Quarterly 3/99

POLISH ECONOMIC OUTLOOK

TRENDS • ANALYSES • FORECASTS

Summary

The Polish economy overcame the adverse effects of the Russian crisis in 3Q. **We estimate GDP growth at 4.2%.** This was driven by domestic demand – in particular household consumption. In our view, **domestic demand growth was as high as 6%** which gives rise to concern. Such a significant strengthening of domestic demand took place at the expense of a dramatic decline in households' propensity to save in 2Q and 3Q as well as a deterioration in the current account balance. Foreign demand was still weak. According to our estimates, exports were only slightly lower than in 3Q98.

Output and value-added in the manufacturing, mining, and water and gas supply sectors rose by 7.5% – the highest pace since 1Q98. Value-added declined only in the transport and agricultural sectors. The drop in agricultural output is, on the one hand, the result of the weather (i.e. the drought) and, on the other, a reduction in livestock production due to low prices.

We forecast 3.8% GDP growth in 1999 (6.1% in 4Q), 5.4% in 2000 and 6.3% in 2001. Domestic demand will grow 5.1% in 1999, 5.2% and 6.0% in 2000 and 2001 respectively. The stabilisation of domestic demand growth in 2000 at this year's level is primarily due to the anticipated tightening of fiscal policy (i.e. decline in the consolidated budget deficit) and a more restrictive monetary stance in the next 6 months.

A change in economic policy will be determined mainly by the return of inflationary pressures. CPI rose 8% yoy in September, and we forecast 9.2% yoy in December. The rise in inflation is mainly the result of intervention on the agricultural market, the rise in fuel prices and the weak zloty. The inflation peak will occur in February 2000 (our forecast is 9.8%). From then on, inflation will decline reaching 6.6% in December 2000 and 5.4% in December 2001.

We expect that only in the beginning of 2000 will the recovery in the EU result in Polish export growth. At the same time, the stabilisation of domestic demand growth will not allow imports to increase considerably. As a consequence, the merchandise trade balance will deteriorate only slightly. **In 4Q we expect an improvement in the current account deficit. Nevertheless, the deficit will amount to US$(-10.7) billion in 1999 (i.e. 6.7% of GDP). In the following two years it will stay at US$(-10.4) billion (i.e. 6.0%) and US$(-12.6) billion (i.e. 6.6% of GDP) respectively.** The anticipated inflow of foreign investment in Poland will compensate for the current account deficit and raise foreign currency reserves from US$27 billion at end-1999, to US$30.3 billion at end-2000, and US$32.5 billion by end-2001.

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

This issue analyses the economic situation in Poland in 3Q99 focusing on both internal and external risks to economic development and provides an outlook for 1999–2001. Particular attention is drawn to the lack of co-ordination between fiscal and monetary policies and its effects in the form of excessive domestic demand and the drop in domestic savings – principally of households.

All estimates and forecasts are derived from data available at the end of October. One should note that various data for previous years are updated in line with changes in official statistics.

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

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Quarterly 3/99

POLISH ECONOMIC OUTLOOK
TRENDS • ANALYSES • FORECASTS

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Assessment of the economic situation in 3Q99

The 1998 Russian financial crisis and the ensuing contraction in Polish exports to the East were the main reasons behind slower growth in Poland throughout the three consecutive quarters starting from 4Q98. However, the economy gathered steam in 2Q99 and effects of the external shock were overcome in 3Q99. We estimate GDP growth of 4.2% in 3Q representing a higher growth pace than that recorded in the two pervious quarters. As in 2Q healthy growth was mainly driven by domestic demand. On the other hand, foreign demand was weak owing to low volumes of official and cross-border exports to the Commonwealth of Independent States (CIS) and to diminished demand for Polish commodities in the European Union (EU).

Changes in some macroeconomic variables reflected the economic situation in Poland:

- The number of unemployed increased; this was a delayed reaction of enterprises (primarily in the manufacturing, mining, water and gas supply, and construction sectors) that adjusted labour demand to demand for goods and the long-term labour productivity trend,
- Dynamics of real wages and real disposable incomes of households was lower than a year ago,
- Low household propensity to save (close to 2Q-levels),
- Inflation rose from 6.4% in 2Q99 to 7.2% in 3Q99,
- The zloty stabilised at the central exchange rate,
- Money supply growth on the decline,
- The government budget ended 3Q with a small surplus, nonetheless financial troubles of ZUS (state insurer) significantly widened the consolidated budget deficit.

Faster Economic Growth

Faster economic growth stems primarily from the upturn in manufacturing. We estimate that value-added in industry rose 7.5%. Output in the construction sector is still growing at a slower pace compared to 3Q98 and even 2Q. Market services were rising at the same rate as in previous quarters, i.e. approximately 4%. Value-added in non-market services featured a fairly stable growth of roughly 1% *per annum* – considerably slower than in 1997 while faster than in 1998.

Agricultural output and value-added are lower compared to the previous year. This results from less bumpier harvests and smaller production of livestock and milk.

Polish firms reacted well to the drop in demand. Adjustments on the demand side were coupled with a reduction in employment, gradual increases in labour productivity and a lowering of production unit cost dynamics.

Stable Domestic Demand

The pace of households' consumption growth amounted to 5.7% and outpaced growth in the first two quarters of the year. Additionally, investment demand went up as a result of the increase in investment outlays of 10%.

Households' propensity to save was low. The intention to maintain consumption at the same level as well as the relatively slow growth of real income made demand for consumption credits rise, whereas low interest rates did not encourage higher savings.

Current account stabilisation

Like the situation in 2Q99, exports in 3Q were lower than a year ago. We estimate that exports declined 15% yoy in 3Q. Moreover, the balance on unclassified current transactions (a proxy for cross-border trade) deteriorated by US$715 billion yoy.

Slower domestic demand growth and the weaker zloty (as compared to 3Q98) reduced import growth by over 10%. Consequently, the deficit on merchandise trade balance is estimated to be US$(-3.8) billion in 3Q99.

It should be stressed that the decline in export revenues and import payments can be partially explained by the relative strengthening of the dollar versus other currencies. For instance, nominal exchange rate of the dollar versus the euro stood 6.4% higher yoy in 3Q99 and 4.5% in 2Q99 respectively.

The deficit on the current account amounted to US$(-3.0) and it was US$0.2 billion lower than in 2Q99 and US$1.7 billion yoy respectively. A minor deterioration in the deficit as compared to the previous quarter resulted from the deterioration in the merchandise trade balance.

3Q99 saw an improvement in the balance of payments. Privatisation revenues and FDI caused foreign currency reserves to increase from US$25.8 billion at end-June to US$26 billion at end-September.

Stable zloty

A relative improvement in the merchandise trade balance and sizeable privatisation revenues strengthened the zloty in July. The exchange rate fluctuated within the range of 3–6% below the central exchange rate. However, the official statement that privatisation revenues denominated in foreign currencies will not go through the Polish forex market, coupled with a worsening macroeconomic performance (in the opinion of investors), weakened the zloty. At end-September the zloty exchange rate fluctuated around the central exchange rate.

A lowering of households' propensity to save, weaker economic activity and a relative strengthening of the zloty slowed money supply growth from over 27% at end-March to over 20% at end-September.

Credits to households have been growing at a faster rate when compared to the previous year as well to 1Q99 and 2Q99. At end-September credits were 47% higher than a year ago. Growth of credits for households was clearly accelerating (almost 35% in 1Q) whereas credits for corporate credits have been declining since 1Q99. Corporate credits increased over 28% in 3Q.

Higher inflation

The inflationary trend has changed since February when CPI rose 5.6% yoy. Prices still grow at a slower pace than that assumed in the 1999 Budget Act. However, already in September 8%-growth endangered the NBP's inflationary target.

The main reasons behind the inflation rise are the intervention on the agriculture market, increases in import prices (as a result of the weaker zloty) as well as the rise in world prices of oil.

PPI moved in line with CPI and it increased 5.8% yoy.

To recap, the adverse effects of external shock were overcome in 3Q. At the same time the economy reacted in the right way to the cut in interest rates as it did in 2Q. According to our predictions, weak foreign demand was compensated by relatively strong domestic demand with consumption demand playing a key role. Due to the strengthened consumption demand, boost to credits and threat to the NBP's inflationary target, the 28-day repo rate was moved upwards from 13% to 14% on September 22.

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Determinants of Poland's economic development

Our current assumptions concerning Poland's external environment do not differ significantly from those in the April and June issues while the forecast horizon itself is extended up to 2001.

The external assumptions are an appraisal of economic activity in Poland's major trading partners (*inter alia* dynamics of imports in the EU and LIBOR), inflationary trends, commodities prices outlook, as well as the exchange rates of the main currencies.

Our assumptions concerning the Polish economy have changed compared to the previous issue. In particular, we attempted to incorporate the 2000 draft budget and adapt our assumptions for monetary policy to current and future developments on the money markets.

World economic outlook for 1999–2001[1)]

- **Gradual recovery in the EU (in particular in France and Germany)**
- **Weakness of euro persists**
- **High oil prices**

Economic growth

The world economic situation is much better than at the beginning of the year. The effects of the recent financial crises (Asian, Russian and Brazilian crises) have been overcome and many countries are gradually recovering. Currently, developments in the USA pose the biggest threat to the global economy. So far the USA has been the engine of world economic growth making up for the slowdown in the rest of the world directly and indirectly hit by the crises. However, the forecast cyclical economic slowdown in the USA, depending on its length and severity, may adversely affect the global economy. The IMF, in its latest *World Economic Outlook*, assumes a 'soft-landing' scenario (i.e. a mild slowdown in economic activity with minor unfavourable effects for the rest of the world) as the baseline. If future events unfold according to such a scenario and economic activity in the EU gains momentum, then the EU will become the locomotive of the global economy in 2000–2001 (see Table 1).

USA

So far the American economy has not showed any signs of a slowdown. Notwithstanding the temporary drop in the annual growth rate in 2Q (1.9%), growth was exuberant in 3Q reaching an annual rate of 4.8%. High growth in manufacturing was fuelled by rising manufac-

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

turing orders (in August the orders rose 1.3%). As far as the labour market is concerned, the number of unemployed has been declining. As domestic demand growth outpaces domestic production, the deficit in the current account widens.

The European Union

The economic situation has been improving gradually – principally due to the improvement in global economic activity. Despite the lack of healthy indicators of a dynamic recovery, consumer confidence is still strong. The weak euro has boosted external demand which has contributed, among other things, to an improved economic performance in 3Q.

However, the widening gap in the growth rates within the EU is clear. Relatively high rates of growth in Finland, Ireland, Portugal and Spain are in stark contrast to figures for Germany and Italy. It must be kept in mind, however, that the former set of countries account for less than 1/6 of total Euro area GDP.

Despite a rosier outlook, a majority of EU states face problems related to the implementation of structural reforms in the labour market and budgetary policy. The success of these reforms will determine their long-term growth prospects.

Manufacturing output in Germany rose 1.1% mom in August but declined 1.6% yoy. August also saw an unexpected rise in manufacturing orders of 5.1% mom. This could be the harbinger of a considerable (and long-awaited) boost to manufacturing. However, it should be stressed that foreign orders outnumbered domestic ones. According to official statistics, in 3Q GDP remained pretty much at the level recorded in 2Q while rising 0.9% yoy.

The first signs of a recovery have surfaced in Italy – up until now the economic laggard of the Eurozone. These signs have to do with the significant rise in imports of semi-finished products and commodities. Such a rise usually foreshadows output expansion. Nonetheless, according to officials from the Italian central bank, the government's target of a 1.3% growth is still jeopardised.

The United Kingdom recorded healthy GDP growth in 3Q amounting to an annual rate of 1.8%. Growth was largely driven by the service sector. This has shown the best performance in two years. On the other hand, manufacturing output stabilised with a rising trend but still below last year's level.

Stronger-than-expected growth has also taken place in France. This is largely attributable to strong

Table 1. GDP in selected countries, 1996–2001 (% change yoy)

	1996	1997	1998	*1999f*	*2000f*	*2001f*
Global	4.3	4.2	2.5	2.9	3.2	3.0
OECD	2.9	2.8	2.0	2.5	2.4	2.5
USA	2.4	3.8	3.9	4.0	2.8	2.6
Canada	1.5	3.8	3.1	3.5	2.5	3.2
Japan	3.5	0.8	-2.9	0.5	0.0	0.5
European Union	1.7	2.6	2.7	1.9	2.8	2.8
Germany	1.4	2.3	2.0	1.5	2.8	2.6
France	1.5	2.3	3.2	2.1	3.0	2.7
Italy	0.7	1.5	1.3	1.3	2.2	2.8
United Kingdom	2.3	3.1	2.1	1.0	2.8	3.0
Russia	-5.0	0.9	-4.8	-6.0	2.0	2.0
China	9.6	8.8	7.8	6.5	6.0	5.0

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

demand. Both consumer spending and exports were climbing at a two-digit pace. Moreover, a notable rebound in business confidence points to an upturn in industrial production.

CIS

Industrial output is still on the rise in Russia. It increased 5.9% yoy during the period January-August. However, due to the lack of a recovery in other sectors of the economy (primarily in agriculture and construction) GDP was down 1% yoy in the first-half of the year. Domestic output substitutes declining demand for imported goods causing imports to drop 45% yoy in the first-half of 1999. A majority of analysts project positive GDP growth no sooner than 2000. Prices of oil and other natural resources will definitely be crucial to the recovery process. Long-term prospects are still subject to downside risks arising from the lack of structural reforms in the areas of fiscal policy, banking as well as privatisation and enterprise restructuring.

Industrial output and foreign trade turnover have been declining in the Baltic and other CIS states. This is due to the ensuing effects of the Russian financial crisis. CIS countries having strong trade links with Russia suffer the most from the impact of the devaluation of the ruble on the considerable drop in import demand in Russia.

Asia

There are more and more sings of a rapid recovery in Asia – though long-term prospects remain uncertain. Dynamic economic growth in this region will hinge on the success of structural reforms of the financial and corporate sectors as well as on economic developments in the USA.

Japan's economy is on the mend. However, growth has slowed to 0.9% in 2Q after the GDP rise of 1.9% in 1Q. Growth has been driven largely by public spending. At end-3Q, public debt amounted to approximately 10% of GDP. Unfortunately, consumer and business confidence is weak which is reflected in the low level of private investment. If the yen is still strong, export prospects will not be favourable. In addition, the Japanese economy faces a serious problem in restructuring the corporate sector. This issue is critical for the future prosperity of the economy. Japan's recovery will benefit from the upturn in economic activity in Asia.

The risk of devaluation in China has diminished. Despite the sizeable drop in the merchandise trade surplus of 51.3% yoy in January-August period, exports soared 7.5% in July and 17.8% in August. Moreover, China has ample foreign currency reserves. On the downside, weak domestic demand and deflationary trends still persist. Investment in fixed assets as well as foreign direct investment are declining. In the latter case, investment dropped 10% over the January-July period. The GDP growth forecast has been revised downwards although it is still expected to exceed 6%.

Latin America

This situation in Latin America is differentiated. Economic growth in Brazil and Mexico has been revised upwards whereas in Argentina, Chile, Columbia, Ecuador and Venezuela downwards. Future developments will be primarily determined by economic events in the USA (the expected cyclical slowdown) due to strong trade links. In addition, the risks to the recovery stem from unfavourable sentiments of foreign investors. Ecuador experienced serious financial troubles and was in default on one type of Brady Bonds at end-September.

Commodity prices

Oil prices were still rising in 3Q. They have risen 62% in the last 12 months. At the beginning of October, a 17% decline in prices took place followed by a quick rebound shortly after. This decline occurred following news that the realisation of the quotas dropped from 91% to 81%. Production quotas will be a key determinant of prices in the near term but will prove more difficult to enforce. The quotas may be changed no sooner than in March at the next OPEC meeting. It is expected, however, that the tight policy with regard to oil production will be prolonged after March if stocks are not lowered and demand does not pick up. The likely severe winter could cause prices to increase. On the other hand, the increase could be hindered by higher oil production by non-OPEC producers (primarily Russia and Norway).

Industrial metals prices, after bottoming out at the beginning of the year, have been gradually increasing in 2Q and 3Q. However, most of these prices suddenly declined at the beginning of October. Experts are of the opinion that such a situation is transitory. Prospects for metal prices look rosier well into 2000 as the economic recovery in Asia and the EU solidifies. Nevertheless, developments in the USA pose some risks. If the considerable slowdown in the USA take place then the ensuing sharp decline in demand can drag prices down.

Inflation

Prices measured in terms of CPI in the main world economies remain at fairly stable levels. However, in many countries stronger inflationary pressures have surfaced. This is reflected in rising PPI and import prices largely due to increasing oil prices. PPI in the USA rose 1.1% in September (the highest rise since September 1990). The European Central Bank (ECB) warns that inflation may rise in the Eurozone in the coming months. Moreover, M3 growth gives rise to concerns.

Interest rates

The Fed, after having risen interest rate by 25 basis points to 5.25% in June, kept rates unchanged at its last meeting in October 1999. At the same time, it did not

Table 2. GDP deflator in selected countries, 1996–2001 (% change yoy)

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

Source: IMF and forecasts derived from the McFair model devised at Yale University.
Notes: e – estimates; f – forecasts.

Table 3. CPI in selected countries, 1996–2001 (% change yoy)

	1996	1997	1998	*1999f*	*2000f*	*2001f*
OECD	2.0	2.0	1.2	*1.4*	*1.8*	*1.6*
USA	2.9	2.3	1.6	*2.2*	*2.6*	*2.2*
Canada	1.6	1.4	1.0	*1.6*	*1.8*	*2.0*
Japan	0.1	1.7	0.6	*-0.4*	*0.1*	*0.2*
European Union	2.1	1.8	1.4	*1.2*	*1.5*	*1.6*
Germany	1.3	1.5	0.6	*0.4*	*1.2*	*1.4*
France	2.0	1.3	0.7	*0.5*	*1.0*	*1.4*
Italy	3.8	1.7	1.7	*1.6*	*1.4*	*1.4*
United Kingdom	2.4	2.8	2.7	*2.3*	*2.5*	*2.0*
Russia	47.7	14.8	27.7	*90.0*	*20.0*	*11.0*
China	8.3	2.8	-0.8	*-1.6*	*1.0*	*1.0*

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

preclude tightening in the future if inflationary pressures re-emerge. The likelihood of rising interest rates has diminished after data releases on exuberant growth and lack of inflationary pressures (low increase in labour costs – 3.1% over the period January–September, and in deflator – 0.9% at an annual rate).

The ECB followed suit and left interest rates unchanged at its October session. The ECB's decision was backed by the lack of immediate inflationary pressures as well as by the fact that the boost to the Euro economy has not gained momentum yet. However, the ECB stipulated that if more sings of a boost to the economy surface, especially in the face of fast M3 growth, then it will tighten policy. This happened at its meeting in November when the refinancing rate was raised from 2.5% to 3.0%. The higher-than-expected increase is aimed at minimising uncertainty in financial markets.

The Bank of England unexpectedly raised interest rate by 25 basis points to 5.25% in September. At its next meeting in October no changes in monetary policy and the future stance were announced. Costs of commodities and energy went up significantly in September. The higher-than-anticipated rise in wages and declining unemployment give cause for concern for monetary policy. A sudden increase in prices of industrial commodities, strong growth and a tight labour market were arguments for a rise in policy rates by 25 basis points on the session of the Bank of England Monetary Policy Council in November 1999.

Table 4. Long-term interest rates in selected countries, 1996–2001 (%)

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

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, 1996–2001 (% change yoy)

	1996	1997	1998e	*1999f*	*2000f*	*2001f*
Global	6.0	10.5	3.9	*4.0*	*6.1*	*7.0*
OECD	6.2	7.8	7.5	*5.5*	*5.0*	*5.5*
USA	6.4	14.3	10.6	*10.0*	*6.0*	*5.0*
Canada	5.1	12.6	5.8	*5.0*	*3.0*	*4.0*
Japan	10.3	2.1	-7.5	*1.0*	*2.0*	*1.0*
European Union	2.6	6.0	7.8	*3.0*	*4.5*	*5.5*
Germany	2.8	6.1	7.5	*2.4*	*5.2*	*6.0*
France	2.2	6.2	9.3	*1.4*	*4.8*	*5.0*
Italy	-2.0	3.6	6.1	*3.3*	*4.7*	*5.0*
United Kingdom	7.8	8.3	8.4	*2.0*	*3.5*	*4.0*
Russia	10.0	11.0	-16.0	*-20.0*	*4.0*	*6.0*
China	14.0	12.0	-3.8	*2.0*	*5.0*	*7.0*

Source: IMF and forecasts derived from the McFair model devised at Yale University.
Notes: e – estimates; f – forecasts.

Foreign trade

As we forecast in our last issue, global trade volumes will be rising along with the recovery in Asia and the EU (see Table 5). In the long-term, volumes and directions of trade will be affected by the potential membership of China in the WTO. At the moment, there are numerous producers (among others in the USA and the UK) who are interested in entering the huge Chinese market.

