Quarterly 1/2000

POLISH ECONOMIC OUTLOOK
TRENDS • ANALYSES • FORECASTS

Summary

In 1999, the Polish economy grew at a slower pace than in previous years. **We estimate GDP growth of 4.0% for the whole year and 6.1% in 4Q99 respectively**. The stimulus to growth was provided by domestic demand – particularly fast growing household consumption. In our opinion, **domestic demand rose 4.9% and 5.8% in 1999 and 4Q99 respectively**. Such a significant strengthening of domestic demand was made possible at the expense of a dramatic decline in households' propensity to save (compared with 1998) and was due to the deterioration in the general government budget deficit as well as in the current account balance. A relatively weaker position of the zloty and limited demand for Polish-made products in the EU countries were of no help. The fall in exports to Russia and other CIS countries turned out to be too significant to compensate for the whole year.

The fact that the Polish economy, and in particular Polish industry, succeeded in quickly overcoming the adverse effects caused by the Russian crisis is the most encouraging piece of information. We estimate that in 4Q99 the value-added in industry increased 11.6% – a record growth rate value over the whole period of economic transformation.

The most worrisome trend observed by year-end was higher inflationary pressures. In December, CPI increased 9.8% over the whole year, whereas the current account deficit rose to more than US$11.6 billion (i.e. about 7.6% GDP).

In the coming two years we expect that the Polish economy will return to the path of fast growth. In 2000, GDP will increase 5.4%, whereas in 2001 it will be as high as 6.3%. This gain is economically feasible despite a tighter economic policy in 2000 and the trend towards balanced economic growth. As a result, in 2000–2001 domestic demand growth may be relatively low, amounting to 5.1% and 6.1% respectively.

The results of changes in economic policy will not be seen until the second-half of 2000. We expect that until July 2000 the inflation rate will fluctuate around 10%, although it may well drop to more than 7% by December. According to our forecast, prices will rise on average 9.2% and 6.1% in 2000 and 2001 respectively.

Polish exports are expected to increase in 2000. The precondition for this is the strengthening of the euro and higher demand in the EU. Otherwise, growth in exports may not be large enough to bring about a reduction in the current account deficit. At the same time, stable growth in domestic demand will not make it possible to increase considerably import growth. As a result, the merchandise trade deficit will marginally increase. **We expect that in 2000 and 2001 the current account deficit will amount to US$11.1 billion (i.e. 6.3% GDP) and US$11.9 billion (i.e. 6.1% GDP) respectively.** The inflow of foreign investment, in contrast to the situation in 1999, will more than offset the current account deficit and increase the official foreign currency reserves from the forecasted value of US$28.3 billion by end-2000 to US$29.6 billion by end-2001.

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

This issue analyses the economic situation in Poland in 4Q99 and the trends observed throughout the entire previous year. The key short- and long-term threats as well as the most recent economic outlook for the period 2000–2001 are provided. Particular attention is drawn to the most serious threat facing the Polish economy – the high deficit on the current account resulting from a lack between co-ordination of monetary and budgetary policies. For the first time an analysis of core inflation is presented. This issue's special topic is devoted to problems of exchange rate policy.

All estimates and forecasts are derived from data available till February 1, 2000. One should note that data for previous years are updated in line with changes in official statistics.

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

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

Quarterly 1/2000

POLISH ECONOMIC OUTLOOK
TRENDS • ANALYSES • FORECASTS

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Assessment of the economic situation in 4Q99

After the slowdown in growth at the turn of 1999, the Polish economy has returned to a fast-growth path. We estimate GDP increased 6.1% in 4Q99 and 4% for 1999 as a whole. As in previous quarters, economic growth was driven by relatively strong domestic demand, in particular consumption demand. External demand has strengthened, especially from the European Union (EU) as compared to the first-half of 1999. On the other hand, the pace of export recovery to the Commonwealth of Independent States (CIS) was unsatisfactory.

The economic situation in Poland in 4Q99 can be summed up with the following points:

- **double-digit growth of industrial production (excluding construction) and a higher growth rate of construction production coupled with an increase in labour productivity,**
- **the unemployment rate amounted to the end-1996 level (13%) due to weak labour demand in industry and construction; as in 3Q99 the rise in nominal wages was moderate,**
- **CPI surged from 7.2% in 3Q99 to 9.2% in 4Q99,**
- **the rise in inflation reduced growth of real wages and social benefits,**
- **general households' propensity to save remained low, though it rose in comparison to the two previous quarters; this increase did not, however, result from a rise in financial savings,**
- **the foreign exchange market was particularly unstable; exchange rate volatility was influenced largely by political events and the alarmingly high deficit on the current account,**
- **the Monetary Policy Council (MPC) raised main interest rates,**
- **the government budget deficit in 1999 was smaller than planned, but the general government budget deficit was larger.**

An upswing in industrial production

The best economic news of 3Q99 was an upswing in industrial production of 11.7% yoy (excluding construction). This was achieved under circumstances of a considerable decline in industrial employment, lowering of unit labour costs and a rise in prices. Construction production also recorded better results. After unimpressive growth of 3% in 3Q99, it accelerated to 6.2% in 4Q.

Unemployment

An improvement in economic efficiency, coupled with a relatively low increase in industrial production over the whole year, led to a decline in employment estimated at 4%. A rise in employment in market services (especially in trade, real estate and business activities) and non-market services was not enough to stabilise the labour market. As

a result, the unemployment rate rose to 13% at end-1999 from 10.4% at end-1998.

Low rise in real income

Slower economic growth in 1999 (particularly in the first-half of the year), weaker labour demand as well as a smaller increase in real wages caused a considerable slowdown in households' real disposable income growth. We estimate income to have grown approximately 1% in 4Q99. Households' propensity to save was still low in 1998-terms, but slightly higher than in the two previous quarters. This helped to sustain high 5%-growth of households' consumption.

Investment layouts growth on the decline

A decline in enterprises' savings took place in 1999 (particularly in the first-half of the year). It was, to a large extent, offset by foreign direct investment. Investment growth fell from over 14% in 1998 to over 7% in 1999. The reasons for this were slow economic growth, exceptionally low level of producer prices, high unit labour costs in the first-half of 1999 as well as a significant weakening of the zloty and the ensuing rise in import prices. Only in 4Q99 did we see a change in this unfavourable trend as investment grew 8%.

Strong domestic demand

In 1999 GDP growth (estimated at 4%) was attributable primarily to domestic demand growth. We estimate domestic demand to have risen 4.9% in 1999 and 5.8% in 4Q. Only the last quarter recorded slightly higher GDP growth than that of domestic demand due to a rise in exports.

Budget deficit

End-1999 proved to be favourable for the budget, especially for the government. The boost to the economy caused an increase in tax revenues resulting in a lower deficit than that assumed in the Budget Act.

Domestic demand was stimulated yet again by an unexpected widening of the general government budget deficit, estimated at 1% of GDP (primarily due to the financial breakdown of ZUS). This led to a considerable widening of the inflationary gap.

Inflation

CPI rose 9.8% yoy in December. The lowest inflation rate of 5.6% was recorded in February 1999. In 4Q99 all price indices grew at a faster pace than in previous quarters. Acceleration of inflation measured in terms of PPI (7.4% yoy in 4Q) is worrisome. Although it is favourable for enterprises, it will not allow for a fast reduction in growth of retail prices of manufactured goods.

The increase in unemployment in 1999 facilitated the sustainability of slow nominal wage growth. Wages in the enterprise sector rose 10.6%, and 3.1% in real terms. 4Q99 saw slightly faster growth in wages (11.4%), though in real terms it was only 2%. The slower pace of real wage increases in 4Q99 is a result of the surge in inflation – 9.2% (bearing in mind that inflation stood at 7.2% in 3Q99). The reasons behind this CPI hike were the following: poor crops in agriculture, intervention in the agriculture market, a weaker zloty as well as an excessive increase in consumption demand partly caused by the dramatic drop in the propensity to save mentioned above.

Current account deterioration

While export revenues in dollar terms declined over 15% yoy in 3Q99, they were lower only 9% yoy in 4Q99. However, the weakening of the euro versus the dollar (from 1.17 US$/euro in 4Q98 to 1.04 US$/euro in 4Q99) suggests a rise in Polish exports.

Similar downward trends are observed in the case of imports (caused primarily by weakening of the zloty). Consequently, the deficit on the merchandise trade balance amounted to US$4.4 billion, which is US$0.1 billion higher than a year ago.

The current account deficit was US$0.69 billion higher compared to 4Q98 and reached US$3.7 billion. We estimated the deficit at 7.6% of GDP at end-1999.

4Q saw a minor deterioration in the balance of payments. Despite high privatisation proceeds, FDI inflows,

and the slightly worse deficit on the current account (as compared to 3Q99) official foreign reserves dropped from US$26 billion at September-end to US$25.5 billion at December-end 1999.

Volatile exchange rate

The relative stabilisation of the merchandise trade balance and deterioration in the balance of payments in 4Q did not influence the exchange rate market. Political news influenced the zloty exchange rate both in October and November. The alarmingly high deficit on the current account also played a role. Only in December did the relative political stabilisation, better macroeconomic performance, interest rate rise and projected sizeable privatisation proceeds strengthen the zloty.

Like in 3Q99, money supply growth declined from over 20% at end-September (at an annualised rate) to over 19% at end-December. For the sake of comparison, M2 supply increased 25% in 1998. The decline was caused by a fall in growth of households' zloty-denominated deposits.

In 1999 households' credits grew considerably faster than a year ago. They were 53% higher yoy at end-December 1999 (in nominal terms). While household credit growth has been accelerating significantly (from 35% in 1Q99), corporate credit expansion has been on the decline – 32% in 1Q99 and over 22% in 4Q99.

To recap, the economy gathered steam in 4Q99 and this means that the adverse effects of the Russian crisis were finally overcome. At the same time, price intervention on the agricultural market, unexpectedly high crude oil prices as well as the strong dollar and a weak euro fuelled inflation. Continuing strong domestic demand, in particular consumption, started to widen dangerously the inflationary gap.

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Determinants of Poland's economic development

The assumptions regarding the external environment do not differ much from those presented in the last issue of the PEO.

The external assumptions include an appraisal of economic activity in Poland's main trading partners (among other things growth prospects, dynamics of import volume in the European Union (EU), and LIBOR) inflationary trends, forecasts of commodities prices as well as changes in world's main exchange rates.

Assumptions regarding budgetary and monetary policies have been changed. A more restrictive stance of economic policies is assumed. As in the previous issue, the forecast horizon extends up to the year 2001.

Trends in the world economy, 1999–2001[1)]

- **Economic upswing in the EU**
- **Inflationary pressures rear their heads**
- **Prices of main commodities on the rise**
- **A weak euro**
- **Higher interest rates in the US and the EU**

Economic growth

The world economy enters the second year of an economic boom that embraces the most developed countries. It is expected that the year 2000 will see a slight slowdown in US growth and growth acceleration in other regions (see Table 1).

Economic growth will be driven, to agreater extent, by private consumption and investment, and not by government spending. Alongside economic growth and rising employment, inflationary pressures will gain in strength. This, in turn, will lead to tighter monetary policy. A general improvement of the economic situation gives hopes for the alleviation of long-term structural problems that plague numerous countries, e.g. high unemployment, budget deficit and an ailing banking sector.

At the moment, the overheating US economy poses a threat to world economic growth. If the Fed has to cool down domestic demand by significant rises in interest rates, then exports in other countries would be negatively affected. This could be magnified by a weakening of the dollar. In addition, a potential correction in stock exchanges would cause similar revaluations in other countries' stock exchanges, particularly those of Latin America.

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

US

The US economy is still growing dynamically contrary to some economists' fears. If the growth rate is sustained until the end of February, then it will be the longest economic expansion period in American history. GDP growth was 5.7% in 3Q and the first estimate of 4Q is 5.8%. An increase in labour productivity of approximately 5% in the second-half of 1999 was one of the factors facilitating fast economic growth in the absence of inflationary pressures. Despite the drop in the number of people out of work, labour costs dropped 0.2% in November 1999. A 0.3% rise in the index of leading economic indicators in November proves that nothing undermined US economic strength in the second-half of 1999.

However, the high deficit on the merchandise trade balance, stemming from excessive domestic demand, is still a source of concern. In November 1999 it amounted to US$26.5 billion. Some experts are of the opinion that the deficit will not diminish in 1Q00. It also poses a serious threat to the US economy. According to Fed officials, rapid growth of the economy and industrial production cannot be sustained in the long run without fuelling inflationary pressures. Moreover, unemployment remains at a 30-year low (4.1%) and fast growth of new jobs will very likely lead to a rise in wages. In addition, uncertainty about a slump in stocks and the ensuing effects on the real economy persists.

European Union

The EU economy gathers steam. A clear improvement in economic activity in the second-half of 1999 was, to a large extent, attributable to a considerable increase in exports. The latter is due to the weak euro. In December the purchasing managers' index of manufacturing activity in the euro-zone rose for the tenth consecutive moth running at a two and a half year high of 57.4. 4Q99 saw EU unemployment below 10% for the first time in 7 years. However, labour markets still remain inflexible, posing a serious structural barrier to economic growth.

Contrary to positive expectations, German industrial production declined 0.5% in November (seasonally adjusted) dashing optimism with regard to the economic improvement. GDP increased 0.7% qoq and 1.2% yoy in 3Q99. Despite all this, the Ifo index was rising during the subsequent months of 3Q99 to levels 96.1, 98.9 and 99.6%, respectively. December saw the highest level since 1997. Producers' confidence for coming 6 months is positive. In Germany, alike in the whole EU, unemployment is falling. High wage demands put forward by the biggest German labour union (IG Metal) in January gave cause for concern as such measures may spur inflationary pressures. The lowering of the budget deficit from 1.7% in 1998 to 1.2% in 1999 is a good sign giving hope for the introduction of pro-business tax cuts. Insufficient domestic demand (both consumption and investment one) is one of the cru-

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

	1996	1997	1998	1999e	*2000f*	*2001f*
Global	4.3	4.2	2.5	2.9	*3.4*	*3.0*
OECD	2.9	2.8	2.0	2.6	*2.9*	*2.5*
USA	2.4	3.8	3.9	4.0	*3.6*	*2.5*
Canada	1.5	3.8	3.1	3.8	*3.5*	*2.3*
Japan	3.5	0.8	-2.9	0.7	*1.0*	*0.8*
European Union	1.7	2.6	2.7	2.1	*3.0*	*2.8*
Germany	1.4	2.3	2.0	1.3	*2.8*	*2.6*
France	1.5	2.3	3.2	2.8	*3.3*	*3.0*
Italy	0.7	1.5	1.3	1.3	*2.7*	*2.8*
United Kingdom	2.3	3.1	2.1	1.9	*3.0*	*2.8*
Russia	-5.0	0.9	-4.9	1.7	*1.8*	*2.8*
China	9.6	8.8	7.8	7.1	*6.9*	*6.5*

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

cial problems of the German economy. It does not allow an increase in imports which, in turn, limits the prospects for a rise in Polish exports.

Italy is still the slowest growing state in the EU. Nevertheless, even in this case some improvement is apparent. GDP increased 0.9% qoq and 1.2% yoy in 3Q99. The general producer confidence index remains at an unchanged level. The latest business cycle surveys indicate an improvement driven by exports and investment. However, private consumption growth is still low. Analysts expect a more impressive growth rate in the coming two years.

