Quarterly 2/99

POLISH ECONOMIC OUTLOOK
TRENDS • ANALYSES • FORECASTS

Summary

The controversial cut in interest rates in January this year, in the face of falling demand for Polish goods both in the CIS and EU markets, made it possible to sustain growth in consumption demand in the first-half of 1999. However, this happened at the expense of a considerable deterioration in the current account balance as well as a substantial drop in households' propensity to save. A decline in exports was the main reason behind slower growth than forecast in the 1999 Budget Act (5.1%). We estimate GDP growth in the first-half of 1999 to rise 2.3% yoy, 1.5% in 1Q99 and 3% in 2Q99. **According to our forecasts, GDP will grow 3.6% yoy in 1999 and 5.4% in 2000.**

In first-half of 1999, domestic demand increased 3.3% versus 6.6% over the same period of 1998. Personal consumption and investment recorded faster growth of 4.1% and 5.8% respectively. **We forecast domestic demand to grow 3.8% in 1999 and 5.5% in 2000.** Investment will experience the fastest growth – 8% in 1999 and 11% in 2000 – whereas personal consumption will rise at a slower rate of 3.9% and 4.1% respectively.

The continuation of oversupply of foodstuffs in the first-half of the year contributed to a small increase in the retail price of food. In addition, a lower rise in the price of industrial goods as compared to the previous year allowed inflation to decline to 5.6% in February. However, in the subsequent months inflation picked up to 6.5% in June, largely due to the weaker zloty (in contrast to last year) and faster growth in fuel and services prices. **We expect CPI growth to accelerate in the course of 1999, reaching 6.7% in December. This will yield annual average inflation of 6.5% in 1999 and 5.8% in 2000.**

The adverse economic conditions in the EU in 1999 will preclude a substantial increase in the volume of exports. At the same time, we are of the opinion that slower domestic demand and lower dynamics of sold production will result in a decrease in the volume of imports. The merchandise trade balance will deteriorate slightly. However, a collapse in cross-border trade and a considerable deterioration in the balance of trade in services will be largely responsible for the increase in the current account deficit to approximately US$(–10) billion (i.e. –6.4% of GDP). An expected inflow of foreign investment in Poland will help offset the negative current account balance and raise official foreign currency reserves from US$27.4 billion at end-1998 to almost US$28 billion by end-1999.

The Center for Social and Economic Research – Foundation presents the second issue of its quarterly 'Polish Economic Outlook – Trends, Analyses, Forecasts' prepared by CASE economists.

This issue comprises an analysis of the economic situation in Poland in the first-half of the year, internal and external threats to economic growth, and the outlook for 1999 and 2000. We would like to draw your attention to the drop in exports and its impact on Polish economic growth. In addition, we provide a forecast for an alternative scenario which assumes the pursuit of a populist fiscal policy (i.e. a policy that caters to the interests of labour unions) in 2000. The implementation of such a policy would inevitably lead to the collapse of economic growth in the years to come.

We kindly remind our readers that the quarterly is available in hard copy as well as in PDF file format, both in Polish and English.

For information about subscription please contact Michał Górzyński (pgtop@case.com.pl) or check our web site (www.case.com.pl).

Quarterly 2/99

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Assessment of the economic situation in 2Q99

According to our estimates, gross domestic product (GDP) growth was 3% in 2Q99 and thus higher than in 4Q98 and 1Q99. Higher GDP growth was driven mainly by higher domestic demand. On the other hand, external demand slackened after a slight improvement in 1Q99. This stems from the plunge in both official and cross-border exports to the Commonwealth of Independent States (CIS) as well as lower demand for Polish products in the European Union (EU).

Changes in some fundamental macroeconomic indicators were the result of slower economic growth:

- **Unemployment rose in contrast to the corresponding period in the previous year but fell in comparison to the end of 1Q99; the seasonal drop in the number of people out of work was lower than in 1998,**
- **Real wages and household real disposable incomes fell,**
- **A considerable decline in the propensity to save was observed,**
- **Inflation rose slightly from 6.2% in 1Q99 to 6.4% in 2Q99,**
- **The zloty witnessed a relative appreciation,**
- **Growth in money supply was restricted,**
- **2Q99 saw a decline in the budget deficit in comparison to 1Q99.**

Weak exports

After a slight increase in export revenues in 1Q99 (0.6% yoy), a decline of 17% was experienced in 2Q99. The latter can be explained by the depreciation of the euro against the dollar (52.7% of merchandise payments were denominated in Eurozone currencies) and a reduction in the volume of exports. The level of cross-border exports still remains at a low level. It is estimated that the balance of unclassified current transactions (i.e. the cross-border trade balance) fell by almost US$900 million compared to 2Q98.

The manufacturing sector was the most severely hit by the fall in external demand. After the 8% yoy contraction in sold production volumes (in enterprises employing more than 5 workers) in 4Q98 and 3% yoy decline in 1Q99, 2Q99 witnessed a rise of 1.3% yoy.

Gross Domestic Product

Value-added growth in the main sectors of the economy was differentiated. As in previous quarters, the fastest growing sectors were telecommunications, construction and trade. The value-added in industry rose 0.9% in 2Q99 after two consecutive quarters of decline.

We estimate that the value-added in the whole economy increased 2.7% with a 3.7% rise in construction and a 4.2% and 1.2% rise in market and non-market services respectively.

Domestic demand and falling propensity to save

It is estimated that domestic demand (the sum of private consumption, public consumption and accumulation) increased 3.4% in 2Q99 (3.2% in 1Q99). Moreover, the gap between domestic demand growth and GDP growth decreased from 3.8 percentage points in 4Q98 to 0.4 percentage points in 2Q99.

We are of the opinion that the Polish economy adjusted fairly quickly to the external shock which caused a slowdown in economic growth. All components of domestic demand rose much slower than in 4Q98 when the consequences of the external shock were not yet entirely visible. Growth in household real incomes – in particular of salaries, farmers' and small entrepreneurs' income – has declined. At the same time, **for the first time since the beginning of the transformation, 2Q99 witnessed a decline in the net financial savings of households** (calculated as the difference between the growth of deposits, foreign currency deposits, cash in circulation and the growth of credits).

The drop in savings stems, on the one hand, from the controversial cut in interest rates in January 1999 and, on the other, from decreasing household real incomes.

2Q99 witnessed lower growth in public spending (1.5%) than in private consumption (4%). Investment rose 5.5%. As in 1Q99, **stockbuilding was much slower than a year ago. This means the Polish economy has adjusted fairly well to lower demand.**

Foreign trade and the balance of payments

Slower growth in domestic demand and a weaker zloty (in contrast to 2Q98) negatively affected import growth. Thus, we estimate the merchandise trade balance amounted to approximately US$(–3.3) billion in 2Q99 – US$ 0.4 billion more than a year ago. The current account deficit rose from US$(–2.2) billion in 1Q99 to US$(–2.8) in 2Q99 and was US$2.2 billion higher than in 2Q98.

The deterioration in the current account and the overall worsening of the investment climate in emerging markets lowered FDI inflows to Poland. In addition, the country experienced an outflow of portfolio investment in the first-half of 1999.

Consequently, official foreign currency reserves fell from US$27.4 billion at end-1998 to US$25.8 billion at end-June 1999. The current level of reserves is, however, sufficient to cover almost 7 months' imports. It should be noted that a fall in the reserves in nominal terms was partly due to exchange rate movements, in particular the depreciation of the euro against the dollar.

Strengthening of the zloty

The stabilisation of the merchandise trade balance and substantial increase (actual and expected) in privatisation revenues served to strengthen the zloty. Whilst in March 1999 the exchange rate fluctuated around central parity within a (–1.3)/(+1)% band, the limits changed to 3.5/4.3% by end-June 1999.

A decrease in savings, weaker economic activity and the relative appreciation of the zloty caused nominal and real money supply growth to slow. While in 1Q99 money supply growth grew 27.6% in comparison to 1Q98, it increased 22.1% in 2Q99. At the same time, the structure of money demand changed. Lending to households grew considerably (especially in June 1999). The demand for loans denominated in zlotys fell while the demand for loans denominated in foreign currencies rose. The appreciation of the zloty and the anticipated upward pressure on the currency increased the attractiveness of foreign credits to banks and businesses.

Stable inflation

CPI growth still remains below the level set in the 1999 Budget Act. However, since the beginning of February 1999 when prices rose 5.6% yoy CPI has gradually risen to reach 6.5% in June. Rising world oil prices and an increase in the excise tax on fuels constitute the main indirect causes of higher inflation. The price of fuels rose 30% in the first-half of 1999. On the other hand, relatively low prices of agricultural products resulting from excess supply hampered inflation growth. PPI behaved very much like CPI and rose 5.2% yoy in 2Q99.

To conclude, the consequences of the external shock were still visible in 2Q99. The economy reacted to the cut in interest rates with a quarterly lag. A decline in foreign demand was offset by relatively strong domestic demand with consumption demand playing a key role.

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Determinants of Poland's economic development

The assumptions in this issue concerning the external situation and domestic determinants do not differ much from those advanced in the previous issue. A discussion of Poland's external and internal constraints as well as the basic assumptions of the forecast are provided prior to presenting the Polish economic outlook for 1999–2000.

The assumptions can be distinguished in the following manner:

• external – relating to the economic performance of Poland's major trading partners (such as the dynamics of imports in the EU and LIBOR);

• internal – regarding *inter alia* labour resources, employment in the government sector and foreign debt servicing.

World economic outlook for 1999–2000[1)]

• Sluggish economic growth in the EU (in particular Germany and Italy)
• A weak euro
• The rise in oil prices

Economic growth

The world economic situation has improved since the beginning of the year. This is largely attributable to the stabilisation of world financial markets. However, the question remains whether changes in the financial architecture are sufficient to prevent future crises. In addition, the gap in economic growth amongst the largest economies has narrowed. This stems from the relatively mild consequences of the Brazilian crisis as well as the apparent improvement in the Asian economies following the 1997 financial crisis.

The outlook risks are not only however on the downside, threats relating to the surging stockmarket in the USA remain.

USA

Despite the rosier outlook, the economic situation is quite diversified across the globe. Although growth in the USA slowed a bit in 2Q99 to 2.3% yoy (as compared to the previous quarter and 1998), the USA still remains the locomotive of world economic growth. Leading indicators suggest this growth will continue well into 2000, although its pace may slow.

A question remains, however, whether the impressive performance of the American economy can be sustained in

1) Economic forecasts presented in this chapter constitute a consensus of the biggest foreign forecasting centers (IMF, OECD, DIW, commercial investment banks, etc.)

the long-term. The high growth rate, coupled with low inflation, in the first-half of 1999 resulted from low import prices (due to low world prices of commodities and oil as well as the appreciation of the dollar). As mentioned previously, it is possible this trend will reverse itself in the near future as signs of inflationary pressures loom in the horizon. These stem from rising labour costs and commodities prices.

In addition, high equity prices, low household savings and a deteriorating deficit in the current account indicate growing imbalances in the American economy. We still believe there is a risk of a stockmarket collapse which would have a far-reaching impact on the real economy.

The European Union

The EU economic situation tends to be much worse than in the USA. According to the European Commission, GDP growth in Euroland was 0.4% in 1Q99. The poor performance stems primarily from economic problems in Germany and Italy. One should bear in mind that the two countries account for roughly 50% of Eurozone GDP.

Germany recorded an unimpressive GDP growth of 0.4% yoy in 1Q99. Weak domestic demand is the main reason for this. However, growth was twice as strong as was generally forecast. In May industrial production was down again (2.2% yoy). On the positive side, the Ifo index, a key indicator of German business confidence, rose unexpectedly in June. This data does not, in itself, point to a recovery and it is simply too early to make a firm appraisal of the situation. However, many experts are of the opinion that the second-half of 1999 will witness an improvement, although the pace of recovery will be sluggish.

Italy performed even worse. GDP rose by a mere 0.2% yoy and 0.9% qoq in 1Q99. May marked the eighth consecutive month of decline in industrial production – 0.3% mom and 4.6% yoy. Recent statements from the Italian government concerning spending cuts to rein in the budget deficit may further delay recovery.

Sluggish growth also prevailed in the United Kingdom, where GDP was essentially flat. However, 2Q99 saw the first signs of recovery stemming largely from the substantial easing of monetary policy.

Most experts forecast a boost to the EU economy in the second-half of 1999 and 2000. Faster growth will be driven by increased exports resulting from rising demand in the USA and the delayed effects of a weak euro. However, given the fact that external trade in the EU accounts for only for 15% of GDP, the export stimulus will not prove decisive.

Table 1. GDP in selected countries, 1996–2003 (% change yoy)

	1996	1997	1998e	*1999f*	*2000f*	*2001f*	*2002f*	*2003f*
Global	4.0	4.1	1.7	*2.3*	*2.8*	*2.9*	*2.9*	*2.7*
OECD	2.9	2.8	1.9	*2.5*	*2.4*	*2.5*	*2.5*	*2.3*
USA	2.4	3.8	3.9	*4.0*	*2.8*	*2.6*	*2.5*	*2.0*
Canada	1.5	3.8	3.1	*3.5*	*2.5*	*3.2*	*2.7*	*2.2*
Japan	3.5	0.8	-2.9	*0.5*	*0.0*	*0.5*	*1.5*	*2.0*
European Union	1.7	2.6	2.6	*1.9*	*2.9*	*2.9*	*2.6*	*2.4*
Germany	1.4	2.3	2.0	*1.5*	*2.8*	*2.6*	*2.4*	*2.2*
France	1.5	2.3	3.2	*2.1*	*3.0*	*2.7*	*2.5*	*2.3*
Italy	0.7	1.5	1.3	*1.3*	*2.2*	*2.8*	*2.5*	*2.4*
United Kingdom	2.3	3.1	2.1	*1.0*	*2.8*	*3.0*	*2.8*	*2.5*
Russia	-5.0	0.9	-4.8	*-6.0*	*2.0*	*2.0*	*4.5*	*6.0*
China	9.6	8.8	7.8	*6.5*	*6.0*	*5.0*	*5.0*	*6.0*

Source: IMF and forecasts derived from the McFair model devised at Yale University.

Notes: e – estimates, f – forecasts.

Slow growth in the EU endangers Poland's economic development. In addition, weak business activity and a weak euro result in a decline in import demand in the EU. It should be noted that Poland exports primarily to the European market (68.4 % of total exports in 1998). Thus EU economic performance, in particular that of Germany, will be a key determinant of Polish economic growth in the second part of 1999 and in 2000.

CIS

A rise in industrial production of 3.1% yoy in Russia in the first-half of the year suggests the Russian economy is starting to recover. The industrial recovery stems largely from the increase in world commodity prices, in particular crude oil, as well as from the weaker rouble. It is confined to export (specifically natural resource-based) sectors. Nevertheless, most forecasting centres still expect Russian GDP to contract this year. The absence of a long-term strategy for economic restructuring gives cause for concern and it is unlikely that such a plan will be put forward prior to the presidential elections at 2000-end.

Equally unfavourable economic conditions prevail in Ukraine. Due to the lack of a clear economic policy and the ongoing fiscal crisis, GDP is forecast to decline in 1999. Depressed economic activity in Russia and Ukraine has adverse effects on economic development in the Baltic states. The unstable economic situation in the region hinders Polish export growth.

Asia

Asian countries are on the mend following the 1997 crisis. However, only in the year 2000 will we see a boost in economic growth. In 1Q99, most Asian countries experienced an upturn in industrial production, driven primarily by manufacturing and exports.

South Korea has been growing unexpectedly fast. The IMF forecasts growth of 6–7% this year (versus a 5.8% GDP contraction last year). However, a full economic stabilisation in South Korea is still uncertain, especially in the light of recent events. Following Daewoo's announcement on debt refinancing, investor panic ensued which caused the stockmarket to fall 15% and interest rates to rise.

China is still expected to grow rapidly, although the pace of growth in 1999 and 2000 will be slower than in the last five years. GDP rose 8.3% yoy in 1Q99 and 6.9% in 2Q99. Declining consumer spending and net export surplus pose serious problems for the Chinese economy. The latter stems largely from the surge in imports resulting from an overvalued currency. China's growth is still driven by public consumption.

After six consecutive quarters, Japan recorded GDP growth of 1.9% in 1Q99. The recovery was mainly attributable to government consumption and, to a lesser extent, individual consumption. Macroeconomic fundamentals are still unstable. The Japanese government, in the face of an uncertain situation, believes that the stimulation of the economy should continue.

Latin America

The situation in Latin America has been improving and the symptoms of the crisis seem to be fading. The earlier-than-expected return of foreign capital mitigated the adverse effects of the economic slump. Experts forecast a recovery in the region, although its pace will be far from buoyant. Growth prospects will hinge on commodity prices (Latin America is a major commodity exporter) as well as on developments in Brazil (the biggest economy in this region) which will experience a decline in GDP this year.

Commodity prices

Prices of most commodities have been picking up. At the same time, the discrepancy in prices of crude oil and other commodities is widening in favour of the former.

Crude oil prices climbed to their highest level in 19 months exceeding US$19 per barrel. The rise stems largely from the unexpected (and strict) adherence to oil production quotas set by OPEC countries in March this year. The production limits were meant to drive the price to US$18–20 per barrel. Now this price seems quite realistic. On the other hand, the higher the price, the more tempting it is to renege. This adds to uncertainty about prices in the long-term. Other factors behind the surge in oil prices were signals of smaller oil inventories (4.6% yoy decline in the first-half of 1999) and expectations regarding the rise in demand in the Asian economies.

Higher oil prices will be mirrored by higher Polish fuel prices. More expensive fuel, in turn, will affect inflation. However, this impact does not have to be very strong (see chapter on prices).

Not only was there an increase in oil prices but in the price of industrial metals as well. Although in the latter growth was not that fast. A rise in the price of nickel (45.8% since the year-end 1998), copper (due to production cuts), zinc (following news of the closure of the largest mine in Europe) and aluminium was recorded. In general, price growth stems from production cuts. Nevertheless, metals prices have not reached their pre-Asian crisis levels yet and this will happen no sooner than 2000. Given limited world inventories, it is expected that a rise in industrial metals prices will be fuelled by a rising demand for these commodities in Asian countries, where the recovery seems to be gathering pace.

Inflation

World prices still remain at a low level, although deflation trends – quite apparent at end-1998 – do not pose a serious threat anymore. The recent USA data do not indicate any signs of inflation measured both by CPI and PPI.

Similar inflationary trends occur in the Eurozone. According to the European Central Bank (ECB), prices should be stable (i.e. inflation rate staying below 2%) in the short- and medium-term. It should be stressed that inflation falls relatively faster in emerging economies, in particular in Asia, than in the OECD.

Table 2. GDP deflator in selected countries, 1996–2003 (% change yoy)

	1996	1997	1998e	*1999f*	*2000f*	*2001f*	*2002f*	*2003f*
OECD	1.5	1.4	1.0	*1.3*	*1.7*	*1.3*	*1.1*	*1.1*
USA	2.2	2.0	1.0	*1.5*	*1.9*	*1.6*	*1.5*	*1.5*
Canada	1.3	0.5	-0.6	*1.3*	*1.5*	*1.3*	*1.0*	*1.0*
Japan	-0.1	0.5	0.4	*-0.2*	*0.3*	*0.2*	*0.0*	*0.0*
European Union	2.4	1.6	1.5	*1.6*	*1.9*	*1.4*	*1.0*	*1.0*
Germany	1.0	0.6	1.0	*1.4*	*1.8*	*1.4*	*1.0*	*1.0*
France	1.6	1.0	0.9	*0.8*	*1.4*	*1.4*	*1.0*	*1.0*
Italy	4.4	2.6	2.8	*2.1*	*2.4*	*1.4*	*1.0*	*1.0*
United Kingdom	3.1	2.2	2.5	*2.0*	*2.3*	*1.4*	*1.0*	*1.0*

Source: IMF and forecasts derived from the McFair model devised at Yale University.

Notes: e – estimates, f – forecasts.

Table 3. CPI in selected countries, 1996–2003 (% change yoy)

	1996	1997	1998	*1999f*	*2000f*	*2001f*	*2002f*	*2003f*
OECD	2.0	2.0	1.2	*1.3*	*1.6*	*1.5*	*1.4*	*1.4*
USA	2.9	2.3	1.6	*2.1*	*2.3*	*2.1*	*2.0*	*1.8*
Canada	1.6	1.6	1.0	*1.2*	*1.3*	*1.4*	*1.2*	*1.2*
Japan	0.1	1.7	0.6	*-0.4*	*0.1*	*0.2*	*0.2*	*0.3*
European Union	2.1	1.4	1.2	*1.1*	*1.5*	*1.4*	*1.2*	*1.2*
Germany	1.3	1.7	0.9	*0.6*	*1.5*	*1.3*	*1.2*	*1.2*
France	2.0	1.2	0.7	*0.7*	*1.0*	*1.3*	*1.2*	*1.2*
Italy	3.8	1.8	2.0	*0.7*	*1.4*	*1.3*	*1.2*	*1.2*
United Kingdom	2.4	3.1	2.7	*2.2*	*2.0*	*1.5*	*1.2*	*1.2*
Russia	47.7	14.8	27.7	*94.0*	*15.0*	*9.0*	*6.0*	*5.0*
China	8.3	2.8	-0.8	*-1.6*	*0.8*	*1.0*	*1.5*	*1.5*

Source: IMF and forecasts derived from the McFair model devised at Yale University.