Exchange rates

The euro did not strengthen significantly during 3Q contrary to analysts' expectations. This stems from the lack of discernible sings of improvement in economic activity in the Euro area as well as from the good performance of the US economy. However, most experts expect that by end-year the euro will strengthen reaching a level of 1.11 per US$ (see Table 6).

In 3Q the yen appreciated considerably against the dollar and, to a lesser extent, against the euro. The yen hit the lowest exchange against the dollar of 103 JPY/US$ in the three-and-a-half-years. Moreover, a majority of big investment banks forecast a further strengthening below 95 JPY/US$ within coming 6 months. The Bank of Japan does not want to loosen monetary policy so as to weaken the Japanese currency despite pressure from G7 countries. However, it decided to commence outright purchase of short-term government securities in order to boost liquidity.

The world economy is expected to grow in the nearest future. Due to the recovery inflationary pressures will surface leading to monetary tightening. A boost to foreign trade is also forecast. Uncertainty regarding growth prospects in the USA poses the highest risk to the global economy. The depth and length of the economic slowdown in the USA will determine, to a large extent, growth prospects in many regions of the world.

From the Polish perspective, the economic boost in the EU is a key factor in the near-term. Polish growth will benefit from higher exports. On the downside, continued high oil prices will hinder inflation decline.

Forecast assumptions – domestic determinants

A slower-than-anticipated economic recovery in the EU has forced us to revise down our assumptions regarding exports to the region. However, we are of the opinion that demand for Polish goods may increase in the first-half of 2000. This will be largely due to the adjustment of Polish enterprises to the new economic situation as well as to the expected boost in the EU. 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 with descriptions just below.

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 the 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.

A more detailed description of the forecast assumptions is presented below.

1. We assume that the government will pursue economic policies aimed at sustaining macroeconomic stability and the projected budget deficit. Three basic assumptions for macroeconomic policy lie at heart of our forecast:

Table 6. Dollar exchange rate vs. the euro and the yen, 1996–2001

	1996	1997	1998	*1999f*	*2000f*	*2001f*
Euro	–	–	1.12	*1.08*	*1.13*	*1.15*
Yen	109	121	131	*117*	*108*	*115*

Source: IMF and forecasts derived from the McFair model devised at Yale University.
Notes: 1. f – forecasts,
2. Annual averages.

Table 7. Forecast assumptions for 1999–2001

Compulsory debt servicing to the Paris Club and the London Club	Annual interest payments of US$1.3, US$1.7 and US$2.2 billion, respectively
Increase in the volume of EU imports	See Table 2
Average LIBOR (US$, year)	See Table 4
Increase in the Polish labour force	0.4% to 0.5% *per annum*
Increase in a number of people who are either retired or receive disability allowance	1.5% to 2.3% *per annum*
Average customs duty rate	A gradual dismantling to 0% in trade with the EU and at the 1997 level with other countries
Exchange rate policy	Until end-1999 crawling-peg and then floating exchange rate regime; see point 1 below the table
Transfers from the EU	See point 2 below the table
FDI *(per annum)*	See point 3 below the table
Privatisation	Acceleration of privatisation and its termination in 2001; see point 4 below the table
Social security system	See point 5 below the table
Tax rates	See point 6 below the table
Employment in the public sector	An annual increase of 0% – 0.3%; see point 7 below the table

Source: CASE.

(i) The NBP will tighten monetary policy in 4Q99 and the first-half of 2000 by rising main interest rates. Subsequent loosening may take place only at the end of the first-half of 2000;
(ii) Budgetary policy will aim at minimising the financing of debt via the domestic financial system;
(iii) The present exchange rate regime will be replaced by the floating exchange one in 2000.

2. Transfers from the EU will increase from approximately US$0.3 billion in 1999 to US$0.6 billion in 2000 and US$0.9 billion in 2001.
3. FDI according to the balance of payments nomenclature will amount to US$6.8 billion in 1999, US$7.0 billion in 2000 and US$8.0 billion in 2001.
4. Privatisation revenues will reach 12, 17 and 14 billion zloty over the period 1999–2001.
5. The indexation of primary social benefits; the real increase in average social benefits will be next to 0% in 2000 and 1% in 2001.
6. In 2000 the personal income tax (PIT) rates will be maintained at their 1999 level, whereas corporate income tax (CIT) rates will be lowered by 3 percentage points. Excise tax and VAT rates will be at the level proposed in the draft of the 2000 Budget Act. In 2001 CIT rates will be further lowered by 4 percentage points and then set at the level adopted in the government tax reform proposal of 18% and 28%. In addition, the VAT base will be extended. According to government plans, agriculture and municipal sectors will be covered by VAT.
7. Employment in the public sector will be stable. We assume an employment decline in the education and health care sectors and an increase in the broad administrative sector.

Center for Social
and Economic Research

Analysis of the economic situation and outlook for 1999–2001

Domestic demand

- **Domestic demand as the engine of growth**
- **Faster growth of private consumption in 3Q99 and slightly weaker forecast figures for 2000–2001**
- **Stable public consumption**
- **Forecast of improved investment climate in 2000–2001**

According to our estimates, 3Q99 saw GDP growth of 4.2% yoy. This represents a gradual acceleration of economic growth bearing in mind that, according to the Central Statistical Office (CSO),1Q99 GDP increased 1.5% whereas in 2Q99 it rose 3.0% (our July estimates were also 3.0%).

Whereas up to end-2Q98 it was Polish exports rather than domestic demand that drove economic growth, in the subsequent period domestic demand once again became the main determinant of growth as a result of the Russian crisis and the ensuing substantial contraction in Polish exports.

In this report, domestic demand will be referred to as the sum of consumption and accumulation. Consumption is defined as the sum of private consumption (i.e. the sum of consumption of households and that of non-commercial institutions) and public consumption (i.e. consumption of central and local government institutions). Accumulation is, in turn, defined as the sum of investment (gross outlays in fixed assets, gains in livestock inventories and intangible assets) and stockbuilding.

Faster growth beginning in 2Q99 is also the result of measures taken by the National Bank of Poland (NBP) since September 1998 with the aim of indirectly strengthening domestic demand. In our opinion, reductions in nominal official interest rates as well as a lowering of interest rates in the interbank market helped to boost credit expansion – especially that of consumption credits. The demand for household credits was generated mostly by the tendency to maintain a relatively high level of consumption and the expectations of a fast economic recovery with the resulting increase in real incomes.

The growth of household demand for credits was tempered, to a certain extent, by weaker demand – compared to the previous year – from the government sector (due to the 1999 budget deficit financed mostly from privatisation) and by slower growth in investment outlays (for detailed data on the dynamics of the basic components of aggregate demand see Table 8). On the other hand, domestic demand was indirectly boosted by a significant increase in the consolidated budget deficit involving central budget, local budgets and some para-budgets (such as those of the Social Security Board (ZUS)).

In our opinion, an analysis of the main trends in basic macroeconomic aggregates leads to the conclusion that the Polish economy in 3Q99 overcame the consequences of the external shock and returned to the path of long-term economic growth.

Domestic demand is estimated to have risen 4.6% and 6% yoy in the two consecutive quarters of 1999 following a decline of more than 6% in the second-half of 1998 to 3.2% in 1Q99.

What is particularly worrying is the higher domestic demand growth associated with relatively low economic growth and a decline in exports. 3Q99 saw domestic demand growth at a level similar to that recorded in 1998. This was possible largely as a result of much lower household propensity to save.

The gap between domestic demand growth and GDP increased from 1.6 percentage points in 2Q99 to 1.8 percentage points in 3Q99. By way of comparison, in the first two quarters of 1998 this gap amounted to 1.0 and 4 percentage points respectively, and only in the period following the Russian crisis in 4Q98 did it

Table 8. Components of aggregate demand, 1997–2001

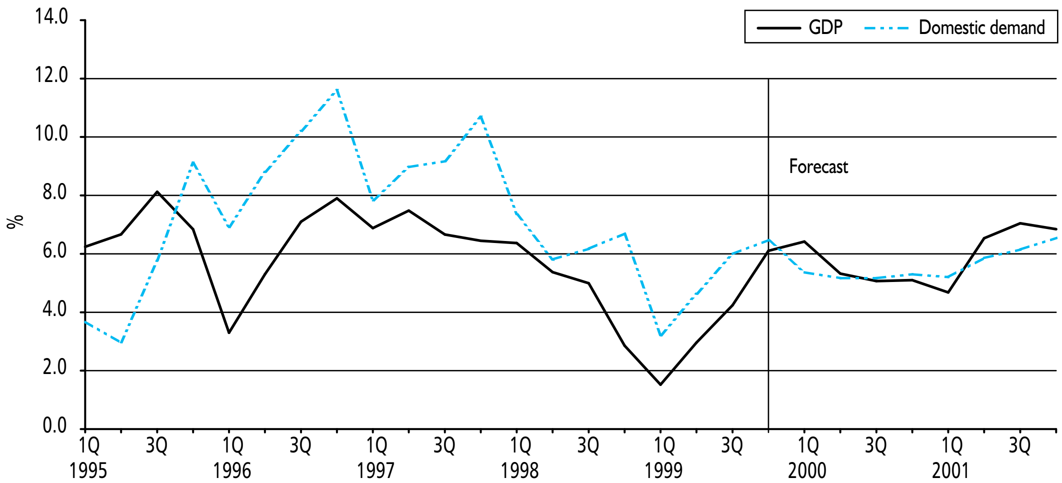
		GDP	Domestic demand	Households' consumption	Public consumption	Investment in fixed assets
1997	1Q–4Q	6.9	9.2	6.9	3.4	21.7
1998e1	1Q–4Q	4.8	6.5	4.9	1.5	14.5
forecast						
1999	*1Q–4Q*	*3.8*	*5.1*	*4.9*	*1.5*	*9.1*
2000	*1Q–4Q*	*5.4*	*5.2*	*4.3*	*1.3*	*10.6*
2001	*1Q–4Q*	*6.3*	*6.0*	*5.0*	*1.6*	*10.9*
1997	1Q	6.9	7.8	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	10.7	6.6	2.6	23.2
1998e1	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
1999	1Qe1	1.5	3.2	4.2	1.4	6.0
	2Qe1	3.0	4.6	4.8	1.3	6.7
	3Qe2	4.2	6.0	5.7	1.5	9.9
forecast						
1999	*4Q*	*6.1*	*6.5*	*4.7*	*1.6*	*11.3*
2000	*1Q*	*6.4*	*5.4*	*4.0*	*1.5*	*11.6*
	2Q	*5.3*	*5.2*	*4.2*	*1.4*	*12.0*
	3Q	*5.1*	*5.2*	*4.4*	*1.2*	*11.5*
	4Q	*5.1*	*5.3*	*4.5*	*1.0*	*9.0*
2001	*1Q*	*4.7*	*5.2*	*4.8*	*1.7*	*10.0*
	2Q	*6.5*	*5.9*	*5.0*	*1.8*	*10.9*
	3Q	*7.0*	*6.1*	*5.2*	*1.5*	*11.2*
	4Q	*6.8*	*6.5*	*4.8*	*1.3*	*11.0*

Source: Data and estimates (e1) – CSO; estimates (e2) and forecasts – CASE.
Notes: 1. Data in 1998 prices.
2. % change yoy.
3. Domestic demand is defined as the sum 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.

increase by as much as 3.8 percentage points (whereas it was 1.7 percentage points in 1Q98).

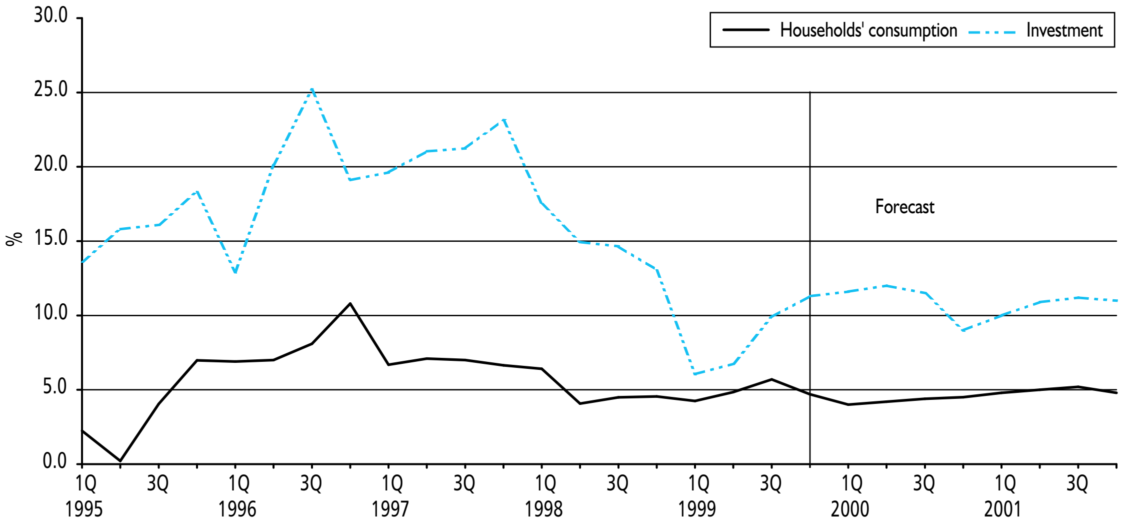
It was mostly consumption demand that affected domestic demand growth in 3Q99. At present, domestic demand hit the highest level since 1Q98 and has been on the increase since 1Q99. According to our estimates, in 3Q99 households' consumption (individual or private consumption) grew 5.7% yoy and, as in 3Q98, grew at a rate faster than that of GDP. Higher private consumption dynamics resulted from the dramatic fall in households' propensity to save in 2Q99 and 3Q99 compared with the preceding two years. What is also noteworthy is that, like in the preceding three quarters, the rate of consumption growth exceeded that of GDP growth. Trends of this kind seem to be difficult to sustain in the longer run. Any

Figure 1. GDP and domestic demand, 1995–2001 (% change)



Source: CSO and CASE.
Note: CASE forecast starting from 4Q99.

Figure 2. Private consumption and investment, 1995–2001 (% change)



Source: CSO and CASE.
Note: CASE forecast starting from 4Q99.

future change in this respect may be caused either by more rigorous monetary policy (increase in nominal interest rates) or by faster economic growth reflected in higher households' real incomes and savings. Otherwise the stability in the above relationships poses the threat of new inflationary pressures.

Investment outlays have still remained at quite a high level but their rate of increase compared to the preceding four years was exceptionally low. According to our estimates, outlays increased 6.0%, 6.7% and 9.9% respectively in the first three quarters of this year. In 1998, the rate of increase in investment outlays on machinery, equipment and transport was higher that that on construction, whereas in the first two quarters of 1999 this situation was reversed as demand for investment equipment by large firms increased by more than 5%. By way of comparison, in 1998 the rate of growth of investment outlays exceeded 20%. The drop in investment growth has been caused mostly by weaker economic growth which, in turn, led to lower corporate profits resulting in the need to revise future development plans. However, as early as 3Q99 the dynamics of investment growth increased as a result of a gradual improvement in Poland's economic performance as well as more foreign investment and larger investment credits. Nevertheless, one should not expect that the rate of investment growth will accelerate to levels reached in 1995–1998. Slower growth of domestic savings and high FDI inflows are the main reasons for slower investment rates which, since they still exceed the rate of GDP growth, may provide a larger contribution to GDP. Once both the efficiency and the structure of investment improves, with more investment located in infrastructure, a growing contribution of investment to GDP will ensure that relatively high annual economic growth of 5 to 6% can be maintained.

Since 1993, public consumption has increased at a much slower rate than the remaining components of domestic demand. A similar situation occurred in 3Q99 when public consumption increased 1.5% yoy. What needs to be emphasised is that public consumption growth was similar to that in 1998 which was possible despite strong budgetary tensions resulting from the adoption of financial reforms and higher-than-expected costs of social security reforms.

Following a temporary fall in stockbuilding in 1Q99 caused by the adaptation of production to lower demand, the two consecutive quarters saw a real gain in stockbuilding compared to that of the previous year. This indicates that the Polish economy has adjusted to both lower demand and growth. For detailed data see Table 8.

We expect GDP growth to amount to 3.8% in 1999. This means that, despite our two preceding downward revisions, we now predict that GDP growth will be 0.2 percentage points higher compared to our July forecast. In other words our predictions are still more pessimistic bearing in mind the 5.1% adopted in the 1999 Budget Act and the 4.0% figure quoted in the 2000 Budget draft forecast published by the Ministry of Finance. We are, however, more optimistic than most western analysts and the State Centre for Strategic Studies.

Table 9. Contributions to GDP growth, 1997–2001 (%)

	GDP	Households' consumption	Public consumption	Investment in fixed assets	Stock-bulidling	Net exports	Exports	Imports
1997 1Q–4Q	6.9	4.3	0.6	4.4	0.0	-2.5	2.7	-5.6
1998 1Q–4Q	4.8	3.0	0.3	3.4	0.1	-1.9	0.3	-1.8
forecast								
1999 1Q–4Q	*3.8*	*3.0*	*0.2*	*2.3*	*-0.2*	*-1.6*	*-1.0*	*-0.6*
2000 1Q–4Q	*5.4*	*2.7*	*0.2*	*2.8*	*-0.1*	*-0.2*	*1.8*	*-2.0*
2001 1Q–4Q	*6.3*	*3.1*	*0.2*	*3.0*	*0.0*	*0.0*	*1.8*	*-1.8*

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 sum of contributions to GDP may not square due to approximations.

If economic growth in 4Q99 turns out to be higher than our forecast of 6.1%, which is strongly dependent on the existence of new pro-export stimuli, then GDP growth in 1999 could even amount to 4% – the figure quoted by the Ministry of Finance.

In 2000, GDP may be as high as 5.4% with higher growth in the first-half of the year (5.8%) than in the second-half (5.1%). Faster growth in the first-half, associated with the absence of strong growth-enhancing incentives, will stem mainly from the upturn in 1999 as well as in relation to low GDP in the same period of 1999.

From early 2000 onwards we expect a strong pro-export stimulus to occur which, in 2001, may be further strengthened by the anticipated larger demand for imports from the CIS – especially Russia and Ukraine. This would make it possible to increase growth to 6.3% in 2001.

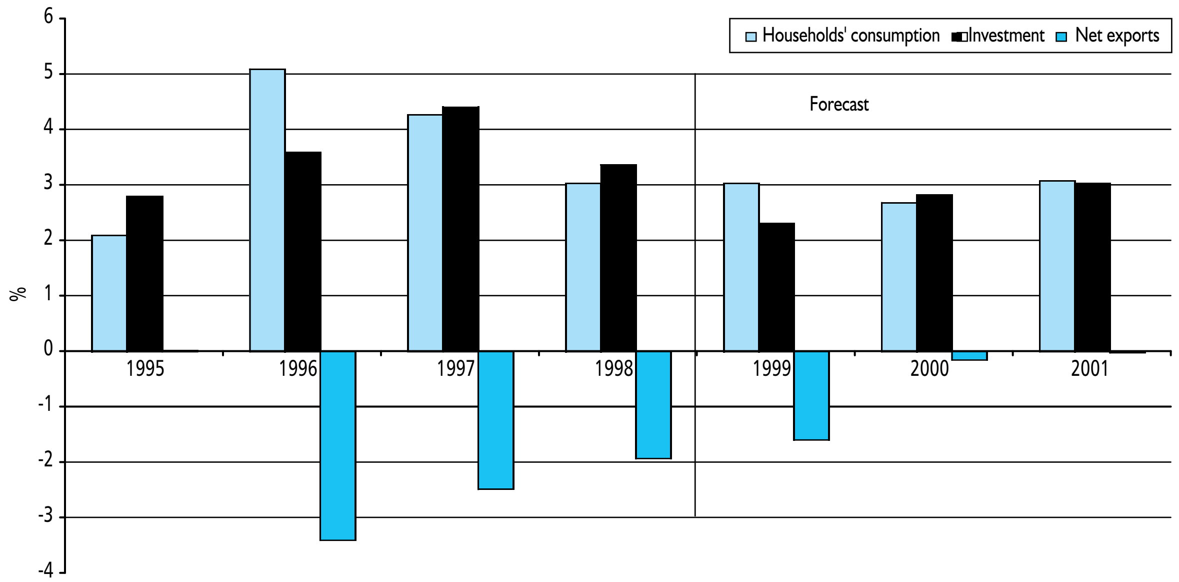
Table 10. Household disposable income, 1997–2001

	Disposable income	Wages and salaries	Social benefits	Savings rate	Real disposable income
	% change	% change	% change	%	% change
1997 1Q–4Q	23.4	23.8	19.7	13.4	7.4
1998 1Q–4Q	15.2	17.3	15.3	12.1	3.0
forecast					
1999 1Q–4Q	*10.5*	*12.2*	*9.9*	*9.4*	*3.3*
2000 1Q–4Q	*14.0*	*10.5*	*8.6*	*10.6*	*5.4*
2001 1Q–4Q	*12.5*	*9.1*	*9.0*	*11.5*	*5.2*
1997 1Q	21.6	23.0	19.0	12.4	3.8
2Q	23.9	19.8	22.4	13.0	7.6
3Q	25.5	25.5	22.3	12.3	9.8
4Q	22.7	22.7	16.6	15.7	8.4
1998 1Q	19.6	20.9	17.0	11.1	5.0
2Q	14.7	17.9	15.4	12.1	1.4
3Q	15.5	15.5	14.1	11.3	3.8
4Q	11.4	15.0	14.9	13.9	2.0
1999 1Q	14.9	8.7	12.7	13.5	8.2
2Q	7.6	9.5	9.0	6.3	1.1
3Q	9.9	10.7	9.5	7.1	2.6
forecast					
1999 4Q	*9.8*	*10.0*	*8.7*	*10.7*	*1.4*
2000 1Q	*9.1*	*11.4*	*8.2*	*10.0*	*-0.2*
2Q	*16.0*	*12.2*	*9.4*	*8.9*	*7.0*
3Q	*15.7*	*10.7*	*8.0*	*9.9*	*7.5*
4Q	*15.3*	*8.0*	*8.5*	*13.3*	*7.4*
2001 1Q	*12.4*	*8.6*	*9.0*	*10.6*	*5.3*
2Q	*12.7*	*7.7*	*9.0*	*9.9*	*5.9*
3Q	*12.4*	*6.4*	*9.0*	*10.7*	*6.0*
4Q	*12.4*	*0.5*	*9.0*	*14.7*	*6.4*

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.

