.0	3.1	2.4	1.9	2.2	3.0	4.1	4.0	3.8
Export (acc. to NBP)	EURm	-2.3	-4.1	-3.9	-4.0	-3.7	-3.5	-3.6	-3.2	-3.2	-3.1	-3.2	-3.3	-3.4	-1.3
Import (acc. to NBP)	EURm	3 223	2 761	2 635	2 957	2 969	3 015	3 018	3 282	2 862	3 302	3 564	3 367	3 620	3 040
Trade balance (acc.to NBP)	EURm	4 166	3 895	3 219	3 467	3 833	3 696	3 512	4 107	3 615	3 838	4 208	4 000	4 140	3 933
Current account balance	EURm	-943	-1 134	-584	-510	-864	-681	-494	-825	-753	-536	-644	-633	-520	-893
Budget deficit (cumulative)	PLNbn	-484	-711	-483	-248	-460	-411	-100	-239	-111	58	198	-286	-125	-463
Budget deficit (cumulative)	% annual plan	-39.4	-4.1	-11.7	-15.5	-18.0	-23.2	-23.8	-27.7	-29.6	-33.1	-34.8	-35.5	-37.0	-5.6
CPI	%YoY	100.0	10.6	30.2	40.0	46.6	60.0	61.5	71.5	76.4	85.4	89.9	91.8	95.5	14.5
PPI	%YoY	0.8	0.5	0.5	0.6	0.3	0.4	0.8	0.8	0.7	0.9	1.3	1.6	1.7	1.8
Broad money (M3)	%YoY	2.2	2.5	2.9	3.6	2.9	2.0	2.0	1.9	1.8	2.1	2.7	3.7	3.9	3.7
Deposits	%YoY	-2.0	-1.4	-1.2	0.5	0.8	0.3	1.3	0.7	1.7	3.1	4.7	5.6	5.5	5.1
Credits	%YoY	-4.2	-4.1	-3.8	-2.3	-2.3	-2.9	-1.9	-2.5	-1.7	-0.2	1.5	3.3	3.7	3.3
USD/PLN	PLN	5.3	5.5	5.7	8.7	8.5	7.6	5.9	5.0	5.2	5.7	7.2	8.5	8.6	8.6
EUR/PLN	PLN	3.91	3.84	3.87	4.01	3.96	3.74	3.80	3.90	3.92	3.98	3.92	3.94	3.79	3.75
Reference rate *	%	3.99	4.08	4.17	4.33	4.30	4.33	4.44	4.44	4.37	4.46	4.59	4.62	4.66	4.69
WIBOR 3M	%	6.75	6.50	6.25	6.00	5.75	5.50	5.25	5.25	5.25	5.25	5.25	5.25	5.25	5.25
Lombard rate *	%	6.82	6.56	6.37	6.17	5.90	5.53	5.38	5.26	5.16	5.17	5.42	5.68	5.60	5.60
Yield on 52-week T-bills	%	8.75	8.50	8.00	7.75	7.25	7.00	6.75	6.75	6.75	6.75	6.75	6.75	6.75	6.75
Yield on 2-year T-bonds	%	5.78	5.74	5.83	5.67	5.43	4.75	4.66	4.85	4.82	4.91	5.30	5.95	6.02	6.02
Yield on 5-year T-bonds	%	5.75	5.55	5.66	5.52	5.16	4.78	4.79	4.89	4.86	5.02	5.53	6.31	6.49	6.49
Yield on 10-year T-bonds	%	5.67	5.57	5.58	5.36	5.15	4.88	4.90	5.17	5.38	5.60	6.04	6.86	6.82	6.82