Notes: f – forecasts.

However, inflationary pressures are expected to strengthen in the second-half of 1999 as a result of rising commodity prices, in particular crude oil and metals. The pressure will be reflected mainly in PPI. In the Eurozone, the influence of higher prices of imported commodities may be mitigated to some extent by the expected strengthening of the euro.

Interest rates

The US Federal Reserve increased American interest rate by 25 base points to 5% in June. It also announced a neutral bias. This may signify no other increases in the near future. It is a good sign for emerging markets, including Poland, as a further hike in interest rates would cause capital flight to more secure and attractive capital markets in the USA.

In Europe, contrary to the USA, there has been pressure to reduce interest rates in order to boost economic growth. The Bank of England cut its interest rate from 5.25% to 5% in June. It was the seventh cut in the last 9 months leaving interest rates at their lowest level in 22 years. The ECB at its last meeting in June kept interest rates unchanged (the last cut took place in April 1999). On June 15 the ECB president, Wim Duisenberg, suggested the possibility of an interest rate increase. However, the majority of analysts interpreted this simply as an attempt to prop up the weak euro. It is expected that given the lack of strong inflationary pres-

Table 4. Long-term interest rates in selected countries, 1996–2003 (%)

	1996	1997	1998	*1999f*	*2000f*	*2001f*	*2002f*	*2003f*
USA	6.4	6.3	5.3	*5.5*	*5.6*	*5.0*	*4.7*	*4.5*
Canada	7.2	6.1	5.3	*5.2*	*5.0*	*4.8*	*4.6*	*4.5*
Japan	3.0	2.3	1.5	*2.0*	*2.5*	*2.5*	*2.3*	*2.0*
Euro area	6.2	5.7	4.7	*4.0*	*4.0*	*4.0*	*4.0*	*4.0*
United Kingdom	7.8	7.0	5.5	*5.0*	*5.0*	*4.5*	*4.5*	*4.5*
LIBOR (US$/year)	5.6	5.9	4.8	*5.0*	*5.2*	*4.6*	*4.2*	*4.0*

Source: IMF and forecasts derived from the McFair model devised at Yale University.

Notes: f – forecast.

Table 5. The volume of imports in selected countries, 1996–2003 (% change yoy)

	1996	1997	1998e	*1999f*	*2000f*	*2001f*	*2002f*	*2003f*
Global	6.1	9.1	3.4	*5.0*	*6.0*	*7.0*	*7.5*	*7.0*
OECD	6.2	7.8	7.5	*5.5*	*5.0*	*5.5*	*6.1*	*6.1*
USA	6.4	14.3	10.6	*10.0*	*7.0*	*5.0*	*5.5*	*4.0*
Canada	5.1	12.6	5.8	*5.0*	*4.0*	*4.0*	*5.0*	*5.0*
Japan	10.3	2.1	-7.5	*0.0*	*1.0*	*1.0*	*3.0*	*5.0*
European Union	2.6	6.0	7.8	*3.0*	*4.5*	*5.5*	*5.8*	*5.8*
Germany	2.8	6.1	7.5	*2.0*	*5.5*	*6.0*	*5.0*	*4.0*
France	2.2	6.2	9.3	*1.0*	*5.0*	*5.0*	*5.5*	*5.0*
Italy	-2.0	3.6	6.1	*3.0*	*4.7*	*5.0*	*6.0*	*5.0*
United Kingdom	7.8	8.3	8.4	*2.0*	*2.8*	*4.0*	*7.0*	*6.0*
Russia	10.0	11.0	-16.0	*-21.0*	*5.0*	*8.0*	*9.0*	*10.0*
China	14.0	12.0	-3.8	*2.0*	*8.0*	*9.0*	*11.0*	*12.0*

Source: IMF and forecasts derived from the McFair model devised at Yale University.

Notes: e – estimates, f – forecasts.

sures, interest rates will remain unchanged until the end of 1999 and possibly even in 1Q00.

Foreign Trade

It is expected that world trade turnover will increase in the near future. This will be largely attributable to the forecast global economic recovery, in particular in Asia.

Exchange rates

2Q99 marked a further slide of the euro against the dollar. Since the euro's birth (1 January 1999) it has lost 15% against the dollar. The weak economic performance of the EU, in particular Germany, in comparison to the American economy was the main reason behind this slide. The dollar appreciation was also supported by a rise in American interest rates.

Table 6. Dollar exchange rate vs. the euro and the yen, 1996–2003

	1996	1997	1998	*1999f*	*2000f*	*2001f*	*2002f*	*2003f*
Euro	–	–	1.11	*1.08*	*1.10*	*1.12*	*1.13*	*1.15*
Yen	109	121	131	*122*	*135*	*134*	*133*	*132*

Source: IMF and forecasts derived from the McFair model devised at Yale University.

Note: f – forecasts.

In the second-half of July the euro gained a bit against the dollar. We still stand by our assumption that the euro will appreciate in the second-half of 1999 and 2000. However, the euro is not expected to regain its initial value against the dollar before year-end.

On the other hand, the dollar dipped against the yen. The Bank of Japan intervened four times in order to prevent an excessive appreciation of the yen in recent weeks. Similar actions are expected to take place in the future for the strong yen is hindering Japan's economic growth.

Summarising, it should be stressed that the situation in the world economy is more stable than at the beginning of the year and growth prospects are considerably rosier. World market conditions will definitely influence the Polish economy. The following factors, in particular, will be crucial:

• Economic revival in the EU (especially in Germany, Italy and the UK) and a recovery in CIS countries. These factors determine Polish economic growth via the export channel.

• Commodity prices (mainly crude oil and industrial metals) – continued growth of prices will make it difficult to curb inflation.

• Direction of the euro exchange rate – euro strengthening against the zloty increases the chances to boost exports to the EU.

Forecast assumptions – domestic determinants

The worse-than-previously-expected economic performance of the EU caused a revision of our assumptions concerning exports to the region. However, we are of the opinion that the demand for Polish goods in the EU will grow faster in the second-half of 1999 than in the first-half. This will be possible due to the adaptation of Polish enterprises to the new economic situation, as well as the expected revival of the EU and CIS economies. Currently we assume that the recovery of Polish exports to Russia and Ukraine will be slower than previously envisaged. Detailed assumptions are given in Table 7.

Despite the stabilisation of foreign investment in the first-half of the year, it is expected that increased capital inflows will be visible in the second-half. Our forecast assumes, optimistically, that the situation in world financial and capital markets will not be subject to any major turmoil. At the same time, we are of the opinion that foreign investors will distinguish Poland from other transition economies primarily due to its sound macroeconomic fundamentals and consistent economic policies.

Table 7. Forecast assumptions for 1999 and 2000

Compulsory debt servicing to the Paris Club and the London Club	Annual interest payments of US$1.4 billion
Increase of the volume of EU imports	See Table 5
Average LIBOR (US$, year)	See Table 4
Increase in Polish labour resources	0.4% to 0.5% per year
Increase in a number of people who are either retired or receive disability allowance	1.5% to 2.3% per year
Average customs duty	In trade with the EU: a gradual dismantling to 0%; with other countries: at the 1997 level
Exchange rate policy	Until end-1999 crawling-peg and then market exchange rate
Transfers from the EU	US$0.2–0.5 billion
FDI flows (per year)	US$4.5–8.0 billion in balance of payments terms
Privatisation	Acceleration of privatisation and its termination in 2001
Social security system	Maintaining price indexation
Tax rates	PIT the same as in 1998
Employment in the public sector	An annual increase of 0%– 0.3%

Source: CASE

We assume that the government's economic policy will be focused on sustaining macroeconomic stability and the projected budget deficit. Our forecast rests on the following three assumptions with regard to economic policy:

• reduction of NBP's main interest rate may take place only at the end of 4Q99;

• budgetary policy will aim at minimising the financing of debt via the domestic financial system;

• current mechanism of exchange rate setting will continue.

Perhaps optimistically, we do not assume any amendments to the Budget Act and reckon that the potential shortfall in financing resources stemming from an underestimation of reform costs, in particular health care, may be covered by revenues from accelerated privatisation.

Analysis of the economic situation and outlook for 1999–2000

Domestic demand

- **Stable consumption demand**
- **Weaker investment demand**
- **Slower stockbuilding**
- **Forecast of improving investment climate in 2000**

According to our estimates, 2Q99 saw GDP growth of 3% yoy after five consecutive quarters of decline in GDP growth. This can be perceived as a sign of gradual improvement in economic performance. The lowest growth was recorded in 1Q99 – 1.5% according to the Central Statistical Office (CSO) (our April estimate was 1.6%). In the first-half of 1999 GDP increased 2.3% – the worst result since mid-1992.

In the period 4Q97–2Q98, as a result of the improved economic performance of the EU, the importance of the external environment to economic growth in Poland increased. Nevertheless, beginning in 3Q98, following the Russian crisis and the ensuing contraction in Polish exports, the main determinants of Polish economic growth were again internal, i.e. domestic demand (defined as the sum of consumption and accumulation). Consumption is defined as the sum of private consumption (i.e. the sum of households' and non-commercial institutions' consumption) and public consumption (i.e. consumption of central and local governments institutions). Accumulation is defined as the sum of investment (gross outlays in fixed assets, changes in livestock inventories and intangible assets) and stockbuilding.

Faster economic growth was mainly the result of measures aimed at strengthening domestic demand that had been taken by the NBP since 4Q98. In our opinion, reductions in nominal official interest rates and the lowering of interest rates in the interbank market boosted bank credits and reduced significantly the propensity to save in 2Q99. The influence of interest rate changes was, to a certain extent, tempered by weaker demand (compared to the previous year) from the government sector and weaker investment (see Table 8 for detailed data on the dynamics of basic components of aggregate demand). Other factors hindering a faster recovery from the external shock are the low level of exports to Russia and other East European countries following the collapse in 4Q98 as well as the weak performance of EU economies, notably Germany and Italy.

In our view, an analysis of trends in the basic macroeconomic aggregates indicates that the Polish economy has adjusted fairly quickly to slower economic growth stemming from the external shock. We estimate domestic demand growth of 3.4% in 2Q99.

Domestic demand growth was much lower than in last three years and the extent of its decline was larger than the GDP decline. Consequently the gap between the two growth rates narrowed to 0.4 percentage points in 2Q99. Hence the situation returned to the one present before the Russian crisis. For reference – in the first two quarters

of 1998 the gap amounted to 1.0 and 0.4 percentage points respectively, while just after the crisis it widened to 3.8 percentage points in 4Q98 and 1.7 percentage points in 1Q99.

The increase in domestic demand in 2Q99 was fuelled mainly by higher investment and consumption demand. The level of investment remains high, even though its growth has slowed markedly in comparison to the previous four years. We estimate that in the first two quarters of 1999 investment outlays increased 6.0% and 5.5% respectively. The growth of investment outlays in buildings and other construction (especially in the case of projects carried out by large companies) was considerably lower. On the other hand, growth of outlays in machinery and transport equipment was slightly higher. Lower growth in investment is attributable to the stabilisation of foreign investment, the reduction of corporate profits, and relative increases in the price of investment goods (mainly due to the depreciation

Table 8. Components of the aggregate demand, 1996–2000

		GDP	Domestic demand	Private consumption	Public consumption	Investment in fixed assets
1996	1Q-4Q	6.0	9.5	8.3	3.4	19.5
1997	1Q–4Q	6.8	9.3	6.9	3.4	21.7
1998e 1	1Q–4Q	4.8	6.5	4.9	1.5	14.5
forecast						
1999	*1Q–4Q*	*3.6*	*3.8*	*3.9*	*1.5*	*7.9*
2000	*1Q–4Q*	*5.4*	*5.5*	*4.1*	*1.5*	*10.6*
1996	1Q	3.3	6.9	6.9	2.4	12.9
	2Q	5.3	8.8	7.0	5.4	20.1
	3Q	7.1	10.2	8.1	3.4	25.2
	4Q	7.9	11.6	10.8	2.4	19.1
1997	1Q	6.9	7.9	6.7	3.5	19.6
	2Q	7.5	9.0	7.1	3.7	21.0
	3Q	6.7	9.2	7.0	3.6	21.2
	4Q	6.4	10.6	6.6	2.6	23.2
1998e 1	1Q	6.4	7.4	6.4	2.1	17.5
	2Q	5.4	5.8	4.1	1.5	14.9
	3Q	5.0	6.2	4.5	1.4	14.6
	4Q	2.9	6.7	4.6	1.0	13.1
1999e2	1Q	1.5	3.2	4.2	1.4	6.0
	2Q	3.0	3.4	4.0	1.5	5.5
forecast						
1999	*3Q*	*3.9*	*3.9*	*3.8*	*1.6*	*7.6*
	4Q	*5.7*	*4.4*	*3.6*	*1.5*	*10.3*
2000	*1Q*	*5.3*	*4.9*	*3.8*	*1.5*	*11.0*
	2Q	*5.2*	*5.1*	*4.0*	*1.4*	*10.6*
	3Q	*5.2*	*5.3*	*4.2*	*1.5*	*10.2*
	4Q	*5.8*	*6.3*	*4.4*	*1.6*	*10.6*

Source: Data and estimates (e1) – CSO; estimates (e2) and forecasts – CASE.
Notes: 1. Data in 1997 prices.
2. % change yoy.
3. Domestic demand is defined as the sum of private consumption (consumption of households and non-commercial institutions), public consumption and investment. This table does not provide separate indicators for the consumption of non-commercial institutions.
4. Data are not seasonally adjusted.

of the zloty in the February–May period and thus higher costs of imports). Sustaining the high level of investment outlays was possible due to the continued rise in enterprises' indebtedness.

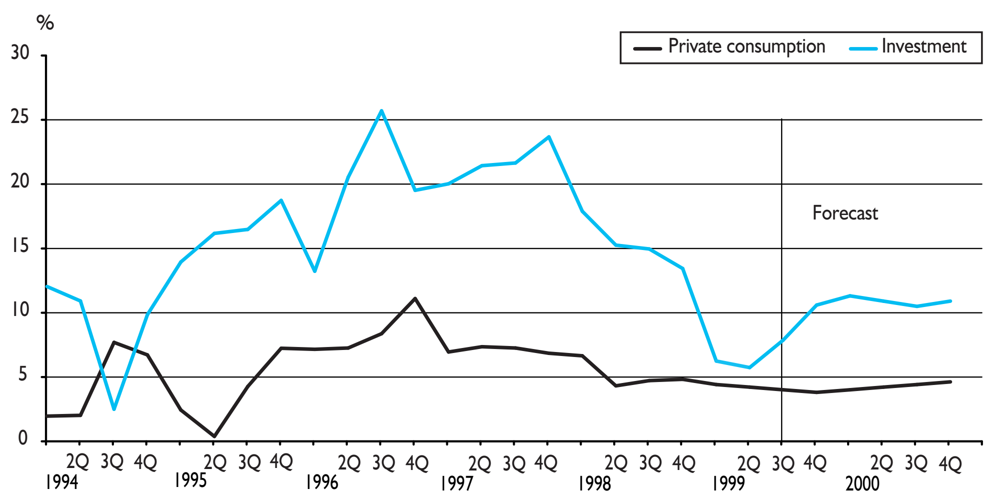
We estimate that households' consumption (private consumption) grew 4.0% yoy in 2Q99. Its rate of growth was thus higher than the rate of GDP growth. The same holds true for 1Q99. The maintenance of such a high rate of growth resulted largely from the sharp reduction in households' propensity to save. This phenomenon is not good for the Polish economy but we think than in the following quarters real income (and thus the propensity to save) may reverse itself again.

In line with the four-year trend, the growth of public consumption was significantly slower than other components of domestic demand. Nevertheless, regardless of budgetary problems and the higher-than-expected costs of introducing social reforms, its rate of growth was the same as in 1998.

Figure 1. GDP and domestic demand, 1994–2000 (% change)

Source: CSO and CASE.
Note: CASE forecast starting from 3Q99.

Figure 2. Private consumption and investments, 1994–2000 (% change)



Source: CSO and CASE.
Note: CASE forecast starting from 3Q99.

In 2Q99, as in 1Q99, stockbuilding was noticeably slower than a year ago. This indicates that the Polish economy adjusts relatively well to lower demand (see Table 8).

We expect GDP growth to slow to 3.6% in 1999. This is slightly less than in our previous forecast three months ago (3.7%) and represents the second consecutive downward revision. Our forecast is also more pessimistic than the 5.1% assumed in the 1999 Budget Act and the current Ministry of Finance forecast of 4.0%. Nevertheless, we are more optimistic than most western observers as well as the Government Centre for Strategic Studies (GCSS). We expect that GDP growth will pick up again, reaching 4.8% in the second-half of 1999. In the first and second-half of 2000 economic growth may reach 5.3% and 5.6% respectively. Faster GDP growth in the second-half of 1999 – a period in which no major development-enhancing impulses are expected – will be attributable mainly to the maintenance of growth trends similar to those prevailing in 1Q99. In addition, the second-half of 1998 (the period from which comparisons will be made) witnessed poor economic performance. An additional factor will be the presence of export-enhancing developments we expect to occur in the second-half of the year.

Domestic demand growth will decrease to 3.8% in 1999 and then rise to 5.5% in 2000. In 1998 it stood at 6.6%. Investment outlays will record the highest growth rate – amounting to roughly 8% and 12% in 1999 and 2000 respectively. Private consumption will, in turn, grow at a lower rate than in 1998 (reaching 3.9% and 4.1% in 1999 and 2000 respectively). The gap between GDP and domestic demand growth will thus narrow in 1999 and 2000 – in contrast to 1998.

Contributions to GDP are shown in Table 9. The results presented in the table should be interpreted as follows: (e.g.) in 1999 domestic demand would, *ceteris paribus*, result in GDP growth of 2.5%, etc. One must remember that the growth rates of macroeconomic aggregates are related to the GDP level in the previous year and that the sum of the growth rates of all components of demand (domestic demand, inventories and foreign demand) should equal the total GDP growth rate.

The contribution of consumption to GDP growth in 1999–2000 will be lower than in 1996–1998. We expect this figure to fall to 2.5% in 1999 and then to slightly increase to 2.6% in 2000.

Investment contributed to 3.4% GDP growth, thus more than private consumption. We expect that this will reverse itself in 1999 with investment contribution falling to 2.0%. In 2000 it should reach 2.8%. The decreasing investment contribution to economic growth throws into question the government's long-term economic strategy, in particular the goal of achieving annual growth of 7%.

A substantial deterioration of export dynamics in the last four months of 1998 resulted in the lowest contribution of exports to GDP growth since 1991. In addition, the negative impact of imports diminished. As a consequence the

Table 9. Contributions to GDP growth, 1996–2000 (%)

	GDP	Private consumption	Public consumption	Investment in fixed assets	Stock-building	Net exports	Exports	Imports
1996 1Q–4Q	6.0	5.1	0.6	3.6	0.2	-3.4	2.8	-6.2
1997 1Q–4Q	6.8	4.3	0.6	4.5	0.1	-2.6	3.0	-5.6
1998 1Q–4Q	4.8	3.1	0.3	3.4	0.1	-2.0	0.7	-2.7
forecast								
1999 1Q–4Q	*3.6*	*2.5*	*0.2*	*2.0*	*-0.8*	*-0.4*	*0.5*	*-0.9*
2000 1Q–4Q	*5.4*	*2.6*	*0.2*	*2.8*	*0.1*	*-0.4*	*1.7*	*-2.1*

Source: CSO (GDP) and CASE (other data).
*Notes: 1. Contributions to GDP growth were calculated using the following formula: (annual increase of X / annual increase in GDP) * rate of growth of X.*
2. GDP growth and the sume of contributions to GDP may not square due to approximations.

overall effect of foreign demand was negative (–2.0%) in 1998. We expect that this negative impact will be reduced to around (–0.4)% in 1999–2000 as a result of slower growth in imports.

The cooling down of the economy resulted in slower growth in household nominal and real incomes (see Table 10). We estimate real disposable income growth at nearly 6% in 4Q98, i.e. over 2 percentage points less than the average for 1997. Nevertheless, it took two quarters for the full effect of slower GDP growth to filter down to real incomes. We estimate the latter to contract by around 2.0% in 2Q99 as a result of the external shock. Such a substantial deterioration in the dynamics of real incomes resulted primarily from the lower profits of enterprises. Wages and social transfers, on the other hand, served to stabilise real income.