Domestic demand growth will fall from 6.5% in 1998 to 5.1% in 1999 and 5.2% in 2000. In 2001, domestic demand is expected to increase 6%. The fastest growth is predicted in investment outlays with the annual rate ranging between 9 and 12%. Private consumption growth may be slower in 2000 than in 1999 mainly as a result of the anticipated increase in the propensity to save. In 2001, the dynamics of consumption are due to increase again to 5% per annum.

Figure 3. Contributions to GDP growth, 1995–2001 (%)



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

Figure 4. Change in household real disposable income and savings rate, 1995–2001 (%)

Source: CSO and CASE.
Note: CASE forecast starting from 4Q99.

Given the above, it follows that in the period 2000–2001 domestic demand may be lower than GDP growth which would ensure macroeconomic stability and balanced economic growth. Slower domestic demand growth will be offset by increased exports which would make it possible to bring down the current-account deficit and stabilise the exchange rate.

The effect of individual components of aggregated demand on GDP growth is shown in Table 9. The results of the decomposition of GDP growth should be interpreted as follows: in 1999, for example, private consumption would have led to a 3% increase in GDP *ceteris paribus.* It should be kept in mind that a gain in an individual aggregate must be related to the level of GDP in the preceding year and the sum of the growth rates, calculated for all components (domestic, inventories and foreign) of demand, should be equal to GDP growth.

In the period 1999–2001, the contribution of consumption to GDP will be 3% – similar to that in 1998. In 2000, the contribution of consumption is expected to fall to 2.7% while in 2001 it will increase to 3.1%. We would like to point out again that the relatively high economic growth in 1999, despite the significant fall in exports, was possible thanks to the stable contribution of consumption to GDP.

In 1998, GDP increased 3.4% due to investment (in other words its growth was higher than that of private consumption). In 1999, investment is expected to have a smaller effect (down to 2.3%), being even lower than the contribution of consumption. A similar situation may occur in the years ahead. In 2000, the investment contribution to GDP growth is predicted to increase to 2.8% and to 3% in 2001. The relatively small investment contribution throws into question the government's long-term economic strategy of which the most important part is related to the government's aim of accelerating annual economic growth to some 7%.

We expect that in 1999 the contribution of exports to GDP growth will be smaller than that of the previous year. This situation can only improve in the years 2000–2001. At the same time, the negative impact of imports will diminish due to anticipated lower investment demand in 1999 which, in large measure, is reflected in demand for imports. As a result, in 1999 the effect of foreign demand will be negative, i.e. it will be expressed by a negative value of (-1.6%). In the period 2000–2001, as a consequence of relatively slower dynamics of imports (stemming from the expected lower domestic demand), the negative effect of foreign demand in terms of foreign trade balance may fall to about 0%.

Following the relatively high growth (8.6%) in real incomes in 1Q99, mainly due to significantly lower inflation and the delayed response of companies to weaker domestic and foreign demand, the cooling of the economy caused a drop in nominal and real households' incomes (see Table 10). Our estimates show these incomes rose almost 2% and 4% in 2Q99 and 3Q99 respectively. The slowdown in the dynamics of real incomes stems, above all, from lower revenues. On the other hand, revenues from salaries and social benefits were helpful in stabilising real incomes.

In 1999, the dynamics of real incomes are expected to be similar to those of the previous year. However, in the next two years higher growth can be expected mainly due to the faster GDP growth. Nevertheless, in 4Q99 as well as in 1Q00 the rate of growth in real incomes will be slower than the average rate in 1999. A resumption of an upward trend in real incomes can be expected from 2Q00 onwards.

In 3Q99, as in the previous quarter, **households' savings were extremely low.** These savings were calculated to represent the difference between the growth of zloty and foreign currency deposits, on the one hand, and cash in circulation (excluding vault cash and credit expansion), on the other. The controversial decision in January this year to cut interest rates, as well as lower households' real incomes, contributed to lower savings rates (calculated as a ratio of households' savings to disposable incomes) from an average of 12% in 1998 to 6.3% and 7.1% in 2Q99 and 3Q99 respectively.

In our forecast period, no increase in household savings to the levels of 1997–1998 is foreseen. The savings growth rate is, however, expected to increase from 4Q99 onwards – exceeding 11% in 2001. The anticipated growth in household savings will stem from faster economic growth and higher real incomes rather than from changes in nominal and real interest rates.

Value-added

- Domestic demand as the driving force of growth
- Industrial production hits its peak since 1Q98
- Construction sector is marked by a slower growth
- Market services feature stable growth
- Value-added growth will be faster in the period 2000-2001

We estimate the total growth of value-added in the economy at 4.2% yoy in 3Q99 which is similar to the figures in 3Q98. This means that domestic industrial output grew at a higher rate than in previous quarters and the downturn between 4Q98 and 2Q99 was overcome.

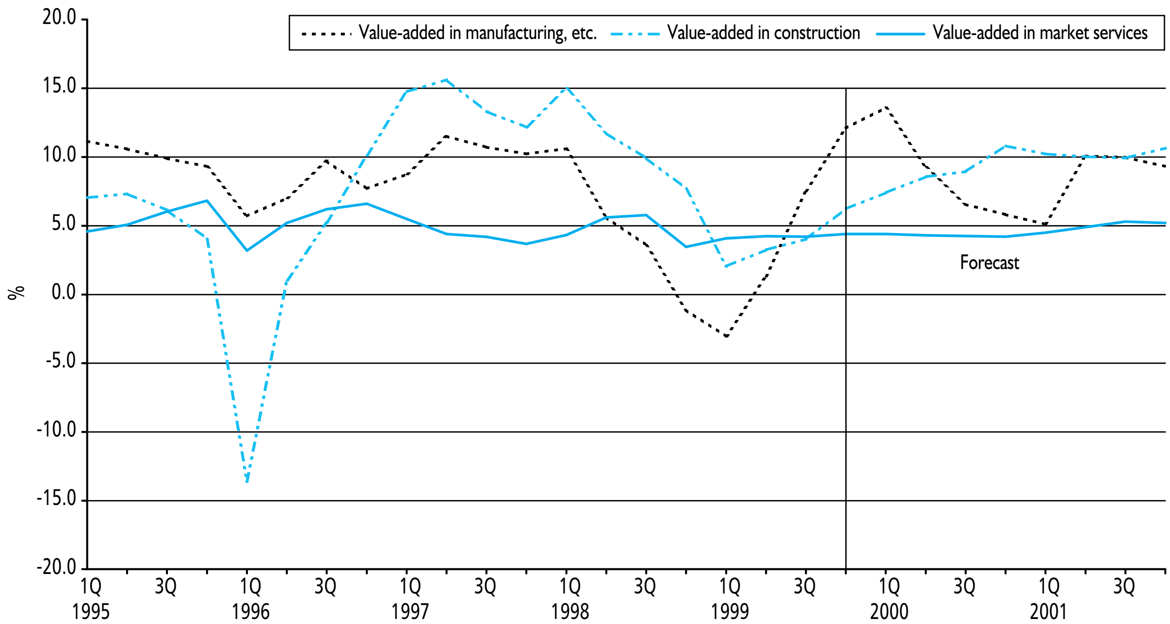
Value-added in non-agricultural sectors (i.e. excluding agriculture, forestry, hunting, off-shore and inland fishery) increased 4.8% compared with 2Q98. It grew even faster in industry, telecommunications and trade. On the other hand, it was lower than average in other sectors such as construction and non-market services. The results of the estimates are shown in Table 11.

In 3Q99, growth of value-added in the whole economy would have been even greater had it not been for the fall in agricultural production. Lower crops of cereals (down 8% yoy) as well as lower potato, sugar beet, vegetable and fruit crops – combined with lower animal production – led to a decline in value-added by 5%.

It was the 7.5% growth yoy in sales by companies with more than 5 employees (see Table 12) that contributed to faster economic growth in 3Q99. The value in the manufacturing sector, as well as in water and energy supplies, grew at a faster rate (8.3% and 7.8% respectively). As in the previous quarters, the mining sector suffered a decline with output decreasing 5.1%. According to our estimates, value-added in the entire industry was up 7.5% yoy. As mentioned earlier, faster growth in industrial production was mostly the result of a strengthening in domestic demand.

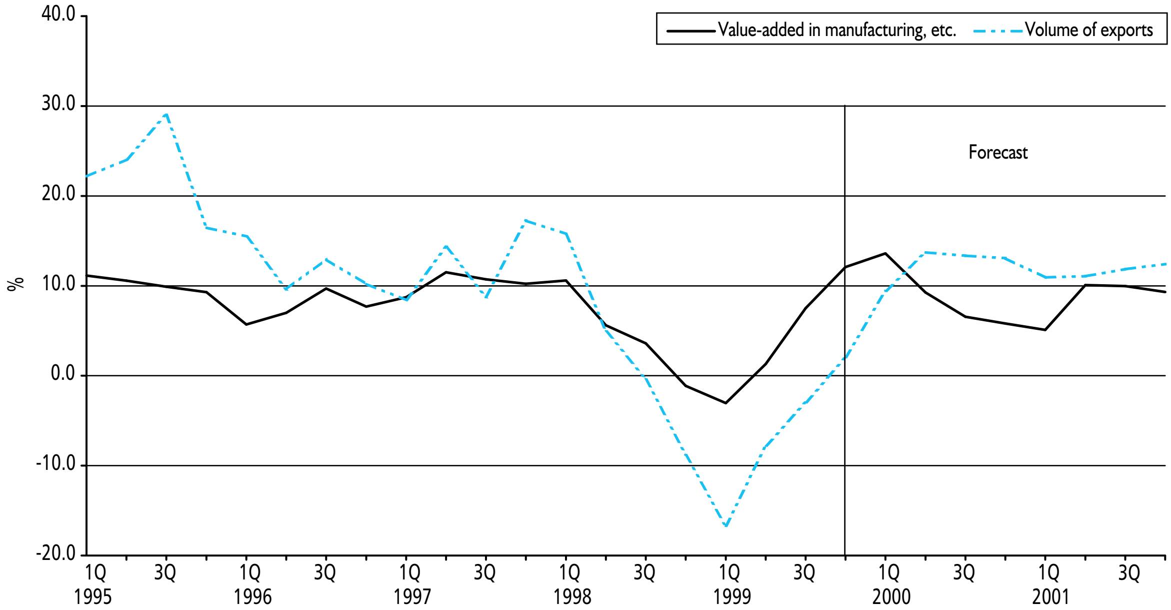
Construction activity by large companies (i.e. those employing more than 20 workers), following higher growth of 4% in 2Q99, was up 3.1% yoy in 3Q99 according to the CSO (see Table 12). Slightly lower growth in construction production was offset by faster growth in other sectors of the construction industry. We estimate

Figure 5. Value-added in major sectors of the economy, 1995–2001 (% change)



Source: CSO and CASE.
Note: CASE forecast starting from 4Q99.

Figure 6. Value-added in manufacturing and volume of exports, 1995–2001 (% change)



Source: CSO and CASE.
Note: CASE forecast starting from 4Q99.

that in 3Q99 the value-added in all sectors of construction companies (including construction implemented by household owners themselves and by smaller contractors) increased 4%.

As in 1998, as well as in the previous two quarters, sales of large trade companies (i.e. those employing more than 20 workers) increased substantially. According to the CSO, retail sales in these firms increased 16.5% whereas, according to our own estimates, they were up 19% in 3Q99. One notes a steady trend of faster growth in sales in large companies compared with sales in the sector as a whole. We calculated that in 3Q99 the value-added in trade rose by more than 5%.

Despite faster growth, demand for both freight and passenger transport services continued to fall. As in previous quarters, this fall stemmed mainly from the dramatic decline in the transport of coal as well as smaller exports to the East involving fewer transport services (see Table 12). The smaller demand for passenger transport is caused by the growing number of passenger cars which helps explain why public transport is gradually being replaced by private transport.

The value-added in non-market services (defined as the sum of value-added in services implemented by central and local government, education and health care) increased 1.0% – similar to that in 2Q99. The relatively small increase in value-added is indirectly the result of social reforms which rationalize employment in the education and health care sectors. The reduction in employment and the lack of a significant improvement in productivity were the main reasons behind the relatively small increase in value-added.

We expect that in 1999 the value-added in the whole economy will increase 3.7%. In the following two years, growth will accelerate to 5.2% and 6.1% respectively. This will be possible due to faster growth of value-added which will reach 8.5% and 8.7% in industry and 9.3% and 10.3% in construction respectively. In 2000, value-added in agriculture will decrease 4% while in 2001 it is expected to grow by more than 4% as a result of the shift to the next phase of the production cycle – assuming agricultural production remains at levels attained in the four previous years.

In the first-half of 2000, growth of value-added will be relatively higher than it was in the second-half of the year. This will be mainly the result of very weak growth indexes in the first-half of 1999.

As in previous quarters, the anticipated value-added growth will be more stable in services than in other sec-

Table 11. GDP and value-added in major sectors of the economy, 1997–2001 (% change)

		GDP		Value-added				
				total	Manufacturing, mining, water and gas supply	construction	market services	non-market services
		zloty billion	%	%	%	%	%	%
1997	1Q–4Q	469	6.9	6.5	10.3	13.5	4.4	3.0
1998e1	1Q–4Q	551	4.8	4.6	4.4	10.2	4.8	0.1
forecast								
1999	*1Q–4Q*	*623*	*3.8*	*3.7*	*4.7*	*4.4*	*4.2*	*1.0*
2000	*1Q–4Q*	*709*	*5.4*	*5.2*	*8.5*	*9.3*	*4.3*	*0.8*
2001	*1Q–4Q*	*801*	*6.3*	*6.1*	*8.7*	*10.3*	*5.0*	*2.0*
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
1999	1Qe1	133	1.5	1.3	-3.0	2.0	4.1	0.9
	2Qe1	150	3.0	2.8	1.3	3.2	4.2	1.0
	3Qe2	160	4.2	4.2	7.5	4.0	4.2	1.0
forecast								
1999	*4Q*	*181*	*6.1*	*5.7*	*12.1*	*6.2*	*4.4*	*1.3*
2000	*1Q*	*154*	*6.4*	*6.2*	*13.6*	*7.4*	*4.4*	*1.0*
	2Q	*171*	*5.3*	*5.1*	*9.3*	*8.6*	*4.3*	*0.8*
	3Q	*181*	*5.1*	*4.8*	*6.6*	*8.9*	*4.3*	*0.7*
	4Q	*204*	*5.1*	*4.9*	*5.8*	*10.8*	*4.2*	*0.8*
2001	*1Q*	*172*	*4.7*	*4.5*	*5.1*	*10.2*	*4.5*	*1.8*
	2Q	*194*	*6.5*	*6.3*	*10.1*	*10.0*	*4.9*	*2.0*
	3Q	*205*	*7.0*	*6.8*	*10.0*	*9.9*	*5.3*	*2.1*
	4Q	*230*	*6.8*	*6.6*	*9.3*	*10.6*	*5.2*	*2.2*

Source: Data and estimates (e1) – CSO; estimates (e2) and forecasts – CASE.
Notes: 1. Data in 1998 prices.
2. % change yoy.
3. Data are not seasonally adjusted.

tors of the economy. It is expected to be 4.3% and 5.0% in 2000 and 2001 respectively. It will not, therefore, be much different from the upward trend in 1996 and 1998 when annual value-added growth ranged between 4.4% to 5.4%. At the same time, value-added will display a slower rise than that for the entire economy. We expect sectors such as telecommunications, trade, hotels, etc. will experience similar faster growth as in the previous years whereas transport and services involving real estate, renting and business activities will have slower growth.

According to our forecast, value-added growth in non-market services will continue to be weak. We also expect that in 2000 a more efficient allocation of employ-

Table 12. Selected short term indicators of the Polish economy, 1997–2001 (% change yoy)

		Output		Transport		Corporate sector	
		Manufacturing, mining, water and gas supply	construction	freight	passengers	average employment	real gross wages
1997	1Q–4Q	11.5	16.5	1.5	-2.4	3.6	5.5
1998e1	1Q–4Q	4.6	11.4	-3.4	-2.9	0.3	3.7
forecast							
1999	*1Q–4Q*	*5.1*	*4.0*	*-4.0*	*-2.1*	*0.0*	*3.5*
2000	*1Q–4Q*	*8.6*	*8.5*	*2.6*	*-1.2*	*0.3*	*3.7*
2001	*1Q–4Q*	*8.8*	*9.6*	*2.0*	*-0.2*	*0.0*	*3.5*
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
1998e1	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
1999	1Qe1	-3.1	0.6	-3.7	-0.4	-0.4	2.5
	2Qe1	1.2	4.0	-6.6	-2.5	-1.2	3.8
	3Qe2	7.5	3.1	-7.6	-1.5	-1.6	3.8
forecast							
1999	*4Q*	*12.7*	*6.0*	*-2.5*	*-0.6*	*-1.3*	*3.5*
2000	*1Q*	*13.9*	*8.0*	*-2.2*	*-0.9*	*-0.2*	*2.9*
	2Q	*9.5*	*6.4*	*-0.4*	*1.5*	*0.5*	*4.2*
	3Q	*6.7*	*7.6*	*-1.7*	*0.0*	*1.0*	*4.1*
	4Q	*5.9*	*7.9*	*-2.0*	*0.2*	*1.0*	*3.8*
2001	*1Q*	*5.3*	*8.0*	*-1.0*	*0.4*	*0.5*	*4.0*
	2Q	*10.2*	*9.2*	*-0.6*	*0.7*	*0.6*	*4.0*
	3Q	*10.1*	*9.0*	*0.3*	*0.3*	*0.6*	*4.2*
	4Q	*9.4*	*8.9*	*1.2*	*0.1*	*0.5*	*4.4*

Source: Data and estimates (e1) – CSO; estimates (e2) with an exception of output and real gross wages, 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).

ment resulting from reforms in education and health care will depress value-added growth to roughly 1% per year. It is only in 2001 that higher growth of more than 2% annually can be expected.

Labour market

- Weak demand for labour
- Increase in the number of registered unemployed
- Forecast of a downward trend in unemployment in 2001

In 3Q99, labour demand was weaker than in the previous quarter (see Table 13). Our estimates show that the average number of employed decreased 1.8% yoy. However, for the first time since 1992 average employment figures fell compared with those of the previous quarter. The seasonal growth of labour demand observed up until now has ensured both higher employment and a smaller number of people out of work.

Lower labour demand is a delayed effect of lower economic growth and, as a consequence, a more efficient allocation of labour in Polish companies.