After unspectacular growth in 1999 (estimated at 1.9%) the United Kingdom enters a stage of faster growth which may last until end-2001. The effects of the strong pound on exports will be, to some extent mitigated by better global economic conditions. The latter will facilitate faster growth of industrial production. A fast rate of growth of domestic demand (higher than that of GDP) is still worrisome as it raises inflationary pressures.

France has also forecast an increase in economic growth driven largely by strong external demand which already contributed to GDP growth in the second-half of 1999. A balanced budgetary policy will be conducive to faster growth. The anticipated decline in unemployment and rise in incomes will make it possible to sustain high consumer spending. It seems that France will become an economic leader among the biggest countries in the EU in the coming years.

CIS

The economic situation in Russia is improving considerably. GDP rose 1.5% yoy during the first three quarters of 1999. Industrial production edged up as well – 7.8% yoy over the period January-November. However, future economic developments remain uncertain. Low investment and impoverishment are of serious concern. Moreover, it seems that the devaluation stimulus has ceased to work. The economic recovery is due primarily to the external situation – mainly to the increase in crude oil prices. Over this year political events will play a significant role in the economy. A new political leader will be elected in the coming presidential elections in March. Very likely it will be Vladimir Putin, who currently acts as a president after the resignation of Boris Yeltsin. In addition, the course of war in Chechnya and mounting military expenditure will take their toll on the economy. Finally, the settlement of foreign debt and potential IMF credits is of considerable importance for Russia.

Contrary to Russia, the economic situation in Ukraine has deteriorated. The main threat is the necessity of US$3 billion spending in order to service foreign debt. A lack of reserves and tough requirements put forward by the IMF, the World Bank and other international institutions (concerning principally the introduction of radical economic reforms) may on the one hand result in attempts to conduct reforms while, on the other hand, default may be announced. Although the probability of default is rather low, it affects expectations of a hryvna devaluation. If the budget is settled and principal structural reforms are introduced, then an initial slowdown in growth over the period 2000–2001 – followed by a period of faster growth – should be expected. Planned legalisation of the grey economy which dominates the entire Ukrainian economy could be very helpful.

CEFTA

The year 2000 is believed to bring better economic performance in countries of the Central European Free Trade Area (CEFTA). A particular improvement is forecast for the Czech Republic. Both GDP and industrial production – after two years with regard to the former and one year with regard to the latter – will be on the rise in 2000 and 2001. Hungary maintains a trend of fast growth, driven mainly by industrial production. Hungarian GDP will expand at pace of over 4% annually and industrial production at almost 2-digit rate. Strong production contributes to an increase in exports.

Asia

Asian economies show clear sings of recovery – however the pace is not uniform across the region. The biggest improvement was achieved by South Korea, Singapore, Malaysia, Philippines, and Thailand. At the far end there is Indonesia. Exports (stemming from the devaluation) still remain the main engine of growth that, in turn, stimulate industrial production. However, in the near future domestic demand will play a bigger role.

The situation in the second largest economy in the world – Japan – is still far from clear. GDP contracted 1% yoy in 3Q99 and a similar outcome is expected in 4Q99. Consumption continues to decline – December marked the 29th consecutive month of a fall in retail sales and wholesales indices. Ample government spending did not jumpstart domestic demand and only caused a rise in public

debt (105.4% of GDP). The draft Budget Act for the fiscal year commencing in 2000 assumes further increases in spending. Consequently, the expected budget deficit will amount to 9.4% of GDP and public debt to 114% of GDP in 2000. The strong yen continues to be a potential threat to economic growth as it limits export potential. Notwithstanding the above, exporters' confidence remains strong. The adverse price impulse is to some extent offset by demand stimulus from buoyant Asian economies.

Chinese economic growth was at a ten-year low (7.1%) – though it was still one of the highest in the world. The main reason behind the slowdown is deflation that has persisted for 27 months. As a consequence, corporate profits decline and consumers postpone purchases expecting lower prices in the future. Large public spending proved insufficient to stop falling GDP growth. A rapid increase in money supply gives hopes for combating deflation. The surplus on the merchandise trade balance has diminished due to faster growth in imports (18%) as compared to exports (6%). The prospective membership of China in the World Trade Organisation (WTO) should benefit exports and domestic investment. However, on the other hand, it would cause a further fall in foreign direct investment.

Latin America

The economic outlook for Latin America in 2000 is more optimistic. GDP growth will reach 3.4% which is a significant improvement in comparison to 1999 – the worst year in terms of economic performance for over 10 years. Sources of improvement are found in favourable external factors, stable public finances as well as rising prices of commodities – primarily oil and metals.

Despite the general improvement in economic activity across the region, particular economies have serious financial troubles – in particular Ecuador, Columbia, and Venezuela. Ecuador attempted to stabilise its economy with the introduction of the US dollar as its official currency at the beginning of January 2000. Venezuela suffered from vast floods that hit the country in December 1999. In addition, political conditions are not conducive to the successful implementation of structural reforms.

Some experts draw attention to the fact that the current improvement in Latin America rests largely on external factors (higher commodities prices) and not on structural changes. As a corollary long-term growth prospects are not robust. Economies of this region remain susceptible to external shocks, particularly dependent on foreign capital. Thus, expectations on increases in interest rates in the US and the EU as well as the slowdown in growth of North America (crucial trade partners) will negatively affect the economic situation in Latin America.

Commodities prices

Prices of most commodities saw an upward trend in 1999 after their collapse due to the Asian crisis. At end-1999, prices of industrial metals reached record highs – nickel a 3-year peak, aluminium a 2-year peak, and copper since April 1999. Experts expect the continuation of the trend in this year. Such expectations are reflected in the Reuters annual poll of metal price forecasts. The biggest gains are forecast for nickel – then aluminium, copper, zinc, tin, and lead. The boost to prices comes from stronger economic activity in the world economy and it will probably continue in 2001.

We expect the price of crude oil to run on average at US$20 per barrel. Probably prices above US$20 per barrel will still remain in 1Q00. However, the end-December prices should not be expected to be sustained in the long run due to the warmer-than-expected winter and ensuing lower demand for energy. Moreover, it turned out that OPEC countries conformed to the production quotas only in 70% in December (80% in September, and 90% at the beginning of 3Q99). One should expect that the discipline will not improve in 2000. At the end of 1Q00 when the winter ends oil demand should diminish resulting in lower prices. Also in March the agreement on production quotas ceases to be in force. OPEC members indicate their willingness to prolong the Hagga agreement, although it seems that sustainability of prices in longer run above US$20 per barrel is not feasible. OPEC announcements attempt to secure a 'soft landing'. Moreover, Norway and Russia assumed higher oil production to boost relevant budgetary revenues. If, on top of that, Iraq reaches an agreement with the Security Council for the second-half of this year, oil prices should stabilise within the range of US$18–20 per barrel.

Inflation

It is expected that prices in the euro-zone will be growing at a faster pace at the beginning of 2000. This is attributable to high prices of crude oil, the weak euro as

well as a slowdown in the decline of food prices. In the second-half of 2000 the inflation rate will be falling so forecast inflation will reach 1.5% in the whole year (see Tables 2 and 3). According to European Central Bank (ECB) officials, only excessive wage claims by labour unions (especially in Germany) can endanger price stability in the euro-zone.

In the US no significant rise in prices is observed. Both CPI and PPI are stable. Core inflation (i.e. excluding food and energy prices) was 1.9% in the entire 1999 and was the lowest figure since 1965.

It should be expected that inflationary pressures in the main economies will be stronger in 2000 compared to 1999. This stemms largely from high oil prices and the outlook for higher prices of industrial metals. In addition, faster economic growth and declining unemployment will bring about higher wage claims.

Interest rates

An analysis of the current situation in the leading world economies points to the fact that rises in interest rates are inevitable (with the exception of Japan), however their magnitudes remain uncertain (see Table 4).

It was the Bank of England which, for the first this year, increased the main interest rate by 25 base points up to a

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

	1996	1997	1998	1999e	*2000f*	*2001f*
OECD	1.5	1.4	1.0	1.1	*1.4*	*1.7*
USA	2.2	2.0	1.0	1.4	*1.5*	*2.1*
Canada	1.3	0.5	-0.6	1.6	*2.8*	*3.0*
Japan	-0.1	0.5	0.4	-0.8	*-0.4*	*0.2*
European Union	2.4	1.6	1.5	1.6	*2.0*	*1.7*
Germany	1.0	0.6	1.0	1.0	*1.5*	*1.7*
France	1.6	1.0	0.9	0.6	*1.2*	*1.7*
Italy	4.4	2.6	2.8	1.5	*1.6*	*1.7*
United Kingdom	3.1	2.2	2.5	2.7	*2.4*	*2.0*

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

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

	1996	1997	1998	1999e	*2000f*	*2001f*
OECD	2.0	2.0	1.1	1.4	*1.7*	*1.8*
USA	2.9	2.3	1.6	2.2	*2.6*	*2.5*
Canada	1.6	1.4	1.0	1.8	*2.4*	*2.5*
Japan	0.1	1.7	0.6	-0.3	*0.0*	*0.1*
European Union	2.1	1.8	1.4	1.3	*1.4*	*1.6*
Germany	1.3	1.5	0.6	0.6	*1.1*	*1.3*
France	2.0	1.3	0.7	0.5	*1.0*	*1.3*
Italy	3.8	1.7	1.7	1.7	*1.2*	*1.3*
United Kingdom	2.4	2.8	2.7	2.3	*2.4*	*2.6*
Russia	47.7	14.8	27.7	86.0	*20.0*	*11.0*
China	8.3	2.8	-0.8	-1.3	*0.0*	*1.0*

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

level of 5.75%. At its previous meeting in December, no changes in monetary policy were implemented. The January increase was not a surprise to the market given rising prices of real estate, mortgage credits and wages. Members of the Monetary Policy Council at the Bank of England justified their decision due to the endangered inflation target (2.5%) as a result of excessive growth in consumer spending. The latter stems from a rise in wealth, higher wages and credits. Further hikes in interest rates cannot be ruled out given faster economic growth and strong domestic demand.

The European Central Bank (ECB), after its last rise in interest rates in November 1999 (due to sings of the economy gathering steam and fast growing money supply) did not alter its monetary policy during the January sessions. However, experts expect that no sooner than in 1Q00 (at February or March meeting) interest rates will be on the rise by as much as 50 basis points. This seems more likely if the euro remains weak contributing to imports of inflation. The latter effect will be magnified especially in the case of high oil prices.

The Fed announced a neutral bias after the increase in interest rates up to a level of 5.5% in November 1999. However, already in February main interest rates rose 25 base points. This measure was widely expected by market participants. Some analysts forecast a further tightening during this year (even 75 base points). This is in line with the Fed's stance. Tighter policy would prevent the overheating of the American economy and curb inflationary pressures.

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

	1996	1997	1998	1999	*2000f*	*2001f*
USA	6.4	6.3	5.3	5.7	*6.8*	*6.8*
Canada	7.2	6.1	5.3	5.5	*7.0*	*7.0*
Japan	3.0	2.3	1.5	1.8	*2.0*	*2.6*
Euro area	-	-	-	4.6	*5.5*	*5.5*
United Kingdom	6.2	5.7	4.7	4.6	*5.5*	*6.0*
LIBOR (US$/year)	7.8	7.0	5.5	5.0	*6.0*	*6.2*

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	1998	1999e	*2000f*	*2001f*
Global	6.0	10.5	3.9	4.5	*8.9*	*8.0*
OECD	6.2	7.8	7.5	6.0	*8.0*	*7.0*
USA	6.4	14.3	10.6	11.6	*10.5*	*7.0*
Canada	5.1	12.6	5.8	8.5	*8.0*	*6.6*
Japan	10.3	2.1	-7.5	4.0	*11.0*	*11.0*
European Union	2.6	6.0	7.8	4.3	*6.2*	*5.3*
Germany	2.8	6.1	7.5	4.4	*7.0*	*6.0*
France	2.2	6.2	9.3	3.5	*7.3*	*5.0*
Italy	-2.0	3.6	6.1	3.2	*4.0*	*4.0*
United Kingdom	7.8	8.3	8.4	7.0	*8.0*	*4.0*
Russia	10.0	11.0	-16.0	-20.0	*3.0*	*5.0*
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.

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

	1996	1997	1998	1999	*2000f*	*2001f*
Euro	-	-	1.11	1.07	*1.07*	*1.14*
Yen	109	121	131	114	*104*	*96*

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

International trade

We continue to hold the opinion presented in the previous issues of PEO that increased trade turnovers are in the pipeline along with more healthy growth throughout the world (see Table 5).

It is expected that the US trade deficit will widen further. Due to continued cheap currencies of most Asian countries their trade surpluses will be sustained. There is hope that after the debacle of WTO talks in Seattle last year, renewed negotiations on trade liberalisation will shortly commence again. And this time they will be more fruitful causing an additional stimulus for trade turnovers.

Exchange rates

The first year of the euro proved to be unfavourable for the currency as it depreciated 15% versus the dollar. The initial exchange rate was 1.17 per dollar and already in July it was close to parity. The euro managed to remain above a level of 1.05 per dollar during the next three months. However, only in November and December did it approach parity. The euro also lost against the yen. At the very beginning the exchange rate amounted to approximately 130 yen/euro, while by end-December it was only slightly above 100 yen/euro.

One of the reasons behind the euro depreciation was that the initial exchange rate was believed to be set at too high a level. The other reason is the worse macroeconomic fundamentals of the EU compared to the US ones. In 1999 European economic performance without doubt was not impressive. This also relates to unfavourable directions of capital flows which did not work in favour of the euro. Net outflow of portfolio and foreign direct investment came to 143 billion euros during the first three moths of 1999.

Currently expectations regarding the euro exchange rate are more optimistic, although nobody anticipates such a significant strengthening as assumed last year. The outlook for 1Q00 indicates that the euro will not rise above 1.03 dollar. This is determined by the fact that the US economy still is growing fast and is driven by strong domestic demand. However, in the second-half of the year when world economic growth will be more evenly distributed, there is a chance that the euro will gain in strength. We forecast 1.12 dollar per euro at year-end. The drop in the euro exchange rate below parity at end-January may, however, cast some doubt over the forecast.

3Q99 saw a strengthening of the yen versus the dollar. Such a strong position of the yen endangers the economic recovery and therefore led to the Japanese government's call for mutual action of G7 countries aimed at weakening of the yen. However, the present forecast of the yen points to a further strengthening, mainly in the second-half of the year. This will stem from the improvement in macroeconomic fundamentals of Japan.

The improvement in economic activity in the EU (mainly in Germany) as well as in our southern neighbours is a good sign for Polish exports. On the other hand, there are potential factors acting against an increase in exports – among others the continued weak euro as well as increased competitiveness in world markets (mainly form Asian countries). The expectations of rising interest rates in the US and the EU may cause portfolio capital inflows to diminish. At the same time world prices of crude oil will not probably record significant declines and thus will shape the price level in Poland to some extent.

Forecast assumptions – domestic determinants

As in the previous issue of PEO, we assume that the economic revival in EU states and improvement in economic efficiency in Poland in 1999 (a drastic decline in unit

labour costs) will result in increased demand for Polish goods in the first-half of 2000. We also assume a stabilisation of Polish exports to Russia and Ukraine at the level achieved in 1999.

We anticipate increased inflows of foreign capital. High interest rates and expected strengthening of the zloty in the first-half of the year may boost inflows of portfolio capital. If the situation in the international financial and capital markets do not experience any major turmoil, then a minor outflow of portfolio capital should be expected in the second-half of the year. We are of the opinion that the main deterrent of capital inflows to Poland could be the high deficit on the current account. If trends in the current account structure do not change in the first-half of the year, then the zloty could be significantly weaker at year-end than is assumed in our forecast.