Table 10. Household disposable income, 1996–2000

		Disposable income	Wages	Social benefits	Savings rate	Real disposable income
		% change	% change	% change	%	% change
1996	1Q–4Q	24.9	30.7	23.2	12.8	4.2
1997	1Q–4Q	23.4	23.8	19.7	13.4	7.4
1998	1Q–4Q	16.8	17.3	15.3	13.2	4.5
forecast						
1999	*1Q–4Q*	*8.8*	*10.7*	*9.9*	*10.6*	*2.1*
2000	*1Q–4Q*	*11.8*	*10.1*	*8.6*	*11.4*	*5.7*
1996	1Q	25.0	34.8	25.6	14.2	3.6
	2Q	25.8	38.8	20.1	11.9	4.9
	3Q	23.7	31.7	22.7	10.5	3.0
	4Q	25.1	24.3	25.2	14.4	5.0
1997	1Q	21.7	23.0	19.0	12.4	3.9
	2Q	25.1	19.8	22.4	13.0	8.7
	3Q	24.0	25.5	22.3	12.3	8.5
	4Q	22.9	22.7	16.6	15.7	8.6
1998	1Q	20.3	20.9	17.0	11.6	5.6
	2Q	16.5	17.9	15.4	12.5	3.0
	3Q	15.6	15.5	14.1	11.8	4.0
	4Q	15.5	15.0	14.9	16.8	5.7
1999	1Q	15.4	8.7	12.6	13.2	8.7
	2Q	4.2	9.5	11.6	8.7	-2.1
forecast						
1999	*3Q*	*9.2*	*10.7*	*10.3*	*9.2*	*2.3*
	4Q	*10.4*	*10.0*	*9.4*	*11.7*	*3.3*
2000	*1Q*	*6.3*	*9.6*	*8.3*	*10.8*	*0.0*
	2Q	*15.1*	*10.0*	*6.9*	*11.4*	*8.8*
	3Q	*10.8*	*10.4*	*7.2*	*11.5*	*4.9*
	4Q	*11.3*	*10.6*	*7.8*	*13.1*	*5.5*

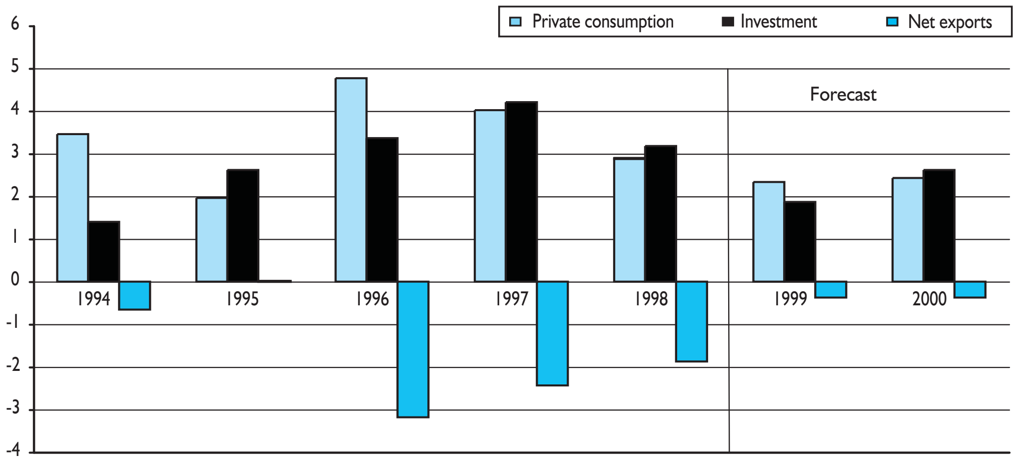
Source: Annual data – CSO, quarterly data and forecast – CASE.
Notes: 1. % change yoy.
2. The savings rate is shown as a percentage of nominal disposable income.

Because inflation will be growing faster than nominal income, we forecast a slowdown in the dynamics of real income in 1999 (see discussion in the section on prices). A slower increase in real incomes mirrors weaker economic growth. Some revival in income growth is expected from the beginning of 2000.

For the first time since the start of the transition net household savings (calculated as the difference between growth of deposits denominated in zlotys and foreign currencies, cash in circulation (excluding vault cash) and growth of credits) decreased. Lower savings resulted from the controversial decision by the NBP to cut interest rates in January 1999 as well as from the contraction in household real incomes.

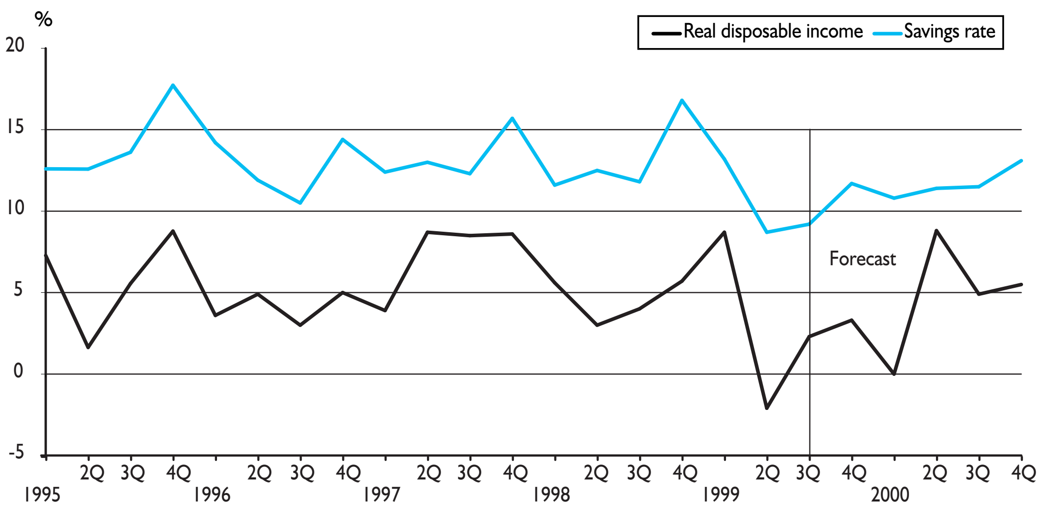
In the forecast period, households' propensity to save will be reduced, primarily as a result of lower nominal and real interest rates.

Figure 3. Contributions to GDP growth, 1994–2000 (%)



Source: CSO and CASE.
Note: CASE forecast starting from 1999.

Figure 4. Change in household real disposable income and savings rate, 1995–2000 (%)



Source: CSO and CASE.
Note: CASE forecast starting from 3Q99.

Value-added

- Domestic demand-led growth
- Industrial production expands after two quarters of decline
- Production in construction sector picks up
- Market services stabilise economic growth
- Faster value-added growth in 2000

In 1Q99, total value-added increased 1.3% yoy. This was the lowest growth figure since 3Q93 and, if we disregard the effects from the introduction of VAT, the lowest since 3Q92.

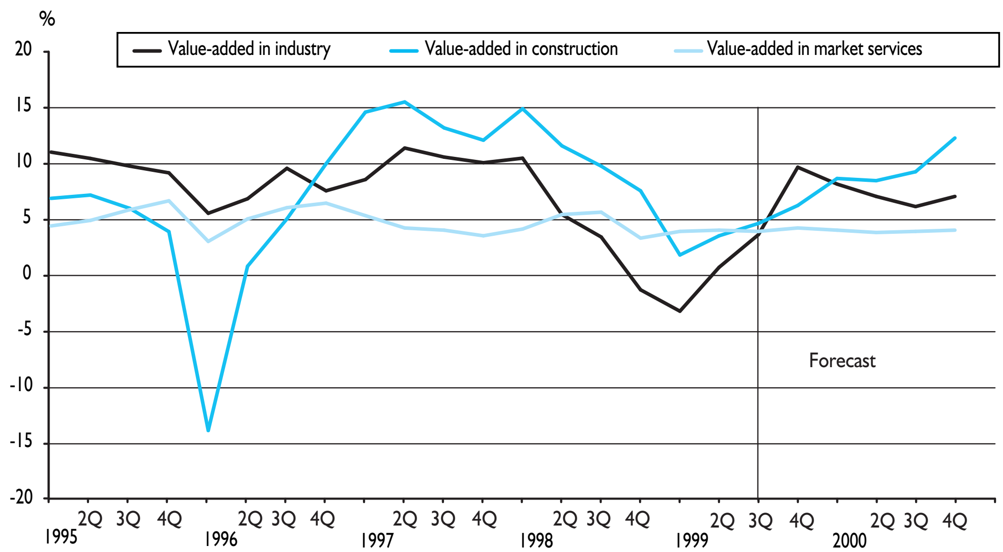
We estimate the growth of value-added in the whole economy at 2.7% in 2Q99. The value-added in non-agricultural sectors (i.e. excluding agriculture, forestry, hunting, offshore and inland fishery) increased 2.6%. As in the previous quarters, the growth in major non-agricultural sectors varied from sector to sector. It was higher in market services which include trade and telecommunications (4.2% growth) and in construction (3.7%). Non-market services performed below average. Details are presented in Table 11.

Sold industrial production of enterprises with more than 5 employees experienced an increase of 1.2% yoy in 2Q99 after two consecutive quarters of contraction (see Table 12). The collapse of exports to the east was again the main reason behind the poor results of the manufacturing sector. Moreover, developments in the mining sector (sales decreased 7.1%) contributed significantly to lower output growth. Sold production of the manufacturing sector grew faster (1.9% yoy) than the average for the entire industry.

In 1Q99, large enterprises (i.e. those with more than 20 employees) in the construction sector reported the worst results since 1996. According to CSO estimates, their production grew 4% in 2Q99 compared to 2Q98 (see Table 12). The weaker results in 1Q99 stemmed from both lower investment demand and unfavourable weather conditions. We estimate that in 1Q99 value-added in all construction enterprises (including construction of households and small firms) increased 3.7%.

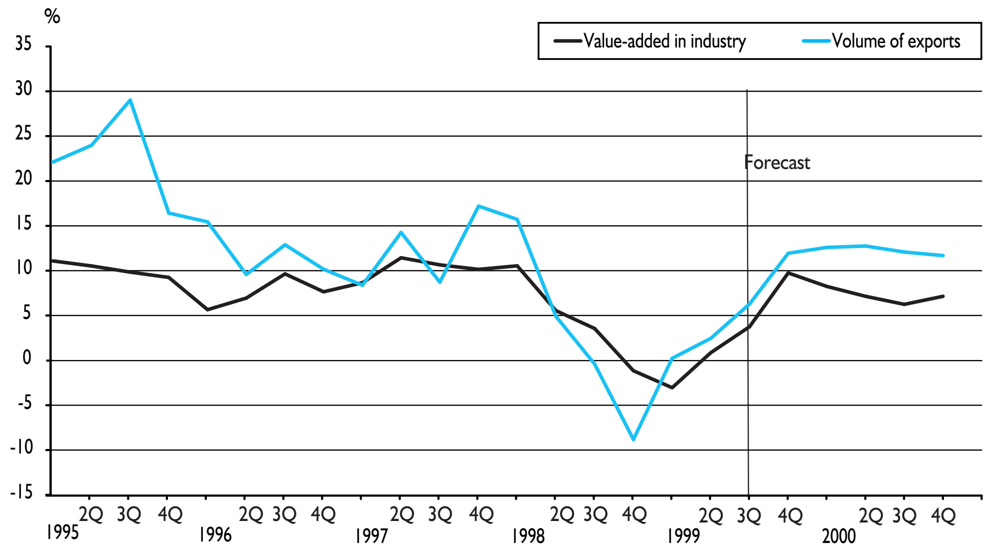
Stable growth of consumption demand benefited the development of large trade companies. The CSO estimates growth of retail sales in this sector at above 10% in 1Q99 and

Figure 5. Value-added in major sectors of the economy, 1995–2000 (% change)



Source: CSO and CASE.
Note: CASE forecast starting from 3Q99.

Figure 6. Value-added in industry and volume of exports, 1995–2000 (% change)



Source: CSO and CASE.
Note: CASE forecast starting from 3Q99.

our estimate for 2Q99 is above 14%. Larger enterprises experienced faster-than-average growth in sales, which supported the trend of increased consolidation in the sector. We estimate that value-added in the trade sector grew over 4% in 2Q99.

The demand for transport services was lower, mainly as a result of the substantial drop in coal shipments and lower exports (and thus reduced freight transportation) to the east (see Table 12). Communication (mainly telecommunication) services continued to expand at a fast rate. According to our estimates, the value-added in the transport sector contracted more than 3% while in the communication sector as a whole it expanded by more than 9% in 2Q99.

The value-added in non-market services (i.e. state administration, education and health services) increased 1.2% in 2Q99, i.e., slightly faster than in 1Q99.

We expect growth of total value-added to drop from 4.8% in 1998 to 3.4% in 1999. In the non-agricultural sectors the figures are 4.3% and 3.5% respectively. One can expect continued low growth of value-added in 3Q and a revival in 4Q. In 2000 we forecast 5.2% growth with the second-half of the year registering better results than the first. This improvement will be driven by industry (value-added growing 3.0% and 7.2% in 1999 and 2000) and construction (growth of 4.7% and 10.2% respectively). In addition, faster growth of the value-added in industry and construction in the second-half of 1999 will constitute an important factor improving the overall figure in this period.

Unlike in other sectors of the economy, growth of the value-added in market services will remain stable, reaching 4.2% and 4.1% in 1999 and 2000. It will therefore follow closely the trend witnessed in 1996–1998 when the figure varied from 4.4% to 5.6%. We expect that communication, trade and hotel services will continue to develop rapidly, with transport and services related to real estate and business activities growing at a somewhat slower pace.

The growth of the value-added in non-market services may be lower than in the three preceding years. We expect that a more efficient allocation of employment and supply of services stemming from the educational system and health care reforms will lower growth of value-added to little over 1% in 1999–2000.

Table 11. GDP and value-added in major sectors of the economy, 1996–2000 (% change)

		GDP		Value-added				
				total	industry	construction	market services	non-market services
		zloty billion	%	%	%	%	%	%
1996	1Q–4Q	385	6.0	5.3	7.6	2.8	5.4	2.7
1997	1Q–4Q	469	6.8	6.5	10.3	13.6	4.4	3.0
1998e1	1Q–4Q	551	4.8	4.5	4.4	10.2	4.7	0.1
forecast								
1999	*1Q–4Q*	*606*	*3.6*	*3.4*	*3.0*	*4.7*	*4.2*	*1.1*
2000	*1Q–4Q*	*680*	*5.4*	*5.2*	*7.2*	*10.2*	*4.1*	*1.6*
1996	1Q	85	3.3	3.0	5.7	-13.6	3.2	2.4
	2Q	92	5.3	5.2	7.0	1.0	5.2	1.8
	3Q	98	7.1	6.3	9.7	5.2	6.2	2.9
	4Q	111	7.9	6.5	7.7	10.1	6.6	3.4
1997	1Q	103	6.9	6.4	8.7	14.7	5.5	4.7
	2Q	112	7.5	6.7	11.5	15.6	4.4	1.8
	3Q	118	6.7	6.4	10.7	13.3	4.2	0.7
	4Q	136	6.4	6.3	10.2	12.2	3.7	4.0
1998e1	1Q	123	6.4	6.2	10.6	15.0	4.3	1.6
	2Q	133	5.4	5.1	5.6	11.7	5.6	-2.0
	3Q	139	5.0	4.7	3.6	9.9	5.8	-0.4
	4Q	156	2.9	2.7	-1.1	7.7	3.5	0.7
1999e2	1Q	133	1.5	1.3	-3.0	2.0	4.1	0.9
	2Q	145	3.0	2.7	0.9	3.7	4.2	1.2
forecast								
1999	*3Q*	*153*	*3.9*	*3.6*	*3.8*	*4.8*	*4.1*	*1.1*
	4Q	*175*	*5.7*	*5.5*	*9.8*	*6.4*	*4.4*	*1.1*
2000	*1Q*	*150*	*5.3*	*5.1*	*8.3*	*8.8*	*4.2*	*1.5*
	2Q	*163*	*5.2*	*4.9*	*7.2*	*8.6*	*4.0*	*1.6*
	3Q	*171*	*5.2*	*5.0*	*6.3*	*9.4*	*4.1*	*1.8*
	4Q	*196*	*5.8*	*5.6*	*7.2*	*12.4*	*4.2*	*1.7*

Source: Data and estimates (e1) – CSO; estimates (e2) and forecasts – CASE.
Notes: 1. Data in 1997 prices.
2. % change yoy.
3. Data are not seasonally adjusted.

Table 12. Selected short term indicators of the Polish economy, 1996–2000 (% change yoy)

		Output		Transport		Corporate sector	
		industry	construction	freight	passengers	average employment	real gross wages
1996	1Q–4Q	8.3	3.0	0.3	-4.9	0.4	5.8
1997	1Q–4Q	11.5	16.5	1.5	-2.4	3.6	5.5
1998e 1	1Q–4Q	4.6	11.4	-3.4	-2.9	0.3	3.7
forecast							
1999	*1Q–4Q*	3.4	3.9	-4.0	-2.1	0.0	3.3
2000	*1Q–4Q*	7.3	6.7	2.6	-1.2	0.3	4.3
1996	1Q	8.9	-17.7	-5.2	-3.3	-0.6	6.6
	2Q	7.4	6.5	0.3	0.3	-1.3	5.6
	3Q	10.3	15.8	-1.2	-6.3	-0.9	6.0
	4Q	8.9	18.4	3.3	-2.3	-0.6	5.2
1997	1Q	7.9	19.6	3.8	-5.4	1.0	4.2
	2Q	13.9	24.9	3.9	-4.1	1.4	5.6
	3Q	11.8	13.3	-1.8	-4.6	1.7	6.7
	4Q	11.2	13.9	0.5	-4.7	0.6	5.3
1998e 1	1Q	10.9	24.0	-5.6	-2.0	1.9	4.4
	2Q	6.0	10.2	-5.7	-2.5	1.7	3.3
	3Q	3.9	13.2	1.5	-2.6	1.0	3.6
	4Q	-0.8	4.4	-4.7	-4.4	1.6	3.7
1999e2	1Q	-3.1	0.6	-3.7	-0.4	-0.4	2.5
	2Q	1.2	4.0	-6.8	-3.0	-1.2	3.8
forecast							
1999	*3Q*	*4.2*	*5.1*	*-7.8*	*-2.9*	*-0.5*	*3.6*
	4Q	*10.3*	*5.5*	*-3.0*	*-2.1*	*-0.1*	*3.2*
2000	*1Q*	*8.6*	*8.0*	*0.6*	*-2.4*	*0.9*	*3.5*
	2Q	*7.4*	*5.4*	*3.5*	*0.5*	*1.7*	*4.2*
	3Q	*6.5*	*5.8*	*3.0*	*0.6*	*1.0*	*4.6*
	4Q	*7.4*	*6.4*	*2.8*	*0.8*	*0.7*	*4.7*

Source: Data and estimates (e1) – CSO; estimates (e2) and forecasts – CASE.
Notes: 1. Data on construction and assembly and transportation calculated from the monthly data.
2. Changes calculated from data published in Statistical Bulletin (CSO).
3. Annual data on average employment relate only to enterprises classified as "large enterprises" (e.g. in industry – those with more than five employees).

Labour market

- **Weak labour demand**
- **Unemployment higher than a year ago**
- **Forecast of stabilising unemployment**

In 2Q99, labour demand was still low (see Table 13). Average employment fell 0.8% in this period (applying the CSO definition as used in the Statistical Bulletin states; employed category comprises employment in large enterprises and the government sector).

We estimate that average employment in non-agricultural sectors (including all enterprises) decreased by around 20,000 (0.2%) in 2Q99 compared to 2Q98. In comparison with 1Q99, employment grew by around 190,000 which is less than the increase of roughly 250,000 between 1Q98 and 2Q98. The lower growth figure resulted primarily from the slowdown in the economy.

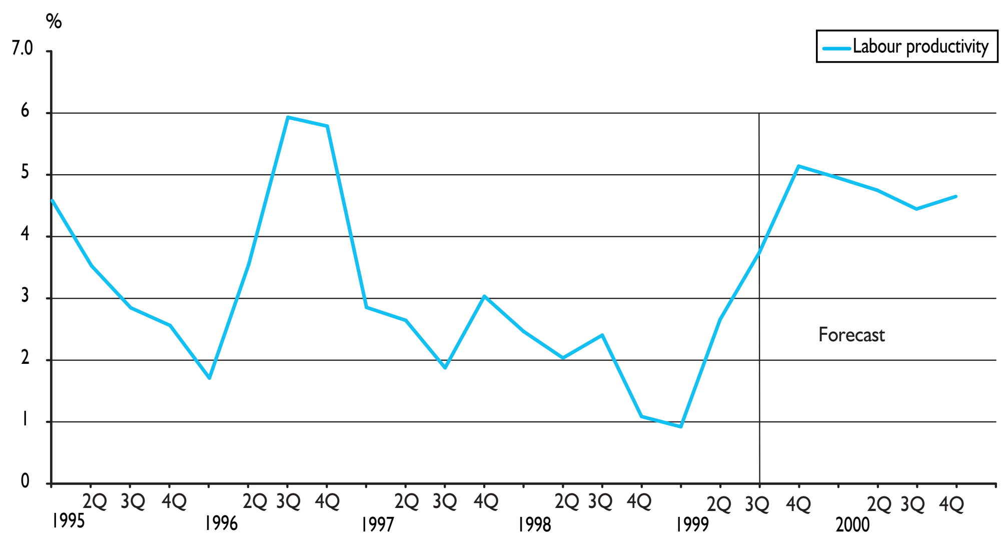
Weak labour demand is also reflected in the growing number of people out of work. According to the Labour Force Survey (LFS), the unemployment rate increased to 12.5% in February 1999 (it was 10.3% in August and 10.6% in November 1998).