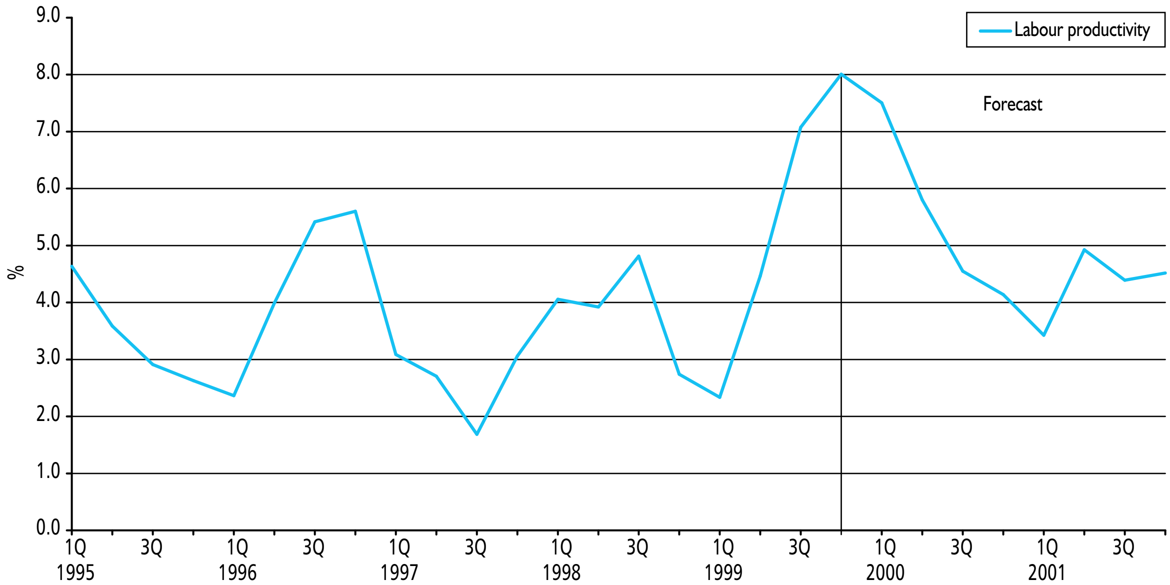
Unemployment

By end-September 1999, the number of registered unemployed was 2177.8 thousand, up 104.8 thousand on June figures, and 501.1 thousand yoy. The unemployment rate was 12.2% which represents a 2.5-point increase over the same period of the previous year.

The figure of 551.1 thousand registered unemployed by end-September, of which 148.3 thousand are graduates, refers to people who have not worked previously. It should be noted that since June the number of unemployed graduates increased by 81.5 thousand and as a % of total people out work by 70.4 thousand. This means that the number of unemployed who are not graduates has in fact fallen by 11.1 thousand. The higher inflow of graduates on the market constitutes a normal seasonal effect observed in 3Q.

Since mid-1997, the share of unemployed as a % of the total number of people out of work has increased. In May 1997, it was only 15.6% whereas in August 1997 it was as high as 25.5%. Since the beginning of this year, the total number of unemployed has increased by 19% while the figure for those who have not worked previously grew by roughly 34%. This confirms the observation

Figure 7. Labour productivity in non-agricultural sectors of the economy, 1995–2001 (%)



Source: CSO and CASE.
Note: CASE forecast starting from 4Q99.

that employers prefer to award jobs to people with professional qualifications. In Poland, this is accentuated by the relatively high minimum wage which is not differentiated according to the number of years at work as well as by an educational system poorly adapted to a market environment.

We expect that by year-end registered employment will be as high as 2.3 million people whereas unemployment will be close to 13%. According to our forecasts, the unemployment rate will continue to increase until 1Q01. Subsequently, faster economic growth will result in a gradual reduction in unemployment.

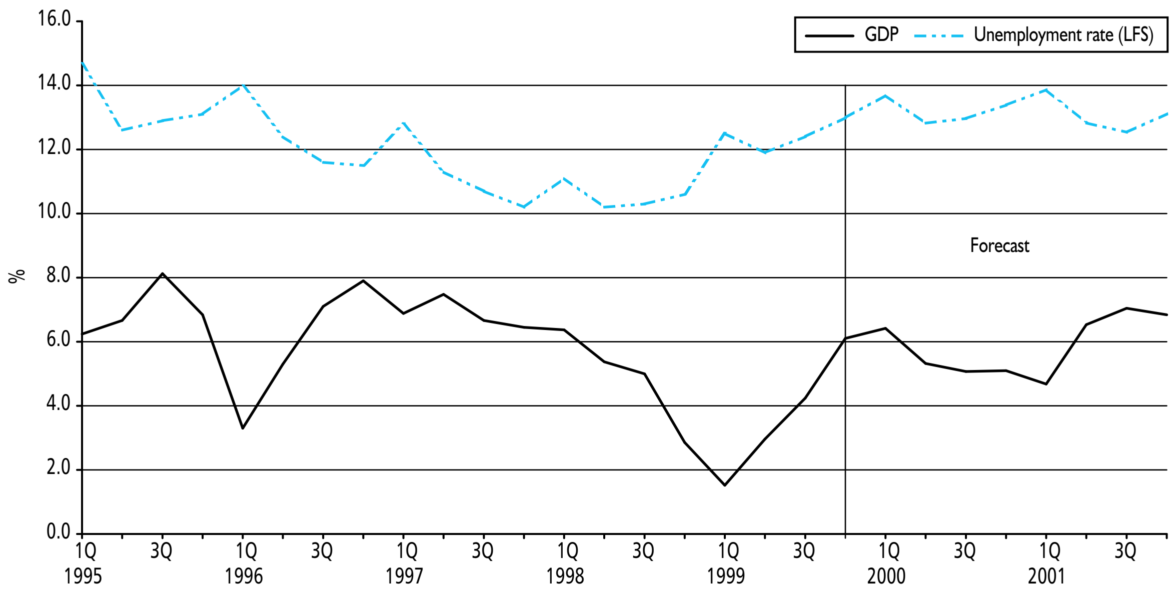
Employment in enterprises

In 3Q99, the typical trend witnessed this year of falling monthly employment continued. In September, enterprises registered a fall of 5735 thousand people – representing a drop of 12 thousand. Employment figures include only large enterprises (we use the definition of enterprises contained in the "Statistical Bulletin" published by the CSO). In September 1998, employment rose by 94 thousand which means that the annual drop was 1.6%. This figure, reflected in statistical data on the labour market, indicates a slight upward trend in the share of employees dismissed due to reasons involving their place of work in the total number of unemployed. The above share increased from 6.8% at the beginning of the year to 7.3% in September.

The recent fall in employment has been mostly noticeable in the industrial sectors. In the period between the beginning of the year and end-September, employment in industrial enterprises employing more than 5 people diminished by 92 thousand whereas that in enterprises rose by 7 thousand people.

The rapid fall in industrial employment should not be regarded as an entirely negative effect. This is because 66 thousand people (i.e. 72% of the net number of all those dismissed) had been employed in the following sectors of industry with a total of 531 thousand workers or 17.5% of the total employed: mining, production of metals, textiles, production and processing of leather articles. All these sectors, especially those belonging to heavy industry, are in desparate need of swift and deep reductions in employment. This is why an acceleration of labour-shedding, visible since the beginning of the year, is a positive sign of the reforms leading to the restructuring of the Polish economy.

Figure 8. GDP and unemployment rate (LFS), 1995–2001 (%)



Source: CSO and CASE.
Note: CASE forecast starting from 4Q99.

Regional differentiation

The highest unemployment in September was recorded in Warmińsko-Mazurskie. Lubuskie and Zachodniopomorskie voivodships (21.4%, 16.6% and 16.1% respectively). The lowest rate was in Mazowieckie (9.0%), Śląskie(9.3%) and Małopolskie (9.4%) voivodships.

Śląskie and Lubuskie voivodships witnessed the highest relative increase in unemployment since the beginning of this year. In the former, unemployment increased by 30.6% and in the latter by 30%. Since the beginning of the year unemployment has been on rise in all voivodships with Podlaskie, Podkarpackie and Warmińsko-Mazurskie recording figures of 8.1%, 11.2% and 11.3% respectively.

The growth of unemployment in Śląskie voivodship has to do with the process of restructuring heavy industry. As mentioned earlier, this is not likely to change within the next few months. Lubuskie voivodship represents a different situation since it covers an area close to the border featuring a large number of small private

Table 13. Components of the labour market, 1997–2001

		Employment		Registered unemployment	Unemployment rate	
					registered	LFS
		thousand	% change	thousand	%	%
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*	*15276*	*-1.4*	*2270*	*12.8*	*13.0*
2000	*1Q–4Q*	*15259*	*-0.1*	*2357*	*13.2*	*13.4*
2001	*1Q–4Q*	*15404*	*1.0*	*2327*	*12.9*	*13.1*
1997	1Q	15048	2.5	2236	12.6	12.8
	2Q	15374	3.0	2040	11.6	11.3
	3Q	15594	3.4	1854	10.7	10.7
	4Q	15739	2.3	1826	10.3	10.2
1998	1Q	15276	1.5	1846	10.4	11.1
	2Q	15479	0.7	1688	9.6	10.2
	3Q	15551	-0.3	1677	9.6	10.3
	4Q	15657	-0.5	1831	10.4	10.6
1999	1Q	15123	-1.0	2170	12.1	12.5
	2Q	15280	-1.3	2074	11.6	11.9
	3Q	15268	-1.8	2178	12.1	12.4
forecast						
1999	*4Q*	*15432*	*-1.4*	*2270*	*12.8*	*13.0*
2000	*1Q*	*15025*	*-0.7*	*2419*	*13.4*	*13.7*
	2Q	*15238*	*-0.3*	*2257*	*12.5*	*12.8*
	3Q	*15288*	*0.1*	*2298*	*12.7*	*13.0*
	4Q	*15485*	*0.3*	*2357*	*13.2*	*13.4*
2001	*1Q*	*15115*	*0.6*	*2469*	*13.6*	*13.9*
	2Q	*15358*	*0.8*	*2277*	*12.5*	*12.8*
	3Q	*15488*	*1.3*	*2238*	*12.2*	*12.5*
	4Q	*15655*	*1.1*	*2327*	*12.9*	*13.1*

Source: Annual and quarterly data with an exception of employment data – CSO; quarterly employment data, forecasts and LSF forecast for 2Q99 and 3Q99 – CASE.
Note: LFS – labour force survey.

trading firms engaged in the "grey sphere". These firms usually exhibit a large degree of flexibility and their situation with respect to employment is expected to improve.

The recent growth in unemployment is largely concentrated in towns. However this is likely to be reversed in the near future once necessary agricultural restructuring begins. It is difficult to assess the consequences of restructuring for the labour market since so-called 'hidden unemployment' in Polish agriculture is estimated to range between 600 thousand and 920 thousand.

Wages

In September 1999, average gross wages in enterprises were 1870.21 zloty – up 43.61 zloty (2.4%) on the previous quarter. What is interesting is that despite the difficult situation in the labour market as a result of significant growth in unemployment, real wages have shown a constant upward trend. In September, they were 3.9% higher yoy. Similar dynamics in real wages were observed since early-1998. The steady increase in wages is the best sign of real rigidity in real wages and may be one of the most important factors hindering the decline in unemployment.

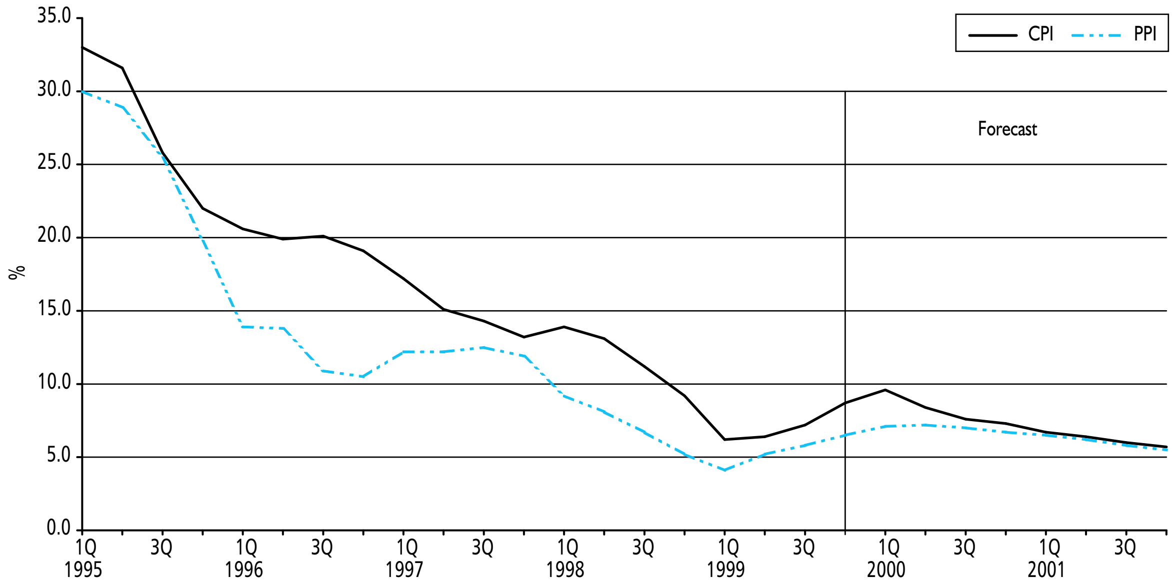
The recent sensible proposal put forward by the government to introduce regional differentiation in minimum wages has our support. Lower minimum wages in regions suffering high unemployment is likely to help them regain competitiveness vis-a-vis other regions and offers a better chance of employment for those entering the labour market. On the other hand, it is questionable whether the voivodship is the optimal region to introduce uniform minimum wages. Differentiation in the labour market within voivodships seems to be just as important as among them. From an economic standpoint, what would be desirable is differentiation of minimum wages within smaller regions called "powiaty" (counties) so that such a socially expensive operation could bring about better results.

Prices

- **Faster inflation in 3Q99**
- **Forecast of a further increase in inflation till 1Q00**
- **Return to disinflation following 1Q00**

In 3Q99, both the Consumer Price Index (CPI) and the Producer Price Index (PPI) – industry, after two quarters of low growth, have risen at a pace which threatens the inflation target of 6.6–7.8% yoy set by the NBP.

Figure 9. CPI and PPI, 1995–2001 (% change yoy)



Source: CSO and CASE.
Note: CASE forecast starting from 4Q99.

The main factors behind accelerated inflation were:

- **Intervention in the agricultural market and import quotas on agricultural products,**
- **Increase in the price of fuels and in the excise tax on fuels,**
- **Increase in the prices of imports resulting from the relatively weaker position of the zloty reflected in faster growth of PPI.**

Since February 1999 when CPI increased 5.6% yoy inflation started to rise again reaching 8.0% in September.

In July and August, the seasonal fall in agricultural prices was smaller than usual which stemmed from poorer crops of vegetables as well as the August intervention of the Agricultural Agency on the meat market. The procurement price of pork meat increased 20% which was reflected in the growth in the retail price of pork by 5.1% in the same month. This increase – with a 10% weight in the CPI – brought about an additional 0.5% increase in prices. Food prices in August would have fallen 0.1% rather than 0.6% had there been no intervention. In the past, growth of procurement prices resulted in growth in retail prices – albeit with a lag. However by June 1999,

Table 14. Basic price indicators, 1997–2001 (% change yoy)

	Price indices				Currency basket	GDP deflator
	CPI	PPI	exports	imports		
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	*7.1*	*5.4*	*8.0*	*6.7*	*9.8*	*9.0*
2000 1Q–4Q	*8.2*	*7.0*	*4.6*	*3.9*	*7.1*	*7.9*
2001 1Q–4Q	*6.9*	*6.4*	*4.6*	*3.8*	*4.4*	*6.1*
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	8.1	2.6	9.0	6.6
2Q	6.4	5.2	7.0	7.3	12.5	9.4
3Qe	7.2	5.8	11.0	11.0	7.7	10.4
forecast						
1999 4Q	*8.7*	*6.5*	*6.0*	*6.0*	*9.6*	*9.1*
2000 1Q	*9.6*	*7.1*	*5.0*	*5.2*	*6.7*	*8.5*
2Q	*8.4*	*7.2*	*5.0*	*4.0*	*7.1*	*8.4*
3Q	*7.6*	*7.0*	*4.5*	*2.0*	*8.1*	*7.6*
4Q	*7.3*	*6.7*	*4.0*	*4.5*	*6.6*	*7.3*
2001 1Q	*6.7*	*6.5*	*5.0*	*5.2*	*5.8*	*5.5*
2Q	*6.4*	*6.2*	*5.0*	*4.0*	*4.2*	*4.9*
3Q	*6.0*	*5.8*	*4.5*	*2.0*	*4.2*	*4.6*
4Q	*5.7*	*5.5*	*4.0*	*4.5*	*3.6*	*4.1*

Source: Annual data – CSO; currency basket – NBP; GDP deflator, estimates (e) with an exception of CPI, PPI and the currency basket, and forecasts – CASE.

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

due to a food surplus and strong competition, retailers did not pass on higher costs of products to consumers by lowering the profit margin. The situation has now changed. This was due to retailers' lack of enthusiasm for lowering their profits through food agents as well as to the economic revival. In addition, it should be noted that meat exports to the East, especially pork, registered growth partly as a result of lower subsidies for exporters from the EU. This is one of the reasons why Polish food products have once again become attractive for Russia and Ukraine. Consequently, pork meat supplies in the domestic market diminished resulting in price increases.

The prices of non-food products rose by 8.6% July-on-July, by 9.5% August-on-August, and 9.6% September-on-September. Their growth rate was of course much higher than that of total CPI. This was the result of the significant increase in oil prices. All these factors, including a weaker zloty, caused higher import prices which, in turn, influenced PPI. In addition, along with the world price increase of crude oil, the excise tax on this product was raised in Poland which directly caused the prices of non-food products to increase. It should be emphasised that the upward trend in prices of non-food products have been observed since March 1999 which may be interpreted as a symptom of growth in core inflation. Fast growth of consumption credits (mostly intended for durable goods), with the nominal rate exceeding 48% in September, may be one of the causes of this effect.

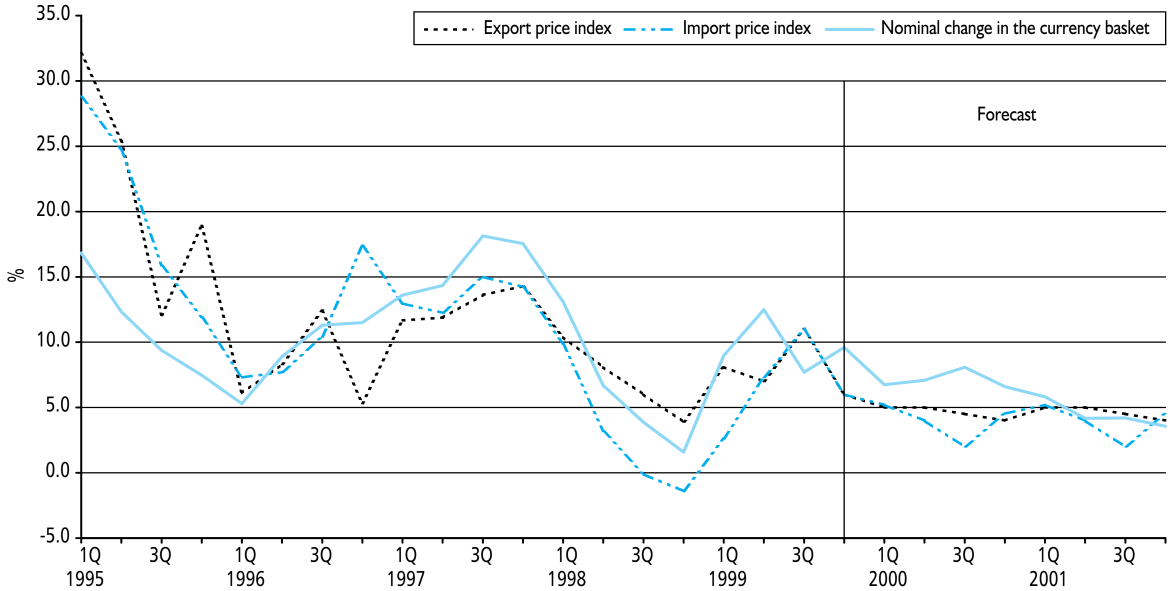
The prices of services were stable in July and August amounting to 10.4% yoy. This was due to the absence of any stimuli on the part of state-administered prices. It was only in September that the prices of services began their upward trend of 11% over the whole year.

The increase in PPI derived mostly from the import/export prices due to fast growing crude oil prices. Moreover, the higher excise tax on oil forced the producers to raise the price of oil products. Moreover, economic growth makes it possible to pass on higher costs to agents and consumers.

In our opinion, 4Q99 prices will continue to rise. CPI inflation will increase to 9.2% yoy in December whereas PPI will hit 7% yoy in December.

We expect that food prices will grow in the next six months. This will be due to the increase in the price of pork meat resulting from the decline in live-stocks of swine and the slow resumption of demand from Poland's Eastern neighbours. Growth in the price of cereals stemming from lower-than-expected harvest and crops will also contribute to changes in food prices. In addition, we think that high-

Figure 10. Export and import price indices and nominal change in the currency basket, 1995–2001 (% change)



Source: CSO and CASE.

Notes: 1. CASE forecast starting from 4Q99.

2. Currency basket over 1996–98 consists: 55% of US$ and 45% of DM, and from 1999: euro – 55% and US$ – 45%.

er vegetable and fruit prices, as well as protective tariffs on agricultural produce and an economic revival, will be reflected in the upward trend in food prices.