The following points explain in greater detail the assumptions behind our forecast for 2000−2001:

1. Government's short-term economic policy will aim at lowering the deficit on the current account and projected deficit on the general government budget. Our forecast rests on the three following assumptions with regard to economic policy:
   (i) The NBP will keep its restrictive monetary policy till the end of 3Q00; the decline in main NBP interest rates is possible only in 4Q00;
   (ii) Budgetary policy will be tight; we assume a significant reduction of the deficit in the general government budget, and in particular in the central government budget and ZUS (state insurance company); in addition, we assume a pursuit of as low as possible financing of the deficit within the domestic financial system;
   (iii) In the second-half of 2000 the floating exchange rate regime will be introduced; at the same time we do not assume full liberalisation of capital flows to happen (despite the Poland's obligations towards the OECD).
2. Costs of compulsory debt servicing to the Pairs Club and the London Club as well as indebtedness of the private sector will amount to US$1.7 billion in 2000 and US$2.2 billion in 2001.
3. Labour force will grow 0.4 and 0.5%, respectively.
4. An increase in a number of people who are either retired or receive disability allowance will be 1.5 and 1.4%, respectively.
5. Average customs duties will be gradually dismantled to 0% in trade with the EU and maintained at the 1997 level in trade with other countries.
6. Transfers from the EU will increase from approximately US$0.3 billion in 1999 to US$0.6 and US$0.9 billion over the next two years.
7. Foreign direct investment (according to the balance of payments nomenclature) will reach US$7.0 and US$8.0 billion, respectively.
8. Privatisation will accelerate and end definitely in 2001; privatisation proceeds will amount to 21 and 14 billion zlotys in 2000 and 2001.
9. The indexation of primary social benefits will be maintained; nominal average social benefits will increase 6% in 2000 and 7.5% in 2001.
10. In 2000 the personal income tax rates will be maintained at their 1999 level, whereas corporate income tax rates will be lowered (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 PIT rates to 18% and 28% (as projected in the government reform draft); the VAT base will be extended (according to the government plan, agricultural and municipal sectors will be covered by VAT).
11. Employment in the public sector will be stable; an employment increase will float within a range of 0−3%; 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 2000–2001

- **Domestic demand as the engine of growth in 1999**
- **Weaker domestic demand in the first-half of 2000**
- **Stable public consumption**
- **Improvement of the investment climate in 2000–2001**

According to our assessment, 1999 saw GDP growth of 4% yoy. After having analysed the main trends of the basic macroeconomic aggregates we can safely state that Polish economy has overcome the consequences of the external shock and has returned to the path of long-term growth.

In 3Q99, it was mainly domestic demand that drove Polish economic growth. However, according to our estimates, 4Q99 saw slower domestic demand growth than that of GDP, which may indicate that the economic acceleration also stemmed from the rise in 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) as well as stockbuilding.

The relatively faster growth of domestic demand was the result of the considerably less restrictive economic policy implemented in 1999 which was reflected in reductions in basic, and nominal official interest rates offered by the National Bank of Poland (NBP), and the unexpectedly higher general government budget deficit (mostly resulting from the financial problems besetting the Social Insurance Board (ZUS)).

According to our estimates, in 1999 domestic demand rose 4.9% yoy. Detailed data on the growth of the main components of the aggregated demand are given in Table 7. **Up to 3Q99, domestic demand rose faster than GDP.** The difference between the respective growth rates in the preceding quarters was 1.6 percentage points in 2Q99, whereas that in 3Q99 amounted to 1.8 percentage points. However, the higher growth rate in 4Q99 as well as relatively lower domestic demand growth helped to alleviate the internal and external disequilibria.

The continued high domestic demand growth was made possible mainly by the significant increase in consumption demand, boosted by credit expansion, particularly that of consumption credits. Households' propensity to save was also lower, as expressed in a much lower (compared with 1998) dynamics of zloty-denominated deposits.

The growth of household demand for credits was tempered, to a certain extent, by weaker demand – compared with the previous year – from the government sector (as a result of the 1999 budget deficit financed mostly from privatisation revenues) and by slower growth of credits for enterprises. On the other hand, significantly higher general government budget, involving government budget, local

budgets and some para-budgets (such as those of the Social Security Board (ZUS)) indirectly helped to boost domestic demand.

Since 1Q99, consumption demand has been on the increase. According to our estimates, in 4Q99 household consumption increased 5.0% yoy and, for the first time since 3Q98, its rate of growth was lower than that of GDP (see Table 7). Higher dynamics of private consumption stems from a dramatic fall in households' propensity to save. Households made every effort to maintain their high rate of consumption demand in the situation when the growth of their real incomes was exceptionally low. Trends of this kind seem to be difficult to sustain in the longer term. In order to resist this trend a policy is required of maintaining a high level of nominal interest rates and a faster economic growth as reflected in higher households' real incomes and savings.

Table 7. Components of aggregate demand, 1997–2001

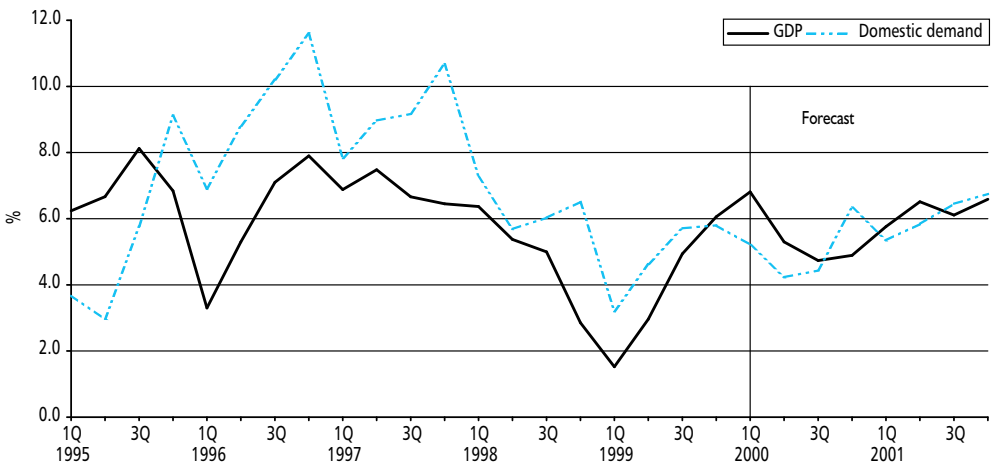
		GDP	Domestic demand	Households' consumption	Public consumption	Investment in fixed assets
1997	1Q-4Q	6.8	9.2	6.9	3.4	21.7
1998	1Q-4Q	4.8	6.4	4.7	1.6	14.2
1999	1Q-4Q	4.0	4.9	4.9	1.6	7.2
forecast						
2000	*1Q-4Q*	*5.4*	*5.1*	*3.6*	*2.0*	*10.9*
2001	*1Q-4Q*	*6.3*	*6.1*	*4.1*	*2.0*	*13.7*
1997	1Q	6.9	7.8	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	7.3	6.3	2.2	17.3
	2Q	5.4	5.7	3.9	1.6	14.6
	3Q	5.0	6.0	4.3	1.5	14.3
	4Q	2.9	6.5	4.4	1.2	12.7
1999	1Qe1	1.5	3.2	4.2	1.4	6.0
	2Qe1	3.0	4.6	4.8	1.3	6.7
	3Qe1	4.9	5.7	5.4	1.9	7.1
	4Qe2	6.1	5.8	5.0	1.9	8.0
forecast						
2000	*1Q*	*6.8*	*5.2*	*3.8*	*2.0*	*9.2*
	2Q	*5.3*	*4.2*	*2.8*	*2.1*	*10.0*
	3Q	*4.7*	*4.4*	*3.5*	*2.0*	*10.9*
	4Q	*4.9*	*6.3*	*4.3*	*1.9*	*12.0*
2001	*1Q*	*5.8*	*5.4*	*4.4*	*1.8*	*12.8*
	2Q	*6.5*	*5.8*	*4.2*	*1.9*	*13.3*
	3Q	*6.1*	*6.4*	*4.0*	*2.0*	*14.0*
	4Q	*6.6*	*6.7*	*3.9*	*2.2*	*14.0*

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.

According to our estimates, in 1999 investment outlays were higher by 7.2%, and those in 4Q99 were higher by 8%. Investment outlays on machinery, equipment and transport again accelerated.

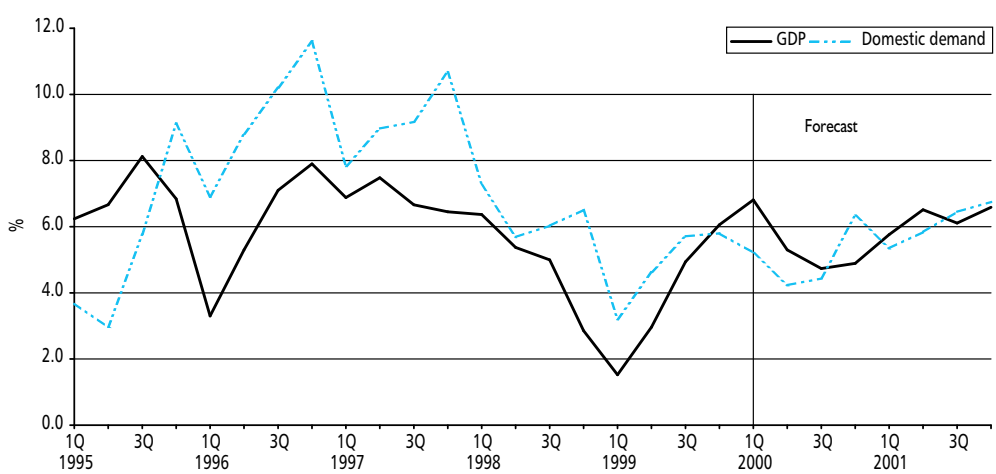
The slowdown in investment in 1999 was caused mostly by lower savings in the business sector due to weaker economic growth, exceptionally low dynamics of industrial production in the first-half of 1999, coupled with a weaker position of the zloty, which in turn affected the price of imported raw materials and intermediate goods. The continued increase in the dynamics of investment growth, higher than that of GDP, was mainly a consequence of larger volume of foreign investment and larger investment credits.

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



Source: CSO and CASE.
Note: CASE forecast starting from 1Q00.

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



Source: CSO and CASE.
Note: CASE forecast starting from 1Q00.

For over two years, the growth of public consumption has been low. The rate of public consumption has been markedly lower than that of other components of the domestic demand. At the same time, the growth over the whole year of 1999 remained at the level similar to that in 1998. This increase was attained despite serious difficulties with the Budget resulting from the reforms in the sector of public finances and higher-than-expected costs involved in the implementation of social reforms.

We expect GDP growth to amount to 5.4% in 2000. Our forecast is, therefore, more optimistic than the adopted 5.2% in the 2000 Budget Act, and the mean value obtained from the forecast of 4.8% assumed for Poland and published in January by *Consensus Forecasting*. Faster growth in the first-half of 2000, with the prediction of the absence of any stronger development-enhancing impulses, will stem mainly from continued upward trends in 1999. 1Q00 may see especially high economic growth and GDP may increase by as much as 6.8%, partly as a result of the low base effect (1.5% in 1Q99).

From early 2000 onwards we expect a strong pro-export stimulus to occur. Unlike the previous issue of the PEO, in this issue we do not predict any larger demand for Polish-made products from the CIS, especially Russia and Ukraine in 2001. However, the combination of pro-export stimuli and progressively faster growth of the domestic demand will make it possible to accelerate economic growth to 6.3% in 2001.

Another period of boom in investments may be anticipated. However, the rate of growth of investments equal to that attained between 1995 and 1997 (more than 20% annually) can hardly be expected to occur. On the other hand, the still high level of foreign investment as well as the predicted increase in enterprises' savings will make it possible to push the growth rate of investment outlays from over 7% in 1999 to about 14% in the second-half of 2001. Provided there is further improvement in efficiency of business performance and investment, the growing contribution of investment to GDP may ensure that the relatively high annual economic growth of 5–6% will be sustained.

Domestic demand growth will increase from 4.9% in 1999 to 5.1% in 2000, and 6.1% in 2001. In the period 2000–2001, private consumption may grow at a slower rate than in 1999, mostly due to the anticipated increase in the propensity to save. At the same time, the dynamics of public consumption are expected to stabilise at the level of 2% per annum.

More restrictive economic policy (in comparison to 1999), especially that implemented in 2000, in the years 2000–2001 may lead to domestic demand growth lower than that of GDP, which would make it possible to achieve macroeconomic stabilisation and balanced economic growth in the years after 2001. The lower increase in domestic demand will be compensated for by faster exports, which will help to relatively improve the current account balance and to stabilise the zloty exchange rate.

The contribution of the separate components of aggregated demand to GDP growth is shown in Table 8. In the years 2000–2001 the contribution of consumption to GDP is expected to be small, its value being even as low as 2.3% in 2000. In 2001, however, it may rise slightly to 2.6%. **It should again be emphasised that for high economic growth to be maintained in 1999, despite the fall in exports (defined according to the system of national accounts, i.e. including exports of services and cross-border trade balance), the contribution of consumption to GDP had to be kept at a stable level.**

In 1999, the investment contribution to GDP growth fell to 1.8%, whereas that in the period 1997–1998 was as high as 4.4% and 3.3%, respectively, being thus lower than private consumption. In the years 2000–2001, this downward trend may reverse itself. In 2000, the investment contribution to GDP is expected to increase to 2.8%, while that in 2001 may even amount to 3.8%.

According to our estimates, in 1999 the contribution of exports to GDP was negative (-1.2%), whereas that in 1998 was 3.7%. This situation is expected to improve in the years 2000–2001. At the same time, the negative impact of imports will diminish due to anticipated lower dynamics of domestic demand. As a result, in 2000 the contribution of foreign demand will fall to 0%, while in 2001 it may be slightly negative as expressed by a negative value of (-0.2%).

In 1999, the dynamics of households' real incomes was exceptionally low (see Table 9) as a result of (1) low growth of nominal and real wages, (2) higher-than-expected inflation in the second-half of the year, and (3) relatively small increase in real incomes due to business activity stemming from cooling down of the economy.

Since December 1998 the payments of old-age pensions and disability benefits have increased 11.1%, whereas employee pensions 11.7% and those for farmers by 7.9% respectively. When taking into account larger number of old-age and disability pensioners, the real increase of the average employee pension was 1.3%, whereas that of the average farmer's pension was 0.6%.