At the end of May the number of people registered as unemployed amounted to 2073.1 thousand and was 49.1 thousand (2.31%) lower than the April-end figure. This resulted in registered unemployment falling 0.2 percentage points to 11.6% in the same period. May was the second month this year when a decrease in the number of unemployed was recorded. The highest number was registered in March (2170.4 thousand) when the official unemployment rate amounted to 12.1%. Regrettably, in June the declining trend in unemployment reversed itself with the figure growing slightly to 2074.0 thousand. The official unemployment rate did not change.

At the June-end 1597.5 thousand or 77.0% of all unemployed were not eligible for unemployment benefits. This share has been stable since May 1998.

487.7 thousand or 23.4% of all registered unemployed had not worked before. The share of this category (among all registered) increased since end-May by 23.6 thousand, i.e. 1.2 percentage points. In addition, the number of people who became jobless due to reasons related to their firms increased to 148.9 thousand or 7.2% of all registered unem-

Figure 7. Labour productivity in non-agricultural sectors of the economy, 1995–2000 (%)



Source: CSO and CASE.
Note: CASE forecast starting from 3Q99.

ployed (at end-May the corresponding figures were 147.8 thousand and 7.1%).

In June the number of newly registered unemployed increased considerably to 189.7 thousand, while in April and May it amounted to 144.5 and 148.4 thousand respectively. At the same time, the number of those de-registering as unemployed decreased slightly. This means that the growth of unemployment at the end of 2Q99 was mainly the result of higher levels of entry into the labour market of people who had not worked previously.

The above tends to indicate that a revival in the labour market usually observed in the spring proved weaker in 1999. This does not support the hypothesis of a long-term positive trend in the Polish labour market. These facts may indicate a stagnation of the labour market in the months to come with stable or slightly increasing unemployment in July partly as a result of the higher number of graduates entering the labour market. Some improvement in this area might be observed at the end of 3Q99.

Employment

The observation of a weak spring resurgence in the labour market this year can be supported by an analysis of the last few months' employment figures in enterprises. In June 1999, employment in this sector totalled 5,771 thousand and hus represented a drop of 8,000 since end-May. The trend of falling monthly employment figures has been observed since February. It should be noted that this results primarily from reduced employment in industry.

The negative trend mentioned above will be maintained as a result of mass lay-offs in enterprises. According to the May National Labour Office data, 260 public enterprises and 209 private companies plan to reduce employment in the near future by 18,840.

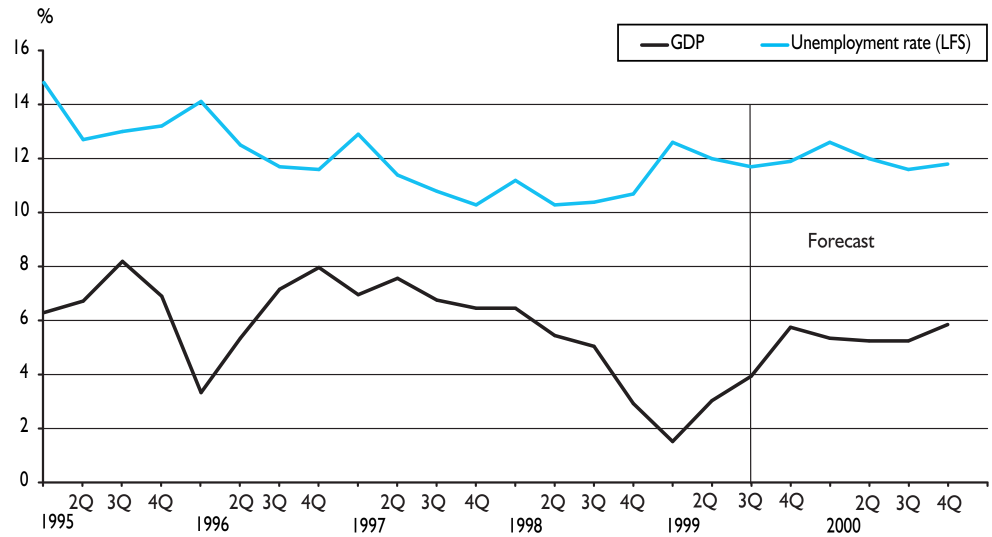
Additional problems in the coming months stem from expected lay-offs in the health care sector. The number of dismissals amounted to 20,906 by end-May and there are plans to dismiss a further 3,000 workers in the near future.

Regional differentiation

The highest unemployment by end-June was recorded in Warminsko-Mazurskie and Zachodniopomorskie voivodships (21.0% and 15.5% respectively). The lowest rate was in Slaskie (8.5%) and Mazowieckie (8.6%) voivodships.

Administrative reforms make it difficult to analyse regional labour markets in the long-term. Nevertheless, an interest-

Figure 8. GDP and unemployment rate (LFS), 1995–2000 (%)



Source: CSO and CASE.
Note: CASE forecast starting from 3Q99.

ing observation can be advanced. Since the end of December 1998, the highest relative increase in unemployment was recorded in Slaskie voivodship – 19.3% as opposed to 13.2% in the whole Poland, while the highest absolute growth was in Lubuskie voivodship. Taking into account the special significance of Slaskie voivodship in the process of restructuring the economy, coupled with the above-mentioned trend of a fast relative decline in industrial employment, this may indicate the beginning of restructuring. In the future this is likely to result in increased unemployment in the voivodship, as well as in Poland as a whole.

Labour demand will be reduced in 1999 due to slower economic growth. We forecast that the average number of employed will decrease 0.1 percentage point and average employment in non-agricultural sectors will expand 0.2 percentage point. The revival in growth in 2000 will again increase labour demand. Average total employment and employment in non-agricultural sectors will grow 0.1 and 0.5 percentage points respectively.

Lower demand for labour will result in increased unemployment. At the end of 1999, registered unemployment will reach

Table 13. Components of the labour market, 1996–2000

		Employment		Registered unemployment	Unemployment rate	
					registered	LFS
		thousand	% change	thousand	%	%
1996	1Q–4Q	15021	1.9	2360	13.2	11.5
1997	1Q–4Q	15439	2.8	1826	10.3	10.2
1998	1Q–4Q	15491	0.3	1831	10.4	10.6
forecast						
1999	*1Q–4Q*	*15463*	*-0.2*	*2060*	*11.6*	*11.8*
2000	*1Q–4Q*	*15586*	*0.8*	*2067*	*11.5*	*11.7*
1996	1Q	14682	-2.0	2726	15.4	14.0
	2Q	14932	1.7	2508	14.3	12.4
	3Q	15083	1.0	2341	13.5	11.6
	4Q	15386	2.0	2360	13.2	11.5
1997	1Q	15048	-2.2	2236	12.6	12.8
	2Q	15374	2.2	2040	11.6	11.3
	3Q	15594	1.4	1854	10.7	10.7
	4Q	15739	0.9	1826	10.3	10.2
1998	1Q	15276	-2.9	1846	10.4	11.1
	2Q	15479	1.3	1688	9.6	10.2
	3Q	15551	0.5	1677	9.6	10.3
	4Q	15657	0.7	1831	10.4	10.6
1999	1Q	15163	-3.2	2170	12.1	12.5
	2Qe	15410	1.6	2070	11.6	11.9
forecast						
1999	*3Q*	*15568*	*1.0*	*1990*	*11.3*	*11.6*
	4Q	*15712*	*0.9*	*2060*	*11.6*	*11.8*
2000	*1Q*	*15275*	*-2.8*	*2199*	*12.2*	*12.5*
	2Q	*15528*	*1.7*	*2093*	*11.6*	*11.9*
	3Q	*15698*	*1.1*	*2000*	*11.2*	*11.5*
	4Q	*15845*	*0.9*	*2067*	*11.5*	*11.7*

Source: Annual data – CSO, quarterly employment data, estimates (e) and forecast – CASE.
Note: LFS – labour force survey.

11.6% (a 1.2 percentage point increase from end-1998). The unemployment rate measured according to LFS methodology will grow from 10.6% to 11.8% in the same period. In 2000, we expect a further increase in unemployment – to 12.1% (based on the registry) and 12.3% (LFS methodology).

An acceleration in industrial restructuring (in both state-owned and private enterprises) will further reduce demand for labour and lead to higher unemployment. Nevertheless, the situation in the labour market can be perceived as stable. The only source of concern is slowing growth in productivity in non-agricultural sectors. A further slowdown in growth should be perceived as a serious threat to effectiveness-enhancing processes.

Prices

- **Stabilisation of inflation in 1999**
- **Higher growth of export and import prices**
- **Forecast of a further drop in prices in 2000**

CPI continues to grow at a lower rate than forecast in the 1999 Budget Act. However, starting from February 1999 when CPI increased 5.6% the rate of inflation kept on growing up to reach 6.5% yoy.

The main factors behind accelerating inflation were:

- **increasing prices of imports** resulting from, on the on hand, a weakening zloty in 1Q99 and, on the other, increasing world oil and commodity prices;
- **increase of the excise tax on fuels**;

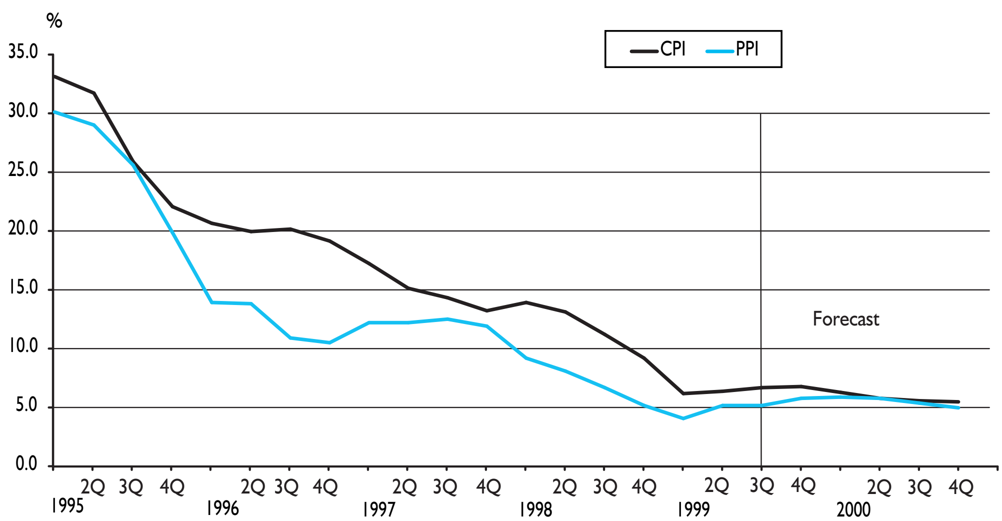
while the main factors suppressing inflation were:

- **bumpier harvest in agriculture which**, coupled with the Russian crisis and falling exports, caused a substantial increase in the supply of agricultural products, particularly meat, to the domestic market;
- **slower growth of base prices** (in relation to CPI) in Polish industry, especially in the manufacturing sector.

PPI followed the trend in CPI and grew 5.2% yoy in 2Q99 (detailed time-series data are provided in Table 14).

The ratio of procurement prices in agriculture to manufacturing prices continues to be less advantageous for farmers. The prices of foodstuffs grew very slowly in 2Q99 and fell 1% yoy in April, 0.7% in May and 0.2% in June. The highest drop was recorded in meat prices, in particular poultry

Figure 9. CPI and PPI, 1995–2000 (% change yoy)



Source: CSO and CASE
Note: CASE forecast starting from 3Q99.

(10.7% and 13.4% in April and May yoy respectively). Fruit prices experienced the fastest growth: 15.5% in April and 20.6% in May yoy.

Rents increased 19.8% in April and 20.2% in May. In addition, fuel prices rose 12.5% in April, 18.8% in May and 22.2% in June yoy.

The prices of non-food products rose slightly faster than CPI (7.9% in April and 8.1% in May yoy). On the other hand, prices of services grew considerably faster: 11.1% in April and May and 11.2% in June.

Average price levels in 2Q99 were affected by many factors. The domestic market experienced an excess supply of foodstuffs which was a consequence of a contraction in exports to eastern markets. A rise in procurement prices in agriculture did not lead to a corresponding increase in retail prices due to falling demand for foodstuffs and increased competition among retailers (the effect of an increasing number of supermarkets).

World oil prices displayed an upward trend. This was the result of OPEC countries' adherence to production quotas as well as falling oil inventories in the US. In 1Q99 Russia increased its oil production. In due course, however, it complied with the

Table 14. Basic price indicators, 1996–2000 (% change yoy)

		CPI	PPI	Price indices		Currency basket	GDP deflator
				of exports	of imports		
1996	1Q–4Q	19.9	12.4	8.1	11.1	9.3	18.6
1997	1Q–4Q	14.9	12.2	12.9	13.6	16.0	14.0
1998	1Q–4Q	11.8	7.3	6.8	2.4	6.1	12.0
forecast							
1999	*1Q–4Q*	*6.5*	*5.1*	*8.8*	*7.4*	*7.9*	*6.2*
2000	*1Q–4Q*	*5.8*	*5.5*	*4.6*	*3.9*	*2.9*	*6.3*
1996	1Q	20.6	13.9	6.1	7.3	5.3	18.4
	2Q	19.9	13.8	8.3	7.7	8.9	18.5
	3Q	20.1	10.9	12.4	10.4	11.3	15.7
	4Q	19.1	10.5	5.3	17.4	11.5	21.5
1997	1Q	17.2	12.2	11.7	13.0	13.6	13.8
	2Q	15.1	12.2	11.9	12.2	14.3	13.2
	3Q	14.3	12.5	13.6	15.0	18.1	13.4
	4Q	13.2	11.9	14.3	14.2	17.6	15.2
1998	1Q	13.9	9.2	10.4	9.9	13.1	12.3
	2Q	13.1	8.1	8.1	3.2	6.7	12.4
	3Q	11.2	6.7	6.0	-0.1	3.9	11.8
	4Q	9.2	5.2	3.9	-1.4	1.6	11.8
1999	1Q	6.2	4.1	8.0	2.6	9.0	6.6
	2Qe	6.4	5.2	10.3	10.0	12.5	6.2
forecast							
1999	*3Q*	*6.7*	*5.2*	*11.0*	*11.0*	*5.5*	*6.1*
	4Q	*6.8*	*5.8*	*6.0*	*6.0*	*4.6*	*5.9*
2000	*1Q*	*6.3*	*5.9*	*5.0*	*5.2*	*1.8*	*6.9*
	2Q	*5.8*	*5.8*	*5.0*	*4.0*	*0.8*	*6.7*
	3Q	*5.6*	*5.4*	*4.5*	*2.0*	*3.9*	*5.9*
	4Q	*5.5*	*5.0*	*4.0*	*4.5*	*4.9*	*5.9*

Source: Annual data – CSO; GDP deflator, estimates (e) and forecasts – CASE.
Note: Currency basket over 1996–98 consists: 55% of USD and 45% of DM, and from 1999: euro – 55% and USD – 45%.

quotas. The rise in world oil prices, coupled with increase in excise tax on fuels together with the weak zloty, caused fuel prices to rise. The latter resulted in inflation in transport prices.

The end of 1Q99 witnessed a rise in state-administered prices in housing. Gas and electricity prices experienced the highest growth. However, only in 2Q99 did the full effect of this increase become apparent. This was matched, in part, by a rise in PPI. Increasing oil prices were also a factor behind the PPI increase as a result of soaring import prices.

It is estimated that in the second-half of 1999 prices will be rising slightly faster than in the first-half. CPI inflation will reach 6.7% yoy in 3Q99 and 6.8% in 4Q99 yoy. Similar trends will be observed in PPI growth, which will rise 5.4% in 3Q99 and 5.8% in 4Q99.

A slight increase in procurement price of cereals is expected in the second-half of 1999. Despite the high efficiency of tillage the crops will be small. On the other hand, the demand for cereals will decrease due to declining live-stocks of swine. Decreasing live-stocks of swine and cattle will result in higher retail prices of meat. Although the dioxin scandal may improve the prospects for meat exports, prices are unlikely to rise much due to high inventories.

It is expected that the second-half of 1999 will bring a slight increase in world oil prices. This will be the result of decreasing US oil reserves and the determination of OPEC countries to adhere to production quotas. Increasing demand in those countries recovering from the South-Asian crisis is another factor that is likely to contribute to higher world oil prices.

The above trends and the announcement of a further rise in excise tax rates will contribute to higher fuel prices and, in turn, to higher prices in transport services and PPI. Such pressures on fuel prices and PPI will, however, be mitigated by the effects of an appreciating zloty.

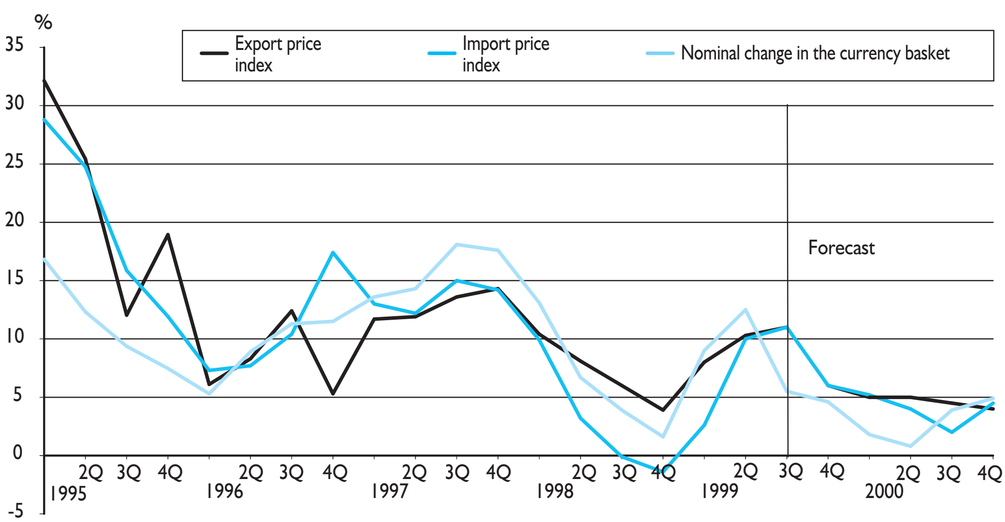
Since February 1999, growth in the manufacturing sector has contributed to rising (yoy) PPI.

The weakening of the zloty influenced the dynamics of export and import prices. Starting from the beginning of 1999, both indices grew faster and the export price index rose at a faster rate than PPI. The growth of import prices was slower than those of exports.

In our opinion, inflationary pressures declined significantly in 2Q99. The rate of GDP deflator growth – a measure of the average price level – amounted to 6.2% (6.6% in 1Q99).

We anticipate similar inflation trends in the second-half of 1999 and believe that slower growth in non-foodstuffs and service prices will compensate for the slightly faster growth in foodstuff prices.

Figure 10. Export and import price indices and nominal change in the currency basket, 1995–2000 (% change)



Source: CSO and CASE.
Note: CASE forecast starting from 3Q99.

The weakening of the zloty in 1Q99 is an additional factor that will contribute to higher inflation through a more rapid (7.4%) growth in import prices (in contrast to 1998).

A further lowering of the inflation rate and a more sluggish growth in all basic price indicators is expected in 2000. This wil occur as a result of a subsequent decline in the growth of import prices, together with a downward trend in PPI.

In 1999 and 2000, the GDP deflator is expected to increase 6.2% and 6.3% respectively. Starting from 3Q00, inflationary pressures will ease again and reach 5.9% in 4Q00.