Over the forecast period, the prices of non-food products will depend on the growth of producer prices. Moreover, what has been witnessed for some time now is an economic recovery at home and a better economic performance in the West. Both of these factors have generated demand pressures which should be reflected in continued growth in money supply dependent, in large measure, on the credit boom.

In our opinion, in 4Q99 prices of services should not rise unduly in the absence of price regulation. On the other hand, what can be expected in 1Q00 is faster growth resulting from the release of state-administered prices.

According to our forecast, in February 2000 CPI will increase 9.8% yoy and in the consecutive months inflationary pressures will weaken. This will be caused, on the one hand, by a weakening cost effect as we expect world crude oil prices to stabilise and the nominal depreciation rate of the zloty to diminish. On the other hand, the predicted growth of nominal interest rates and households' propensity to save will lead to relatively weaker consumption demand.

In 2000, the annual average CPI and that calculated on a December-on-December basis, will rise 8.2% and 6.6% respectively. These figures exceed the 5.7% predicted in the Budget Act as an average for the whole year. The downward trend in inflation will continue well into 2001 with prices increasing 6.9% and 5,4% respectively.

A similar upward trend is expected for PPI with prices growing by about 5% annually by end-2001.

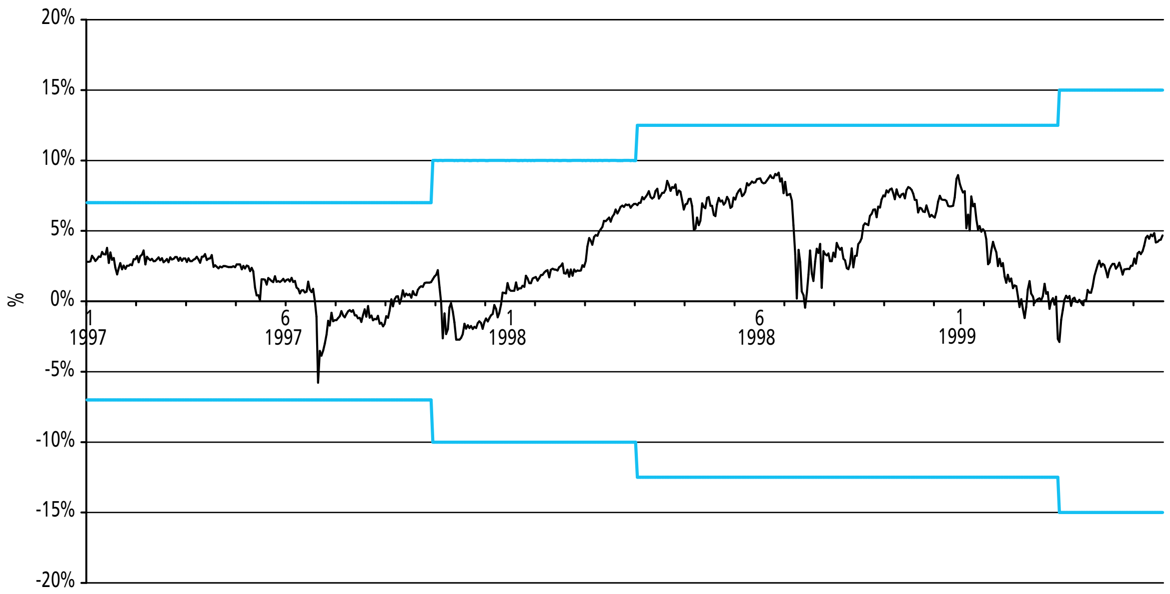
In 2000–2001, a downward trend is predicted for the GDP deflator. After a spell of faster growth in the GDP deflator than CPI, the trend is expected to reverse itself in the above period. By end-2001, the GDP deflator is likely to increase 4% annually.

Exchange rate

- **Growth of real effective exchange rate**
- **Press statements as a source of fluctuations in the zloty exchange rate**
- **Low pace of foreign capital inflows**

In 3Q99, the zloty exchange rate was determined by intermittently good and bad news about Polish economic

Figure 11. Average deviation of US$/zloty from the central parity, 1997–1999

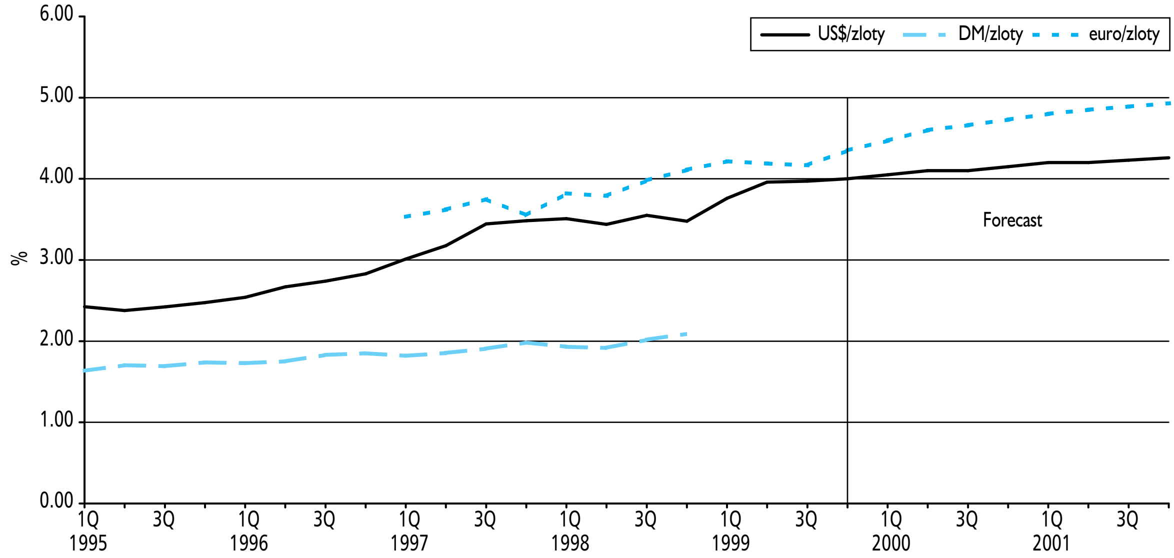


Source: NBP.

activity as well as press statements which invariably led to a weakening of the zloty. The weak position of the foreign currency market, also caused by the "hunt" for speculators by the National Bank of Poland (NBP), has produced a situation in which small money resources (finances) and press statements could significantly upset the market balance. There are no financial institutions which may be interested in assuming the risk of fighting daily speculations by the majority of market leaders.

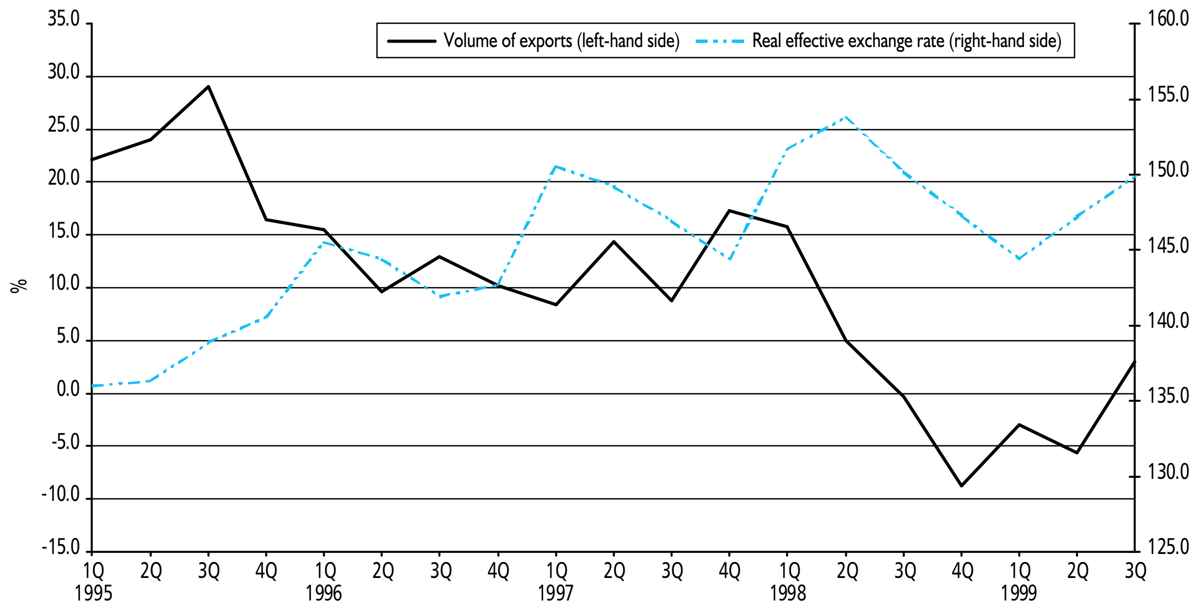
Following a marked weakening of the zloty by the end of 1Q99, the real effective exchange rate fell significantly (see Table 15). However, as early as 2Q99 the rate resumed its upward trend to hit the level of the preceding

Figure 12. Basic exchange rates, 1995–2001 (per zloty)



Source: CSO and CASE.
Note: CASE forecast starting from 4Q99.

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.

year in 3Q99. The decision by the Monetary Policy Council (MPC) taken in early 1999 led to some weakening of the exchange rate only over the period of one quarter. Therefore, there is little hope that in such a situation exchange policy will eventually stimulate exports.

Political developments involving endless controversies within the ruling coalition would inevitably result in destabilising any exchange rate. In Poland, in 3Q99 the above situation was made more difficult by the deteriorating deficit in the public finance sector as well as by the absence of reliable data on the real effects of reforms in the public sector. The scope and range of financial problems involved in restructuring state-run enterprises in the mining and arms industries have made things even more difficult. In addition, the EU countries did not show any

Table 15. Basic exchange rates, 1997–2001 (per zloty)

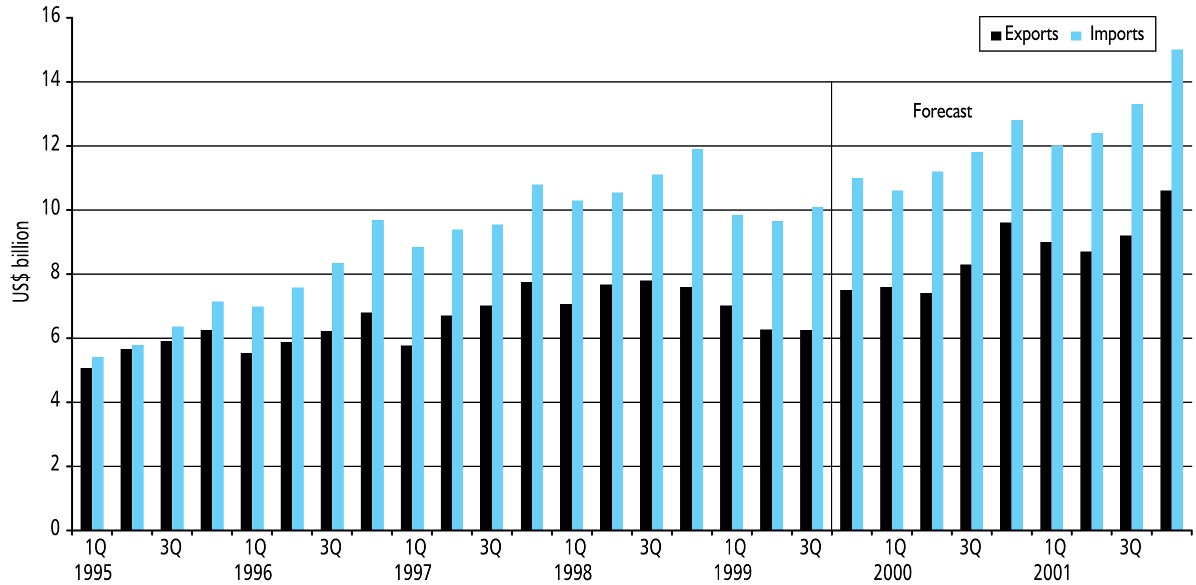
		US$	German mark	ECU/Euro	Real effective exchange rate
1997	1Q–4Q	3.28	1.89	3.71	147.7
1998	1Q–4Q	3.49	1.99	3.92	149.9
forecast					
1999	*1Q–4Q*	*3.92*		*4.23*	
2000	*1Q–4Q*	*4.10*		*4.62*	
2001	*1Q–4Q*	*4.22*		*4.87*	
1997	1Q	3.01	1.82	3.53	150.6
	2Q	3.18	1.85	3.62	149.2
	3Q	3.44	1.91	3.75	146.9
	4Q	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	150.2
	4Q	3.48	2.09	4.11	147.3
1999	1Q	3.76		4.22	144.4
	2Q	3.96		4.19	147.2
	3Q	3.97		4.17	149.9
forecast					
1999	*4Q*	*4.00*		*4.35*	
2000	*1Q*	*4.05*		*4.47*	
	2Q	*4.10*		*4.60*	
	3Q	*4.10*		*4.66*	
	4Q	*4.15*		*4.73*	
2001	*1Q*	*4.20*		*4.80*	
	2Q	*4.20*		*4.85*	
	3Q	*4.23*		*4.89*	
	4Q	*4.26*		*4.93*	

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.

clear signs of economic recovery which questioned the forecast for Poland's exports. Foreign investors aslo became worried by trends in the US economy – and in the stock market in particular. Traditionally the period between September and October does not seem to be auspicious in the eyes of investors.

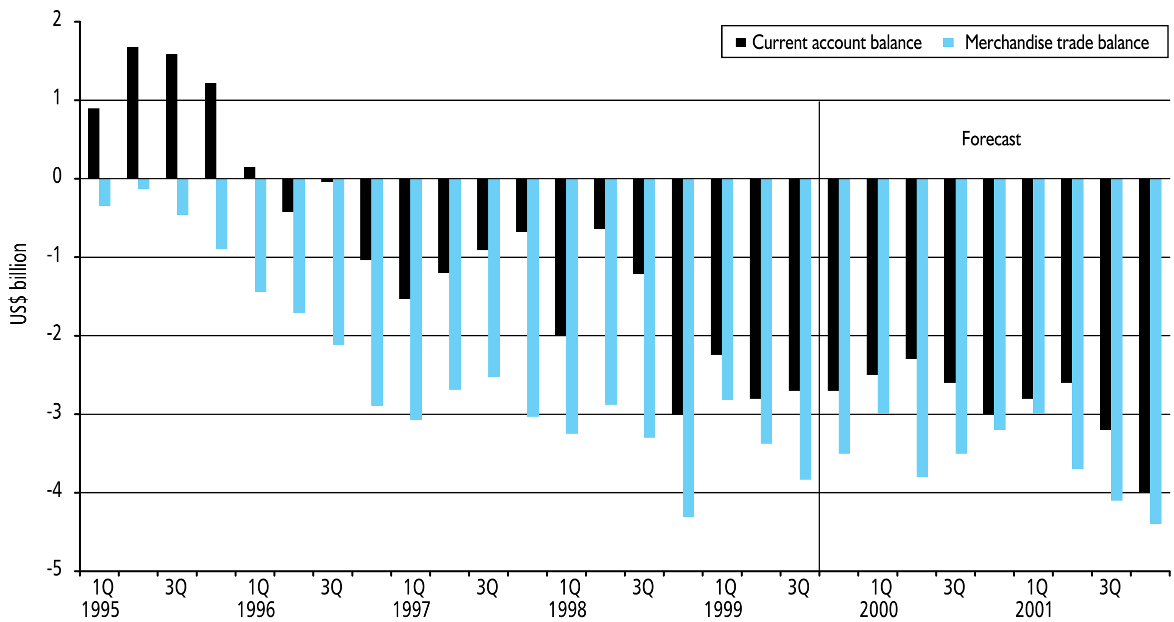
After some stabilisation was achieved in the positive and negative press statements in 2Q99, such as the presentation in April of a "black" scenario by Mr Kropiwnicki, head of the Government Centre for Strategic Studies, and the information provided in June by Professor Rosati on the inflow of foreign currency from privatisation on the

Figure 14. Exports and imports, 1995–2001 (US$ billion)



Source: NBP and CASE.
Note: CASE forecast starting from 4Q99.

Figure 15. Merchandise trade balance and current account balance, 1995–2001 (US$ billion)



Source: NBP and CASE.
Note: CASE forecast starting from 4Q99.

forex market, in 3Q99 negative statements predominated over positive ones and, as a result, the zloty exchange rate was weaker. In July, the inflow of financial resources forecast by the privatisation of Pekao SA Group and Bank Zachodni contributed to the stronger position of the zloty exchange rate – 6% above the central rate. In August, such factors as Mr Kropiwnicki's summing-up of the preceding six months with his emphasis on negative trends such as the foreign trade deficit, the current state of the budget deficit, and poorer performance in industry as well as lower-than-expected GDP growth, all led to a weaker position of the zloty by about 1 percentage point over the period of two days. Professor Gomułka added fuel to the fire by announcing the prospective sterilisation of returns from privatisation of enterprises other than those in the exchange market, i.e. TP SA (Polish Telecommunications), PKN, PZU (Polish Insurance Company) SA, and the air-line LOT SA. As a result, the zloty exchange rate fell below the central rate. 4Q99 again began by a pessimistic outlook presented by Mr Kropiwnicki who announced results inferior to those from official forecasts covering the period to end-1999 and 2000.

In such a volatile situation in the currency markets caused by political factors and politicians' statements, with confidence in the stability of the currency and economic reforms being undermined, fundamentals seem to be of minor importance. This is because the success or failure of economic reforms are still identified in those countries undergoing transformation with the position of the domestic currency versus the dollar.

According to our forecasts, from 4Q99 onwards the dollar will weaken against the euro and yen. We also predict that in 4Q99 the zloty exchange rate will range between (–2) and 2 percentage points around the central rate reaching the value of 4 PLN/USD. In 2000–2001, the zloty rate of exchange over the whole year will be respectively 4.1 and 4.22 PLN/USD.

Foreign trade

- **Low dynamics in exports**
- **Fall in the share of eastern markets for Polish exports**
- **Likelihood of recovery in exports in the second-half of 2000**

Polish foreign trade will continue to be determined, to a large extent, by the economic collapse in the CIS countries (caused by the Russian crisis) as well as slower economic growth in the EU.

The absence of the anticipated economic revival among Poland's main EU trade partners constitutes the main reason why the upward trend in exports is slow to materialise. The situation in Germany and Italy at the end of 3Q99 gives little hope for dramatic improvement in exports by the end of this year. A weak euro resulting in low demand for EU imports is another factor limiting Polish export growth.

Unfortunately, our expectations of a fast recovery in exports to CIS countries, and to Russia in particular, have not materialised. Trade turnover with countries of Central and Eastern Europe between January and August (in US dollars) have fallen 33.6% yoy whereas trade turnover with CEFTA countries (included in the previous group) rose 4%. After seven months, Russia, which has traditionally been among the first three most important partners for Polish exports, now occupies a position outside the first ten. In view of the present economic situation in the CIS, any revival of Polish exports to eastern markets will take quite some time.

After the first three quarters of 1999, merchandise trade (in US dollars) fell by more than 13% yoy. Payments from imports were lower by more than 7%. We estimate that the volume of Polish exports and imports in terms of national accounts fell by 4% and 1% respectively.

The fall in imports was caused, above all, by the lower pace of domestic demand in 1Q99 and by the downward trend in investment outlays. We predict that the anticipated economic recovery in 2000 will influence import growth. However, weaker consumption demand also predicted for 2000 may partly offset increased imports of investment goods. We therefore expect a higher growth in imports to take place as late as 2001 when consumer demand is likely to resume its upward trend and economic growth exceeds 6%.

In 2000–2001, the rise in exports will be due to higher demand in the EU whereas in 2001 it will be the result of a resumption of higher exports to CIS markets. Higher export growth in 2000 will make it possible to stabilise the foreign trade balance, although a deterioration will be observed in 2001.

Balance of payments

- **Deterioration in the current account deficit**
- **Large inflows of foreign direct investment (FDI)**
- **Considerable outflows of portfolio capital in September**

The current account balance dropped to US$(–2.96) billion. This is the best piece of evidence that the deficit has continued its downward trend since the beginning of the year. 3Q99 recorded a higher deficit by US$1.7 billion yoy which was higher by US$194 million qoq. This situation was mostly due to a lower merchandise trade balance, unclassified current transactions balance (only mom), as well as lower current transfers and services balance.

Exports amounted to US$6.3 billion, down US$1.6 billion yoy and down US$19 million qoq. This downward trend has been observed since the beginning of the year. Weak exports stem from the lack of a significant EU economic revival (in Germany and Italy in particular) as well as in the CIS. **We would like to point out that the expectations voiced by some analysts that the weaker position of the zloty would lead to a recovery in Polish exports have not materialised. Thus our opinion expressed in January this year that what is more important for Poland's exports is demand side (i.e. increase or decline in demand) rather than price stimulus still holds.**

Imports amounted to US$10.1 billion in 3Q99, down US$1.0 billion yoy, but up US$0.4 billion qoq. This slight increase can be accounted for by faster growth of domestic demand during the quarter.