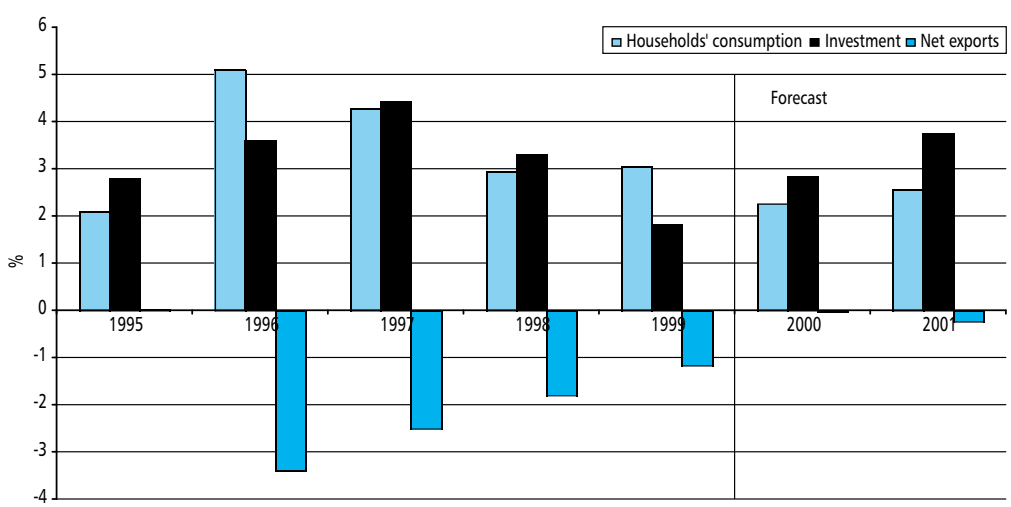
In 1999, budgetary expenditures on unemployment benefits increased considerably. In December, they were as high as 194.5 million, that is, higher by 57.2 million yoy, representing a real increase of 32.4%. This situation was primarily a result of a large increase in the number of unemployed registered over the previous twelve moths. In December 1999, there were 554.1 thousand of the registered unemployed entitled to unemployment benefits, up 133.8 thousand yoy. In 1999, one unemployed received a benefit (in real terms) 1.9% lower than that in the preceding year, whereas the real value of his/her benefit fell even more, i.e. by as much as 2.7%. This means that the structure of unemployment has changed. In 1999, it was people entitled to higher benefits that lost jobs. This fact seems to

Table 8. Contributions to GDP growth, 1997–2001 (%)

		GDP	Households' consumption	Public consumption	Investment in fixed assets	Stock-building	Net exports	Exports	Imports
1997	1Q-4Q	6.8	4.3	0.6	4.4	0.1	-2.5	3.0	-5.5
1998	1Q-4Q	4.8	2.9	0.3	3.3	0.0	-1.8	3.7	-5.5
1999	1Q-4Q	4.0	3.0	0.3	1.8	0.0	-1.2	-1.2	0.1
forecast									
2000	*1Q-4Q*	*5.4*	*2.3*	*0.3*	*2.8*	*0.0*	*0.0*	*2.3*	*-2.4*
2001	*1Q-4Q*	*6.3*	*2.6*	*0.3*	*3.8*	*-0.1*	*-0.2*	*2.9*	*-3.1*

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

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



Source: CSO and CASE.
Note: CASE forecast starting from the year 2000.

prove, at least partially, that the growth of recent unemployment has restructuring related causes.

In 1Q00, the growth rate of real incomes is expected to be similar to that in the second-half of 1999, whereas a faster rate can be anticipated by the end of 2001 mainly due to the faster economic growth.

In 4Q00, as in the two previous quarters, **net financial households' savings were very low.** These savings were calculated in terms of the difference between the growth of the zloty and foreign currency deposits and cash in circulation (excluding cash vaults and credit expansion). Lower savings rates (calculated as a ratio of households' savings to disposable incomes) resulted, on the one hand, from the controversial decision taken in January 1999 to cut interest rates, and on the other hand from lower households real incomes.

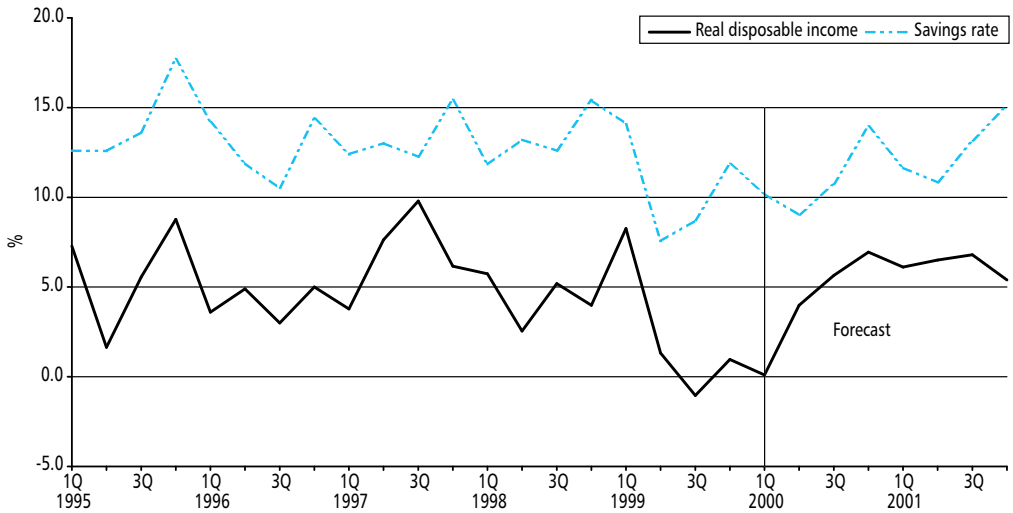
In the period covered by our forecast, gradual increases in households' propensity to save is foreseen, however

Table 9. Household disposable income, 1997–2001

		Disposable income	Wages and salaries	Social benefits	Savings rate	Real disposable income
		% change	% change	% change	%	% change
1997	1Q-4Q	23.0	23.8	19.7	13.2	7.1
1998	1Q-4Q	16.8	17.3	15.3	13.3	4.5
1999	1Q-4Q	9.7	10.7	9.1	10.6	2.3
forecast						
2000	*1Q-4Q*	*13.7*	*12.7*	*9.4*	*11.0*	*4.1*
2001	*1Q-4Q*	*12.6*	*13.0*	*9.0*	*12.7*	*5.0*
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	20.2	22.7	16.6	15.5	6.2
1998	1Q	20.4	20.9	17.0	11.8	5.7
	2Q	16.0	17.9	15.4	13.2	2.5
	3Q	17.0	15.5	14.1	12.6	5.2
	4Q	13.5	15.0	14.9	15.4	4.0
1999	1Q	15.0	9.1	10.9	14.1	8.3
	2Q	7.8	10.4	7.3	7.6	1.3
	3Q	6.1	11.4	9.5	8.7	-1.0
	4Q	10.3	11.8	8.7	11.9	1.0
forecast						
2000	*1Q*	*10.2*	*13.3*	*10.0*	*10.2*	*0.1*
	2Q	*14.3*	*13.8*	*11.2*	*9.0*	*4.0*
	3Q	*15.5*	*11.8*	*8.0*	*10.7*	*5.6*
	4Q	*15.1*	*11.9*	*8.5*	*14.0*	*6.9*
2001	*1Q*	*13.1*	*11.3*	*9.0*	*11.6*	*6.1*
	2Q	*13.1*	*11.1*	*9.0*	*10.8*	*6.5*
	3Q	*13.1*	*11.1*	*9.0*	*13.2*	*6.8*
	4Q	*11.2*	*10.1*	*9.0*	*15.1*	*5.4*

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.

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



Source: CSO and CASE.
Note: CASE forecast starting from 1Q00.

the levels attained will be lower than those of 1997–1998. We expect that in the first three quarters of 2000 the savings growth rate will amount to some 10%, and it will be only in the next few quarters that a higher propensity to save exceeding 10% can be anticipated.

Value-added

- **Double-digit growth of industrial production**
- **Slower growth in construction sector**
- **Market services as a stabilising factor of economic growth**
- **Faster growth of value-added in the years 2000–2001**

We estimate the total growth of value-added in 1999 at 3.8%, and at 5.7% yoy in 4Q99 alone, which represents a rate similar to that achieved in the first-half of 1998.

The growth of the total value-added both in 1999 and in 4Q99 became reduced additionally by the fall in agricultural production. Lower potato, sugar beet, vegetable and fruit crops, together with lower animal production resulted in a decline in the value-added in the agricultural sector by about 4%.

The value-added in non-agricultural sectors (i.e. excluding agriculture, forestry, hunting, off-shore and inland fishery) increased 3.9% yoy and 6% compared with 4Q98. It grew even faster than average in manufacturing, telecommunications and trade. On the other hand, it was lower than average in other sectors such as transport, construction, and non-market services. The results of the estimates are shown in Table 10.

4Q99 witnessed an exceptionally fast growth in manufacturing, although it was slightly lower than that predicted in the previous issue of PEO. The growth of output was boosted not only by a stronger domestic demand but also by greater exports.

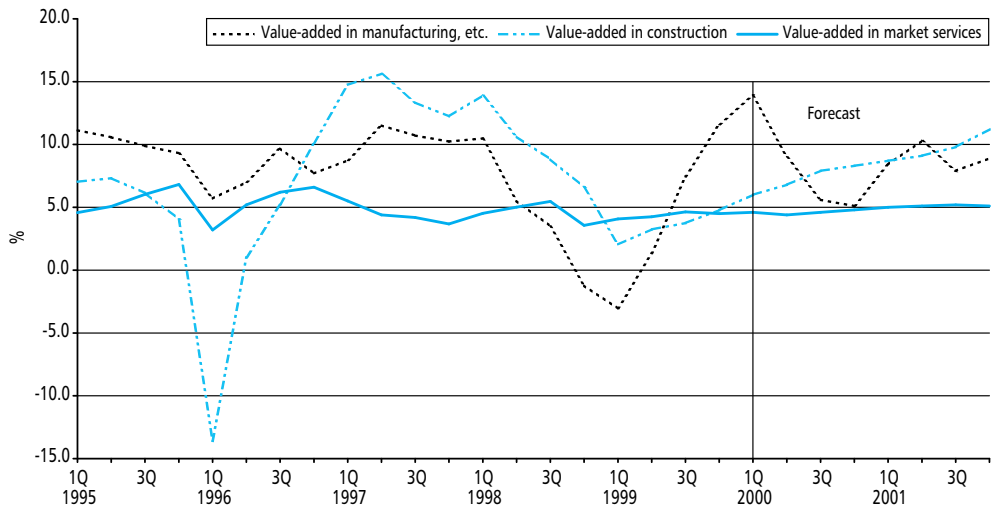
Industrial production (excluding construction) of enterprises employing more than 5 workers increased 11.7% yoy (see Table 11), whereas only manufacturing increased 14.2%. The dynamics for the whole industry was diminished by lower output in mining, where the production fell 11.6%. We also estimate that the value-added for the whole industry was 11.6% higher yoy. However, the growth assessed over the whole year was found to be only slightly higher (4.5%) than that in 1998.

Contrary to the upward trend in manufacturing, lower investment dynamics led to a considerably lower growth

rate in the construction sector. In 1999, the value-added in the latter sector increased 3.8%. It was only in 4Q99 that the growth rate increased to 4.8% as a result of the 6.2% growth of construction activity by large companies (i.e. those employing more than 20 workers).

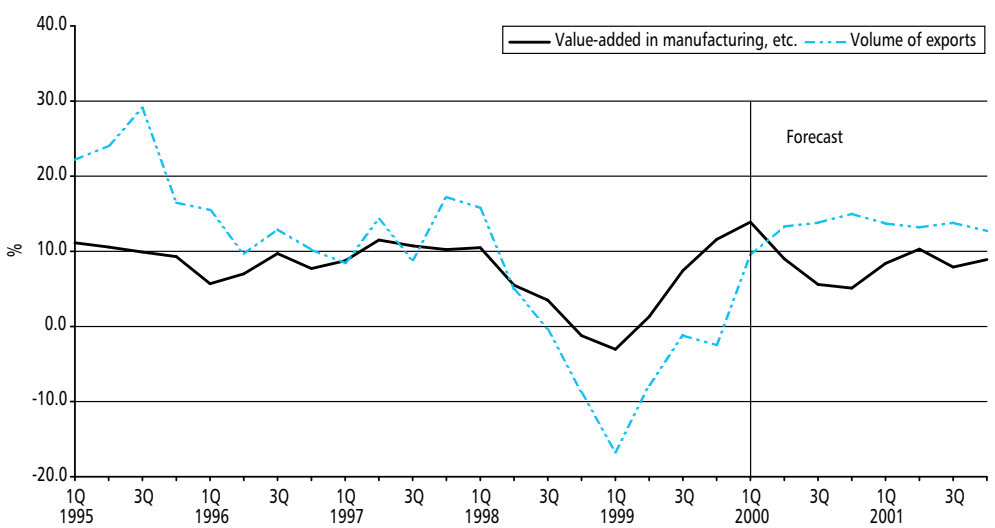
According to our estimates, in 4Q99 the value-added in trade grew more than 5%. A much faster growth was recorded by large trade companies, employing more than 20 workers. According to the Central Statistical Office (GUS), in 3Q99 retail sales in these firms increased 18.9%,

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



Source: CSO and CASE.
Note: CASE forecast starting from 1Q00.

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



Source: CSO and CASE.
Note: CASE forecast starting from 1Q00.

Table 10. 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	6.8	6.5	10.3	13.6	4.4	3.0
1998	1Q-4Q	549	4.8	4.7	4.3	9.1	4.6	1.9
1999e1	1Q-4Q	619	4.0	3.8	4.5	3.8	4.4	1.2
forecast								
2000	*1Q-4Q*	*713*	*5.4*	*5.2*	*8.1*	*7.5*	*4.6*	*1.5*
2001	*1Q-4Q*	*803*	*6.3*	*6.0*	*8.9*	*10.0*	*5.1*	*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	6.3	10.5	13.9	4.5	2.4
	2Q	133	5.4	5.2	5.5	10.6	5.0	2.0
	3Q	139	5.0	4.9	3.5	8.8	5.5	1.5
	4Q	155	2.9	2.8	-1.2	6.6	3.6	1.6
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
	3Qe1	154	4.9	4.7	7.4	3.7	4.6	1.5
	4Qe2	181	6.1	5.7	11.6	4.8	4.5	1.5
forecast								
2000	*1Q*	*158*	*6.8*	*6.5*	*13.9*	*6.0*	*4.6*	*1.6*
	2Q	*174*	*5.3*	*5.1*	*9.0*	*6.8*	*4.4*	*1.8*
	3Q	*177*	*4.7*	*4.5*	*5.6*	*7.9*	*4.6*	*1.5*
	4Q	*205*	*4.9*	*4.7*	*5.1*	*8.3*	*4.8*	*1.3*
2001	*1Q*	*178*	*5.8*	*5.6*	*8.4*	*8.7*	*5.0*	*1.6*
	2Q	*197*	*6.5*	*6.3*	*10.3*	*9.1*	*5.1*	*2.0*
	3Q	*198*	*6.1*	*5.9*	*7.9*	*9.8*	*5.2*	*2.1*
	4Q	*230*	*6.6*	*6.3*	*8.9*	*11.2*	*5.1*	*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.

whereas, according to our own estimates, they were up by 21% in 4Q99.

The value-added in transport was lower than that in the preceding year, mostly due to weaker demand for both freight and passenger transport. As in the previous two years, the value-added in telecommunications experienced a significant growth. In this sector, a dynamic increase in telecommunications services was the main factor contributing to overall growth.

We estimate that the value-added in market services increased 4.4% in 1999, the respective values for the last two quarters being 4.6% and 4.5%. It should again be pointed out that it was market services that played a role of a stabilising factor in the economic growth last year.