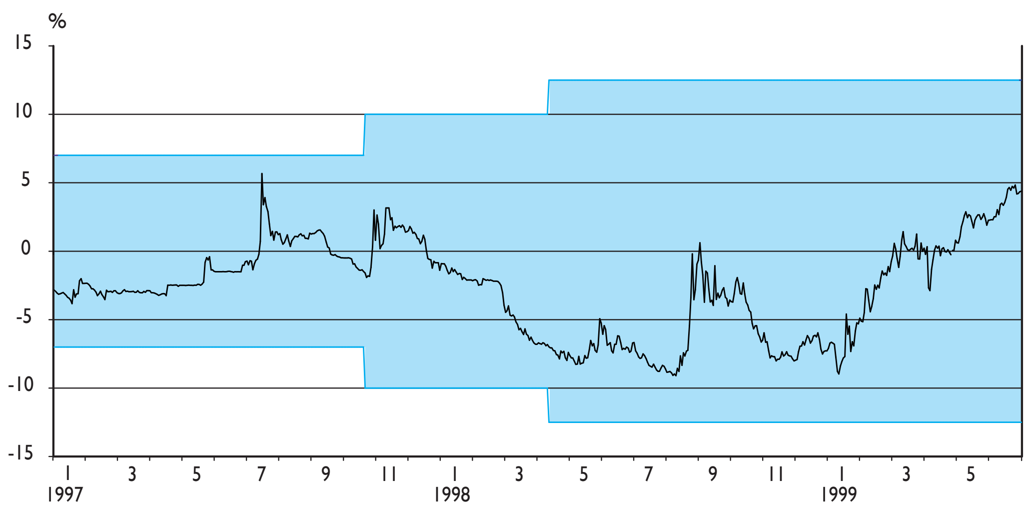
Exchange rate

- **Continued strengthening of the zloty**
- **Forecast of a further strengthening of the exchange rate as a result of a capital account surplus**

The lowering of the NBP's interest rates, a deterioration in the current account and an outflow of short-term capital contributed to a weakening of the zloty. Starting from 6 January 1999 when the zloty reached its lowest level (8.97% below the central rate), a steady but systematic increase in the exchange rate occured. Only the first and third week of April were an exception. The statement by Minister Kropiwnicki from the Government Centre for Strategic Studies forecasting an economic collapse accounts for the drop in the first week. Moreover, his statement coincided with the publication of rather weak economic results in 1Q99. The statement was by no means discarded as the foreign exchange market reacted sharply by bidding for the exchange rates of foreign currencies. This reaction was reinforced by news of declining foreign currency reserves. The downward pressure on the exchange rate reached its nadir on 1 April amounting to 2.88% below parity. The second period of a weak exchange rate resulted from investor uncertainties associated with the Kosovo conflict. On 22 April, the zloty fell 0.26% below the central rate.

Domestic banks, which play a key role in the foreign exchange markets, were aggresively buying foreign currencies and avoided a long-position in zlotys. Foreign investors were more cautious and kept selling foreign currencies at session-ends. Yet another strategy was to buy currency on the interbank market, push its price up, and then sell it back to the NBP during the fixing session when the NBP itself was buying currencies at the market closing price which, due to speculation, was the highest price of the day. Whilst the pursuit of such a strategy has been made possible since 16 May, 1995, when average turnover

Figure 11. Average deviation of US$/PLN and DM/PLN (EURO/PLN since 1999) from the central parity, 1997–1999



Source: NBP.
Note: Currency basket over 1996–98 consists: 55% of USD and 45% of DM, and from 1999: euro – 55% and USD – 45%.

amounted to roughly US$1 billion, it is only transactions of US$100–200 million that are capable of substantially influencing the exchange rate. Whilst laying down the rules of fixing transactions, the NBP only set a bottom limit for fixing transactions and not a top one. The NBP also charges commissions on fixing transactions as of 15 December, 1998. The minimum amount required for transaction and commission costs constituted a barrier for many Polish banks but not for large foreign investors. As a result, the NBP ceased to trade with commercial banks during fixing transactions on 7 June, 1999 in order to put an end to speculative practices. Nevertheless, this does not mean a total ban on intervening in the interbank market. Transactions may still be carried out if the NBP deems them justified.

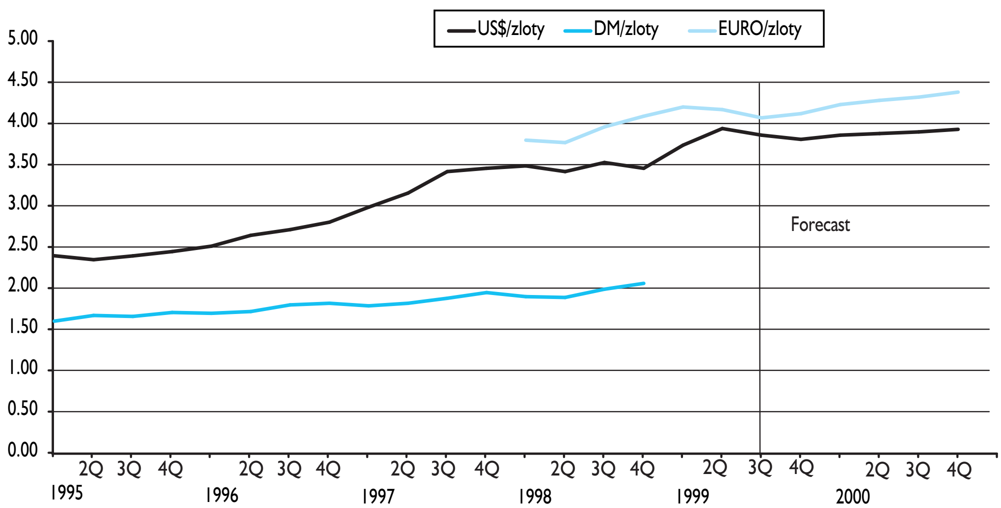
The zloty exchange rate was appreciating both in nominal and in real terms in May and June and reached its highest level of 4.84% above parity on 22 June, 1999. In our opinion, such a trend will continue for the following reasons: higher GDP growth starting from 2Q99, a gradual stablilisation of the merchandise trade deficit ta 1998 levels, a worsening of the current account mainly as a result of falling cross-border trade. These circumstances remain the main reference points for short-term foreign investors. Moreover, a cut in central interest rates seems unlikely (see section on monetary policy).

Table 15 shows the average exchange rate of the dollar and euro (and in the period 1996–1998 of the German mark) as well as the average real effective exchange rate (measured as a share of exports weighed average of 26 currencies of developed countries and 20 developing countries).

Table 15 shows that the real effective exchange rate has been decreasing since 2Q98, thus in the same period the real value of the zloty declined with reference to the basket of currencies and corresponding inflation indices. It is expected that the real exchange rate could reach an even lower level in the first-half of 1999. Nevertheless, if in the coming months there is no financial turmoil similar to the Brazilian crisis, upward pressure on the zloty is expected.

We forecast that inflows of foreign investment stemming from final stages of the privatisation of Bank Pekao SA, Bank Zachodni SA and TP SA will offset the negative balance on the current account and cause official foreign currency reserves to increase to US$28 billion by end-1999 and US$32 billion by end-2000. Our forecast assumes, as it did in April, that the situation in world financial markets will be relatively stable. A continuation of the current exchange rate mechanism is also expected. It is assumed that the rate of devaluation of the central exchange rate is likely to be lowered from the current 0.3% level to 0.0% by year-end. Despite the considerable weakening of the euro against the dollar in the first-half of the year, we still assume a gradual appreciation of the euro starting in 3Q99. We support our previous forecast of a nominal appre-

Figure 12. Basic exchange rates, 1995–2000 (per zloty)



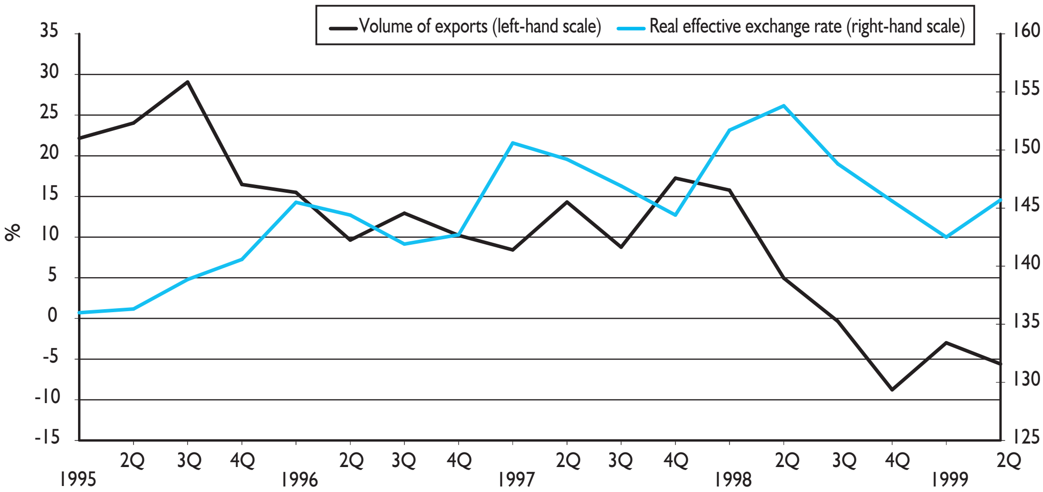
Source: CSO and CASE.
Note: CASE forecast starting from 3Q99.

Table 15. Basic exchange rates, 1996–2000 (per zloty)

		US$	German mark	ECU/Euro	Real effective exchange rate
1996	1Q–4Q	2.70	1.79	3.38	143.6
1997	1Q–4Q	3.28	1.89	3.71	147.7
1998	1Q–4Q	3.49	1.99	3.92	149.9
forecast					
1999	*1Q–4Q*	*3.86*		*4.16*	
2000	*1Q–4Q*	*3.91*		*4.32*	
1996	1Q	2.54	1.73	3.2	145.5
	2Q	2.67	1.75	3.3	144.4
	3Q	2.74	1.83	3.46	141.9
	4Q	2.83	1.85	3.55	142.7
1997	1Q	3.01	1.82	3.53	150.6
	2Q	3.18	1.85	3.62	149.2
	3Q	3.44	1.91	3.75	146.9
	4Q	3.48	1.98	3.55	144.4
1998	1Q	3.51	1.93	3.82	151.7
	2Q	3.44	1.92	3.79	153.8
	3Q	3.55	2.02	3.98	148.8
	4Q	3.48	2.09	4.11	145.6
1999	1Q	3.76		4.22	142.5
	2Q	3.96		4.19	145.7
forecast					
1999	*3Q*	*3.88*		*4.09*	
	4Q	*3.83*		*4.14*	
2000	*1Q*	*3.88*		*4.25*	
	2Q	*3.90*		*4.30*	
	3Q	*3.92*		*4.34*	
	4Q	*3.95*		*4.40*	

Source: NBP, real effective exchange rate – JP Morgan, forecast – CASE.
Note: 1. Average exchange rates.
2. Real effective exchange rate, 1990 average = 100.
3. 1996–1998 Ecu, since 1999 euro.

Figure 13. The volume of exports and real effective exchange rate, 1995–1999 (% change)



Source: CSO and JP Morgan.
Note: Real effective exchange rate (right-hand scale), 1990 average = 100.

ciation of the zloty against the dollar in the second-half of the year. The forecast for the exchange rate of the zloty against the dollar is between 3.88 and 3.83 for 3Q99 and 4Q99 respectively. The zloty will strengthen against the euro in 3Q99 but 4Q99 will witness a weakening of the currency (a gradual appreciation of the euro against the dollar is assumed). The forecast for the exchange rate is between 4.09 and 4.14 in 3Q99 and 4Q99 respectively.

Foreign trade

- **Fall in exports to the EU**
- **Uncertain prospects for export growth to the CIS**
- **Forecast recovery of exports in the second-half of 1999**

The dynamics of foreign trade in the first-half of 1999 were, to a large extent, determined by exceptionally volatile economic conditions in partner countries. At the beginning of 1999, it seemed that Polish exports to the CIS had recovered from the Russian crisis. However, a worsening economic conditions in the EU in 2Q99, coupled with a weakening of the euro, negatively affected exports to the region. At the same time, declining foreign investment and a lowering of domestic demand resulted in a drop in imports.

Falling exports to the EU

The continuation of trends observed in the first-half of 1999 in EU economies would augur badly for a recovery of Polish exports and, in turn, for faster economic growth. It should be noted that exports to the EU constituted almost 70% of overall Polish exports in 1998. Although most observers forecast an improvement in the economic situation of the EU, one can expect that the pace of recovery will not be impressive.

Weak economic conditions in the EU in the first-half of 1999 stemmed largely from economic problems in Germany, Italy and the United Kingdom. Domestic demand was sustained by inventories and, to a lesser extent, domestic production and imports. Moreover, the euro gradually weakened against the dollar from the beginning of 1999 until mid-July and lost roughly 15% of its initial value. Both factors – a low level of economic activity and a weak currency – contributed to falling demand for imports (and thus Polish goods and services) in the EU.

The volume of Polish exports to the EU will also hinge on exchange rate movements. The anticipated strengthening of the zloty in the second-half of 1999 (due to revenues from privatisation) will hamper export growth. This will be mitigated, to some extent, by the strengthening of the euro. It should be stressed that changes in exchange rates have a delayed effect on trade volumes of about 3 to 6 months.

Uncertain prospects for exports to the CIS

After the substantial fall in Polish exports resulting from the Russian financial crisis (collapse of the real sector and devaluation of the rouble), a revival in exports to the CIS will only proceed at a slow pace. Developments in the Russian economy, one of our main trading partners, will play a crucial role. Recent statistics, notably growth in the manufacturing sector, indicate that Russia is overcoming the negative effects of the August crisis fairly quickly. This is due mainly to rising world oil prices. However, the continuing impoverishment of Russian households, together with the weak condition of industry (the export sector is the exception), do not give much hope for a quick and sustained rise in import demand for foodstuffs and machinery. The latter two constitute roughly 60% of Polish exports to CIS. Thus the recovery of Polish exports to the region will be sluggish and one should not expect exports to reach their pre-crisis levels.

The drop in domestic demand negatively influenced the dynamics of import growth. We estimate that imports fell 6% yoy in 2Q99 while imports are estimated to have fallen 2% yoy in 1Q99.

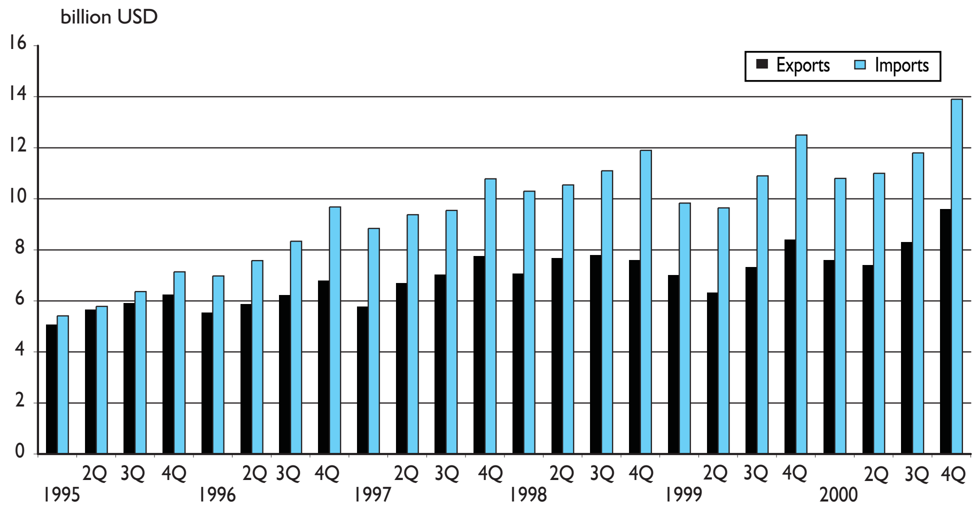
Table 16. Exports, imports and the foreign trade balance; 1996–2000 (US$ billion)

		Exports		Imports		Net exports	
		NBP	**CSO**	**NBP**	**CSO**	**NBP**	**CSO**
1996	1Q–4Q	24.42	24.44	32.57	37.14	-8.15	-12.70
1997	1Q–4Q	27.23	25.75	38.50	42.31	-11.27	-16.56
1998	1Q–4Q	30.12	28.23	43.84	47.05	-13.72	-18.82
forecast							
1999	*1Q–4Q*	*29.05*	*30.30*	*42.88*	*48.53*	*-13.83*	*-18.23*
2000	*1Q–4Q*	*32.90*	*33.75*	*47.50*	*53.52*	*-14.60*	*-19.78*
1996	1Q	5.54	5.95	6.98	8.20	-1.44	-2.25
	2Q	5.87	5.78	7.58	9.06	-1.70	-3.28
	3Q	6.22	6.37	8.34	9.30	-2.11	-2.93
	4Q	6.79	6.34	9.68	10.58	-2.89	-4.24
1997	1Q	5.77	6.12	8.84	9.77	-3.07	-3.65
	2Q	6.69	6.31	9.38	10.56	-2.69	-4.24
	3Q	7.02	6.21	9.55	10.15	-2.53	-3.94
	4Q	7.75	7.11	10.78	11.84	-3.03	-4.73
1998	1Q	7.06	7.02	10.30	11.09	-3.24	-4.06
	2Q	7.67	7.04	10.55	11.70	-2.88	-4.65
	3Q	7.80	6.89	11.10	12.00	-3.30	-5.10
	4Q	7.60	7.27	11.90	12.28	-4.31	-5.00
1999	1Q	7.01	6.57	9.83	10.20	-2.82	-3.62
	2Qe	6.32	6.20	9.65	11.10	-3.33	-4.90
forecast							
1999	*3Q*	*7.32*	*7.00*	*10.90*	*11.60*	*-3.58*	*-4.60*
	4Q	*8.40*	*8.20*	*12.50*	*12.80*	*-4.10*	*-4.60*
2000	*1Q*	*7.60*	*7.50*	*10.80*	*11.40*	*-3.20*	*-3.90*
	2Q	*7.40*	*7.00*	*11.00*	*11.70*	*-3.60*	*-4.70*
	3Q	*8.30*	*8.00*	*11.80*	*12.60*	*-3.50*	*-4.60*
	4Q	*9.60*	*9.20*	*13.90*	*14.50*	*-4.30*	*-5.30*

Source: NBP, CSO, estimates for CSO data (e) and forecasts – CASE.

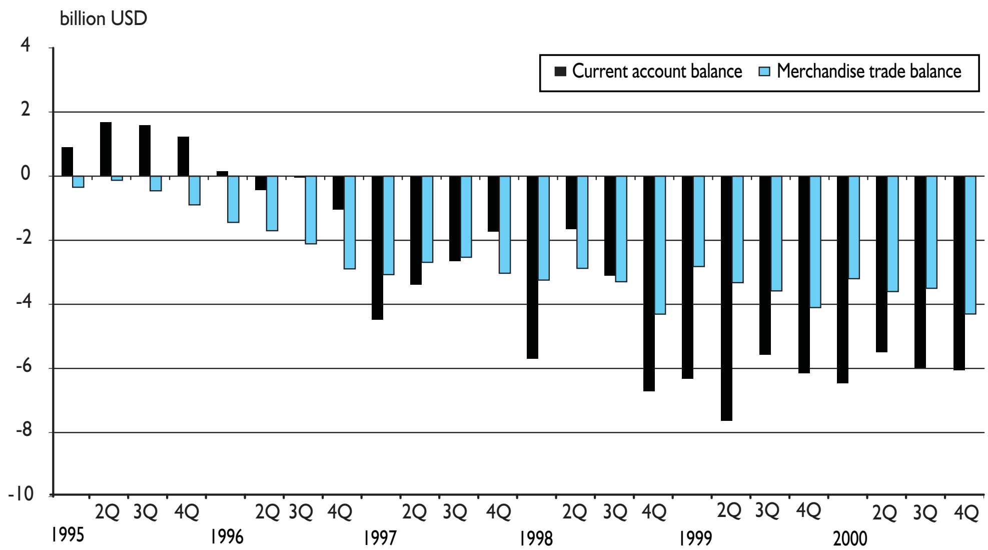
The adverse conditions in foreign trade should stabilise in the second-half of 1999. However, the merchandise trade deficit calculated over the whole year will reach US$13.8 billion (over 8% of GDP). We estimate that the volume of exports will increase over 2% in 1999 and over 9% in 2000. The rate of import growth, meanwhile, will stabilise at roughly 7% annually. This will result in a US$14.6 billion negative balance in merchandise trade. Detailed information on the volume of Polish foreign trade calculated on the basis of both merchandise trade payments (NBP) and customs statistics (CSO) is provided in Table 16.

Figure 14. Exports and imports, 1995–2000 (US$ billion)



Source: NBP and CASE.
Note: CASE forecast starting from 3Q99.

Figure 15. Merchandise trade balance and current account balance, 1995–2000 (US$ billion)



Source: NBP and CASE.
Note: CASE forecast starting from 3Q99.