Source: CSO, NBP, BZ WBK

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

Quarterly and annual economic indicators

		2002	2003	2004	1Q03	2Q03	3Q03	4Q03	1Q04	2Q04	3Q04	4Q04
GDP	PLNbn	771.1	804.4	857.6	184.5	197.6	198.9	223.3	195.3	209.2	212.4	240.7
GDP	%YoY	1.4	3.6	4.5	2.2	3.8	3.9	4.3	4.6	3.8	4.2	5.2
Total consumption	%YoY	2.8	2.3	2.8	1.0	2.8	2.9	2.7	2.5	2.6	3.1	3.2
- Private consumption	%YoY	3.3	2.9	3.2	1.4	3.8	3.4	3.0	2.9	3.0	3.5	3.5
Fixed investments	%YoY	-5.8	1.0	9.9	-3.6	-1.7	0.4	5.0	8.0	9.0	10.0	11.0
Industrial production	%YoY	1.5	8.7	7.3	4.4	9.1	8.9	12.2	9.0	6.5	7.0	6.7
Retail sales (real terms)	%YoY	3.3	7.1	6.8	1.2	9.8	6.4	10.8	12.0	6.0	5.0	4.0
Unemployment rate *	%	18.0	18.0	17.2	18.6	17.7	17.5	18.0	18.4	17.4	17.0	17.2
Gross wages (real terms)	%YoY	1.5	1.7	1.4	1.4	1.7	1.7	2.2	1.9	1.2	0.8	1.5
Export (acc. to NBP)	EURm	34 746	37 352	38 880	8 353	9 002	9 446	10 551	9 042	9 452	9 729	10 656
Import (acc. to NBP)	EURm	45 712	45 530	48 207	10 581	11 041	11 560	12 348	10 901	11 593	12 254	13 459
Trade balance (acc.to NBP)	EURm	-10 966	-8 178	-9 327	-2 228	-2 039	-2 114	-1 797	-1 859	-2 141	-2 524	-2 803
Current account balance	EURm	-7 188	-2 918	-4 717	-1 442	-971	-292	-213	-1 049	-1 285	-1 262	-1 121
Current account balance	% GDP	-3.6	-1.6	-2.5	-3.1	-2.7	-2.4	-1.6	-1.4	-1.6	-2.1	-2.5
Budget deficit (cumulative)*	PLNbn	-39.4	-37.0	-45.3	-15.5	-23.8	-33.1	-37.0	-19.7	-28.7	-36.3	-45.3
Budget deficit (cumulative)*	% GDP	-5.1	-4.6	-5.3	-8.4	-4.2	-4.7	-1.8	-10.1	-4.3	-3.6	-3.8
CPI	%YoY	1.9	0.8	2.3	0.5	0.5	0.8	1.5	1.9	2.3	2.7	2.4
CPI*	%YoY	0.8	1.7	2.5	0.6	0.8	0.9	1.7	1.9	2.5	2.6	2.5
PPI	%YoY	1.0	2.7	3.2	3.0	2.3	1.9	3.4	3.2	3.7	3.3	2.4
Broad money (M3)	%YoY	-2.1	5.5	5.8	0.5	1.3	3.1	5.5	5.7	6.2	7.0	5.9
Deposits	%YoY	-4.3	3.7	4.9	-2.3	-1.9	-0.2	3.7	5.0	6.6	7.9	5.9
Credits	%YoY	5.3	8.6	11.9	8.7	5.9	5.7	8.6	8.7	11.1	11.6	12.0
USD/PLN	PLN	4.08	3.89	3.67	3.90	3.83	3.93	3.89	3.72	3.64	3.69	3.64
EUR/PLN	PLN	3.85	4.40	4.59	4.19	4.36	4.42	4.62	4.65	4.55	4.62	4.55
Reference rate *	%	6.75	5.25	4.50	6.00	5.25	5.25	5.25	5.00	4.50	4.50	4.50
WIBOR 3M	%	9.09	5.68	4.87	6.37	5.60	5.20	5.57	5.23	4.85	4.70	4.70
Lombard rate *	%	8.75	6.75	6.50	7.75	6.75	6.75	6.75	6.50	6.00	6.00	6.00
Yield on 52-week T-bills	%	8.18	5.33	5.00	5.75	4.94	4.86	5.76	5.40	4.80	5.00	4.80
Yield on 2-year T-bonds	%	7.94	5.38	4.50	5.58	4.91	4.92	6.11	6.20	5.50	5.90	5.70
Yield on 5-year T-bonds	%	7.86	5.61	5.80	5.50	4.98	5.38	6.57	6.80	6.50	7.00	6.80
Yield on 10-year T-bonds	%	7.34	5.77	6.10	5.60	5.19	5.63	6.68	6.90	6.60	7.00	6.80

Source: GUS, NBP, BZ WBK

* at the end of period

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