Table 11. 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
1998	1Q-4Q	4.6	11.4	-3.4	-2.9	0.3	3.7
1999e1	1Q-4Q	4.5	3.9	-4.0	-2.1	0.0	3.0
forecast							
2000	*1Q-4Q*	*8.2*	*8.4*	*1.0*	*-1.2*	*0.3*	*2.9*
2001	*1Q-4Q*	*9.0*	*11.0*	*1.8*	*-0.2*	*0.0*	*3.6*
1997e1	1Q	7.9	19.6	3.6	-3.1	1.0	4.2
	2Q	13.9	24.9	2.8	-0.3	1.4	5.6
	3Q	11.8	13.3	-1.7	-5.2	1.7	6.7
	4Q	11.2	13.9	0.5	-2.3	0.6	5.3
1998e1	1Q	10.9	24.0	-5.6	-0.8	1.9	4.4
	2Q	6.0	10.2	-4.7	-3.4	1.7	3.3
	3Q	3.9	13.2	1.5	-2.6	1.0	3.6
	4Q	-0.8	4.5	-4.7	-4.4	1.6	3.7
1999	1Qe1	-3.1	0.6	-1.9	-2.6	-0.4	2.5
	2Qe1	1.2	4.0	-6.3	-2.5	-1.2	3.8
	3Qe1	7.5	3.2	-7.2	-1.6	-1.3	3.8
	4Qe2	11.7	6.2	-3.7	-0.3	-1.3	1.8
forecast							
2000	*1Q*	*13.8*	*7.4*	*-2.4*	*-0.1*	*-0.8*	*1.3*
	2Q	*9.0*	*7.9*	*-1.5*	*0.5*	*-0.2*	*2.8*
	3Q	*5.7*	*8.8*	*-0.7*	*1.0*	*0.4*	*3.4*
	4Q	*5.2*	*8.8*	*-0.6*	*0.6*	*0.6*	*4.3*
2001	*1Q*	*8.6*	*9.4*	*-1.0*	*0.4*	*0.7*	*5.1*
	2Q	*10.4*	*10.1*	*-0.6*	*0.2*	*0.7*	*4.9*
	3Q	*8.0*	*11.0*	*0.3*	*0.1*	*0.6*	*4.8*
	4Q	*9.0*	*12.5*	*0.8*	*0.1*	*0.5*	*4.5*

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 manufacturing – those with more than five employees).

Following a weak six-month period in the second-half of 1999 the value-added growth rate in non-market services (defined as the sum of value-added in services implemented by central and local government, education and health care) increased only slightly. In 4Q99 the value-added in non-market services was 1.5% higher yoy. The relatively small increase is indirectly the result of social reforms, which to some extent rationalised employment in the education and health care sectors of the economy. The reduction in employment was the main reason behind this relatively small increase in value-added.

We expect that in 2000 the value-added in the whole economy will increase 5.2%, whereas in 2001 it will reach

6%. In the first-half of 2000, the value-added growth may be relatively higher than that in the second-half of the year. This will be achievable when compared to the weak results of the first-half of 1999.

Faster growth of the value-added will be made possible thanks to its faster growth predicted for industry – excluding construction – (in the years 2000–2001 increasing 8.1% and 8.9% respectively) and construction (respective increase of 7.5% and 10%). In 2000, the value-added in agriculture may fall more than 1% due to weak crops in 1999, which will result in higher prices of animal products, especially those from imports. We do not foresee any significant improvement in the situation in 2001, although animal production is expected to increase.

The anticipated value-added growth in market services will remain at 1997–1999 levels, but it will be more stable than in the other sectors of national economy. At the same time, it will experience a slower rate than the total value-added in contrast to the situation in the years 1998–1999. We expect that telecommunications, trade, hotels will continue to notch up a fast rate of development, with transport and other services regarding real estate, renting and business activities developing at a slower rate.

We predict that the value-added growth in non-market services will continue to remain slow. It is only from 2001 onwards that a higher annual growth rate of more than 2% (similar to that achieved in 1998) can be expected.

Labour market

- **Fall in industrial employment**
- **Increase in the number of registered unemployed**
- **Greater tensions in the labour market in 2000**
- **Lowering of the unemployment rate after the second-half of 2000**

In 4Q99, as in 3Q99, labour demand was weaker (see Table 12). We would like to point out that differences in the estimations of the average number of employed between those quoted in the previous issue of PEO and those in the present one have resulted from changes in the official data for 1998.

Weaker labour demand stems mainly from lower economic growth, and from a significant increase in productivity in industry.

Unemployment

By end-December 1999, the number of registered unemployed was 2349.8 thousand and the unemployment rate was 13.0%, which represents a 0.5-point increase mom, and 2.6-point increase yoy.

In December 1999, the number of unemployed who have not worked previously was 556.9 thousand, or 23.7% which compared with end-3Q99 indicates a slight fall in this category of unemployed and constitutes a normal seasonal effect. Since mid-1997 the share of unemployed as a percent of the total number of unemployed has continued to increase, however this increase seems to have been slower lately. This tendency of a slower growth of the share of those who have not worked previously in the total number of unemployed may signal some improvement on the labour market in the nearest future since it is a sign that people entering the labour market tend to find jobs easier.

In December, the number of graduated registered at employment agencies was 149.8 thousand, this is up 39.1 thousand yoy, and the share of graduates as a percent of the total number of unemployed rose 0.3-point which is more than 1 point less than over the same period of the previous year.

The number of people taking up work has increased. In December 1999, the number of people that took up work increased 13.3% yoy. Moreover, for the first time since April 1997, the number of those de-registered as unemployed in October, November and December were smaller (respectively 3.5%, 4.5% and 5.5%) than in the respective months of 1998. The turnover rate of the labour market has also been observed to be on the increase. In other words, the total number of unemployed registered and those de-registered as unemployed has been growing. The greater activity of unemployment agencies may also signify that the upward trend in unemployment has been overcome.

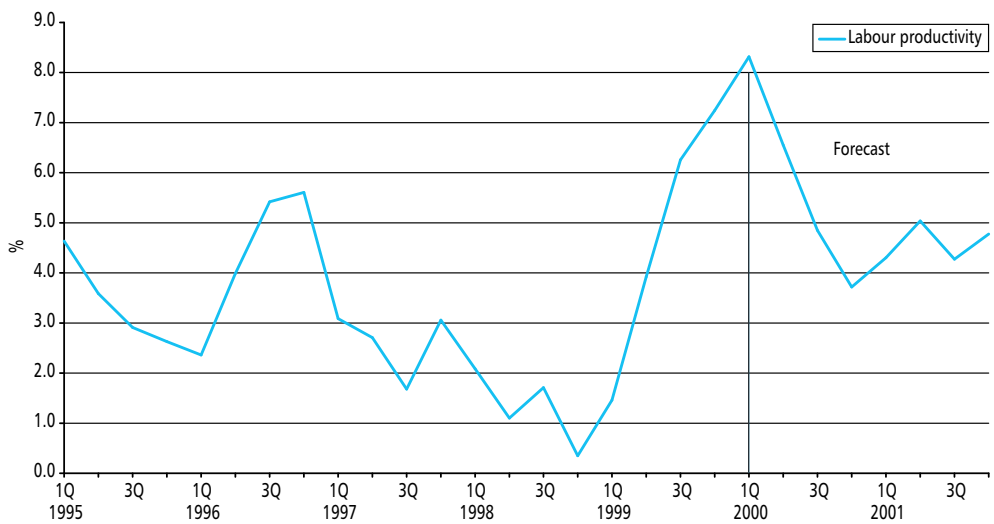
Despite all the above considerations, our forecast for 1Q00 is not optimistic. Winter is always a period of increased unemployment which involves a fall in the num-

ber of places of work in agriculture, construction and in some sectors of industry. We predict that unemployment may be as high as 13.5% by end-1Q00. In the next quarters of 2000, the growth of unemployment should be halted. However, the unemployment rate cannot be expected to fall until mid-2001.

Employment in enterprises

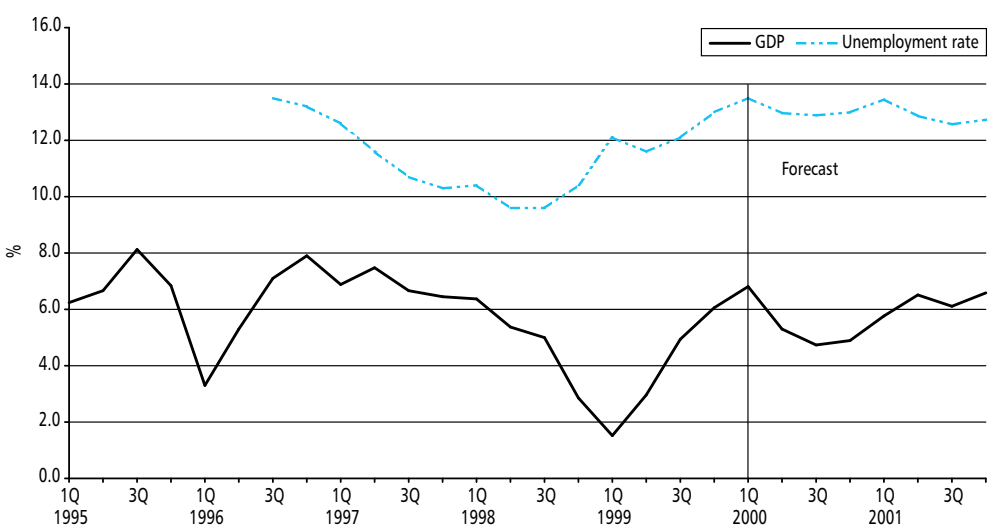
In December 1999, employment in enterprises was 5679.4 thousand, being lower by 89.6 thousand (1.6%) yoy. It seems that in the nearest future this fall in employment may be smaller as a result of some optimistic forecast

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



Source: CSO and CASE.
Note: CASE forecast starting from 1Q00.

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



Source: CSO and CASE.
Note: CASE forecast starting from 1Q00.

concerning economic growth in 2000. Increase in employment may be expected to take place in the second-half of 2000.

For the first time in four years, last year witnessed a fall in employment in construction. In December, in this sector 568 thousand people were employed, that is 15 thousand fewer than last year which a warning sign that the situation in construction is serious. It does not necessarily mean that it is only the dynamics of construction outcome that are expected to be slower; it may as well be that illegal employment in this sector, most susceptible to such practices, will increase.

In November 1999, two thousand enterprises envisaged mass-layoffs: they intend to lay off 87 thousand workers, which is less than the respective figures for October 1998, when 89.5 thousand were to be dismissed.

Table 12. Components of the labour market, 1997–2001

		Employment		Registered unemployment	Unemployment rate
		thousand	% change	thousand	%
1997	1Q-4Q	15439	2.8	1826	10.3
1998	1Q-4Q	15800	2.3	1831	10.4
1999	1Q-4Q	15658	-0.9	2350	13.0
forecast					
2000	*1Q-4Q*	*15601*	*-0.4*	*2367*	*13.0*
2001	*1Q-4Q*	*15756*	*1.0*	*2337*	*12.7*
1997	1Q	15048	2.5	2236	12.6
	2Q	15374	3.0	2040	11.6
	3Q	15594	3.4	1854	10.7
	4Q	15739	2.3	1826	10.3
1998	1Q	15506	3.0	1846	10.4
	2Q	15819	2.9	1688	9.6
	3Q	15921	2.1	1677	9.6
	4Q	15953	1.4	1831	10.4
1999	1Q	15423	-0.5	2170	12.1
	2Q	15680	-0.9	2074	11.6
	3Q	15748	-1.1	2178	12.1
	4Q	15782	-1.1	2350	13.0
forecast					
2000	*1Q*	*15275*	*-1.0*	*2439*	*13.5*
	2Q	*15538*	*-0.9*	*2337*	*13.0*
	3Q	*15708*	*-0.3*	*2338*	*12.9*
	4Q	*15885*	*0.7*	*2367*	*13.0*
2001	*1Q*	*15405*	*0.9*	*2449*	*13.5*
	2Q	*15678*	*0.9*	*2337*	*12.9*
	3Q	*15888*	*1.1*	*2298*	*12.6*
	4Q	*16055*	*1.1*	*2337*	*12.7*

Source: Annual and quarterly data with an exception of employment data – CSO; quarterly employment data and forecasts – CASE.

It seems that this trend is consistent with that observed earlier of slower fall in employment and slower growth of the number of people registered in employment agencies, as well as with the trend of a greater number of people taking up work, compared with October 1998.

On the other hand, the share of employees dismissed due to reasons involving their place of work in the total number of unemployed has not changed. In December 1999, the above share amounted to 7.4%, i.e. it was as high as this in November but increased 0.1-point by end-3Q99 and 0.6-point yoy. In view of the processes of restructuring in some sectors of heavy industry the above index should not be expected to fall in the nearest future.

Regional differentiation

The highest unemployment in December was recorded in Warmińsko-Mazurskie, Lubuskie and Zachodnio-Pomorskie voivodships (22.8%, 7.5% and 17.5%, respectively). The lowest rate was in Mazowieckie (9.6%), Śląskie (9.9%) and Małopolskie (10.3%) voivodships.

Compared with the beginning of 1999 figures, the highest relative increase in unemployment was recorded in Śląskie (40.0%), Małopolskie (38.2%) and Lubuskie (37.8%) voivodships, whereas the lowest increase was recorded in Podlaskie (15.9%), Warmińsko-Mazurskie (19.2%) and Podkarpackie (19.9%) voivodships.

The unemployed in Lubuskie voivodship, where 1699 unemployed are registered for one offer of employment, have the poorest chance of finding a job. The unemployed in Świętokrzyskie voivodship are faced with a similarly difficult situation with 1580 people registered for one offer of employment. At the other end of the scale, there are the unemployed in the Pomorskie voivodship, where one offer of employment attracts only 191 unemployed. On average, the above ratio is like 385 to 1.

The largest number of unemployed without the right to unemployment benefits is recorded in Śląskie (82.2%), Podlaskie (81.8%) and Lubelskie (81.5%) voivodships, the lowest numbers are found in Pomorskie (72.1%), Warmińsko-Mazurskie (73.2%) and Lubuskie (73.5%) voivodships. The high share of employees deprived of unemployment benefits may be perceived as a sign of a high rate of long-lasting unemployment in the region. This relationship may be, however, obscured by the regulations which make it possible to draw unemployment benefits for a longer time in regions featuring higher unemployment rates. The period of drawing an unemployment benefit ranges from 6 to 18 months depending on the situation on the labour market in the poviat.

Wages

In December 1999, average gross wages in enterprises were 2186.03 zloty – up 311.12 zloty (16.6 %) on the previous quarter, and 12.3% up on November.

In 4Q99, real wages showed a slower upward trend compared with the last year. This growth is estimated to be a mere 1.8%. Lower real growth of wages may be due to two factors. First, it may stem from higher-than-expected inflation. At the time when wages were established neither employers nor employees expected the prices to rise to such a high level. If this is the main cause of the fall in the rate of wage increase, an error of this kind may be expected to correct itself and the economy will return to the path of continued increase in terms of real wages. Second, another factor influencing lower real growth of wages may be linked to the difficult situation on the labour market, which enables employers to offer lower wages. If this is the case, the above situation may offer the best proof that sound economic mechanisms are currently in operation in the Polish economy. Provided the above trends are kept up within the next few months the situation on the labour market will undoubtedly improve in the coming year.

Prices

- **Increase in CPI of 9.8% in December 1999**
- **Increase in core inflation by end-1999**
- **Stabilisation of the inflation rate at about 10% by July 2000**
- **Lower inflation from August 2000**

In 4Q99, both the Consumer Price Index (CPI) and Producer Price Index (PPI), like those in 3Q99, showed a strong upward trend and exceeded the inflation target of 6.6–7.8% yoy set by the Monetary Policy Council (MPC). The CPI reached 9.8% yoy and PPI 8.0% yoy.