Table 17. Components of the balance of payments, 1996–2000 (US$ billion)

		Balance on					Net direct investment	Net portfolio investment	Net credits beyond 1 year	Change in foreign currency reserves	Foreign currency reserves
		current account	current account: % of GDP	merchandise trade	unclassified current transactions	capital account					
1996	1Q–4Q	-1.35	-0.9	-8.15	7.15	4.78	2.74	0.24	-0.24	3.07	18.03
1997	1Q–4Q	-4.31	-3.0	-11.27	6.01	5.41	3.04	2.10	0.42	2.64	20.67
1998	1Q–4Q	-6.86	-4.3	-13.72	6.00	10.80	4.97	1.33	1.72	6.71	27.38
forecast											
1999	1Q–4Q	*-10.04*	*-6.4*	*-13.83*	*4.20*	*8.65*	*5.14*	*0.50*	*1.75*	*-0.38*	*27.00*
2000	1Q–4Q	*-10.40*	*-6.0*	*-14.60*	*5.30*	*12.40*	*6.20*	*1.60*	*1.90*	*3.50*	*30.50*
1997	1Q	-1.53	-4.5	-3.07	1.12	1.28	0.46	0.41	0.05	-0.06	17.98
	2Q	-1.19	-3.4	-2.69	1.47	2.36	0.78	1.07	0.17	1.71	19.69
	3Q	-0.91	-2.6	-2.53	1.62	0.80	0.78	0.64	-0.06	0.37	20.05
	4Q	-0.67	-1.7	-3.03	1.80	0.97	1.03	-0.02	0.26	0.62	20.67
1998	1Q	-2.00	-5.7	-3.24	1.16	3.24	1.00	0.21	0.24	2.39	23.06
	2Q	-0.64	-1.6	-2.88	1.72	2.19	1.26	0.36	0.36	2.19	25.26
	3Q	-1.22	-3.1	-3.30	1.87	2.64	1.68	-0.86	0.06	1.83	27.08
	4Q	-3.01	-6.7	-4.31	1.25	2.73	1.02	1.61	1.07	0.30	27.38
1999	1Q	-2.24	-6.3	-2.82	0.80	1.15	1.14	-0.30	-0.05	-0.78	26.60
	2Q	-2.80	-7.6	-3.33	0.90	2.20	1.30	0.10	0.60	-0.75	25.85
forecast											
1999	*3Q*	*-2.20*	*-5.6*	*-3.58*	*1.10*	*2.80*	*1.60*	*0.30*	*0.60*	*0.15*	*26.00*
	4Q	*-2.80*	*-6.1*	*-4.10*	*1.40*	*2.50*	*1.10*	*0.40*	*0.60*	*1.00*	*27.00*
2000	*1Q*	*-2.50*	*-6.5*	*-3.20*	*1.20*	*3.20*	*1.30*	*0.50*	*0.50*	*2.00*	*29.00*
	2Q	*-2.30*	*-5.5*	*-3.30*	*1.30*	*3.20*	*1.60*	*0.40*	*0.50*	*0.40*	*29.40*
	3Q	*-2.60*	*-6.0*	*-3.70*	*1.50*	*3.00*	*1.80*	*0.40*	*0.50*	*0.20*	*29.60*
	4Q	*-3.00*	*-6.1*	*-4.40*	*1.30*	*3.00*	*1.50*	*0.30*	*0.40*	*0.90*	*30.50*

Source: Data – NBP, forecast – CASE.

Balance of payments

- **Stabilisation of the merchandise trade balance**
- **Decline in unclassified current transactions balance**
- **Forecast rise in official foreign currency reserves**

The stabilisation of the negative balance in merchandise trade observed in the first-half of 1999 had a positive effect on the current account balance. The worsening of the current account balance was the result of an increase in the trade deficit in services and a decline in the surplus in unclassified current transactions. The latter is estimated to have declined US$900 million in comparison to the previous year. According to the NBP, the negative balance in the current account amounted to US$(–2.2) billion in 1Q99. We estimate that the figure for 2Q99 will be US$ (–2.8) against US$(–0.64) billion in 2Q98.

The lower exchange rate did not give a sufficient stimulus to exports. Revenues from exports fell 17% yoy in 2Q99. The foreign trade deficit increased despite the fact that monthly trade indicators (June was an exception) revealed signs of improvement compared to the same period in the previous year. The deterioration in the current account deficit in comparison to 1Q99 was the result of a deterioration in both the balance of unclassified current transactions and of trade in services.

In addition, one should note the persistent fall in portfolio investment since February 1999. Smaller differentials in interest rates, coupled with a depreciating zloty, constituted a barrier for foreign capital. Foreign direct investment reached last year's level in 1Q99 but declined in 2Q99. Some significant changes occurred in the balance of other types of investment flows. The sum of domestic liabilities abroad, saving deposits, and deposits in current accounts were more than three times lower in 1Q99 than in the same quarter of the previous year. In 2Q99, the trend remained unchanged. 1Q99 experienced a decline in domestic liabilities abroad as a result of repayments of loans with maturities of over 1 year and withdrawals of deposits by foreigners. 2Q99 witnessed a reversal of this trend which caused a further increase in loans. In addition, foreign saving deposits and deposits in current accounts on the account of domestic liabilities abroad showed signs of recovery. Hence the balance of foreign direct investment and portfolio investment was lower in 2Q99 than in 1Q99 and only the balance of other investments witnessed a rise.

The inflow of currency due to portfolio, foreign direct and other investments was insufficient to cover the negative balance on the current account. Consequently, gross official foreign currency reserves declined from US$27.38 billion at end-December 1998 to US$25.8 billion at end-June 1999 (information on selected items of the balance of payments is provided in Table 17).

It is estimated that the deficit on the current account calculated according to NBP methodology reached 6.3% and 7.6% of GDP in 1Q99 and 2Q99 respectively. The deficit as a % of GDP measured according to IMF methodology (excluding the balance on unclassified current transactions) was higher and amounted to 8.6% and 10.2% of GDP respectively.

It is expected that the balance of payments will see an improvement starting in 3Q99. The following quarters are likely to witness a gradual stabilisation of the current account deficit, although at a relatively high level. We estimate it will increase to approximately US$10 billion (6.4% of GDP) in 1999 and US$10.4 billion (6% of GDP) in 2000.

Budget

- **Difficult budgetary situation in the first-half of 1999**
- **Budget deficit reaches 88% of the planned annual amount**
- **Threat of excessive growth in the consolidated budget deficit**

The situation of the state budget appears extremely difficult in 1999 as macroeconomic assumptions outlined in the Budget Act turned out to be unrealistic. This applies mainly to the overly-optimistic GDP growth forecast (5.1%), a higher rate of annual inflation than forecast by most institutes (8.5%), an underestimation of the level of unemployment (9.7% to 9.4%) and a deficit in the current account. The indirect consequences of the Russian crisis and the ensuing economic slowdown are clearly apparent in the budget's implementation. In our opinion they will also be relevant to the 2000 budget.

Despite the above difficulties, budget revenues increased in the first-half of 1999 in line with the Ministry of Finance's assumptions. Higher-than-expected revenues from indirect taxes offset smaller revenues from direct taxes – especially corporate tax. The latter is the result of the changing structure of demand. The share of goods in households' expenditure subject to the highest VAT rate (22%) increased at the expense of smaller purchases of food products (subject to 0% or 7% VAT).

The volume of planned expenditures was far more than in the same period in previous years. Higher expenditures are a consequence of the implementation of both social and state administrative reforms. As a consequence, in the first-half of the year the budget deficit amounted to 88% of the level planned for the entire year.

Changing priorities, the scope for financing by the central government, as well as the implementation of local government

Table 18. Selected items of the state budget, 1996–2000 (US$ billion)

		Revenues		Expenditures	Budget deficit	
		total	of which tax revenues		zloty billion	% of GDP
1996	1Q–4Q	99.7	83.7	108.8	-9.2	-2.4
1997	1Q–4Q	119.8	98.5	125.7	-5.9	-1.3
1998	1Q–4Q	126.5	113.8	139.8	-13.3	-2.4
forecast						
1999	*1Q–4Q*	*125.8*	*112.1*	*138.5*	*-12.7*	*-2.1*
2000	*1Q–4Q*	*141.1*	*125.9*	*152.4*	*-11.3*	*-1.7*
1996	1Q	21.3	17.0	24.0	-2.8	-3.3
	2Q	22.5	19.2	25.0	-2.5	-2.8
	3Q	26.3	22.0	27.0	-0.7	-0.7
	4Q	29.7	25.5	32.8	-3.1	-2.8
1997	1Q	23.5	20.2	27.4	-3.9	-3.8
	2Q	27.1	21.1	30.6	-3.5	-3.1
	3Q	32.8	26.4	31.4	1.4	1.1
	4Q	36.4	30.7	36.3	0.1	0.1
1998	1Q	28.7	25.6	32.3	-3.5	-2.9
	2Q	29.3	26.3	35.1	-5.8	-4.4
	3Q	33.1	29.9	34.1	-1.1	-0.8
	4Q	35.5	32.1	38.3	-2.8	-1.8
1999	1Q	27.7	24.4	36.5	-8.7	-6.5
	2Q	28.7	25.4	31.3	-2.7	-1.8
forecast						
1999	*3Q*	*32.9*	*29.5*	*32.1*	*0.8*	*0.5*
	4Q	*36.5*	*32.8*	*38.6*	*-2.1*	*-1.2*
2000	*1Q*	*30.9*	*27.2*	*34.6*	*-3.7*	*-2.4*
	2Q	*31.9*	*28.3*	*37.1*	*-5.2*	*-3.2*
	3Q	*36.8*	*32.9*	*37.6*	*-0.8*	*-0.5*
	4Q	*41.5*	*37.4*	*43.1*	*-1.6*	*-0.8*

Source: Data – Ministry of Finance, forecast – CASE.

reforms (establishment of voivodships and poviats), health reforms (establishment of local health funds – kasy chorych) and pension reforms beginning 1 January 1999 lowered the level of budgetary expenditures in contrast to the previous year. As a consequence, the share of local budget expenditures in the state budget rose. The trend is considered to be beneficial for the economy as a whole as local governments generally use their budgetary resources in a more efficient manner.

In terms of budget revenues, domestic demand is considered more important than GDP growth as revenues consist largely of indirect taxes. Our forecast for domestic demand is consistent with that set out in the budget. The only difference in both assumptions concerns the rate of inflation. It is rather unlikely that annual average inflation will reach 8%. If, instead, inflation is in line with the forecast of CASE (6.5%), the difference between actual and expected nominal budget revenues will be substantial.

We are of the opinion that tensions in the budget may ease in the second-half of 1999. Expected higher GDP growth and higher inflation in the second-half of the year will deliver higher tax revenues. Moreover, budget expenditures are usually higher in 3Q than in 1Q and 2Q. This will allow a US$1 billion budget surplus to occur according to our estimation. If the Ministry of Finance is successful in limiting some expenditures (one of our assumptions), it is possible that the planned budget deficit will be achieved.

Additional difficulties may be encountered in 2000 as a result of the repayment of the health care system's debt, compensations, and the costs of re-privatisation estimated at PLN8 billion.

Obstacles to financing the appropriated funds (especially ZUS) may lead to an expansion in the consolidated budget deficit from 2.5% to 3.3% of GDP in 1998 and 1999 respectively.

Proposed changes to the tax system may produce a fiscal increase (increase of expenditures in the consolidated budget in relation to GDP growth). It is quite possible that revenues form direct taxes will be smaller but it is also conceivable that increasing revenues from ZUS, VAT, and excise taxes may outweigh the former. It should be stressed that a fiscal increase, coupled with a decline in both households' propensity to save as well as corporate profits, contradict the government's long-term economic strategy.

On the other hand, an increase in consolidated budget revenues and a tightening of expenditure would ease tensions in the budget sector and lower the consolidated budget deficit to 2.6% of GDP in 2000.

Monetary policy

• Fading consequences of the NBP's controversial decision to cut interest rates on 20 January 1999
• Weaker demand for money
• Decline of net financial savings of households for the first time since the beginning of the transformation
• No immediate consequences of the decision to reduce the obligatory reserve ratio on 21 July 1999

The effects of the January interest rate cut on the exchange rate proved to be short-lived as the zloty started to strengthen as early as the end of the month. Since then, the upward trend has continued with the exception of a speculative period in April (see section on exchange rate). The strengthening of the zloty and the expected continuation of upward pressure enhanced the attractiveness of foreign loans for banks and businesses. The expansion of individual credit by domestic banks coincided with the lowering of the growth in money supply and triggered a reduction in households' propensity to save.

Reserve money and monetary policy instruments

The cumulative growth of reserve money in 2Q99 was slower by almost two-fold than in previous years and amounted to 10.2% (Table 19). An increase in the share of net foreign assets to 14% stemmed from the strong appreciation of the zloty at the end of the period surveyed. In nominal terms, official currency reserves kept falling by about US$200–300 million monthly in 1Q99 and 2Q99 and reached US$25.8 billion. The figure did not change the monthly imports-reserves ratio which still remains above the 7-month level. It should also be noted that the nominal decrease in currency reserves was, to some extent, caused by exchange rate fluctuations but largely as a result of the weakening of the Euro against the dollar. Changes in the structure and origins of capital inflows indicate an intensification of activities of domestic agents in the world capital markets. The expansion of net national bank credit to government was surprisingly small (PLN1.5 billion in

2Q99) given the high costs of state reforms. It is worth mentioning the substantial growth in net claims on government to PLN2.5 billion in June 1999. Net claims on deposit money banks were negative in 2Q99 but the scale of financing was smaller than in previous years. Hence the expansion of domestic credit was limited.

The exhaustion of the range of monetary policy instruments following the January interest rate cut and the subsequent monitoring of its effects forced the NBP to restrain from taking any active measures in 2Q99. Throughout this period the responsibility for the co-ordination of monetary and fiscal policy rested with the budget and the Ministry of Finance. 1Q99 did not experience any significant expansion of net domestic credit, although the quarter proved difficult in terms of financing. This indicates a high level of budgetary discipline from the government. Increasing expenditures and a budget deficit did not match the wave of protests from various labour groups. Fears by some members of the Monetary Policy Council stemmed from the high level of domestic credit growth (mainly to individuals) which, if combined with net foreign assets growth in the second-half of 1999, may put pressure on the money supply. The possibility of a rise in interest rates remains constrained by both external and internal factors. Historically, the level of interest rates in the EU and Asia is very low primarily as a result of slow economic growth in these regions. An additional factor is the economic prosperity and good prospects for the US economy, which means there is little incentive for the Fed to raise interest rates. Given such a situation, a potential rise in NBP interest rates would increase the interest rate disparity and thus cause an inflow of short-term capital which could, in turn, contribute to upward pressure on the zloty. The scope for sterilisation of foreign capital inflows will be determined, to a large extent, by the current financing of the budget and the extent of the budget deficit in the government sector.

The change in the method of accounting the obligatory reserve ratio on deposits should not significantly influence the liquidity of the banking sector. Nevertheless, the combination of expected increases in net foreign assets, expansion of credit to the private sector and lower levels of reserves pose a threat to money supply growth. A change in the obligatory reserve ratio to the standard 5% level, together with the absorption of the excess resources by bonds issued by the NBP with a yield at the level of inflation which cannot be traded outside the interbank market, does not appear favourable to the banking sector. The NBP's decision to introduce such a measure was driven by the impossibility of reaching a compromise amongst commercial banks. **The new obligatory reserve regime will prove costly for big retail banks such as PKO BP and Bank Pekao SA. For this reason, a decline in interest rates on loans is more likely than a rise of interest rates on deposits.**

Table 19. Components of the reserve money supply, 1997–1999 (cumulative % change)

		Reserve money (RM)	Net foreign assets (NFA)	Net domestic assets (NDA)	Net claims on government (NCG)	Claims on deposit money banks(CDMB)	Other items net (OIN)
1997	1Q	10.12	5.82	12.05	14.22	-2.17	-7.75
	2Q	20.44	30.20	5.66	26.67	-21.01	-15.43
	3Q	31.65	43.47	11.55	25.77	-14.21	-23.38
	4Q	23.50	57.60	54.16	17.14	37.01	-88.27
1998	1Q	4.82	25.37	-7.00	-5.31	-1.69	-13.55
	2Q	17.54	36.32	-10.22	-8.74	-1.48	-8.56
	3Q	17.50	48.85	-4.39	-6.35	1.96	-26.94
	4Q	26.78	63.44	-0.90	2.95	-3.85	-35.75
1999	1Q	0.44	-0.78	-0.57	-0.50	-0.07	1.79
	2Q	10.20	14.18	1.81	2.15	-0.35	-5.80

Source: The NBP Bulletin and authors' calculations.

Notes: 1. The shares of components of reserve money are calculated using the following formula:

$\Delta RM/RM_{-I} = \Delta NFA/RM_{-I} + \Delta NCG/RM_{-I} + \Delta CDMB/RM_{-I} + \Delta OIN/RM_{-I}$, *cumulative in the current year. Net foreign assets were re-estimated (valuation adjustment) using the average exchange rate of the currency basket for a given period to account for fluctuations in the exchange rate of the zloty.*

2. Changes in comparison to PEO 1/99 stem from the introduction of the currency basket into calculations instead of using USD/PLN exchange rate.

The banking system and broad money

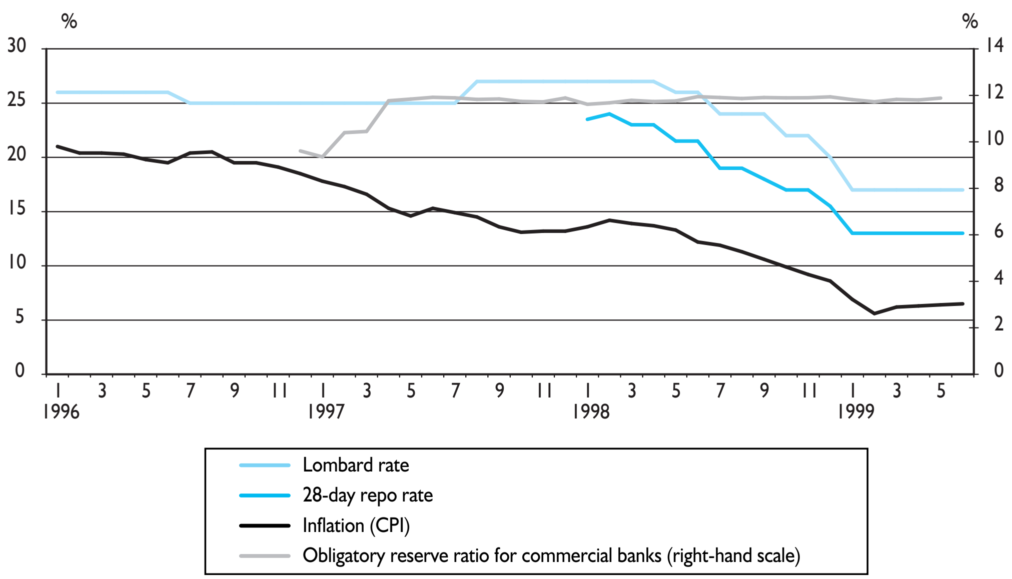
Cumulative M2 growth of 6.3% in 2Q99 was slower than expected mainly as a result of falling net foreign assets. The latter resulted from an appreciating zloty and a decline in net foreign assets denominated in USD in the banking system (see Table 20). This was due to continued decreasing net foreign assets of the NBP as well as a higher rate of growth in the liabilities of foreign commercial banks in relation to their assets. This indicates a resumption of the position of international financial markets as lenders to domestic banks after a period of sharp falls in their liabilities since August 1998. Such a development may suggest expectations of an appreciating zloty, on the one hand, and the expected maintenance of low interest rates (especially in the EU), on the other. This will lower the costs of loans, notably for credible domestic debtors. The role played by international markets in the domestic banking system will inevitably expand with the liberalisation of the currency law and the banking law. The lowering of the interest rate disparity in this context means further cuts in interest rates, which may prove discouraging for short-term foreign investors but at the same time is likely to boost domestic consumption credit.

The expansion of credit to the private sector in 2Q99 was consistent with last year's level and was mainly caused by an increase in claims on individuals (7% by end-May). Similar cumulative levels of growth were achieved in 1998 with the only difference being that credit to business rose twice as fast as in 1998. On the liabilities side of the balance sheet of banking system, the deposits of the non-financial sector denominated in zlotys rose slower yoy. Moreover, the average maturity of deposits shortened. A shift in assets from time deposits to current accounts indicates a higher sensitivity of savers to changes in the level of interest rates. As a consequence, **for the first time since the beginning of the transformation 2Q99 witnessed a decline in net financial saving of households (calculated as the difference between the growth of deposits, foreign currency deposits, cash in the banking system and the growth of credits).**

The drop in saving stems, on the one hand, from the controversial cut in interest rates in January 1999 and, on the other, from a decrease in household real income and continuing growth in individual consumption.

As forecast, M2 money grew faster than cash money. A drop in corporate currency deposits, especially in corporate fixed

Figure 16. Monetary policy instruments, 1996–1999



Source: NBP and CASE.
Note: CASE forecast starting from 3Q99.

Table 20. Components of broad money, 1997–1999 (cumulative %)

		M2	Net foreign assets (NFA)	Net claims on government (NCG)	Claims on deposit money banks (CDMB)	Other items net (OIN)
1997	1Q	5.04	-0.06	2.29	5.91	-3.10
	2Q	12.59	6.02	2.17	10.72	-6.33
	3Q	20.38	10.91	1.66	16.43	-8.63
	4Q	30.89	15.20	6.28	20.90	-11.49
1998	1Q	2.25	3.76	-2.85	3.70	-2.36
	2Q	8.97	4.79	-2.60	7.86	-1.08
	3Q	15.35	4.33	0.86	12.90	-2.74
	4Q	25.12	9.72	3.42	17.18	-5.20
1999	1Q	4.30	-0.53	1.18	4.55	-0.91
	2Q	6.34	2.86	1.55	7.36	-5.43

Source: The NBP Bulletin and authors' calculations.