Table 16. Exports, imports and net exports; 1997–2001 (US$ billion)

		Exports			Imports			Net exports		
		NBP	CSO	National accounts	NBP	CSO	National accounts	NBP	CSO	National accounts
1997	1Q–4Q	27.23	25.75	36.72	38.55	42.31	42.80	-11.32	-16.56	-6.07
1998	1Q–4Q	30.12	28.23	37.36	43.84	47.05	45.45	-13.72	-18.83	-8.09
forecast										
1999	*1Q–4Q*	*27.04*	*26.71*	*33.61*	*40.58*	*44.61*	*44.44*	*-13.54*	*-17.90*	*-10.83*
2000	*1Q–4Q*	*32.90*	*32.70*	*40.70*	*46.40*	*50.20*	*52.09*	*-13.50*	*-17.50*	*-11.39*
2001	*1Q–4Q*	*37.50*	*37.00*	*45.00*	*52.70*	*57.00*	*56.37*	*-15.20*	*-13.20*	*-11.37*
1997	1Q	5.77	6.12	9.33	8.84	9.77	9.95	-3.07	-3.65	-0.62
	2Q	6.69	6.31	9.06	9.38	10.56	10.51	-2.69	-4.24	-1.45
	3Q	7.02	6.21	8.85	9.55	10.15	10.19	-2.53	-3.94	-1.34
	4Q	7.75	7.11	9.48	10.78	11.84	12.15	-3.03	-4.73	-2.67
1998	1Q	7.06	7.02	8.99	10.30	11.09	10.81	-3.24	-4.06	-1.82
	2Q	7.67	7.04	9.58	10.55	11.70	11.30	-2.88	-4.65	-1.72
	3Q	7.80	6.89	9.32	11.10	12.00	11.24	-3.30	-5.10	-1.92
	4Q	7.60	7.27	9.47	11.90	12.28	12.10	-4.31	-5.00	-2.63
1999	1Q	7.01	6.59	7.89	9.83	10.42	10.64	-2.82	-3.84	-2.75
	2Q	6.27	6.59	8.22	9.64	10.99	10.99	-3.37	-4.40	-2.76
	3Qe	6.25	6.34	8.30	10.10	11.30	10.75	-3.85	-4.96	-2.45
forecast										
	4Q	*7.50*	*7.20*	*9.20*	*11.00*	*11.90*	*12.07*	*-3.50*	*-4.70*	*-2.87*
2000	*1Q*	*7.60*	*7.40*	*9.20*	*10.60*	*11.40*	*11.90*	*-3.00*	*-4.00*	*-2.70*
	2Q	*7.40*	*7.70*	*9.50*	*11.20*	*11.70*	*12.44*	*-3.80*	*-4.00*	*-2.94*
	3Q	*8.30*	*8.40*	*10.40*	*11.80*	*12.60*	*13.05*	*-3.50*	*-4.20*	*-2.65*
	4Q	*9.60*	*9.20*	*11.60*	*12.80*	*14.50*	*14.70*	*-3.20*	*-5.30*	*-3.10*
2001	*1Q*	*9.00*	*8.60*	*10.70*	*12.00*	*12.90*	*13.72*	*-3.00*	*-2.80*	*-3.02*
	2Q	*8.70*	*9.00*	*11.10*	*12.40*	*13.40*	*13.91*	*-3.70*	*-2.70*	*-2.81*
	3Q	*9.20*	*9.30*	*10.60*	*13.30*	*14.20*	*12.96*	*-4.10*	*-3.30*	*-2.36*
	4Q	*10.60*	*10.10*	*12.60*	*15.00*	*16.50*	*15.77*	*-4.40*	*-4.40*	*-3.17*

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

Note: National accounts according to the CSO definition (merchandise trade plus the value of transport, construction and communication services, net processing turnover, printing services and others).

Table 17. Components of the balance payments, 1997–2001 (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	% of GDP	merchandise trade	unclassified current transactions	capital and financial account					
1997 1Q–4Q	-4.31	-3.01	-11.32	6.01	5.41	3.04	2.10	0.42	2.64	20.67
1998 1Q–4Q	-6.86	-4.35	-13.72	6.00	10.80	4.97	1.33	1.72	6.71	27.38
forecast										
1999 1Q–4Q	*-10.67*	*-6.72*	*-13.54*	*3.98*	*10.85*	*6.50*	*-0.08*	*2.18*	*-0.38*	*27.00*
2000 1Q–4Q	*-10.40*	*-6.01*	*-13.50*	*4.90*	*13.70*	*6.30*	*1.60*	*2.20*	*3.30*	*30.30*
2001 1Q–4Q	*-12.60*	*-6.65*	*-15.20*	*5.00*	*14.80*	*7.80*	*1.60*	*1.90*	*2.20*	*32.50*
1997 1Q	-1.53	-4.48	-3.07	1.12	1.28	0.46	0.41	0.05	-0.06	17.98
2Q	-1.19	-3.38	-2.69	1.47	2.36	0.78	1.07	0.17	1.71	19.69
3Q	-0.91	-2.65	-2.53	1.62	0.80	0.78	0.64	-0.06	0.37	20.05
4Q	-0.67	-1.73	-3.03	1.80	0.97	1.03	-0.02	0.26	0.62	20.67
1998 1Q	-2.00	-5.69	-3.24	1.16	3.24	1.00	0.21	0.24	2.39	23.06
2Q	-0.64	-1.65	-2.88	1.72	2.19	1.26	0.36	0.36	2.19	25.26
3Q	-1.22	-3.10	-3.30	1.87	2.64	1.68	-0.86	0.06	1.83	27.08
4Q	-3.01	-6.71	-4.31	1.25	2.73	1.02	1.61	1.07	0.30	27.38
1999 1Q	-2.24	-6.32	-2.82	0.80	1.15	1.14	-0.30	-0.05	-0.78	26.60
2Q	-2.77	-7.32	-3.37	0.79	2.91	1.19	-0.05	0.54	-0.75	25.85
3Qe	-2.96	-7.37	-3.85	1.15	3.18	2.44	-0.12	0.99	0.18	26.03
forecast										
1999 4Q	*-2.70*	*-5.98*	*-3.50*	*1.24*	*3.60*	*1.70*	*0.40*	*0.70*	*0.97*	*27.00*
2000 1Q	*-2.50*	*-6.58*	*-3.00*	*1.15*	*3.20*	*1.40*	*0.50*	*0.70*	*0.70*	*27.70*
2Q	*-2.30*	*-5.52*	*-3.80*	*1.20*	*3.20*	*1.40*	*0.40*	*0.60*	*0.90*	*28.60*
3Q	*-2.60*	*-5.89*	*-3.50*	*1.35*	*3.30*	*1.50*	*0.40*	*0.50*	*0.70*	*29.30*
4Q	*-3.00*	*-6.11*	*-3.20*	*1.20*	*4.00*	*2.00*	*0.30*	*0.40*	*1.00*	*30.30*
2001 1Q	*-2.80*	*-6.84*	*-3.00*	*1.10*	*3.40*	*1.60*	*0.50*	*0.50*	*0.60*	*30.90*
2Q	*-2.60*	*-5.64*	*-3.70*	*1.20*	*3.30*	*1.70*	*0.40*	*0.50*	*0.70*	*31.60*
3Q	*-3.20*	*-6.60*	*-4.10*	*1.40*	*3.80*	*2.00*	*0.40*	*0.50*	*0.60*	*32.20*
4Q	*-4.00*	*-7.42*	*-4.40*	*1.30*	*4.30*	*2.50*	*0.30*	*0.40*	*0.30*	*32.50*

Source: Data and estimates (e) – NBP; forecasts – CASE.

The balance of trade in services deteriorated by US$356 million yoy, but registered a slight improvement compared with the previous quarter. The balance of unclassified current transactions amounted to US$1.2 billion, considerably lower (by US$0.7 billion) compared to 3Q98. This was due to the continued sluggish cross-border trade transactions following the Russian crisis. However, the balance of cross-border transactions qoq was slightly better which stemmed from more higher levels of tourism during the summer holidays.

A relatively large increase of US$689 million in foreign direct investment in 3Q99 yoy, as well as in relation to the previous quarter (by US$1.3 billion) was observed. As a result, the balance of foreign direct investments improved amounting to as much as US$2.4 billion due to the sale of shares in the Pekao SA Group in August this year.

Table 18. Selected items of the government budget, 1997–2001 (US$ billion)

		Revenues		Expenditures	Government balance	
		total	of which tax revenues		zlotych billion	% of GDP
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*	*125.2*	*112.0*	*137.4*	*-12.2*	*-2.0*
2000	*1Q–4Q*	*140.8*	*126.0*	*152.4*	*-11.5*	*-1.6*
2001	*1Q–4Q*	*155.2*	*139.2*	*163.3*	*-8.0*	*-1.0*
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	24.8	36.5	-8.7	-6.5
	2Q	28.8	25.2	31.4	-2.6	-1.7
	3Q	32.5	29.5	32.4	0.1	0.0
forecast						
1999	*4Q*	*36.2*	*32.5*	*37.1*	*-0.9*	*-0.5*
2000	*1Q*	*31.7*	*28.3*	*34.6*	*-2.9*	*-1.9*
	2Q	*32.6*	*28.7*	*37.1*	*-4.5*	*-2.6*
	3Q	*36.4*	*32.9*	*37.6*	*-1.2*	*-0.7*
	4Q	*40.2*	*36.1*	*43.1*	*-3.0*	*-1.5*
2001	*1Q*	*34.6*	*30.9*	*37.0*	*-2.4*	*-1.4*
	2Q	*36.2*	*32.0*	*39.8*	*-3.6*	*-1.9*
	3Q	*40.3*	*36.5*	*40.4*	*-0.1*	*-0.1*
	4Q	*44.2*	*39.7*	*46.1*	*-1.9*	*-0.8*

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

Since early 1999, a steady outflow of portfolio capital has been observed with the cumulative balance reaching US$(-400) million. In 3Q99, the balance of investment remained stable at US$(–14) million which indicates a substantial improvement of US$844 million yoy. It should, however, be borne in mind that 3Q98 witnessed a substantial capital outflow due to the Russian crisis. It should also be noted that the negative balance in 3Q99 resulted mainly from the considerable outflows in September. In the two previous months capital inflows were recorded and the September drain of foreign investors from Poland was undoubtedly tied up with Professor Gomułka's statement (see the section on foreign exchange).

Nevertheless, we expect the current account deficit to improve from 4Q99 onwards. However, it will be as high as US$(–10.7) billion (i.e. 6.7% of GDP) for the whole 1999. We also predict that in the next two years it will amount to US$(–10.4) billion (6.0% of GDP) and US$(–12.6) billion (6.6% of GDP), respectively. Due to our forecast of foreign capital inflows to Poland it will be possible to cover the current account deficit and help increase official foreign currency reserves from US$27 billion at end-1999, to US$30.3 billion at end-2000, and to US$32.5 billion by end-2001.

Public finances

- **The Budget Act provides no indication of a threat to public finances from other non-budgetary institutions of the public sector**
- **Less restrictive fiscal policy is expected in 1999**
- **Government budget deficit is expected not to exceed 2.1% of GDP in 2000**
- **The deficit of 1.9% of GDP forecast for 2000 appears attainable**
- **Public finances are threatened by the crisis in the social insurance system which is expected to be burdened by debts of 0.9% of GDP and 0.5% of GDP in 1999 and 2000 respectively**
- **The health care sector will generate an annual deficit of the order of 0.5% of GDP in 1999-2000 which will be a burden mostly for local governments**

Government budget in 1999 and 2000

Stronger GDP growth in 3Q99 and rising inflation led to higher budget revenues – particularly in indirect taxes making up more than 60% of all revenues. In 3Q99 corporate tax revenues were much higher. As a result, during the first three quarters of 1999 budget revenues amounted to 69% of the amount planned for the whole year. The prospects for 4Q99 are also quite good due to higher growth of the taxation base as a result of improved economic performance and inflation. As far as expenditures are concerned, the situation is much less favourable. It was only in September that the first installement of subsidies was transferred from the budget to the Labour Fund. What is worse is that only 30% of the Fund's resources laid down in the Budget have been utilised by 3Q99. The costs of foreign debt servicing have been growing at a relatively slow pace with only 63% of all resources spent so far. The latest depreciation of the zloty raises concerns that savings related to exchange rates movements will not be as high as planned. Likewise, higher reference rates set by the MPC and the prospects for their increase will lead to higher costs of foreign debt servicing which, already in the last quarter, displayed a higher rate of growth than other expenditures. Funds contributed to the Social Insurance Fund and subsidies to local governments have also registered faster growth than other expenditure. As a result, during the first three quarters of 1999 budget expenditures amounted to 71% of those planned for the whole year.

At present, the probability that the budget planned for 1999 will be exceeded is small. On the other hand, revenues from privatisation are higher than those planned in the Budget Act. After nine months they are 2.6 billion PLN higher than the target planned for the whole year – the surplus is likely to be as high as 6 billion PLN by year-end. By law, these resources cannot be used to finance the budget deficit so they will therefore partly be used as a loan of 4 billion PLN for ZUS as well as for foreign debt servicing of up to 2 billion PLN.

Government draft budget for 2000

Macroeconomic assumptions of the 2000 budget are realistic. What is debatable is the adoption of a lower inflation rate. However, the increase in the price of non-food products which make up the majority of revenues

Table 19. Public sector balance (% of GDP)

	1998 implemented	1999 budget	1999 MoF	1999 CASE	2000 budget	2000 CASE
Government budget balance	-2.4	-2.1	-2.1	-2.0	-1.9	-1.6
Funds balance	0.1	-0.05	-0.7	-0.9	0.1	-0.5
Regional Health Funds balance	-	0.0	0.0	-0.3	0.0	-0.0
Balance of local governments budgets	-0.3	-0.3	-0.1	-0.3	-0.2	-0.9
Balance of the public finances	-2.6	-2.5	-2.9	-3.6	-2.0	-3.3
Compensations	-	-	-	-	-0.5	-0.5
Second pillar	-	-	0.5	0.5	1.2	1.2
EU funds	-	-	-	-0.1	-	-0.3
Total effect on domestic savings	-2.6	-	-2.4	-3.2	-1.3	-2.9

Source: Ministry of Finance (MoF) and CASE.

from indirect taxes is likely to be smaller than average in 2000. Thus the predicted growth of revenues from indirect taxes may actually be achieved.

Nevertheless, some decisions taken by the parliamentary Commission of Finances are worrying. The Commission consistently rejected all proposals put forward by the Ministry of Finance aimed at increasing revenues from VAT. It maintained the exemption of municipal services and transport from VAT and ivetoed the proposal of adopting a 3% VAT rate on agricultural produce. The amendments to restrict the right to a lower VAT by the so-called "establishments of protected labour" and to waive the right to lower tax on petrol have also not been passed by the Commission. The members of the Commission could not decide whether or not to do away with the investment allowance, but at the same time they increased depreciation rates, which was to compensate for eliminating other allowances or other forms of tax relief. On the other hand, the suggestion of reducing the income tax for two upper income categories from 40% to 36% and from 30% to 29% is not likely to be adopted. The Commission also rejected the proposal that the corporate income tax should be lowered from 34% to 30%, and it maintained its present level of 32%. Nevertheless, the most important change adopted in the present system of taxation are higher excise taxes, primarily those on alcohol and fuels as well as elimination of construction allowances, tax relief on pension and permanent financial burdens.

The proof of the determination by the Ministry of Finance to reduce the deficit to the planned 1.9% of GDP is in the growth of budget expenditures aside from those involving transfers to the Social Insurance Fund. There are, however, serious doubts as to the possibility of obtaining political support for narrowing the budget. This is especially true in a situation where real earnings in the government sector have risen by just 1% and pensions have increased in real terms by only 0.3%. In view of predicted higher interest rates, the level of funds set aside for domestic debt servicing may also be questioned. Although real spending may be higher by 1 billion PLN, the projected level of the deficit is realistic. Moreover, the restrictive budget policy is, to some extent, more apparent than real since the main sources of the deficit of public finances lie mainly outside the state budget.

Social Insurance Fund

When discussing the state of public finances the Social Insurance Fund seems to be something of an unknown quantity. A structural shortage of financial resources from contributions is the best proof of the bankruptcy of the old national insurance system. The changes in demographics have led to a situation in which the working population is unable to provide enough money to finance the present old age pensions. This will be a factor determining the state of public finances in the years to come. However, there are many causes that have led to the current situation where the Fund's own revenues over the first three quarters of this year have turned out to be significantly lower than those planned in the Budget Act. These were: errors of judgement committed in the legislative process, unrealistic assumptions adopted in the Budget, lack of competence in ZUS management, and, last but not least, the closure of the Office of the Minister for the Pension Reform. Various delays and political controversies in the course of the legislative process have also led to formulations that adversely affected the Fund's actual revenues. What in fact happened was that entrepreneurs managed to avoid paying their contributions due in January 1999, excessively high sickness benefits remained unchanged, some privileges enjoyed by workers in special sectors of industry, and the pension age (different for men and women) were also maintained. The short period of time that elapsed between the passing of the pension reform Act by parliament and the implementation of the reform turned out to be inadequate for ZUS to prepare for the new scheme. First of all, the system of insurers' individual accounts which form the basis of the pension reform could not be launched. Inefficient computers led to a total paralysis of ZUS which lost its ability to collect contributions. Due to lower-than-expected revenues ZUS had to obtain a credit of 3 billion PLN from commercial banks and a loan from the state budget of 4 billion PLN. By doing this, the government managed to avoid increasing the budget deficit this year. The loan, financed out of revenues from privatisation which should be repaid within 18 months, can be used to pay off debts to banks (1.5 billion PLN) as well as pay current benefits (2.5 billion PLN). This year, the total increase in ZUS debts will amount to 5.5 billion PLN or 0.9% of GDP. In 1999, the Social Insurance Fund's (FUS) requirements resulting from an underestimation of expenditures by about 1.5 billion PLN due to the failure in passing the necessary legislation by the Parliament, indicate that revenues from contributions have been overestimated by about 4 billion PLN. This latter includes some 1 billion PLN resulting from legislative errors. According to the forecast by the Ministry of Finance, the Social Insurance Fund's own revenues in 2000 have been based on the same assumptions as those in 1999. Thus apart from losses due to faulty legislation in 1999, the above forecast of revenues is overestimated by 4 to 5%. This may involve a shortfall in FUS revenues by about 3 billion PLN. In this situation, ZUS will be unable to repay its bank loans and will have to take out another credit of 1 billion PLN in 2000 in addition to the loan of 2 billion PLN already granted in the Budget draft. By and large, ZUS debts will increase by another 3 billion PLN in 2000, i.e. 0.5% of GDP, provided a new system of information processing and better management are ascertained.

It would be wrong, however, to think of the total flow of funds coming from the government budget and transferred to ZUS as current consumption. Subsidies that are used to cover the outflow of resources to the so-called second pillar of the insurance system would in fact reduce debts incurred by public finances as a whole – not unlike compensations for defaulted earnings and pensions. People presently at work are unable to pay their contributions to their individual accounts and, at the same time, contribute to the benefits of the present-day pensioners. This temporary financial shoertfall is being bridged by the state from revenues obtained from privatisation. By doing this the government can help to implement the new insurance scheme. In other words the above expenditures can be treated as liabilities which unfortunately does not mean that these have no effect on the increase in domestic demand. What should be noted, however, is that there is no difficulty in obtaining financial resources for the open pension funds. Rather the delays in transfers are due to problems in keeping current records of the people insured in the ZUS, errors in estimating the number of such people amounting to 20%. Nevertheless, we believe that, according to the latest statements issued by ZUS, the defaulted contributions totalling nearly 4 billion PLN will have been readily transferred to the open pension funds by the end of this year.

Regional Health Funds

The sector of public finances will be faced with another problem: that of the so-called Regional Health Funds. According to our estimates, revenues from contributions – deducted from the income tax and paid to the Regional Health Funds via ZUS – during the first three quarter of 1999 were about 6% lower than those forecast which resulted in the Regional Health Funds recording a deficit. Moreover, these Funds are limited in their capacity to cut expenditures as they have already drawn up contracts for 1999 and 2000 which will affect their annual deficit of some 1.5 billion PLN. This is why we can expect pressures to raise the contribution from the current level of 7.5% deduction from income. In our opinion, the above demands have very little chance of being satisfied. It means that income tax rates would have to be raised or else the government will be obliged to provide money for a single subsidy to make up for the deficit. The National Health Insurance Act will have to be amended so that the Regional Health Funds can obtain loans from banks since, at present, they reduce their deficit by delaying payments to the providers of benefits. It is impossible to know exactly the level of debts incurred by the Regional Health Funds but we estimate 1.5 billion PLN. Therefore, the total deficit generated by the new system of health care in 1999 and 2000 will amount to 0.5% of GDP. In 1999, half of this will be financed from the state budget while in 2000 it will be fully made up from local budgets.