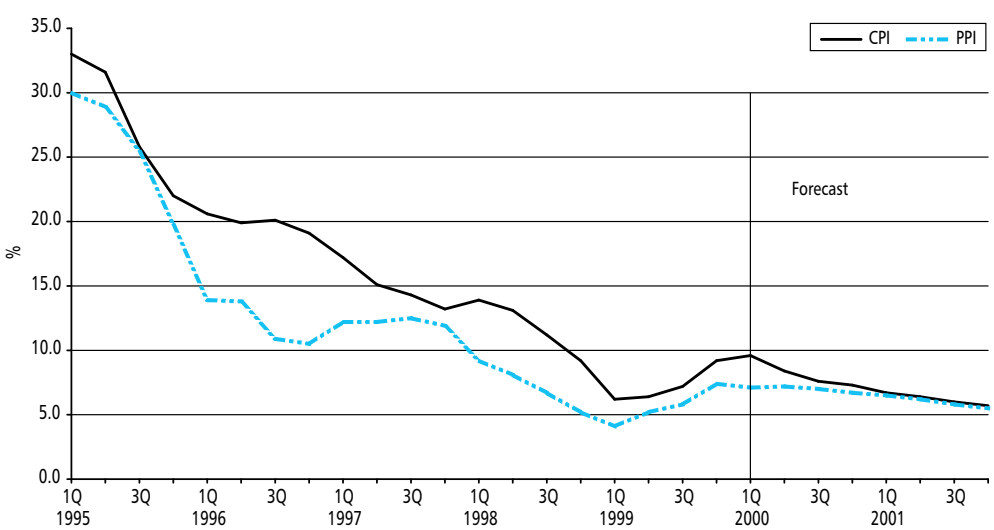
Food prices increased 4.3%, 5.2% and 6.0% yoy in October, November and December. The significant growth of the annual index was, in some measure, due to the exceptionally low prices in 4Q98. Monthly increases, however, were indicative of a downward trend and were 1.8%, 1.5% and 1.4% in October, November and December respectively. The rise in foodstuff recorded in 4Q99 resulted from the fast growth in the prices of vegetables (15.4%, 9.1% and 6.7% in October, November and December respectively) as well as those of fruits (6.0%, 9.9% and 3.3% in October, November and December respectively) due to crops of vegetables and those of fruits poorer by, respectively, 11.3% and over 10% than in the previous year. The prices of milk, cheese, eggs and animal fat as well as those of sugar were also higher, whereas those of meat were relatively stable as a result of the continued supply to the market and high inventories and high procurement prices of pork meat. The latter prices rose 18.8%, 24.1% and 16.7% yoy in October, November and December. Another factor that contributed to the increase in food prices was the continued sharp competition among wholesalers and retailers.

The prices of non-food products rose by 9.6%, 10.1%, and 10.5% yoy in October, November and December. Their growth rate continued to be higher than that of total CPI. In addition, the prices of non-food products once again featured an upward trend that has been observed since March 1999 which may be linked to the rise in PPI and the rising demand pressure as reflected, for example, in the real increase in consumption credits by 40%.

The prices of services increased 11.6% October-on October, by 11.9% November-on November, and 12.4% December-on-December. Thus in 4Q99, a continuation of the upward trend and a higher-than-expected growth rate were observed. It was the prices of transport services, gas, central heating and hot water charges that hit the highest levels as a result, among other things, of growing oil prices.

The increase in PPI was mainly generated by the import prices affected by the weak position of the zloty and high prices of raw materials, including those of crude oil. In addition, faster economic growth made it possible to pass on higher costs to middlemen and consumers. Since September 1999 larger numbers of new orders have been coming in, which enabled the producers to increase their prices in the situation of falling inventories. The PPI rose by 6.8%, 7.3%, and 7.8% yoy in October, November and December.

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



Source: CSO and CASE.
Note: CASE forecast starting from 1Q00.

We expect that food prices will continue to grow in the next six months. This will be due to the upward trend in the price of cereals recorded since August 1999 as a result of poorer crops by 5.2% yoy and greater protection of the market by the introduction of higher custom duties. High duties on flour, together with growing prices of cereals, will contribute to higher prices of processed products, and, in turn, to higher prices of foodstuffs. We are also of the opinion that some increase may be seen in meat exports to the CIS countries, which in conjunction with a decline in livestocks of swine and growth of prices of cereals and potatoes, should, as a result, lead to higher meat prices. The exports of pork meat in the three quarters of 1999 was four-fold higher than that over the same period of 1998. We also expect fruit and vegetable prices to grow, although not in the same measure as in 4Q99. In the second-half of 2000, the increase in food prices should be progressively smaller, which will bring about lower growth of CPI.

Over the forecast period, the prices of non-food products will mainly depend on the growth of PPI. In addition, the significant economic recovery at home and a better economic performance in the West will generate demand pressures which will eventually lead to higher prices. If the rise in real wages can be kept at a moderate level, in the first-half of 2000 – in contrast to those in 1999 – the prices of non-food products should be on a downward trend.

In our opinion, in 1Q00 the prices of services will rise significantly, especially as a result of the continued

Table 13. 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	11.7
1999	1Q-4Q	7.3	5.6	8.0	6.4	10.3	8.3
forecast							
2000	*1Q-4Q*	*9.2*	*7.4*	*4.2*	*3.6*	*3.1*	*9.4*
2001	*1Q-4Q*	*6.1*	*6.0*	*5.6*	*5.4*	*5.1*	*6.0*
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	12.0
	2Q	13.1	8.1	8.1	3.2	6.7	12.1
	3Q	11.2	6.7	6.0	-0.1	3.9	11.5
	4Q	9.2	5.2	3.9	-1.4	1.6	11.4
1999	1Q	6.2	4.1	8.0	2.6	9.0	6.9
	2Q	6.4	5.2	7.0	7.3	12.5	9.7
	3Q	7.2	5.8	4.6	6.6	7.7	6.2
	4Qe	9.2	7.4	12.3	9.1	11.5	9.8
forecast							
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 1996–1998 consists: 55% of US$ and 45% of DM, and from 1999: euro – 55% and US$ – 45%.

process of deregulation of state-administered prices. What will be especially affected are the prices involving the costs of housing and those of gas and electricity bills. In consequence, these price rises will be passed on to prices of services, as well as to PPI in the consecutive months of the year.

In the first-half of 2000, we expect continued growth of PPI as a consequence of the effects of the weaker zloty in the second-half of 1999. This effect usually occurs with a delay of some three to six months. Thus the results of the appreciation of the domestic currency will not be perceived until the second-half of 2000. Moreover, in the first-half of the year producers would probably wish to somehow offset the costs of higher state-administered prices which, in some sectors of trade and industry, constitute a significant share in variable costs.

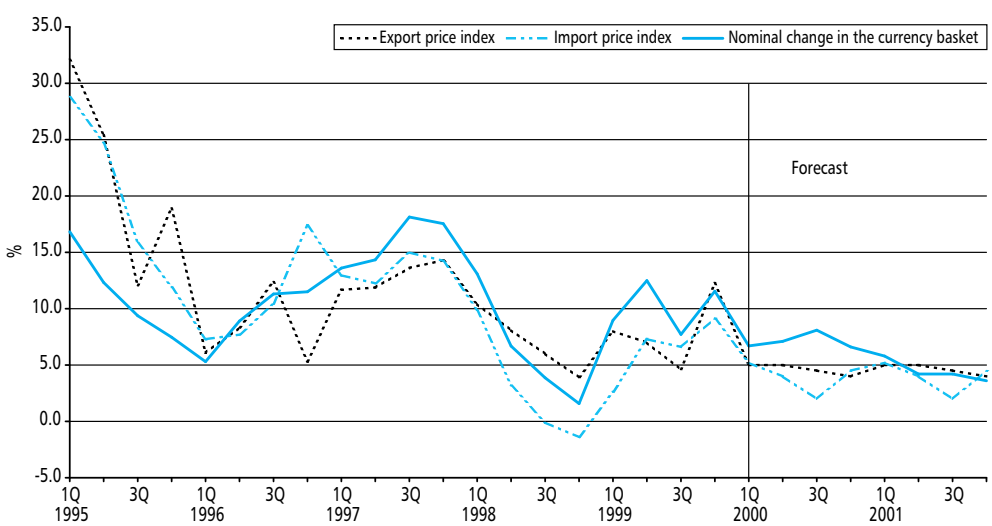
Our forecast does not assume any adverse price shocks. However, if it turns out that prices of foodstuffs are growing more rapidly (due to excessive demand in the meat market coupled with a weaker zloty stemming from deterioration in the current account), then CPI may grow 10.7% in 2000 and 8.2% in 2001 respectively. On the other hand, in the case of bumpier crops and higher agricultural production the respective CPI figures may be 8.6% and 5.8%.

Exchange rate

- **Policy of the zloty exchange rate weakening in 1999**
- **Sterilisation of privatisation proceeds in 2000**
- **Postponement of liberalisation of capital flows and floating of the zloty exchange rate**

In 1999, the zloty was relatively weaker than in the previous years. Factors such as weaker economic growth, tensions stemming from the current account deficit and a record high number of press statements leading, in most cases, to the depreciation of the zloty added to the fears concerning the Y2K problems in 4Q99. All this resulted in a nominal depreciation of the zloty by 9.8% yoy in December 1999. The privatisation proceeds in 1999, together with inflows of direct investment, did not offset the repayments of the Polish foreign debt, current account deficit and short-term capital outflows. As a result, the official gross reserves of the NBP have fallen by nearly US$1.89 billion compared with December 1998. The weaker position of the euro against the dollar (about 15% in 1999) also had its impact on the extent of the fall of official reserves in terms of US dollars.

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 1Q00.
2. Currency basket over 1996–1998 consists: 55% of US$ and 45% of DM, and from 1999: euro – 55% and US$ – 45%.

Core inflation

Recently core inflation has attracted wide interest which is undoubtedly linked with the fact that a large number of countries have adopted the policy of achieving direct inflation targets. In order to pursue this aim, monetary authorities are charged with the task of monitoring inflation pressures occurring in economy as well as with proper assessment of the nature of these pressures so that inflation targets can be achieved using suitable monetary instruments over the appropriate period of time. These instruments should help to differentiate between sporadic shocks in the inflation index and the price rises symptomatic of new trends. What is needed for this purpose is the measure of inflation which would reflect the price changes caused by fundamental demand pressures in economy on the one hand while, on the other, would reduce as much as possible the effect of reversible seasonal supply shocks and/or those resulting from state-administrated price rises. The commonly adopted Consumer Price Index (CPI) does not meet many of these requirements since it is mostly unstable and subject to seasonal fluctuations or other supply shocks. For this reason, CPI is a very ineffective measure to approximate core movements of inflation trends. The optimum measure for core inflation should, therefore, provide information on the changes in trends by eliminating CPI figures from non-representative price changes that only obscure the real pattern of inflation pressures.

The concept of core inflation has not been precisely defined. There are several methods of calculating the value of core inflation. These may be classified under two basic groups:

- **Mechanical methods** which, in computing the mean value, reject some a priori selected groups of goods and services thought to be subject to greatest variability and susceptible to supply shocks. The most often excluded aggregates, such as foodstuffs, energy and fuel, do not provide any information on the long-term inflation trends and/or on the price movements conforming to the long-term changes in the other part of the index. Historical data on prices in Poland, however, fail to bear out the above assumptions. For example, since the beginning of the economic and political transformation processes the prices of energy and fuel have definitely been ahead of CPI inflation, and that is why any calculations of core inflation using mechanical methods may only be applied to economic policy provided their shortcomings are fully recognised.
- **Statistical methods** which, in computing the mean value, reject some extreme price movements not representative of general "core" trends, without a priori determining the category of goods or services covered by these prices. The above methods include a family of mean values trimmed by a pre-determined percentage (fraction) of the consumer basket (symmetrically or non-symmetrically at both ends of the distribution) as well as mean values trimmed according to the standard deviation criterion. Statistical methods make use of all the price data in a more rational way than mechanical methods do, requiring fewer arbitrary decisions.

In order to obtain a more realistic idea of the practical application of core inflation several indicators, which, used in line with the results of studies carried out elsewhere (see Przemysław Woźniak "Various Measures of Underlying Inflation in Poland 1995–1998", CEU-CASE Working Paper Series, No. 25, Center for Social and Economic Analyses, Warsaw 1999), most effectively reproduce inflation trends:

- **For annual data** – the mean value trimmed at the threshold of one standard deviation and a 75% trimmed mean value with an asymmetry parameter of 55.
- **For monthly data** – the trimmed mean value at the 1.5 standard deviation and 59% percentile.

The trimmed mean values, using a standard deviation criterion, are computed by rejecting the values of individual changes in the components of the basket that differ from the mean value of the distribution by more

than a pre-determined multiple of the standard deviation. For Poland, the threshold values were found to be 0.7 for monthly data, and 1 for annual data.

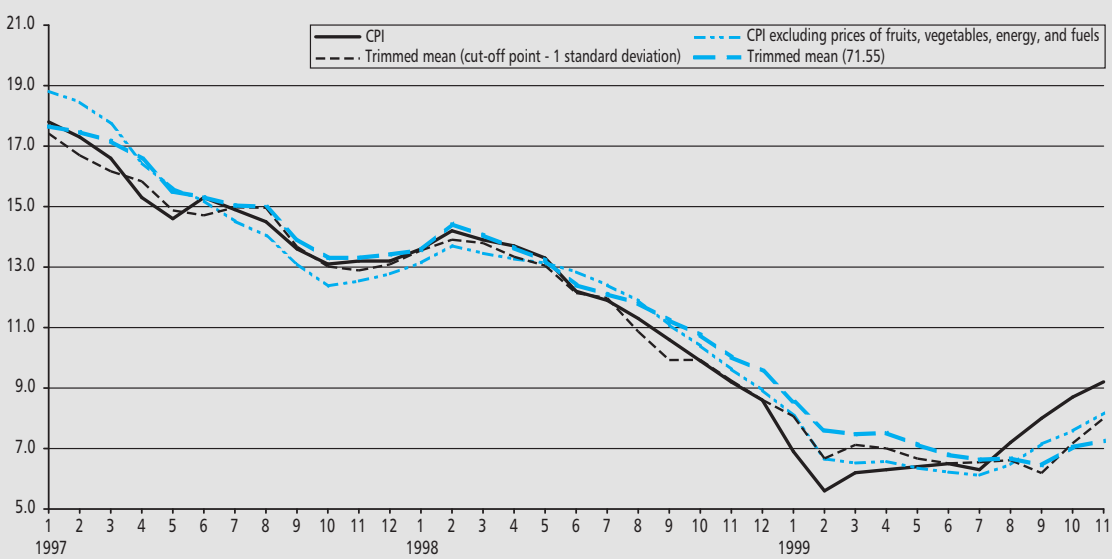
The trimmed mean values are computed by rejecting extreme price changes from the individual price changes in the basket components. They are characterised by two parameters: overall size of the truncation and asymmetry (percentage of the overall truncation at the left side of the distribution). Studies carried out for Poland have shown that the optimum truncation parameters were 71% of the overall truncation with a 55% asymmetry for annual data and 100% truncation with 59% asymmetry (equivalent to 59% percentile).

All the three 12-month core indexes indicate that inflation processes have taken a similar course for the last dozen or so months. Rapid acceleration of disinflation pace, as indicated since end-1998 by the commonly used CPI, has not been equally reflected in the values of the core index. These values, already exceeding the CPI since May 1998, have become even more different from the CPI values since end-1998. These findings seem to suggest that the fall in the rate of price rises, as signalled by CPI, was not tantamount to a steady change in the trend, nor did it result from lower demand pressures in economy. Rather, this situation was a consequence of reduced values of CPI caused by a sharp fall in the prices mainly of flour, meat and dairy products, which are not representative for overall prices. They tend to "pull down" the index as a result of using a weighted mean represented by the simple CPI. The decline in the prices of food in 1998 undoubtedly stemmed from the positive supply shock, caused both by good crops and the elimination of the eastern market due to the Russian financial crisis, which was effectively accounted for by the use of core indexes.