Notes: 1. The share of broad money components are calculated using the following formula:

$\Delta M2/M2_{-l} = \Delta NFA/M2_{-l} + \Delta NCG/M2_{-l} + \Delta CDMB/M2_{-l} + \Delta OIN/M2_{-l}$,

cumulative in the current year. Net foreign assets were re-estimated (valuation adjustment) using the average exchange rate of the currency basket for a give period to account for fluctuations of the exchange rate of the zloty.

2. Changes in comparison to PEO 1/99 stem from the introduction of the currency basket into calculations instead of using USD/PLN exchange rate.

Table 21. Calendar of the most important events in the monetary policy of the NBP in 1Q99 and 2Q99

Official Journal of the NBP No.	Date of the resolution	Events
3	20 January	NBP rediscount rate 15.5% Lombard rate 17% Refinancing rate 17/18% 28-day repo rate of return equal to at least 13%
4	20 January	Upper limit of NBP liabilities resulting from loans and credits drawn from foreign banking and financial institutions should not exceed 14% of the value of basic assets of the NBP (does not concern foreign liabilities related to the issuance of NBP securities)
5	29 January	Interest on money resources on current account in the NBP 5.1%
n/a	March	Reduction of the average monthly rate of devaluation of the zloty in relation to the basket of foreign currencies from 0.5% to 0.3%

Source: Official Journal of the NBP, various issues. Authors' compilation.

deposits, in 2Q99 was also anticipated. Individual currency deposits were growing at a pace similar to that in 1Q99 but their structure witnessed a decrease in average maturity (as did deposits denominated in zlotys). An increase in commercial banks' net lending to the budget sector proved insignificant due to growing financing from the NBP. The frequency of re-monetization (34.6% of GDP in 2Q99) and decreasing velocity of M2 (3.14% and 3.06% of GDP in 1Q99 and 2Q99 respectively) are the same. The money multiplier fell and amounted to 3.97 in 2Q99 (4.27 in 1Q99). Cyclical falls in the money multiplier in the second quarter have been repeating since 1993.

Our forecast is based on two assumptions regarding economic policy: the lowering of basic interest rates by the NBP will only occur at the end of 4Q99; and budgetary policy will aim to minimise the financing of the budget deficit through the domestic financial system. Thus it is assumed that the second-half of 1999 is likely to witness a contraction in the demand for money in the budget sector – although its growth in the third quarter has so far been fairly constant. Such a situation could cause a substantial expansion of the money supply, especially if the combined effects on the supply side (foreign assets, obligatory reserves) are taken into account. It is estimated that M2 growth will be outpaced by GDP growth in 3Q99 and 4Q99. The importance of foreign currency deposits will systematically diminish. Greater discipline by the NBP over the scale of lending (a suggestion in our PEO 1/99) turned out to be difficult to implement especially in view of the lack of effective monetary policy instruments.

However, the fact that lending is lower than in previous years and that it increases in a period of faster GDP growth is regarded as a positive development (Table 20). In the current situation, a decision to raise interest rates would be as controversial as the aggressive cut in January 1999.

An alternative scenario – state budget collapse

An alternative scenario – from now on referred to as the 'black scenario' – considers a situation in which the government succumbs to labour unions' demands, resulting in excessive increases in transfers from the state budget in 2000.

As a consequence, growth in household nominal incomes would rise faster – particularly in the case of poorer households. This, in turn, would reduce the average propensity to save as the extra transfers would mostly be consumed instead of saved. Moreover, the government would be compelled to commit more financial resources to the government sector. This would lead to a rise in budgetary expenditures that would not be matched by current revenues. The budget deficit would grow and the need to finance it would effectively hinder credit expansion.

Hence domestic demand would be over-stimulated leading to increasing imbalances in the balance of payments. The current account would deteriorate as a result of soaring imports and foreign investors would be deterred by populist measures, forcing them to reduce their capital exposure to Poland. In the face of such significant demand impulses, monetary policy would prove ineffective because most of the Polish financial system's resources would be devoted to covering the budget deficit. If monetary policy were tightened, moreover, it would cause recessionary tendencies, decreasing budgetary revenues and rising government demand for money.

The excessive stimulation of domestic demand and the impossibility of implementing effective monetary policy would lead to a collapse of Polish economic growth by end-2000. It would compel the government to quickly devalue the zloty and cut budget expenditures substantially in the following years.

This 'black scenario' assumes that the 2000 Budget Act would call for an increase in nominal wages in the government sector and state-owned enterprises (e.g. steelworks, mines, etc.), as well as other expenditures on budgetary entities. The only way to finance these extra expenditures would be to borrow money from banks and/or foreign financial institutions.

Such measures would quickly reverse the positive trends in Polish financial and capital markets. First, portfolio capital would dry up. In addition, Polish banks and households would lose confidence in the zloty, resulting in a significant weakening of the currency. Moreover, capital outflows denominated in dollars via exchange offices would occur. As a result of such sizeable outflows, the assets of the Polish financial system (as well as possibilities of investing and financing business activity) would decline.

If the financing of the amendments to the Budget Act was not matched by revenues, and this would be very likely, then a rise in the budget deficit would cause an inflationary rise in money supply.

The government would be forced to raise extra revenues by increasing state-controlled prices, customs duties and excise taxes. This would, in turn, lead to a jump in prices and (indirectly) nominal incomes, although faster growth of prices would cause a decline in real household income and real enterprise profits. In addition, it would give the authorities little choice but to raise direct tax rates that would further diminish the purchasing power of households and enterprises' propensity to invest.

The main assumptions of the 'black scenario' and the associated changes vis-a-vis the base forecast are presented below:

1. External assumptions do not change at all.

2. EU transfers to Poland are the same in the two scenarios and they increase from US$0.6 billion in 1999 to US$1.8 billion in 2001.

3. A smaller FDI flow is assumed (in balance of payments terms): in the black scenario up to US$4 billion in 1999 and US$2.5 billion in 2000 versus US$5.5 billion in 1999 in the base scenario. Whereas, a renewed increase up to US$4 billion is forecast for 2001.

4. According to the government programme, privatisation will end in 2001.

5. A rise in direct and indirect tax rates will take place in 2000 and 2001 accounting for 1.5% of total GDP.

6. Employment in the budget sector will decline 1% in 2000 and 1.5% in 2001, whereas initially an increase in employment of 0.2 per cent in 1999 was assumed (in accordance with the Budget Act).

While it is conceivable that such a 'black scenario' could occur, we are of the opinion that the government and the NBP would do their utmost in order to prevent this happening. Simulation results of a collapse of the central budget are presented in Table 22.

Analysis of simulation results

On the one hand, an excessive stimulation of domestic demand would make it possible to maintain high GDP growth in 2000 – possibly even above 6% as in the 1996–97 period. On the other hand, the necessity of cooling down domestic demand arising from the failure of an expansionary macroeconomic policy would lead to a drop in GDP of 1% in 2001 (see Table 22).

The results of the alternative scenario simulation are summarised below:

1. We anticipate, as in the base scenario, that value-added growth in the agricultural sector would be small. On the other hand, in non-agricultural sectors value-added growth would decline to a level below 1% in 2001. Thus we forecast a mild recession in non-agricultural sectors mainly as a result of slower-than-average growth of industrial production (such as in 1998 and 1999).

2. Irresponsible macroeconomic policy would lead to a considerable acceleration in the growth of domestic demand of almost 10% in 2000. The necessity of cooling down demand would cause a reduction in domestic demand of 2.5% in 2001. This would be mainly the result of public spending cuts of 3% (in particular in central and local government institutions), a 7% decline in investment outlays as well as a decline in stockbuilding growth.

3. Due to the fiscal adjustment in 2000 and 2001, domestic demand would not stimulate the economy to a large extent. After an excessive rise in imports in 2001, a reduction in import growth, coupled with increased export expansion, would boost the share of foreign demand in Polish GDP.

4. An increase in consumption demand would stem partly from a reduction in the propensity to save due to low interest rates. Household savings rates would decline from over 13% in 1998 to nearly 9% in 2001.

5. The negative balance in the current account would exceed 10% of GDP in 1999 and 2000. Such a significant deterioration in the balance of payments and other items in the current account would cause a drop in foreign exchange reserves and put downward pressure on the zloty. The nominal exchange rate would reach 5.9 zloty per US$ in 2001 which would mean an increasse of almost 2 zlotys compared to the base scenario.

6. This, in turn, would increase inflationary pressures and ensure that annual inflation remains above 10%. CPI inflation would climb 15% annually over the period 1999–2001. Import prices would grow even faster due to the depreciating zloty.

7. Real interest rates, whilst initially at low levels due to expansionary fiscal and monetary policies, would have to be significantly increased – even above their 1997 levels.

Table 22. Warning forecast

	GDP		Domestic demand	Private consumption	Investment	Budget deficit	Value-added		
							total	industry	construction
	zloty billion	% change	% change	% change	% change	% of GDP	% change	% change	% change
1997 1Q–4Q	469.4	6.8	9.3	6.9	21.7	-1.3	6.5	10.3	13.6
1998 1Q–4Q	551.1	4.8	6.5	4.9	14.5	-2.4	4.5	4.4	10.2
forecast									
1999 1Q–4Q	*606.5*	*3.6*	*3.8*	*3.9*	*7.9*	*-2.1*	*3.4*	*3.0*	*4.7*
2000 1Q–4Q	*692.6*	*6.5*	*8.6*	*6.6*	*16.0*	*-5.2*	*6.0*	*8.2*	*10.4*
2001 1Q–4Q	*806.9*	*-1.0*	*-2.5*	*1.0*	*-6.8*	*1.0*	*-1.2*	*-3.0*	*-6.0*

	Unemployment rate (LFS)	Balance on		M2	Rediscount rate	Dollar exchange rate	Euro exchange rate	CPI	PPI
		current account	merchandise trade						
	%	US$ billion	US$ billion	zloty billion	%	zloty/US$	zloty/ euro	% change	% change
1997 1Q–4Q	10.2	-4.3	-11.3	176.4	24.5	3.28	3.71	14.9	12.2
1998 1Q–4Q	10.6	-6.9	-13.7	220.8	18.3	3.49	3.92	11.8	7.3
forecast									
1999 1Q–4Q	*11.8*	*-8.0*	*-13.7*	*251.5*	*14.5*	*3.86*	*4.16*	*6.5*	*5.1*
2000 1Q–4Q	*10.5*	*-17.0*	*-20.0*	*290.0*	*12.0*	*4.20*	*4.64*	*8.0*	*6.0*
2001 1Q–4Q	*13.0*	*-4.0*	*-9.0*	*345.0*	*30.0*	*5.90*	*6.73*	*17.0*	*15.0*

Source: CASE.

Threats

1. In 1999 and 2000, the economic situation in Poland will be difficult. Considerable tensions in the state budget are forecast. If expenditures – in particular in local budgets and para-budgets – are not limited, then demand for financing the government sector may grow excessively. At the same time, the anticipated smaller budget deficit in the second-half of 1999 may lead to relative credit expansion.

2. Trends in some macroeconomic variables – in particular faster growth in Polish enterprises' indebtedness to foreign creditors, an increase in unemployment and continued rapid growth in household consumption – are a growing concern. The continuation of such trends would give rise to economic tensions similar to those experienced in the second-half of 1996.

3. A significant slump in households' propensity to save is also of enormous concern. The continuation of this trend could jeopardise the government's long-term economic strategy. Household savings have hitherto constituted a crucial component of domestic savings and their decrease, coupled with a decline in corporate profits, would lower investment activity and even derail economic growth.

4. Maintaining a fast pace of growth remains a key dilemma in economic policy. We are of the opinion that, in view of the pick-up in inflation, stimulating domestic demand (and in turn fuelling inflationary pressures) would not be a wise policy.

5. An additional downside risk is the prospect for export growth. A continuation of sluggish growth in the EU poses a serious threat to the Polish economy. Low economic activity and the weak euro imply a decrease in the demand for imported goods in the EU. Therefore we are of the opinion that EU economic growth, in particular in Germany, Italy and Great Britain (the main export markets), will be a key factor determining the possibilities for faster Polish economic growth in the second-half of 1999 and 2000.

Recommendations for economic policy

1. An uncertain situation in the state budget requires tighter fiscal discipline. At the same time any attempts to finance expenditures from non-budget sources should be restrained.

2. Economic policy should take into account slower export growth. We recommend the implementation of export-promoting measures which do not result in excessive increases in budgetary expenditures – such as export guarantees.

3. There should not be an over-stimulation of domestic demand (as this results in a deterioration in the current account balance) **and credit expansion should remain under control.** This will not be an easy task due to the reduction in obligatory reserve rates and pressure for lowering interest rates in the second-half of 1999.

4. Interest rates should be reduced with caution given their stimulating effect on domestic demand.

5. The NBP should not intervene in the exchange market to weaken the zloty. This would prove costly for the budget and result in a drop in the NBP's profits – possibly even negative earnings.

Appendix

CASE
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Table A1. GDP at 1997 prices, 1994–2000 (% change yoy)

		GDP	Gross value-added					
			total	agriculture and forestry	industry	construction	market services	non-market services
1994	1Q–4Q	5.2	4.9	-15.1	9.6	2.7	6.9	7.4
1995	1Q–4Q	7.0	6.7	10.4	10.2	5.8	6.0	2.5
1996	1Q–4Q	6.0	5.3	2.4	7.5	2.8	6.1	2.6
1997	1Q–4Q	6.8	6.5	2.6	10.3	13.6	4.4	3.0
1998e 1	1Q–4Q	4.8	4.5	6.3	4.4	10.2	4.7	0.1
forecast								
1999	*1Q–4Q*	*3.6*	*3.4*	*2.7*	*3.0*	*4.7*	*4.2*	*1.1*
2000	*1Q–4Q*	*5.4*	*5.2*	*3.2*	*7.2*	*10.2*	*4.1*	*1.6*
1995	1Q	6.2	6.6	7.3	11.1	7.0	4.6	4.4
	2Q	6.7	6.7	8.1	10.6	7.3	5.1	3.8
	3Q	8.1	7.4	16.3	9.9	6.1	6.0	3.2
	4Q	6.8	6.1	9.0	9.3	4.1	6.8	-0.3
1996	1Q	3.3	3.0	1.8	5.7	-13.6	3.6	2.8
	2Q	5.1	5.2	2.2	7.0	1.0	6.0	2.6
	3Q	7.1	6.3	3.2	9.7	5.2	6.0	2.6
	4Q	7.7	6.4	2.1	7.7	10.1	6.7	2.3
1997	1Q	6.9	6.4	-1.5	8.7	14.7	5.5	4.7
	2Q	7.5	6.7	1.7	11.5	15.6	4.4	1.8
	3Q	6.7	6.4	2.7	10.7	13.3	4.2	0.7
	4Q	6.4	6.3	0.3	10.2	12.2	3.7	4.0
1998e 1	1Q	6.4	6.2	1.2	10.6	15.0	4.3	1.6
	2Q	5.4	5.1	5.0	5.6	11.7	5.6	-2.0
	3Q	5.0	4.7	5.8	3.6	9.9	5.8	-0.4
	4Q	2.9	2.7	13.4	-1.1	7.7	3.5	0.7
1999e2	1Q	1.5	1.3	3.7	-3.0	2.0	4.1	0.9
	2Q	3.0	2.7	2.3	0.9	3.7	4.2	1.2
forecast								
1999	*3Q*	*3.9*	*3.6*	*2.0*	*3.8*	*4.8*	*4.1*	*1.1*
	4Q	*5.7*	*5.5*	*1.2*	*9.8*	*6.4*	*4.4*	*1.1*
2000	*1Q*	*5.3*	*5.1*	*1.8*	*8.3*	*8.8*	*4.2*	*1.5*
	2Q	*5.2*	*4.9*	*3.0*	*7.2*	*8.6*	*4.0*	*1.6*
	3Q	*5.2*	*5.0*	*3.6*	*6.3*	*9.4*	*4.1*	*1.8*
	4Q	*5.8*	*5.6*	*4.2*	*7.2*	*12.4*	*4.2*	*1.7*

Source: Data and estimates (e1) – CSO; estimates (e2) and forecast – CASE.
Notes: Data not seasonally adjusted.

Table A2. Aggregate demand at current prices, 1994–2000 (billion zloty)

		GDP	Domestic demand	Consumption			Investment	Stock-building	Net exports
				total	personal	public			
1994	1Q–4Q	223.90	219.78	179.40	139.94	39.46	40.39	-0.71	4.83
1995	1Q–4Q	306.32	295.78	238.38	184.78	53.60	57.40	3.30	7.24
1996	1Q–4Q	385.45	387.05	306.66	239.76	66.90	80.39	4.43	-6.03
1997	1Q–4Q	469.37	484.60	373.74	293.87	79.88	110.85	5.15	-20.37
1998e1	1Q–4Q	551.11	573.56	433.89	343.39	90.50	139.67	5.80	-28.25
forecast									
1999	*1Q–4Q*	*606.46*	*644.84*	*480.05*	*382.13*	*97.92*	*164.79*	*2.06*	*-40.44*
2000	*1Q–4Q*	*679.82*	*719.82*	*526.72*	*421.37*	*105.35*	*193.10*	*3.18*	*-43.18*
1995	1Q	69.22	65.27	54.61	42.48	12.12	10.66	0.98	2.98
	2Q	73.85	71.29	59.13	45.23	13.90	12.16	0.94	1.62
	3Q	78.92	75.50	61.01	47.53	13.48	14.49	0.85	2.58
	4Q	84.33	83.72	63.63	49.53	14.10	20.09	0.54	0.06
1996	1Q	84.72	82.74	71.77	55.99	15.78	10.97	0.63	1.35
	2Q	92.28	93.07	77.11	59.87	17.24	15.95	0.72	-1.51
	3Q	97.87	99.17	78.24	61.27	16.97	20.93	1.03	-2.33
	4Q	110.58	112.08	79.53	62.63	16.91	32.54	2.05	-3.54
1997	1Q	103.08	104.01	88.53	69.53	19.00	15.48	0.92	-1.85
	2Q	112.24	115.81	92.52	73.12	19.40	23.29	1.03	-4.60
	3Q	118.39	122.05	94.93	75.50	19.43	27.13	0.96	-4.62
	4Q	135.66	142.72	97.76	75.72	22.05	44.96	2.24	-9.30
1998e1	1Q	123.12	128.37	107.07	84.41	22.66	21.30	1.14	-6.39
	2Q	132.95	137.55	107.94	84.73	23.20	29.61	1.31	-5.90
	3Q	139.02	144.50	111.15	88.10	23.05	33.35	1.33	-6.81
	4Q	156.01	163.14	107.72	86.14	21.58	55.42	2.02	-9.15
1999e2	1Q	133.25	143.49	118.77	94.42	24.36	24.72	0.09	-10.34
	2Q	145.39	154.41	119.93	94.73	25.20	34.48	0.56	-9.58
forecast									
1999	*3Q*	*153.19*	*162.29*	*122.84*	*97.85*	*24.99*	*39.45*	*0.70*	*-9.80*
	4Q	*174.62*	*184.64*	*118.50*	*95.13*	*23.37*	*66.14*	*0.70*	*-10.73*
2000	*1Q*	*150.11*	*159.95*	*130.43*	*104.18*	*26.25*	*29.52*	*0.41*	*-10.24*
	2Q	*163.23*	*171.85*	*131.52*	*104.43*	*27.09*	*40.33*	*0.85*	*-9.47*
	3Q	*170.79*	*180.67*	*134.76*	*107.87*	*26.89*	*45.91*	*0.95*	*-10.83*
	4Q	*195.69*	*207.35*	*130.00*	*104.88*	*25.12*	*77.35*	*0.97*	*-12.63*

Source: Data and estimates (e1) – CSO; estimates (e2) and forecast – CASE.

Note: Domestic demand is defined as the sum of private consumption (i.e. of individuals and non-commercial institutions), public consumption and investment. Consumption of non-commercial institutions is not separated in the table.