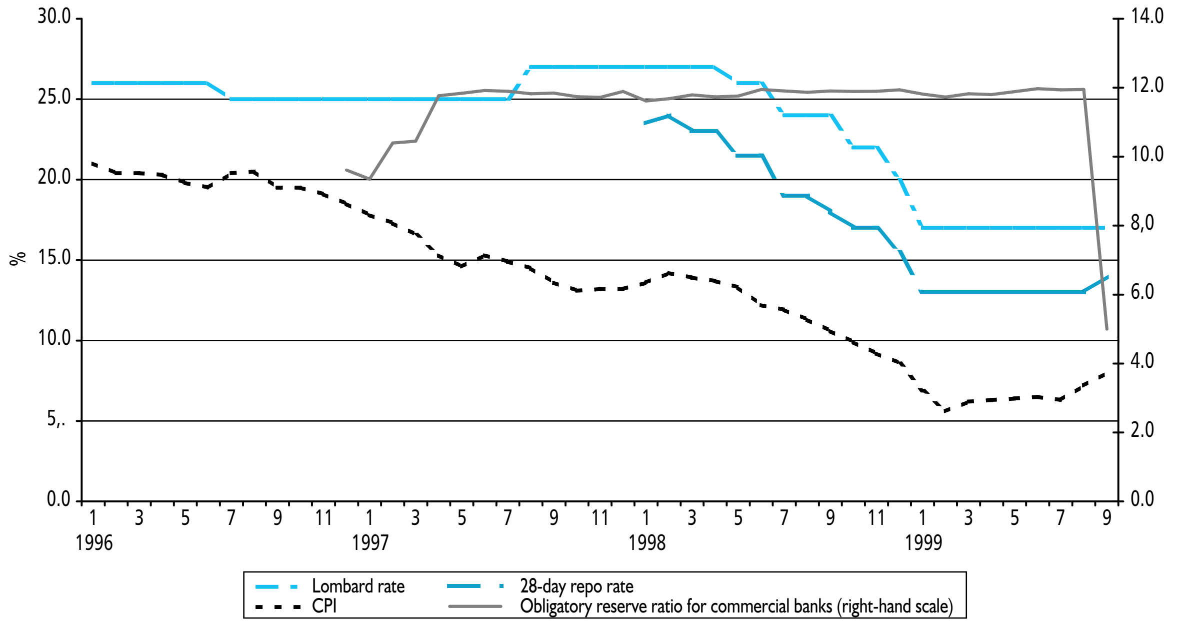
Local governments

In line with the assumptions on which the reform of public finances are based, it is the local governments which take on the political and financial responsibility for debts in health care establishments. Apart from the threat to local governments' budgets posed by accumulated debts in health care institutions, the situation in the whole sector of local governments, especially in voivodships and poviats, seems to be getting better. Instead of deficits assumed in the forecast, local governments recorded a surplus in the first-half of 1999, which, in the case of poviats, was as high as 1.7 billion PLN. These surprising results are due to the high degree of care with which local governments began to take decisions on how to spend their money in the first year of the new administrative system. A similar situation may not occur in 2000. We assume that in 1999 and 2000 local governments will generate a deficit of 0.3% of GDP and 0.9% of GDP respectively.

Assessment of the deficit in public finances

According to the draft Budget Act for 2000, the public finances deficit will amount to 1.96% of GDP which would signify a significant reduction compared with the deficit of 2.9% of GDP predicted by the Ministry of Finance. Table 19 shows the outcome of public finances (together with its effect on the level of domestic savings) assumed in the Budget Act and that obtained according to our own estimates. We also estimate that the public finances deficit will amount to 3.5% of GDP in 1999 and from 2000 onwards it will decrease. In calculating the total effect of fiscal policy on the level of domestic savings we have taken into account three additional factors. The transfers to the second pillar of the new insurance system constitute the part of the deficit which does not lead to any reduction in private savings. The compensations for pensioners and people working in the government sector

Figure 16. Monetary policy instruments, 1996–1999



Source: NBP and CASE.

as well as assistance funds from the EU do not lead to any increase in the budget deficit. Rather, the effect of the deficit is similar to that on domestic demand, inflation and domestic savings. It follows from the results presented in Table 19 that fiscal policy in 2000 will become tighter, and thus negative trends in 1999 may be reversed. As a result, there are hopes that monetary policy will be eased in the second-half of 2000 following a restrictive stance in late 1999 and early 2000.

Monetary Policy

- **Continuation of credit expansion by banks**
- **Inflationary concern**
- **Decision to increase NBP interest rates**

In 3Q99 monetary policy was influenced by two parallel forces. On the one hand, it yielded to pressures of fiscal policy and the growing public sector deficit while, on the other, it operated under increasing domestic demand driven by credit expansion by banks. In addition, the rise in inflation in August and September led to the MPC's decision to increase the reference rate of interest. Unfortunately, 1999 has continued to be marked by an insufficient degree of co-ordination between monetary and fiscal policies (see chapter on co-ordination) which has been exacerbated by the difficult external situation. In the last quarter of 1999, monetary policy is expected to be facing the dilemma of choosing between proper priorities for NBP targets. Will it be inflation, thus forcing the NBP to take measures to strengthen the zloty foreign exchange rate and tighten monetary policy? In this case, the creeping devaluation will be either diminished or eliminated or else information will be issued which would be advantageous for the zloty. Another alternative could consist in influencing the growth in the real sector, or else that of exports coupled with a continuation of the present level of credit expansion and a weaker zloty. In our opinion, the NBP will choose a middle road by sacrificing direct inflation targeting at the expense of a weaker zloty and higher import/export prices. It will also increase interest rates by 50 to 100 base points by end-1999. 2000 will begin with the same starting point as January 1999. In 2000, the external situation, especially in the EU, as well as the internal one will be more advan-

Table 20. 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	14.07	1.54	2.10	-0.57	-5.42
	3Q	-13.94	6.17	-38.03	-2.79	-35.24	17.90

Source: The NBP Bulletin and authors' calculations.

Notes: 1. The shares of components of reserve money are calculated using the following formula: $\Delta RM/RM_{-1} = \Delta NFA/RM_{-1} + \Delta NCG/RM_{-1} + \Delta CDMB/RM_{-1} + \Delta OIN/RM_{-1}$, 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 US$/PLN exchange rate.

Table 21. Components of broad money, 1997–1999 (cumulative %)

		Broad money (M2)	Net foreign assets (NFA)	Net claims on government (NCG)	Claims on private sector (CPS)	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	7.01	2.35	1.77	7.82	-4.93
	3Q	11.43	3.63	0.11	12.99	-5.29

Source: The NBP Bulletin and authors' calculations.

Notes: 1. The share of broad money components are calculated using the following formula: $\Delta M2/M2_{-1} = \Delta NFA/M2_{-1} + \Delta NCG/M2_{-1} + \Delta CPS/M2_{-1} + \Delta OIN/M2_{-1}$, 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 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 US$/PLN exchange rate.

tageous with higher GDP growth and after the monetisation of the deficit of the public sector concealed in previous years.

Reserve money and monetary policy instruments

The real growth in net foreign assets in creating reserve money demand in 3Q99 stemmed from the slight increase in official reserves by almost US$200 million qoq, as well as from the depreciation of the zloty by more than 6% against a basket of foreign currencies. In 3Q99, the share of foreign assets fell to its lowest level in years (see Table 20).

Capital inflows in the accounts of the Ministry of Finance have brought about a fall in net debts of the budget sector in the NBP in 3Q99. This coincided with the growth of debts in the public sector in commercial banks and the population (issue of treasury bonds). The reduction and standardisation of obligatory reserves, enacted since late August 1999, have led to the fall in NBP liabilities against domestic banks in 3Q99 by more than 56% mom (as well as relative to the beginning of 1999). The banking assets, freed of the obligation to be kept in reserve, had to be changed into non-transferable NBP bonds with a 6 to 10-month redemption date and yield at the CPI level (see Table 22). This, in fact, means that some obligatory banking reserves carry interest rates at the real zero level. As a result of negative factors behind supply and changes in statistical data, the cumulated supply of reserve money in 3Q99 diminished by almost 14% (see Table 20) which has not led to any essential changes in the supply of broad money. The successful reduction, standardisation and exchange of obligatory reserves into a passive financial instrument have helped the NBP to increase flexibility in monetary policy. Firstly, what will now become feasible is to gradually exchange passive instruments for active instruments that could be used in transactions in the open market. Secondly, the standardised rate of obligatory reserves at a level already twice as high as that in the EU, together with the liberalisation of the banking market in Poland, will remain an essential monetary policy instrument at the disposal of the NBP.

Table 22. Calendar of the most important events in the monetary policy of the NBP over the period 1Q99–3Q99

Source	Date of the resolution	Events
J. NBP 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%
J. NBP 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)
J. NBP 5	29 January	Interest on money resources on current account in the NBP 5.1%
P.M. 11	31 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%
P.M. 11	31 March	Widening of the allowable float of the average NBP exchange rate from the central parity to +/-15%
J. NBP 15	25 June	Details of emission of the NBP bonds for banks due to cut in reserve requirements rates; bonds of the maturity 6, 7, 8, 9, 10 years with a total face value of pln 20 bil. and interest rates indexed to inflation cpi
J. NBP 15	21 July	Rate of reserve requirement on banks deposits cut and unified at the level of 5% beginning from august 30
J. NBP 19	22 September	28-day repo rate of return equal to at least 14%

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

The increase in the NBP reference interest by 100 base points in September was meant to demonstrate the concern of the MPC with regard to several negative effects such as credit expansion by banks, deteriorating current account deficit and inflationary tensions. It has been pointed out that the interest rates of commercial banks elasticity with respect to NBP interest rates is very limited – especially in imposing an upper limit when the banking system has experienced over-liquidity for about four years. For this reason, the NBP is very interested in any actions that may reduce the source of over-liquidity (in other words in the gain in official reserves since it does not favour nominal appreciation of the zloty). In 2000, a conversion is being planned of the treasury's non-transferable liabilities due to the NBP into transferable securities. This would increase the range of monetary policy instruments at the disposal of the central bank. The NBP's long-term policy aims at changing the central bank's role as a net debtor into one of net creditor of commercial banks.

The banking system and broad money

The gain in broad money supply in 3Q99 was slower than in previous years (see Table 21) mainly as a result of the low share of foreign assets and credits for the budget sector. The requirements for credits in the sector of public finances amounted to more than 1.3 billion PLN between June and August (i.e. about 0.2% of GDP). However, the crowding out effect has so far been insignificant. The share of credits to the private sector in money supply has remained at 1996 and 1998 levels. Although it was 30% lower than the credit expansion peak level of 1997. The growth rate of claims on individuals does seem excessive with the growth rate of claims on the private sector returning to the last year's level of the preceding year as late as September 1999.

The growth of broad money and domestic money (2.43 and 2.88 respectively) remained stable at the level of 2Q99. In August, the money multiplier rose as a result of higher demand for money and changes in the demand structure associated with higher demand for cash. Since June 1999, foreign currency deposits have clearly become more attractive than zloty denominated deposits. This trend manifested itself more in corporate entities than in private individuals – time deposits not being attractive for the latter. Since 2Q99 the propensity of households to save has remained very low. It seems that this trend will reverse itself only when better management of customers' deposits by banks and new banking products have been offered. This, however, cannot be achieved in the short-term. What is also very difficult to reduce is the demand for consumer credit mostly intended for imported goods – especially if the aim is a market economy with a minimum degree of government intervention and protection.

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Co-ordination of monetary and fiscal policies in 1999–2000

Despite the separation of objectives between monetary and fiscal policy – the NBP's increased degree of independence in fighting inflation and developing financial market versus the Ministry of Finance's focus on minimising the cost of public debt – there is a real need for effective co-ordination. Without co-ordination, the whole economy suffers since ineffective policy in one sector of activity affects others and undermines the credibility of the assumed target. For example, loose fiscal policy leads to tighter monetary policy even when the latter is unable to fully offset the effects of the former. Apart from good co-ordination, both policies have to be credible. In Poland, for the past three years, in line with the increased complexity of economic and political problems and the need to carry out the second stage of reforms, co-ordination of monetary and fiscal policies has been insufficiently developed. As a result, planned objectives have not been attained and the credibility of economic policy is thus undermined in the future.

Assumptions of monetary policy

The aim of the NBP's statutory policy is to combat inflation and ensure the stability of prices. The policy mix for 1998 consisted in combining restrictive monetary and fiscal policies. Weaker GDP growth experienced since 2Q99 led to the decision taken by the NBP to cut the basic interest rates in May, July, October and December by a total of 625–800 base points. The higher-than-expected growth of broad money supply by 25% against the expected 16–20% resulted from fast growth of net foreign assets and credits for the private sector. In the second-half of 1998, domestic developments such as cooling down domestic demand and the excess supply of foodstuffs on the home market, as well external factors such as the Russian crisis, proved to be beneficial for disinflationary trends. Together with lower import/export prices in imports resulting from a stronger zloty and from deflation in world prices of raw materials, inflation slowed down to 8.6% – below the NBP forecast of 9.5% by end-1998.

The policy mix for 1999 was to change the macroeconomic policy of 1998 which was not suited to low inflation. In the NBP's opinion, the restrictive monetary policy in 1998, alongside a less restrictive fiscal policy, was the reason for large inflows of foreign currency associated with a real appreciation of the zloty. On the other hand, a restrictive fiscal policy could have prevented current account imbalances. In January 1999, sharper-than-expected interest rate cuts of 275–300 base points excluded the possibility of any similar action being taken during the rest of the year. The above decision by the NBP should be regarded as an indication of the bank's determination to influence the real sector in view of the slowdown in GDP growth and the deterioration in the current account deficit in 4Q98. In addition, this decision may constitute an attempt at forcing the Ministry of Finance to implemen the programme of co-ordination of monetary and fiscal policies in light of the higher deficit in the sector of public finances due to far-reaching reforms. In 1999, monetary policy was influenced by a host of endogenous and exogenous factors negatively affecting the inflation target. The former included higher-than-expected deficit in the sector of public finances (see below), the rise in food prices as well as raw materials (crude oil). The latter included credit expansion with credits used for the import of non-food goods, and the growing depreciation of the zloty since 3Q99. By increasing the reference interest rate by 100 base points in September and by hinting at the possibility of a further rise in interest rates by year-end, the NBP realised an alternative scenario in case the planned deficit of public finances (set out on September 29, 1998 in the guidelines of monetary policy for 1999) was exceeded. As a result, the direct inflation target will not be achieved in 1999 which was to have represented the first year of implementing the medium-term monetary policy strategy.

Assumptions of fiscal policy

The draft 1999 Budget Act, compared with that implemented in 1998, provided for a small deficit (-0.05% of GDP) in non-budget funds and the same in local budgets (-0.3% of GDP). The state budget deficit was to have been smaller by 0.3 of GDP, amounting to (-2.15%) of GDP (see Table 19). However, the costs of launching new reforms proved to be higher with a higher deficit in funds expected to reach (-0.7%) of GDP. According to preliminary estimates, the financial balance of local budgets are likely to be better than expected with the deficit reaching 0.1–0.2% of GDP. The draft 2000 Budget Act envisages a fall in the deficit in the sector of public finances of nearly 1 percentage point down to 1.96% of GDP. The following target values have been projected: surplus in funds of 0.1% of GDP, i.e. at the level achieved in 1998, balanced financial results Regional Health Funds and double deficit in the sector of local budgets up to (-0.2%) of GDP. According to our estimates, in 1999 the deficit of public finances will be as high as 3.5% of GDP whereas in 2000 there will no surplus in funds due to problems involved with the Social Insurance Fund. Doubts are being raised as to the over-optimistic level of 98.8% efficiency in collecting contributions which will result in the need for extending the loan taken out by ZUS in 1999 for another year (5.5 billion PLN, including 4 billion PLN from the government budget) as well as contracting a new credit of about 3 billion PLN (including 2 billion PLN from the government budget). The estimated deficit in funds in its moderately optimistic version will amount to (-0.5%) of GDP. The assumption that the Regional Health Funds will balance their accounts is based on the conservative forecast of 95% efficiency of collecting contributions and the legislative obligation to reach balance in accounts. However, according to our estimates, the debts incurred by the Regional Health Funds may increase which will be reflected in higher liabilities of local governments with their deficit reaching (-0.9%) of GDP.

Privatisation

The Budget Act ensures that revenues from privatisation from 1999 onwards will be intended for financing the deficit to the amount of 6.9 billion PLN. If the amount of privatised property exceeds 11.4 billion PLN the government is entitled to spend another 1.1 billion PLN to help finance the deficit. The preliminary estimates indicate revenues from privatisation will be twice as big as planned. Even after the loan for ZUS of 4 billion PLN has been exhausted by end-1999, a reserve of about 2 billion PLN remains which may be allotted to the repayment of foreign debts in 1999 or 2000. In the draft 2000 Budget Act the sum of 17.1 billion PLN has been projected, of which 8.3 billion PLN is intended for additional financing of the second pillar of the new social insurance system, 3.4 billion PLN in the form of compensation for the public sector, 3 billion PLN in the form of free distribution of

Table 23. Assumptions and implementation of monetary policy, 1998–2000

Target (%)	1998 plan	1998 implementation	1999 plan #1	1999 plan #2	1999 implementation CASE	2000 plan
Inflation, Dec-on-Dec.	9.5	8.6	8-8.5	6,6-7.8	8.7	5.4-6.8
M2 growth	16-20	25.1	15-19	15-19	16.4	15-19

Source: NBP, MPC, "1998 Monetary Policy Guidelines", April 1998; "1999 Monetary Policy Guidelines", September 1998; "1999 Monetary Policy Guidelines", March 1999; CASE forecast.

share among employees, and finally 2 billion PLN for the re-privatisation reserve fund. From the method of distribution of privatisation money it follows that either the foreign currency resources would have to be exchanged for zloty denominated resources (with high fluctuation in the zloty exchange rate), or the inflow and outflow of foreign currency capital would have to be sterilised using financial instruments and/or close time co-ordination of opposed currency flows when foreign debts are being repaid.

Test of the ability to co-ordinate policy

The co-ordination of monetary and fiscal policies in 2000 will be faced with two difficult tasks. The NBP will have to establish credibility in its immediate objective of fighting inflation as failure in doing so throws into question the aim of achieving 4% inflation in 2003. The Ministry of Finance, for its part, will have to keep the deficit of public finances at the planned level for two fundamental reasons. The first is of a political nature and concerns the government's tough stand against pressures from all groups claiming higher funds. The other reason is involved with the need to secure a significant primary surplus in the government budget over the medium-term (possibly from 2001 onwards) to offset the continued current account deficit against the fall in foreign currency revenues from privatisation.

The wider range of inflation (5.4–6.8) envisaged for 2000 in the face of higher uncertainty about future macroeconomic variables does not seem to augur well for diminished inflation. Lower inflation will have to be achieved in conditions of increasingly reduced structural and operational over-liquidity in the banking system. The source of this liquidity – in other words the growth of official reserves mainly due to revenues from privatisation – will be sterilised by an outflow of foreign currency in a situation where the current account deficit is estimated at 7% of GDP in 2000. The NBP does not discount the possibility of some intervention on the foreign currency market when the co-ordination between foreign currency inflows and outflows becomes unsatisfactory. At the same time, 2000 is likely to see full floating of the zloty. Official reserves for end-2000 are to remain at the level of end-1999. In order to reduce over-liquidity in the banking system, generated in previous years, passive financial instruments in the hands of the NBP are to be exchanged for active instruments to be sold to commercial banks within the framework of open market operations. The success in exchanging the banks' resources, freed after the reduction of the rate of obligatory reserves, to non-transferable long-term bonds makes it possible to use the same instrument again in years to come. As a result, the number of monetary policy instruments at the disposal of the NBP will increase which will allow monetary and fiscal policies to be more adjusted to each other.

By using an identity equation

$$\Delta b^a_t + \Delta b^*_t - \Delta\rho^*_t + \sigma_t \equiv d^a_t + (1+g_t)^{-1}*\{(r_t - g_t)b^a_{t-1} + [(1 + r^*_t)(1 + \gamma_t) - (1 + g_t)](b^*_{t-1} - \rho^*_{t-1})\},$$

Table 24. Revenues from privatisation, 1999–2000

	1999 Budget Act	1999 CASE	2000 Budget Act
billion zloty	6.9	13.0	17.1
% of GDP	1.1	2.1	2.5

Source: Council of Ministers, 1999 and 2000 Budget Acts, and CASE forecast.

Table 25. Deficit of public finances and the modification of domestic debt

		Modification of debt in 2000	
		Ministry of Finance	CASE
Deficit of public finances in 2000	Ministry of Finance CASE	2.0 / -0.5	2.0 / -1.0 3.0 / -0.5

Source: 2000 Budget Acts and CASE's calculations.