Core indexes have also indicated that inflation stabilised in the first-half of 1999, whereas the commonly used CPI has registered significant acceleration since March 1999. It was only since September 1999 they the above indexes recorded a modest rise in inflation, with core inflation being significantly lower by 1–2 percentage points than that recorded since 3Q99. No doubt, the above acceleration is due to the cumulative effect of some adverse shocks such as a rise in prices of fuel and food and the lower value of the zloty.

That the above supply shocks were also reflected in the core indexes may be explained by the fact that they became integrated with the "blood stream" of the economy, and by the existence of second-round effects of initial price rises, which, in the absence of an appropriately tight monetary policy, have translated into the core price rises. Another indicator of the above situation is the 7–8-month lag with which the core indexes, compared with the traditional approach, signalled the change in the inflation trends.

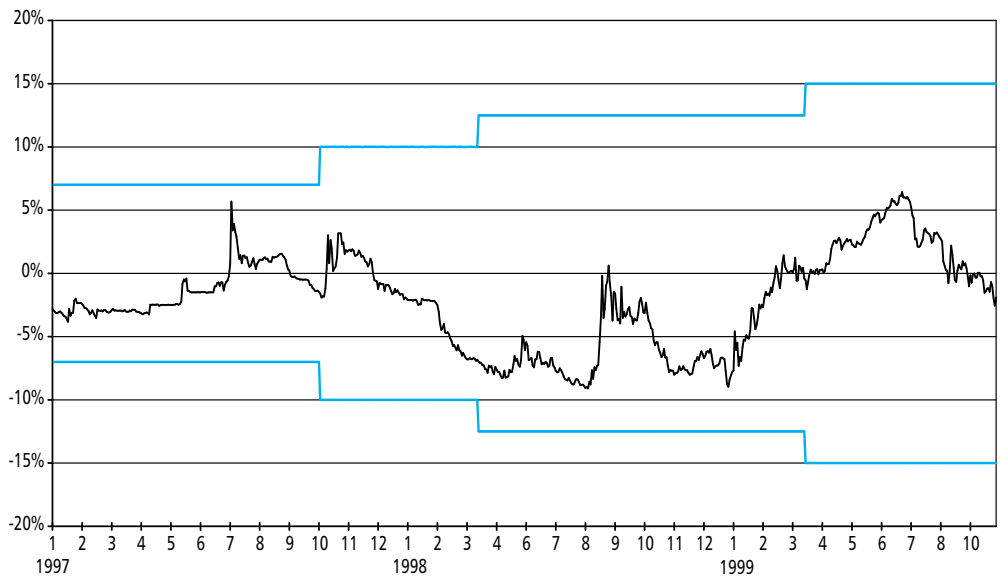
Core inflation, 1997–1999



In 2000, privatisation proceeds, as forecast in the draft Budget Act, and short-term capital inflows are likely to be the main factors influencing the exchange rate. The short-term capital flows may also be affected by nominal interest rates that are higher in Poland than those in the developed countries, and by the relative stabilisation of the zloty envisaged by most investors.

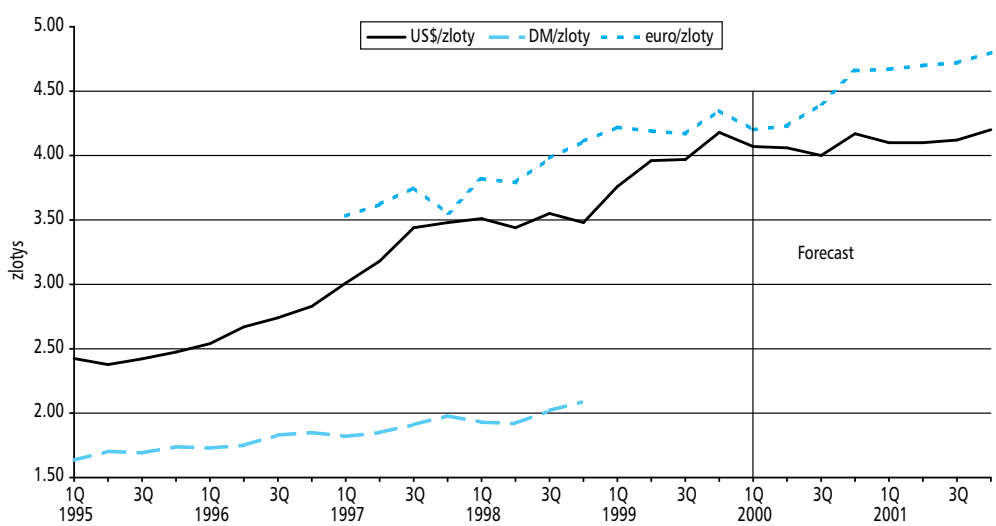
The Ministry of Finance, together with the NBP, has decided to sterilise the returns from privatisation on a spe-

Figure 11. Average deviation of market exchange rate from the central exchange rates of US$ and DM/euro, 1997–1999



Source: NBP.
Note: 1997–1998 – DM and from 1999 – euro.

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



Source: CSO and CASE.
Note: CASE forecast starting from 1Q00.

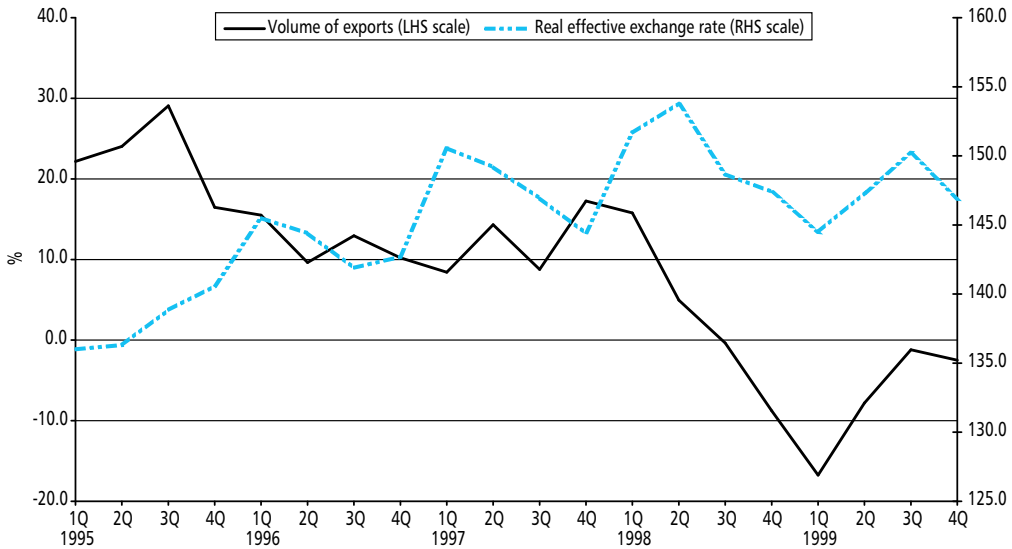
cial account. In the opinion of the Ministry, this procedure is meant to limit the movements in the slowly developing Polish currency market. Despite its operations to the contrary in the previous years, the NBP now declares that it is ready to intervene at both sides of the market having in mind the market's further development. This statement remains in contrast to the Bank's intentions to sterilise capital flows on the special currency account. So far, the exchange rate policy pursued by the NBP was centred on exchange rate movements in the currency market around the central parity, which used to be treated in practice as a core index for financial institutions and companies. The floating of the zloty, already announced last year, will be tantamount to an abandonment by the NBP of the crawling-peg and likely widening of the band of market exchange rate movements. Thus in 2000 the central bank is faced with a choice between a floating exchange rate of the zloty (accompanied by sharp movements and interventions in the currency market) or the continuation of the present exchange rate policy. The freeze imposed on the capital account liberalisation and the failure to meet the obligations vis-a-vis the OECD are the best evidence of the fears expressed by the monetary authorities

Table 14. Basic exchange rates, 1997–2001 (per zloty)

		US$	DM	ECU/Euro	Real effective exchange rate
1997	1Q-4Q	3.28	1.89	3.71	148.8
1998	1Q-4Q	3.49	1.99	3.92	151.3
1999	1Q-4Q	3.97		4.23	147.3
forecast					
2000	*1Q-4Q*	*4.08*		*4.37*	
2001	*1Q-4Q*	*4.13*		*4.72*	
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	147.4
1999	1Q	3.76	2.15	4.22	144.5
	2Q	3.96	2.14	4.19	147.3
	3Q	3.97	2.13	4.17	150.2
	4Q	4.18	2.22	4.35	146.9
forecast					
2000	*1Q*	*4.07*		*4.20*	
	2Q	*4.06*		*4.23*	
	3Q	*4.00*		*4.40*	
	4Q	*4.17*		*4.66*	
2001	*1Q*	*4.10*		*4.67*	
	2Q	*4.10*		*4.70*	
	3Q	*4.12*		*4.72*	
	4Q	*4.20*		*4.80*	

Source: NBP, real effective exchange rate – JP Morgan, forecast – CASE.
Note: 1. Average exchange rates.
2. Real effective exchange rate, 1990 average = 100.

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



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

concerning rapid capital flows. However, the point is that the floating of the zloty will have to be introduced in the nearest future if Poland intends to join the ERM2. The NBP's choice of a middle way, that is the adoption of a policy for example, of abandoning central parity without liberalising capital flows "replaced" by controlled flows from currency accounts, will lead in practice to exchange rate movements just as sharp as those in the presence of floating exchange rates. However, these movements would be caused by macroeconomic factors assessed subjectively by monetary authorities rather than those assessed by the market. In either of the above scenarios we foresee sharp exchange rate movements and a tendency towards nominal appreciation.

Foreign trade

- **Low dynamics of exports**
- **Improvement in exports in 2000 – especially to the EU**
- **Lower growth in imports and slight deterioration in the trade balance in 2000**

In 1999, Polish exports were determined, to a large extent, by the poor economic performance of Poland's main trading partners. The economic collapse in the CIS countries led to a dramatic fall in the share of the CIS markets in Poland's exports. In the first 11 months of 1999, Russia's share in the Polish total volume of exports was as low as 2.5% (11th position in the list of trading partners), whereas that of Ukraine stood at 2.6% (10th position). In addition, slow economic development both in Germany and Italy, as well as the weak position of the euro, were the main obstacles on the way to a significant increase in Poland's exports.

According to NBP estimates, exports in nominal terms amounted to 6.50 billion US dollars in 4Q99 (less by 0.7 billion US dollars against 4Q98). Over the whole year of 1999, 26.39 billion US dollars worth of goods were exported, which was less than in 1998 by 3.76 billion US dollars. It should be noted, however, that these poorer results in terms of US dollars are mainly the effect of changes in the exchange rate of the dollar against the euro. During the first three quarters of 1999 more than 50% of the export trade turnover was carried out in the currencies of the euro zone, whereas in 1999 the euro depreciated by more than 15% against the dollar. Had the euro exchange rate remained at the January 1999 levels, the total annual exports in terms of US dollars would have been higher by about US$2.4 billion, that is about 9%. During the three quarters of 1999, the volume of exports at constant prices of previous year (according to customs statistics) fell by 0.6%.

All things considered, merchandise exports may be said not to have relatively deteriorated. What is of concern, however, is the low value of exports compared with that of imports, and exports of countries such as the Czech Republic and Hungary.

According to NBP data, in 4Q99 imports amounted to US$11.3 billion, whereas those over the whole year of 1999 stood at US$40.85 billion. These results were lower by US$0.6 billion and US$2.99 billion, respectively, compared with the same periods of 1998. As in the case of exports, lower nominal values were caused by the depreciation of the euro against the dollar. A significant rise in imports in 4Q99 on the previous quarter (by US$1.2 billion) stemmed from seasonal effects related to the year-end and Christmas holidays, as well as from faster growth of industrial output since raw materials and intermediate goods constituted 80% of the imports.

Last year did not witness any significant changes in the geographical structure of the Polish imports, whose growth rate (in constant prices) over the first three quarters of 1999 yoy was considerably lower, amounting to some 0.7%.

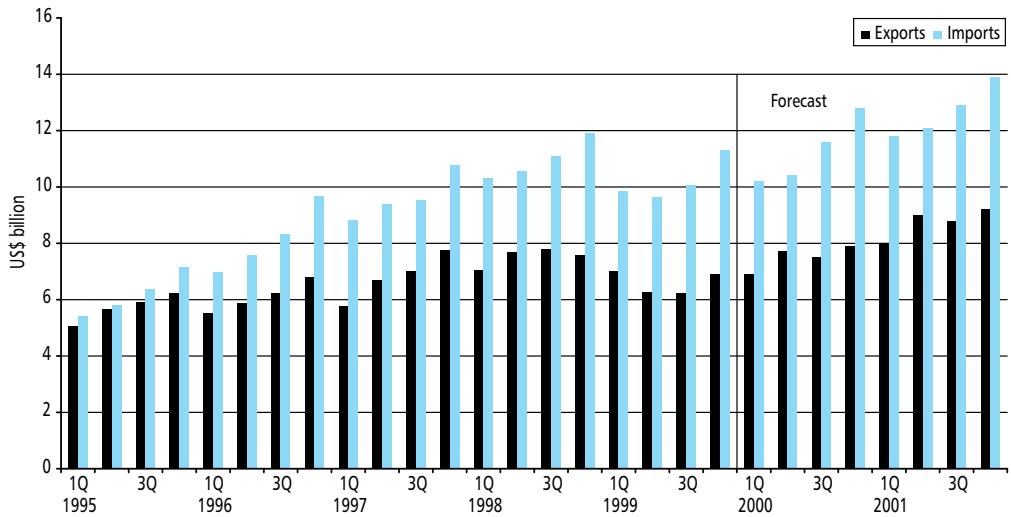
Table 15. Exports, imports and net exports; 1997–2001 (US$ billion)

		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	44.62	43.84	47.05	52.92	-13.72	-18.83	-8.30
1999	1Q-4Q	26.40	27.29	40.62	40.85	44.92	51.89	-14.45	-17.63	-11.27
forecast										
2000	*1Q-4Q*	*30.00*	*31.00*	*46.59*	*45.00*	*49.40*	*58.10*	*-15.00*	*-18.40*	*-11.51*
2001	*1Q-4Q*	*35.00*	*36.10*	*54.25*	*50.70*	*55.25*	*67.15*	*-15.70*	*-19.15*	*-12.90*
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	10.73	10.30	11.09	12.59	-3.24	-4.06	-1.85
	2Q	7.67	7.04	11.45	10.55	11.70	13.16	-2.88	-4.65	-1.71
	3Q	7.80	6.89	11.13	11.10	12.00	13.09	-3.30	-5.10	-1.96
	4Q	7.60	7.27	11.30	11.90	12.28	14.09	-4.31	-5.00	-2.78
1999	1Q	7.01	6.59	9.71	9.83	10.43	12.71	-2.82	-3.84	-3.00
	2Q	6.27	6.56	9.92	9.64	10.99	13.12	-3.37	-4.44	-3.20
	3Q	6.21	7.14	10.59	10.08	11.49	13.10	-3.87	-4.35	-2.52
	4Qs	6.90	7.00	10.41	11.29	12.00	12.96	-4.39	-5.00	-2.55
forecast										
2000	1Q	*6.90*	*7.00*	*10.36*	*10.20*	*11.30*	*12.82*	*-3.30*	*-4.30*	*-2.46*
	2Q	*7.70*	*7.20*	*10.94*	*10.40*	*11.70*	*13.48*	*-2.70*	*-4.50*	*-2.53*
	3Q	*7.50*	*8.10*	*12.15*	*11.60*	*12.50*	*14.90*	*-4.10*	*-4.40*	*-2.75*
	4Q	*7.90*	*8.70*	*13.14*	*12.80*	*13.90*	*16.91*	*-4.90*	*-5.20*	*-3.77*
2001	1Q	*8.00*	*8.30*	*12.28*	*11.80*	*12.90*	*15.09*	*-3.80*	*-4.60*	*-2.81*
	2Q	*9.00*	*8.50*	*12.92*	*12.10*	*13.20*	*15.52*	*-3.10*	*-4.70*	*-2.60*
	3Q	*8.80*	*9.30*	*13.95*	*12.90*	*13.85*	*17.19*	*-4.10*	*-4.55*	*-3.24*
	4Q	*9.20*	*10.00*	*15.10*	*13.90*	*15.30*	*19.35*	*-4.70*	*-5.30*	*-4.25*

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).