Table A3. Aggregate demand at 1997 prices, 1994–2000 (% change yoy)

		GDP	Domestic demand	Consumption			Investment
				total	personal	public	
1994	I–IV	5.2	4.8	3.9	4.3	2.8	9.2
1995	I–IV	7.0	5.5	3.2	3.3	2.9	16.5
1996	I–IV	6.0	9.5	7.1	8.2	3.4	19.7
1997	I–IV	6.8	9.3	6.1	6.9	3.4	21.7
1998e 1	I–IV	4.8	6.5	4.2	4.9	1.5	14.5
forecast							
1999	*I–IV*	*3.6*	*3.8*	*3.4*	*3.9*	*1.5*	*7.9*
2000	*I–IV*	*5.4*	*5.5*	*3.6*	*4.1*	*1.5*	*10.6*
1996	I	3.3	6.9	8.1	6.9	2.4	12.9
	II	5.3	8.8	2.3	7.0	5.3	20.1
	III	7.1	10.2	1.7	8.1	3.4	25.2
	IV	7.9	11.6	-3.1	10.8	2.5	19.1
1997	I	6.9	7.9	6.0	6.7	3.5	19.6
	II	7.5	9.0	6.4	7.1	3.7	21.0
	III	6.7	9.2	6.3	7.0	3.6	21.2
	IV	6.4	10.6	5.7	6.6	2.6	23.2
1998e 1	I	6.4	7.4	5.5	6.4	2.1	17.5
	II	5.4	5.8	3.5	4.1	1.5	14.9
	III	5.0	6.2	3.8	4.5	1.4	14.6
	IV	2.9	6.7	3.8	4.6	1.0	13.1
1999e2	I	1.5	3.2	3.7	4.2	1.4	6.0
	II	3.0	3.4	3.5	4.0	1.5	5.5
forecast							
1999	III	*3.9*	*3.9*	*3.3*	*3.8*	*1.6*	*7.6*
	IV	*5.7*	*4.4*	*3.2*	*3.6*	*1.5*	*10.3*
2000	*I*	*5.3*	*4.9*	*3.4*	*3.8*	*1.5*	*11.0*
	II	*5.2*	*5.1*	*3.4*	*4.0*	*1.4*	*10.6*
	III	*5.2*	*5.3*	*3.6*	*4.2*	*1.5*	*10.2*
	IV	*5.8*	*6.3*	*3.8*	*4.4*	*1.6*	*10.6*

Source: Data and estimates (e1) – CSO; estimates (e2) and forecast – CASE.

Notes: 1. Domestic demand is defined as the sum of private consumption (i.e. of individuals and non-commercial institutions), public consumption and investment. Consumption of non-commercial institutions is not separated in the table.

2. Data are not seasonally adjusted.

Table A4. Employment, 1994–2000 ('000)

		Total	Paid employment				Market services	Non-market services
			of which employment	agriculture and forestry	industry	construction		
1994	1Q–4Q	14475	8519	3887	3641	820	3938	2189
1995	1Q–4Q	14735	8570	3836	3757	841	4054	2248
1996	1Q–4Q	15021	8548	4010	3730	843	4161	2277
1997	1Q–4Q	15439	8637	3985	3740	908	4489	2316
1998	1Q–4Q	15491	8752	3973	3707	937	4522	2352
forecast								
1999	*1Q–4Q*	15463	8728	3939	3633	923	4620	2349
2000	*1Q–4Q*	15586	8791	3925	3613	969	4730	2350
1994	1Q	14300	8486	3891	3587	797	3879	2145
	2Q	14431	8485	3895	3632	822	3931	2152
	3Q	14461	8517	3916	3636	829	3922	2159
	4Q	14706	8587	3904	3708	831	3964	2300
1995	1Q	14489	8507	3839	3657	800	3960	2233
	2Q	14711	8562	3835	3755	847	4042	2233
	3Q	14763	8534	3863	3782	855	4044	2219
	4Q	14977	8668	3856	3835	862	4117	2307
1996	1Q	14682	8487	4002	3635	737	4047	2260
	2Q	14932	8513	4001	3721	837	4119	2255
	3Q	15083	8522	4044	3754	879	4157	2249
	4Q	15386	8671	4038	3811	919	4274	2344
1997	1Q	15048	8567	3982	3645	789	4343	2290
	2Q	15374	8645	3980	3731	913	4440	2311
	3Q	15594	8675	4020	3771	956	4538	2309
	4Q	15739	8706	4006	3813	974	4591	2356
1998	1Q	15276	8717	3960	3651	844	4472	2349
	2Q	15479	8759	3957	3737	943	4501	2341
	3Q	15551	8714	3995	3714	978	4541	2322
	4Q	15657	8817	3978	3729	982	4573	2395
1999	1Q	15163	8747	3930	3558	810	4506	2359
	2Q	15410	8690	3925	3648	920	4568	2350
forecast								
1999	*3Q*	15568	8694	3960	3645	970	4665	2328
	4Q	15712	8783	3940	3681	991	4741	2358
2000	*1Q*	15275	8789	3920	3540	870	4586	2359
	2Q	15528	8790	3910	3620	970	4678	2349
	3Q	15698	8759	3940	3623	1010	4795	2330
	4Q	15845	8825	3930	3668	1025	4861	2360

Source: Annual data – CSO; quarterly data and forecast – CASE.
Note: Employment is calculated according to the CSO's methodology.

Table A5. Unemployment, 1995–2000

		Registered unemployment		Unemployment LFS	
		('000)	%	('000)	%
1995	1Q–4Q	2341	13.5	2018	11.6
1996	1Q–4Q	2360	13.2	1961	11.5
1997	1Q–4Q	1826	10.3	1737	10.2
1998	1Q–4Q	1831	10.4	1827	10.6
forecast					
1999	*1Q–4Q*	*2060*	*11.6*	*2066*	*11.8*
2000	*1Q–4Q*	*2067*	*11.5*	*2073*	*11.7*
1995	1Q	2754	15.5	2491	14.7
	2Q	2694	15.2	2156	12.6
	3Q	2657	15.0	2227	12.9
	4Q	2629	14.9	2233	13.1
1996	1Q	2726	15.4	2349	14.0
	2Q	2508	14.3	2103	12.4
	3Q	2341	13.5	2018	11.6
	4Q	2360	13.2	1961	11.5
1997	1Q	2236	12.6	2176	12.8
	2Q	2040	11.6	1927	11.3
	3Q	1854	10.7	1853	10.7
	4Q	1826	10.3	1737	10.2
1998	1Q	1846	10.4	1896	11.1
	2Q	1688	9.6	1753	10.2
	3Q	1677	9.6	1786	10.3
	4Q	1831	10.4	1827	10.6
1999	1Q	2170	12.1	2141	12.5
	2Qe	2070	11.6	2055	11.9
forecast					
1999	*3Q*	*1990*	*11.3*	*2034*	*11.6*
	4Q	*2060*	*11.6*	*2066*	*11.8*
2000	*1Q*	*2199*	*12.2*	*2149*	*12.5*
	2Q	*2093*	*11.6*	*2077*	*11.9*
	3Q	*2000*	*11.2*	*2043*	*11.5*
	4Q	*2067*	*11.5*	*2073*	*11.7*

Source: Data – CSO; estimates (e) and forecast – CASE.
Note: LFS – labour force survey.

Table A6. Selected price indices, 1996–1999 (% yoy)

		CPI	PPI		Export price index	Import price index
			industry	construction		
1996	01	21.0	14.1	22.0	7.1	6.8
	02	20.4	14.8	21.6	8.6	5.4
	03	20.4	15.5	20.5	3.0	9.8
	04	20.3	14.6	20.5	6.0	8.0
	05	19.8	13.7	19.9	6.6	3.7
	06	19.5	13.2	20.0	12.1	11.6
	07	20.4	11.8	19.7	12.1	7.2
	08	20.5	11.3	18.9	14.6	12.3
	09	19.5	9.6	18.3	10.9	12.3
	10	19.5	10.3	17.5	1.2	17.3
	11	19.1	10.1	16.6	7.5	13.6
	12	18.5	11.2	16.3	8.3	21.7
1997	01	17.8	12.9	14.5	12.5	16.0
	02	17.3	11.9	14.4	7.9	13.4
	03	16.6	11.8	14.5	12.7	9.8
	04	15.3	12.0	14.5	11.9	11.6
	05	14.6	12.4	14.4	9.2	17.0
	06	15.3	12.2	14.0	14.1	8.6
	07	14.9	12.0	14.3	14.5	14.1
	08	14.5	12.5	14.2	10.5	16.2
	09	13.6	13.0	14.1	15.2	14.7
	10	13.1	12.1	14.3	16.3	13.1
	11	13.2	12.1	14.2	12.9	14.8
	12	13.2	11.5	14.5	13.4	14.5
1998	01	13.6	9.2	15.7	9.8	7.9
	02	14.2	9.1	15.7	10.0	11.0
	03	13.9	9.2	15.4	11.5	10.4
	04	13.7	8.4	14.6	8.4	4.4
	05	13.3	8.2	14.4	8.2	0.7
	06	12.2	7.7	14.1	7.8	4.4
	07	11.9	7.0	13.6	6.9	1.5
	08	11.3	6.6	13.0	4.4	–5.6
	09	10.6	6.4	12.4	7.0	3.3
	10	9.9	5.8	11.7	3.8	3.4
	11	9.2	5.1	11.1	3.2	–2.3
	12	8.6	4.8	10.6	4.7	–5.1
1999	01	6.9	3.9	9.9	2.9	–0.4
	02	5.6	3.7	9.4	9.7	1.6
	03	6.2	4.7	9.0	10.7	5.6
	04	6.3	5.0	8.6	9.9	9.1
	05	6.4	5.2	8.4		
	06	6.5	5.3	8.1		

Source: CSO.

Table A7. Exchange rates, 1996–1999 (in zloty)

		US$/zloty	DM/zloty	Euro(ECU)/zloty
1996	01	2.5110	1.7189	3.1702
	02	2.5442	1.7350	3.1858
	03	2.5760	1.7437	3.2304
	04	2.6214	1.7435	3.2605
	05	2.6716	1.7432	3.2826
	06	2.7145	1.7774	3.3630
	07	2.7147	1.8047	3.4098
	08	2.7291	1.8401	3.4612
	09	2.7781	1.8443	3.4956
	10	2.8189	1.8435	3.5322
	11	2.8158	1.8628	3.5766
	12	2.8579	1.8447	3.5542
1997	01	2.9273	1.8312	3.5538
	02	3.0279	1.8104	3.5132
	03	3.0793	1.8163	3.5276
	04	3.1212	1.8250	3.5604
	05	3.1713	1.8605	3.6272
	06	3.2385	1.8749	3.6618
	07	3.3965	1.8962	3.7416
	08	3.4817	1.8948	3.7276
	09	3.4566	1.9333	3.7917
	10	3.4223	1.9454	3.8226
	11	3.5033	2.0230	3.9996
	12	3.5256	1.9852	3.9268
1998	01	3.5316	1.9461	3.8432
	02	3.5386	1.9505	3.8503
	03	3.4593	1.8941	3.7560
	04	3.4194	1.8827	3.7329
	05	3.4188	1.9246	3.7917
	06	3.4789	1.9420	3.8362
	07	3.4592	1.9226	3.8002
	08	3.5850	2.0046	3.9543
	09	3.6066	2.1211	4.1713
	10	3.4955	2.1353	4.2071
	11	3.4496	2.0514	4.0323
	12	3.4858	2.0884	4.0979
1999	01	3.5417	2.1007	4.1087
	02	3.7948	2.1727	4.2494
	03	3.9430	2.1928	4.2886
	04	4.0016	2.1905	4.2843
	05	3.9368	2.1387	4.1830
	06	3.9431	2.0947	4.0969

Source: NBP.
Notes: 1. Monthly average.
2. Until 1998-end the Ecu exchange rate, then the euro exchange rate.

Table A8. Foreign trade, 1996–1999 (US$ million)

		Exports		Imports		Net exports	
		CSO	NBP	CSO	NBP	CSO	NBP
1996	01	1913	1737	2659	2398	–746	–661
	02	1946	1803	2683	2202	–737	–399
	03	2089	1997	2857	2379	–767	–382
	04	1993	1968	3008	2488	–1016	–520
	05	1898	2030	2998	2679	–1100	–649
	06	1893	1876	3059	2411	–1166	–535
	07	2238	2304	3239	2844	–1001	–540
	08	2036	1906	2874	2716	–838	–810
	09	2095	2011	3186	2775	–1091	–764
	10	2384	2196	3679	3327	–1295	–1131
	11	2107	2145	3490	2950	–1384	–805
	12	1848	2447	3407	3405	–1559	–958
1997	01	2011	1905	3405	3383	–1394	–1478
	02	2029	1941	3051	2650	–1022	–709
	03	2081	1920	3313	2805	–1231	–885
	04	2180	2361	3652	3319	–1472	–958
	05	1947	2035	3336	2864	–1388	–829
	06	2187	2296	3569	3196	–1382	–900
	07	2015	2372	3396	3275	–1382	–903
	08	1888	2157	3073	2876	–1186	–719
	09	2304	2489	3677	3397	–1373	–908
	10	2676	2790	3999	3654	–1324	–864
	11	2292	2359	3898	3311	–1606	–952
	12	2142	2604	3940	3819	–1797	–1215
1998	01	2156	2120	3172	3565	–1016	–1445
	02	2377	2265	3667	3078	–1290	–813
	03	2490	2671	4248	3657	–1758	–986
	04	2340	2468	3849	3496	–1509	–1028
	05	2300	2449	3886	3350	–1586	–901
	06	2401	2753	3959	3699	–1558	–946
	07	2393	2936	3929	3924	–1537	–988
	08	2168	2529	3552	3309	–1385	–780
	09	2332	2336	4516	3864	–2183	–1528
	10	2621	2533	4372	3908	–1750	–1375
	11	2369	2369	4098	3695	–1728	–1326
	12	2283	2693	3807	4297	–1524	–1604
1999	01	2040	2119	3153	3331	–1113	–1212
	02	2092	2495	3234	3279	–1143	–784
	03	2442	2398	4028	3223	–1586	–825
	04	2142	2159	3621	3195	–1479	–1036
	05	2100	1989	3610	3020	–1511	–1031
	06		2171		3430		

Source: NBP and CSO.
Note: NBP data on payments basis, CSO's data on SAD basis.

Table A9. Balance of payments, 1997–1999 (US$ million)

		Balance on						Gross foreign exchange reserves
		current account	merchandise	current transfers	unclassified current transactions	direct investment	portfolio investment	
1997	01	–898	–1478	87	379	108	204	–559
	02	–228	–709	89	350	138	352	–306
	03	–408	–885	80	391	210	–148	374
	04	–766	–958	111	493	317	528	–668
	05	–139	–829	88	524	168	310	–328
	06	–289	–900	78	454	294	233	–954
	07	–318	–903	103	508	290	301	–44
	08	–138	–719	68	527	110	203	–419
	09	–454	–908	90	589	377	135	1
	10	–64	–864	120	762	477	421	–823
	11	–283	–952	96	509	292	–246	–8
	12	–327	–1215	140	525	260	–195	143
1998	01	–963	–1443	102	374	477	–309	–97
	02	–278	–813	131	397	150	268	–2197
	03	–755	–986	120	392	277	253	–284
	04	–428	–1001	121	578	334	89	–848
	05	–200	–901	117	587	539	130	–492
	06	–8	–945	399	550	248	144	–650
	07	–102	–988	192	574	589	121	–1378
	08	183	–780	165	856	661	–643	–174
	09	–1296	–1528	163	438	496	–336	649
	10	–962	–1375	159	449	359	–73	228
	11	–830	–1326	149	363	201	723	–634
	12	–1187	–1604	124	437	638	963	178
1999	01	–894	–1 212	101	320	291	–81	74
	02	–512	–784	102	242	317	–177	–83
	03	–833	–825	176	237	530	–46	–142
	04	–938	–1 036	113	232	364	2	108
	05	–690	–1031	108	300	403	–251	64
	06	–1174	–1259	133	253	366	167	–37

Source: NBP.
Note: May and June data – preliminary.

Table A10. Interest rates, 1996–1999

		Rediscount rate	Lombard rate	3-month WIBOR	28-day repo rate
1996	01	23.0	26.0	23.8	–
	02	23.0	26.0	22.7	–
	03	23.0	26.0	22.7	–
	04	23.0	26.0	22.7	–
	05	23.0	26.0	21.9	–
	06	23.0	26.0	21.6	–
	07	22.0	25.0	20.5	–
	08	22.0	25.0	19.7	–
	09	22.0	25.0	19.8	–
	10	22.0	25.0	19.7	–
	11	22.0	25.0	19.8	–
	12	22.0	25.0	22.1	–
1997	01	22.0	25.0	22.4	–
	02	22.0	25.0	22.5	–
	03	22.0	25.0	22.6	–
	04	22.0	25.0	22.8	–
	05	22.0	25.0	22.8	–
	06	22.0	25.0	22.7	–
	07	22.0	25.0	24.0	–
	08	24.5	27.0	25.6	–
	09	24.5	27.0	25.4	–
	10	24.5	27.0	25.2	–
	11	24.5	27.0	25.3	–
	12	24.5	27.0	25.7	–
1998	01	24.5	27.0	26.1	23.5
	02	24.5	27.0	25.2	24.0
	03	24.5	27.0	25.1	23.0
	04	24.5	27.0	24.5	23.0
	05	23.5	26.0	23.2	21.5
	06	23.5	26.0	22.1	21.5
	07	21.5	24.0	21.0	19.0
	08	21.5	24.0	19.8	19.0
	09	21.5	24.0	18.8	18.0
	10	20.0	22.0	17.9	17.0
	11	20.0	22.0	16.7	17.0
	12	18.25	20.0	15.9	15.5
1999	01	15.5	17.0	14.8	13.0
	02	15.5	17.0	13.2	13.0
	03	15.5	17.0	13.2	13.0
	04	15.5	17.0	13.2	13.0
	05	15.5	17.0	13.3	13.0
	06	15.5	17.0	13.3	13.0

Source: NBP.
Note: Month-end except for WIBOR – monthly average.

Table A11. Monetary indicators, 1996–2000 (billion zloty)

		M0	M2	Cash	Zloty deposits			Foreign currency deposits	Credits			Net liabilities of the budgetary sector
					total	individual	corporate		total	individual	corporate	
1996	1Q–4Q	34.2	134.8	27.6	103.2	73.3	29.9	28.1	100.3	16.4	83.9	49.1
1997	1Q–4Q	42.3	176.4	27.3	115.5	80.9	34.6	30.2	106.3	18.4	87.9	55.3
1998	1Q–4Q	53.6	220.8	30.2	156.9	109.6	47.3	33.6	138.5	23.9	114.6	61.3
forecast												
1999	*1Q–4Q*	*61.1*	*251.5*	*35.0*	*182.0*	*130.0*	*52.0*	*34.5*	*173.9*	*32.5*	*141.4*	*71.6*
2000	*1Q–4Q*	*69.8*	*287.2*	*37.4*	*215.0*	*159.0*	*56.0*	*34.8*	*220.2*	*42.1*	*178.1*	*76.9*
1996	1Q	30.0	110.6	20.6	68.9	46.3	22.5	21.1	59.6	6.4	53.2	41.4
	2Q	33.0	116.9	22.3	73.0	49.7	23.3	21.5	64.2	7.8	56.3	44.6
	3Q	32.6	123.3	23.0	77.9	52.8	25.1	22.4	70.6	9.4	61.2	45.6
	4Q	34.2	134.8	23.6	88.0	57.4	30.6	23.3	81.1	11.8	69.3	46.8
1997	1Q	37.7	141.6	24.6	89.4	63.3	26.1	24.6	86.9	12.8	74.1	49.9
	2Q	41.2	151.8	26.8	95.8	68.5	27.3	26.0	93.3	14.8	78.4	49.8
	3Q	44.1	162.3	27.6	103.2	73.3	29.9	28.1	100.3	16.4	83.9	49.1
	4Q	42.3	176.4	27.3	115.5	80.9	34.6	30.2	106.3	18.4	87.9	55.3
1998	1Q	44.4	180.4	27.3	120.2	88.9	31.3	29.1	112.4	18.6	93.8	50.3
	2Q	49.7	192.3	29.7	128.9	95.1	33.8	28.9	118.8	20.1	98.7	50.7
	3Q	49.7	203.5	30.3	138.2	101.8	36.4	30.0	126.9	21.9	105.0	56.8
	4Q	53.6	220.8	30.2	156.9	109.6	47.3	33.6	138.5	23.9	114.6	61.3
1999	1Q	56.6	230.3	32.0	161.2	116.5	44.6	37.1	148.6	25.3	123.3	63.9
	2Q	60.7	234.8	33.4	165.8	118.9	46.9	35.6	154.8	28.4	126.4	64.8
forecast												
1999	*3Q*	*59.0*	*241.4*	*35.5*	*171.0*	*123.0*	*48.0*	*34.9*	*161.7*	*30.0*	*131.7*	*67.4*
	4Q	*61.1*	*251.5*	*35.0*	*182.0*	*130.0*	*52.0*	*34.5*	*173.9*	*32.5*	*141.4*	*71.6*
2000	*1Q*	*63.0*	*256.1*	*35.0*	*187.0*	*138.0*	*49.0*	*34.1*	*183.0*	*33.6*	*149.4*	*67.6*
	2Q	*68.3*	*263.9*	*37.0*	*193.0*	*143.0*	*50.0*	*33.9*	*191.0*	*35.9*	*155.1*	*68.6*
	3Q	*66.6*	*272.7*	*37.6*	*201.0*	*149.0*	*52.0*	*34.1*	*202.4*	*38.4*	*164.0*	*71.7*
	4Q	*69.8*	*287.2*	*37.4*	*215.0*	*159.0*	*56.0*	*34.8*	*220.2*	*42.1*	*178.1*	*76.9*

Source: Data – NBP and forecast – CASE.