The left-hand side represents the sources of financing the deficit of the sector of public finances by increasing domestic debts, b^{a}_{t}; the growth in foreign debts b^{*}_{t}; the decline in reserves ρ^{*}_{t}; and seignorage σ_t; whereas the right-hand side is referred to as the deficit of the sector of public finances corrected for inflation and real GDP growth. We have assumed the values of the interest rate variable to be represented by g_t, the domestic real interest rates by r_t, the foreign real interest rates by r^{*}_{t} and the level of real depreciation of the exchange rate by γ_t resulting from the assumptions in the Budget Act and monetary policy for 2000.

When the whole programme of fiscal and monetary policies as well as revenues from privatisation have been fully implemented, the liabilities of the sector of public finances in 2000 may be lower by 0.5% of GDP. This may also be achieved if the deficit in public finances is at the level estimated by CASE (3.0% of GDP). In both cases, the reduction in the liabilities of the sector of public finances may be regarded as realistic. The planned reduction in interest rates (3-month WIBOR by an average of 170 base points) also seems achievable although in the second case it may turn out to be more difficult in practice. Obtaining the projected privatisation revenues entails an appreciation of the zloty exchange rate (which is planned) or sterilisation of capital inflows and control of the exchange rate coupled with higher interest rates. In these circumstances, interest rates may remain unchanged in the next year or at least in its first-half given the rise of 50–100 base points prior to end-1999. Therefore, what will be of greatest importance is the level of GDP growth and the full implementation of the policy mix.

Threats

1. **In line with the previous Outlook, the maintenance of fast growth remains the key dilemma.** We believe that a stimulation of domestic demand would trigger inflationary pressures would not be prudent given the resurgence of inflation.

2. **Considerable tensions in the consolidated budget should be expected.** The forecast upswing in the economy will secure tax revenues for the budget as well as ample privatisation receipts and will thus make it possible to finance the deficit. However, weaker demand for treasury bonds will shift the interest of potential investors towards financing local budget deficits. If expenditure is not curbed, in particular in local budgets and para-budgets, then financing of this part of the public sector will increase excessively. An uncontrolled demand impulse may also arise. As a consequence, domestic demand would expand excessively leading to macroeconomic imbalances.

3. **An additional downside risk is the limited prospects for export growth – especially to the East.** It is very likely that the recovery in exports to the East will take longer than previously expected. On the other hand, exports to the EU depend on a pickup in economic activity in this area.

4. **The high current account deficit is our greatest concern.** Any further widening will pose threats to macroeconomic stability unless there are possibilities of financing the deficit with an increase in long-term investment.

Recommendations for economic policy

1. A tightening of fiscal and monetary policies will be indispensable in 2000.

2. The uncertain situation in the consolidated budget calls for tighter fiscal discipline and no extra financing of deficits in para-budgets (e.g. ZUS) from privatisation proceeds.

3. Interest rates should be raised primarily due to the renewed rise in inflation and excessive demand for consumption credits.

4. Loosening monetary policy will only be possible after 1Q00 when inflation will start to decline and the current account balance will stabilise.

5. In the case of a weak and short recovery in the EU, economic policy should aim at lowering domestic demand growth.

6. Economic policy should take into account the possibility of declining long-term foreign investment – in particular after 2000 when privatisation revenues will be considerably lower.

Appendix

CASE
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Table A1. GDP at 1998 prices, 1994–2001 (% change yoy)

		GDP	Gross value-added					
			total	agriculture and forestry	manufacturing, mining, etc.	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	2.3	7.5	2.8	6.1	2.6
1997	1Q-4Q	6.8	6.5	1.0	10.3	13.6	4.4	3.0
1998e1	1Q-4Q	4.8	4.6	6.2	4.4	10.2	4.8	0.1
forecast								
1999	*1Q-4Q*	*3.8*	*3.7*	*-2.1*	*4.7*	*4.4*	*4.2*	*1.0*
2000	*1Q-4Q*	*5.4*	*5.2*	*-3.9*	*8.5*	*9.3*	*4.3*	*0.8*
2001	*1Q-4Q*	*6.3*	*6.1*	*3.4*	*8.7*	*10.3*	*5.0*	*2.0*
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	-2.0	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	2.7	9.7	5.2	6.0	2.6
	4Q	7.7	6.4	6.7	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
1998e1	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
1999	1Qe1	1.5	1.3	3.7	-3.0	2.0	4.1	0.9
	2Qe1	3.0	2.8	1.1	1.3	3.2	4.2	1.0
	3Qe2	4.2	4.2	-4.8	7.5	4.0	4.2	1.0
forecast								
1999	*4Q*	*6.1*	*5.7*	*-7.4*	*12.1*	*6.2*	*4.4*	*1.3*
2000	*1Q*	*6.4*	*6.2*	*-8.2*	*13.6*	*7.4*	*4.4*	*1.0*
	2Q	*5.3*	*5.1*	*-6.5*	*9.3*	*8.6*	*4.3*	*0.8*
	3Q	*5.1*	*4.8*	*-0.9*	*6.6*	*8.9*	*4.3*	*0.7*
	4Q	*5.1*	*4.9*	*0.0*	*5.8*	*10.8*	*4.2*	*0.8*
2001	*1Q*	*4.7*	*4.5*	*1.0*	*5.1*	*10.2*	*4.5*	*1.8*
	2Q	*6.5*	*6.3*	*1.9*	*10.1*	*10.0*	*4.9*	*2.0*
	3Q	*7.0*	*6.8*	*4.8*	*10.0*	*9.9*	*5.3*	*2.1*
	4Q	*6.8*	*6.6*	*5.6*	*9.3*	*10.6*	*5.2*	*2.2*

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

Table A2. Aggregate demand at current prices, 1994–2001 (billion zloty)

		GDP	Domestic demand	Consumption			Investment	Stock-building	Net exports
				total	households	public			
1994	1Q-4Q	223.90	219.07	179.40	139.94	39.46	40.39	-0.71	4.83
1995	1Q-4Q	306.32	299.08	238.38	184.78	53.60	57.40	3.30	7.24
1996	1Q-4Q	385.45	391.48	306.66	239.76	66.90	80.39	4.43	-6.03
1997	1Q-4Q	469.37	489.75	373.74	293.87	79.88	110.85	5.15	-20.37
1998e1	1Q-4Q	551.11	579.36	433.89	343.39	90.50	139.67	5.80	-28.25
forecast									
1999	*1Q-4Q*	*623.48*	*665.97*	*491.00*	*391.20*	*99.81*	*169.86*	*5.11*	*-42.48*
2000	*1Q-4Q*	*709.33*	*756.02*	*549.60*	*440.30*	*109.30*	*202.18*	*4.24*	*-46.69*
2001	*1Q-4Q*	*800.61*	*848.57*	*607.87*	*489.81*	*118.06*	*236.64*	*4.06*	*-47.96*
1995	1Q	69.22	66.24	54.61	42.48	12.12	10.66	0.98	2.98
	2Q	73.85	72.23	59.13	45.23	13.90	12.16	0.94	1.62
	3Q	78.92	76.34	61.01	47.53	13.48	14.49	0.85	2.58
	4Q	84.33	84.27	63.63	49.53	14.10	20.09	0.54	0.06
1996	1Q	84.72	83.37	71.77	55.99	15.78	10.97	0.63	1.35
	2Q	92.28	93.79	77.11	59.87	17.24	15.95	0.72	-1.51
	3Q	97.87	100.20	78.24	61.27	16.97	20.93	1.03	-2.33
	4Q	110.58	114.13	79.53	62.63	16.91	32.54	2.05	-3.54
1997	1Q	103.08	104.93	88.53	69.53	19.00	15.48	0.92	-1.85
	2Q	112.24	116.84	92.52	73.12	19.40	23.29	1.03	-4.60
	3Q	118.39	123.01	94.93	75.50	19.43	27.13	0.96	-4.62
	4Q	135.66	144.96	97.76	75.72	22.05	44.96	2.24	-9.30
1998e1	1Q	123.12	129.51	107.07	84.41	22.66	21.30	1.14	-6.39
	2Q	132.95	138.86	107.94	84.73	23.20	29.61	1.31	-5.90
	3Q	139.02	145.83	111.15	88.10	23.05	33.35	1.33	-6.81
	4Q	156.01	165.16	107.72	86.14	21.58	55.42	2.02	-9.15
1999	1Qe1	133.25	143.58	118.77	94.42	24.36	24.72	0.09	-10.34
	2Qe1	149.72	160.67	123.16	97.15	26.02	36.11	1.39	-10.94
	3Qe2	159.91	169.65	127.48	101.50	25.97	40.68	1.49	-9.73
forecast									
1999	*4Q*	*180.60*	*192.07*	*121.59*	*98.13*	*23.46*	*68.34*	*2.14*	*-11.47*
2000	*1Q*	*153.83*	*164.77*	*133.78*	*107.03*	*26.75*	*30.12*	*0.86*	*-10.94*
	2Q	*170.95*	*182.99*	*138.25*	*109.63*	*28.62*	*43.76*	*0.97*	*-12.04*
	3Q	*180.87*	*191.70*	*142.31*	*113.92*	*28.39*	*48.58*	*0.82*	*-10.84*
	4Q	*203.69*	*216.57*	*135.26*	*109.72*	*25.54*	*79.71*	*1.59*	*-12.88*
2001	*1Q*	*171.91*	*184.60*	*148.57*	*119.46*	*29.11*	*35.16*	*0.87*	*-12.68*
	2Q	*193.77*	*205.58*	*153.17*	*122.13*	*31.03*	*51.45*	*0.96*	*-11.81*
	3Q	*205.22*	*215.17*	*157.33*	*126.79*	*30.54*	*57.04*	*0.79*	*-9.95*
	4Q	*229.71*	*243.22*	*148.80*	*121.43*	*27.37*	*92.99*	*1.43*	*-13.52*

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

Note: Domestic demand is defined as the sum of consumption of households, public consumption, non-commercial institutions' consumption and investment. Consumption of non-commercial institutions is not separated in the table.

Table A3. Aggregate demand at 1998 prices, 1994–2001 (% change yoy)

		GDP	Domestic demand	Consumption			Investment
				total	households	public	
1994	1Q-4Q	5.2	4.8	3.9	4.3	2.8	9.2
1995	1Q-4Q	7.0	5.5	3.2	3.3	2.9	16.5
1996	1Q-4Q	6.0	9.5	7.1	8.2	3.4	19.7
1997	1Q-4Q	6.9	9.2	6.1	6.9	3.4	21.7
1998e1	1Q-4Q	4.8	6.5	4.2	4.9	1.5	14.5
forecast							
1999	*1Q-4Q*	*3.8*	*5.1*	*4.2*	*4.9*	*1.5*	*9.1*
2000	*1Q-4Q*	*5.4*	*5.2*	*3.7*	*4.3*	*1.3*	*10.6*
2001	*1Q-4Q*	*6.3*	*6.0*	*4.3*	*5.0*	*1.6*	*10.9*
1996	1Q	3.4	7.9	7.1	8.1	3.4	13.1
	2Q	5.5	6.2	3.4	6.1	-5.3	20.5
	3Q	7.2	10.1	6.7	7.9	2.6	26.8
	4Q	7.9	13.3	11.6	11.1	13.6	17.3
1997	1Q	6.9	7.8	6.0	6.7	3.5	19.6
	2Q	7.5	9.0	6.4	7.1	3.7	21.0
	3Q	6.7	9.2	6.3	7.0	3.6	21.2
	4Q	6.4	10.7	5.7	6.6	2.6	23.2
1998e1	1Q	6.4	7.4	5.5	6.4	2.1	17.5
	2Q	5.4	5.8	3.5	4.1	1.5	14.9
	3Q	5.0	6.2	3.8	4.5	1.4	14.6
	4Q	2.9	6.7	3.8	4.6	1.0	13.1
1999	1Qe1	1.5	3.2	3.7	4.2	1.4	6.0
	2Qe1	3.0	4.6	4.1	4.8	1.3	6.7
	3Qe2	4.2	6.0	4.8	5.7	1.5	9.9
forecast							
1999	*4Q*	*6.1*	*6.5*	*4.1*	*4.7*	*1.6*	*11.3*
2000	*1Q*	*6.4*	*5.4*	*3.5*	*4.0*	*1.5*	*11.6*
	2Q	*5.3*	*5.2*	*3.6*	*4.2*	*1.4*	*12.0*
	3Q	*5.1*	*5.2*	*3.7*	*4.4*	*1.2*	*11.5*
	4Q	*5.1*	*5.3*	*3.8*	*4.5*	*1.0*	*9.0*
2001	*1Q*	*4.7*	*5.2*	*4.2*	*4.8*	*1.7*	*10.0*
	2Q	*6.5*	*5.9*	*4.4*	*5.0*	*1.8*	*10.9*
	3Q	*7.0*	*6.1*	*4.5*	*5.2*	*1.5*	*11.2*
	4Q	*6.8*	*6.5*	*4.1*	*4.8*	*1.3*	*11.0*

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

Notes: 1. Domestic demand is defined as the sum of households' consumption, non–commercial institutions' consumption, public consumption and investment. Consumption of non–commercial institutions is not separated in the table.

2. Data are not seasonally adjusted.

Table A4. Employment, 1994–2001 ('000)

		Total	Paid employment				Market services	Non-market services
			of which employment	agriculture and forestry	manufacturing, mining, etc.	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*	*15683*	*8702*	*3927*	*3633*	*940*	*4393*	*2349*
2000	*1Q-4Q*	*15702*	*8730*	*3888*	*3559*	*966*	*4468*	*2350*
2001	*1Q-4Q*	*15404*	*8806*	*3843*	*3441*	*956*	*4794*	*2371*
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	4590	2356
1998	1Q	15276	8717	3960	3646	840	4481	2349
	2Q	15479	8759	3957	3731	941	4508	2341
	3Q	15551	8714	3995	3718	961	4554	2322
	4Q	15657	8817	3978	3757	937	4590	2395
1999	1Q	15123	8747	3930	3508	821	4475	2390
	2Q	15280	8717	3925	3547	922	4520	2366
	3Q	15268	8634	3960	3526	946	4499	2337
forecast								
1999	*4Q*	*15432*	*8709*	*3940*	*3586*	*932*	*4620*	*2354*
2000	*1Q*	*15025*	*8728*	*3898*	*3410*	*826*	*4497*	*2393*
	2Q	*15238*	*8724*	*3890*	*3477*	*940*	*4565*	*2365*
	3Q	*15288*	*8697*	*3920*	*3486*	*970*	*4576*	*2337*
	4Q	*15485*	*8771*	*3890*	*3551*	*970*	*4721*	*2352*
2001	*1Q*	*15115*	*8801*	*3860*	*3370*	*855*	*4635*	*2395*
	2Q	*15358*	*8795*	*3840*	*3437*	*970*	*4740*	*2370*
	3Q	*15488*	*8778*	*3850*	*3448*	*1000*	*4842*	*2348*
	4Q	*15655*	*8850*	*3820*	*3507*	*999*	*4958*	*2370*

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

Table A5. Unemployment, 1995–2001

		Registered unemployment		Unemployment LFS	
		(' 000)	%	(' 000)	%
1995	1Q-4Q	2629	14.9	2233	13.1
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*	*2270*	*12.8*	*2275*	*13.0*
2000	*1Q-4Q*	*2357*	*13.2*	*2363*	*13.4*
2001	*1Q-4Q*	*2327*	*12.9*	*2336*	*13.1*
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
	2Q	2074	11.6	2055	11.9
	3Q	2178	12.1	2175	12.4
forecast					
1999	*4Q*	*2270*	*12.8*	*2275*	*13.0*
2000	*1Q*	*2419*	*13.4*	*2361*	*13.7*
	2Q	*2257*	*12.5*	*2233*	*12.8*
	3Q	*2298*	*12.7*	*2294*	*13.0*
	4Q	*2357*	*13.2*	*2363*	*13.4*
2001	*1Q*	*2469*	*13.6*	*2451*	*13.9*
	2Q	*2277*	*12.5*	*2233*	*12.8*
	3Q	*2238*	*12.2*	*2202*	*12.5*
	4Q	*2327*	*12.9*	*2336*	*13.1*

Source: Data – CSO; LSF estimates for 2Q99 and 3Q99, and forecasts – CASE.
Note: LFS – labour force survey.

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

		CPI	PPI		Export price index	Import price index
			Manufacturing, mining, etc.	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	2.7	-0.4
	02	5.6	3.7	9.4	9.6	1.5
	03	6.2	4.7	9.0	10.7	5.6
	04	6.3	5.0	8.6	9.9	8.9
	05	6.4	5.2	8.4	10.3	8.2
	06	6.5	5.2	8.1	1.1	4.8
	07	6.3	5.5	7.8	-0.1	5.1
	08	7.2	5.9	7.8		
	09	8.0	5.9	8.3		

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
	07	3.8827	2.0536	4.0166
	08	3.9510	2.0536	4.0166
	09	4.0799	2.0536	4.0166

Source: NBP.

Notes: 1. Monthly average.

2. Until end-1998 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	2041	2119	3156	3331	-1115	-1212
	02	2095	2495	3236	3279	-1140	-784
	03	2450	2398	4032	3223	-1583	-825
	04	2164	2159	3631	3195	-1466	-1036
	05	2234	1989	3698	3020	-1464	-1031
	06	2150	2122	3660	3424	-1510	-1302
	07	2086	2092	3733	3414	-1648	-1322
	08	2046	2078	3543	3311	-1497	-1233
	09		2081		3356		-1275

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 trade	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	-1212	101	320	291	-81	74
	02	-512	-784	102	242	317	-177	-83
	03	-833	-825	176	237	530	-46	-142
	04	-938	-1036	113	232	364	2	108
	05	-690	-1031	108	300	403	-251	64
	06	-1134	-1302	132	253	382	167	0
	07	-1055	-1322	138	301	297	70	-47
	08	-786	-1233	142	429	1393	227	-26
	09	-1115	-1275	137	423	745	-432	443

Source: NBP.
Note: August and September 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
	07	15.5	17.0	13.4	13.0
	08	15.5	17.0	13.7	13.0
	09	15.5	17.0	14.3	14.0

Source: NBP.
Note: End-month except for WIBOR – monthly average.

Table A11. Monetary indicators, 1996–2001 (billion zloty)

		M0	M2	Cash	Zloty deposits			Foreign currency deposits	credits			Net liabilities of the budgetary sector
					total	individual	corporate		total	individual	corporate	
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*	*63.1*	*259.8*	*34.0*	*187.0*	*128.0*	*59.0*	*38.8*	*181.3*	*35.0*	*146.3*	*63.0*
2000	*1Q-4Q*	*72.4*	*298.1*	*35.5*	*224.0*	*156.0*	*68.0*	*38.6*	*224.0*	*43.5*	*180.5*	*70.0*
2001	*1Q-4Q*	*84.0*	*345.5*	*37.0*	*271.0*	*194.0*	*77.0*	*37.5*	*271.4*	*55.0*	*216.4*	*77.0*
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	53.9	230.3	32.0	161.2	116.5	44.6	37.1	148.6	25.3	123.3	63.9
	2Q	59.1	236.2	33.6	166.2	119.2	47.0	36.4	155.8	28.3	127.5	65.2
	3Q	60.1	246.0	34.2	173.4	122.5	51.0	38.4	167.2	32.4	134.8	61.5
forecast												
1999	*4Q*	*63.1*	*259.8*	*34.0*	*187.0*	*128.0*	*59.0*	*38.8*	*181.3*	*35.0*	*146.3*	*63.0*
2000	*1Q*	*62.7*	*268.0*	*34.3*	*194.0*	*137.0*	*57.0*	*39.7*	*192.6*	*37.2*	*155.4*	*64.0*
	2Q	*69.0*	*275.8*	*35.0*	*201.0*	*142.0*	*59.0*	*39.8*	*198.3*	*39.3*	*159.0*	*66.0*
	3Q	*69.0*	*282.6*	*35.6*	*208.0*	*148.0*	*60.0*	*39.0*	*208.1*	*41.0*	*167.1*	*66.0*
	4Q	*72.4*	*298.1*	*35.5*	*224.0*	*156.0*	*68.0*	*38.6*	*224.0*	*43.5*	*180.5*	*70.0*
2001	*1Q*	*71.7*	*306.4*	*35.6*	*233.0*	*167.0*	*66.0*	*37.8*	*235.7*	*46.3*	*189.4*	*73.0*
	2Q	*79.5*	*317.6*	*36.0*	*243.0*	*175.0*	*68.0*	*38.6*	*241.5*	*49.3*	*192.2*	*74.0*
	3Q	*80.1*	*328.1*	*37.0*	*253.0*	*183.0*	*70.0*	*38.1*	*253.1*	*52.0*	*201.1*	*75.0*
	4Q	*84.0*	*345.5*	*37.0*	*271.0*	*194.0*	*77.0*	*37.5*	*271.4*	*55.0*	*216.4*	*77.0*

Source: Data – NBP and forecast – CASE.