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



Source: NBP and CASE.
Note: CASE forecast starting from 1Q00.

The coming year promises a more optimistic picture for Poland's exports. The GDP growth rate and the industrial production in Germany are gaining strength, and a far better economic performance is forecast for all EU countries. Moreover, the Czech Republic, for the first time in the last two years, is expected to register an upturn in economy. On the other hand, exporters may be adversely affected by the euro exchange rate if it is to continue to stay at presently low level. In addition, Polish-made products will be exposed to stiffer competition on developed countries' markets from the Asian producers. We expect that in 2000, exports will reach US$30 billion, whereas in 2001 they will amount to US$35 billion.

The growth rate of imports in 2000 will be similar to that in 1999. However, the demand for investment and intermediate goods is expected to grow faster due to the predicted recovery in manufacturing. On the other hand, imports of consumer goods may become relatively lower owing to the slower growth of households' real incomes. Moreover, the trends in the zloty exchange rate cannot be disregarded. Given that the price impulses are weaker than the demand impulses, the demand for imports may also become weaker in the absence of strong appreciation. In 2000, the imports will reach US$45 billion, whereas in 2001 they could be even as high as US$50.7 billion.

Balance of payments

- **Current account deficit of 7.6% of GDP in 1999 threatens macroeconomic stability**
- **Fall in non-classified current transactions in 1999**
- **Lower foreign exchange reserves at end-1999**
- **Stabilisation of the current account deficit in 2000**

In 4Q99, the current account balance deteriorated due to the surprisingly large current account deficit and lower surplus in the financial and capital accounts. According to preliminary data provided by the NBP, the current account deficit in 4Q99 was as high as US$3.67 billion down by US$0.69 billion qoq. The whole year registered a deficit of US$11.65 billion (i.e. 7.6% of GDP) – up US$4.8 billion yoy. The considerable deterioration in the current account deficit is the most significant indicator of large external imbalances.

In 4Q99, the deterioration in the current account deficit was primarily due to the deterioration in surplus of US$0.9 billion of non-classified current transactions. The balance of the non-classified current transactions was lower than that in the previous quarter (by US$254 million) and also lower (by US$350 million) than in the similar quarter of 1998.

Throughout the whole of 1999, non-classified current transactions amounted to US$3.64 billion and were thus lower than in 1998 by as much as US$2.36 billion. This situation stemmed from the lack of recovery (following the Russian crisis) in cross-border trade and private marketplace trade mostly carried out by Ukrainian and Bealorussian citizens. As a result of currency devaluation in the CIS countries and due to the poor economic performance in these countries the purchasing power of the respective populations fell dramatically.

The high current account deficit in 4Q99 was also influenced by the deficit in trade in services of US$476 million, almost twice as high as in 4Q98. Poland has been registering a continued deficit in trade in services since early 1998. What is also important in this context is the deficit in merchandise trade payments, which deteriorated to US$4.4 billion in 4Q99. The higher deficit by US$0.55 billion in relation to 3Q99 resulted partly from seasonal effects since it was only US$100 million higher yoy.

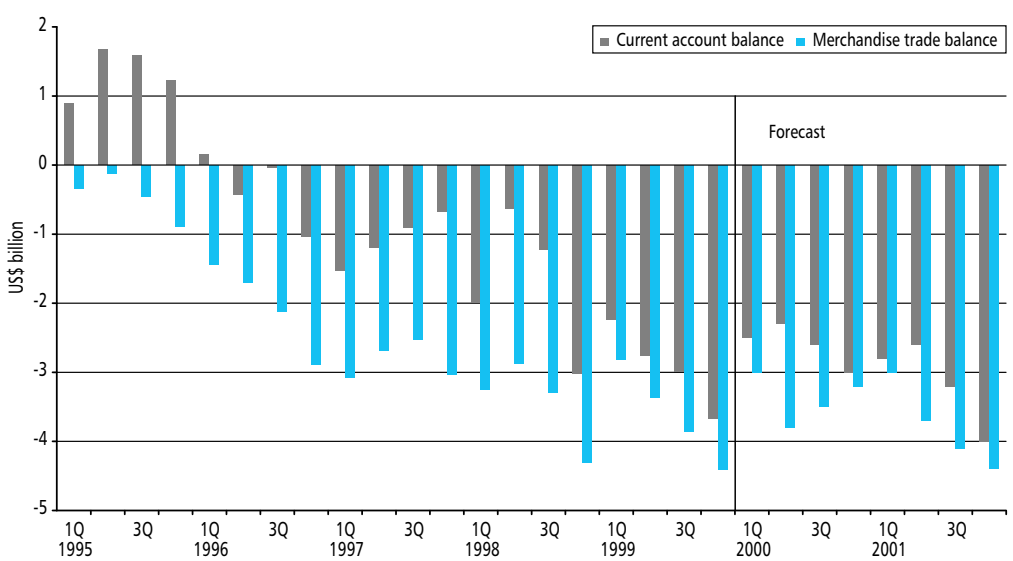
The surplus of capital and financial transactions in 4Q99 was only slightly lower (by US$261 million) than in the previous quarter. In fact, 4Q99 witnessed a continued high inflow of direct investment of US$1.83 billion, lower however by US$0.65 billion than in 3Q99. The inflow of portfolio capital of US$1.66 billion was found to be considerably higher, especially that in November last year which was due to higher NBP interest rates.

As a result of the deterioration in the balance of payments, foreign currency reserves fell by US$1.89 billion, down to US$25.49 billion by end-1999. This fall can partly be accounted for by euro depreciation against the dollar.

In the next two years, the current account deficit is forecast to stabilise at the level between 6.4% and 6.1% of GDP. Although the deficit in the merchandise trade will still be high, i.e. US$15 billion in 2000, and US$15.7 billion in 2001, the surplus of the non-classified current transactions is expected to improve. However, this surplus will not reach the levels prior to 1999.

The positive balance in the capital and financial accounts will be on the rise. In 2000, we foresee high inflows of direct investment at US$8.9 billion, whereas that in 2001 should reach the level of US$7.8 billion dollars. Smaller direct investment will be due to the completion of the process of privatisation – especially that of large companies. In line with the improvement in the balance of payments, official foreign currency reserves are likely to reach US$28.3 and US$29.6 billion in 2000 and 2001 respectively. These reserves will make it possible to cover on average 7-month imports.

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



Source: NBP and CASE.
Note: CASE forecast starting from 1Q00.

Table 16. 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		merchandise trade	unclassified current transactions	capital and financial account					
			% of GDP								
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	-4.36	-13.72	6.00	10.80	4.97	1.33	1.72	6.71	27.38
1999	1Q-4Q	-11.16	-7.16	-14.45	3.94	9.27	6.81	1.36	1.94	-1.89	25.49
forecast											
2000	*1Q-4Q*	*-11.10*	*-6.35*	*-15.00*	*4.90*	*13.90*	*8.90*	*1.00*	*2.85*	*2.80*	*28.29*
2001	*1Q-4Q*	*-11.90*	*-6.12*	*-15.70*	*5.00*	*13.20*	*7.80*	*1.10*	*2.40*	*1.30*	*29.59*
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	-5.71	-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	-3.11	-3.30	1.87	2.64	1.68	-0.86	0.06	1.83	27.08
	4Q	-3.01	-6.74	-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	1.77	1.19	-0.05	0.54	-0.75	25.85
	3Q	-2.99	-7.68	-3.87	1.15	3.28	2.48	-0.08	0.99	0.18	26.03
	4Qs	-3.17	-7.31	-4.39	1.21	3.08	2.00	1.80	0.45	-0.54	25.49
forecast											
2000	*1Q*	*-2.00*	*-5.16*	*-3.30*	*1.15*	*2.90*	*1.70*	*0.90*	*0.55*	*0.90*	*26.39*
	2Q	*-2.50*	*-5.84*	*-2.70*	*1.20*	*3.40*	*2.30*	*0.60*	*0.60*	*0.90*	*27.29*
	3Q	*-2.90*	*-6.56*	*-4.10*	*1.35*	*3.60*	*2.90*	*-0.20*	*0.70*	*0.70*	*27.99*
	4Q	*-3.70*	*-7.54*	*-4.90*	*1.20*	*4.00*	*2.00*	*-0.30*	*1.00*	*0.30*	*28.29*
2001	*1Q*	*-2.30*	*-5.31*	*-3.80*	*1.10*	*3.00*	*1.60*	*-0.10*	*0.80*	*0.70*	*28.99*
	2Q	*-2.60*	*-5.41*	*-3.10*	*1.20*	*2.80*	*1.70*	*0.20*	*0.70*	*0.20*	*29.19*
	3Q	*-3.00*	*-6.23*	*-4.10*	*1.40*	*3.40*	*2.00*	*0.40*	*0.50*	*0.40*	*29.59*
	4Q	*-4.00*	*-7.30*	*-4.70*	*1.30*	*4.00*	*2.50*	*0.60*	*0.40*	*0.00*	*29.59*

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

Public finances

- **In 1999, the central government budget deficit amounted to 2% of GDP; in 2000 it is projected at 2.3% of GDP (according to the Budget Act) and 1.5% (according to CASE forecast)**
- **General government budget deficit – 3.5% of GDP in 1999 and 2.8% of GDP in 2000**
- **Deficit in the ZUS (Social Insurance Board) – 1.2% of GDP**

Comment:

- **The tax battle lost by the Government will be of limited economic and financial importance in 2000. However due to lower corporate and households' savings, future economic growth may be adversely affected.**

Central government budget

In 1999, the Budget deficit stood at 12.6 billion zlotys, that is about 2% of GDP. The budget revenues were fulfilled 97.3%, despite low returns from the income tax from individuals (92.2%). During the same time, budget revenues were fulfilled 97.4%.

Lower-than-expected budget revenues as well as the financial situation of ZUS were reflected in the final 2000 budget. Some assumptions on macroeconomic indicators changed. For example, the WIBOR altered from 12% to 15.7% in 2000 and the foreign currency exchange rate was raised from 3.95 to 4.04 PLN/US$. Also the budget deficit initially forecast to amount to 12.7 billion zlotys (or 1.9% of GDP) increased to 2.3% of GDP. The deficit rose by 2.7 billion zlotys, or by an amount equal to that which the Government decided to use to extend its subsidy to ZUS.

After these changes, the final Budget has undoubtedly become more realistic in reflecting the situation in public finances. This is best illustrated by the Government's decision to revise the deficit of public finances up from 2.9% to 3.5% of GDP in 1999, and from 2% to 2.75% of GDP in 2000, which stems from the higher subsidies to ZUS in 2000. These expectations are close to those given in the present issue of PEO. The underlying intentions of the Budget were that the predicted inflation rate should not be increased. By underestimating inflation it would be possible to tighten fiscal policy and therefore we may expect the budget deficit to amount to some 1.5% of GDP. On the other hand, one may have fears of social conflicts resulting from the low growth rate in old-age pensions and wages in the general government sector.

Privatisation proceeds

Financial discipline continued to be softened by the way privatisation proceeds are taken care of. In 1999, these proceeds amounted to roughly 13.4 billion zlotys, that is they were nearly twice as large as those expected (6.9 billion zlotys). Additional revenues were allocated to financing the loan of 4 billion zlotys for ZUS and to financing the budget deficit. In the 2000 budget, privatisation proceeds are expected to reach 20.1 billion zlotys, compared with the initially projected 11.7 billion zlotys. In 2000, these proceeds, in addition to purposes set out in the Budget Act such as the social insurance reform (11 billion zlotys) and compensations (3.4 billion zlotys), 2 billion zlotys are intended for the new loan for ZUS, whereas 1 billion zlotys is to be granted to Regional Health Funds. These loans, in fact, represent grants from forthcoming Budgets and the resources for debt repayments in the subsequent years will probably come from the budget. It seems as if the need to adjust the social insurance and health insurance schemes to the state's fiscal possibilities is being postponed until some later time in the future. The remaining resources (some 2.6 billion zlotys) will be made use of by the Ministry of Finance for cheap financing of the central government budget deficit.

Tax reform

1999 witnessed a failure in the implementation of tax reform set out by the Ministry of Finance. There is no doubt that the negative effect of the new taxation system lies in the continued presence of large tax reliefs on private housing construction and VAT for companies employing disabled people. The most serious potential problem occurring as a consequence of the dramatic process of enacting the taxation applicable in 2000 could be the legal loopholes in the tax legislation which could lead to lower tax revenues. Due to the present state of public finances there is not much prospect that within the next two to three years conditions will be created to implement a radically new system envisaging lower taxation.

Local governments

The Government's assessment of the financial situation in the local government sphere has not changed. The deficit is planned to amount to 0.1% and 0.2% of GDP in 1999 and 2000, respectively. So far, data on the financial performance in 3Q99 are still unavailable. The increase in the liabilities is known to have reached 1 billion zlotys (0.2% of GDP) between end-1Q99 and end-November 1999. Again we would like to point to the threat to the sector of public finances posed by the debts incurred by local governments – especially with regard to the precarious situation of the regional health funds run by local governments.

Regional Health Funds

As expected, the Government allotted 1 billion zlotys, obtained from the self-presented amendment to the Budget Act for the year 2000, as a loan to the Regional Health Funds to cover partly the 1.2 billion zlotys deficit in 1999. We are still of the opinion that the 7.5% contribution to the health insurance scheme will not be raised in the next two years. On the other hand, the Funds are not very likely to generate resources to repay the budget loan, and that is why the loan has to be paid from the budget. The Regional Health Funds' financial standing is expected to improve as a result of the determination of the Funds to tighten fiscal discipline.

Table 17. Selected items of the central government budget, 1997–2001 (US$ billion)

		Revenues		Expenditures	Central 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
1999	1Q-4Q	125.9	112.7	138.5	-12.6	-2.0
forecast						
2000	*1Q-4Q*	*144.4*	*129.5*	*155.1*	*-10.7*	*-1.5*
2001	*1Q-4Q*	*160.7*	*144.6*	*168.8*	*-8.1*	*-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	32.4	29.5	32.4	0.0	0.0
	4Q	36.9	33.1	38.2	-1.3	-0.7
forecast						
2000	*1Q*	*32.5*	*29.2*	*36.7*	*-4.1*	*-2.6*
	2Q	*33.4*	*29.5*	*37.7*	*-4.3*	*-2.5*
	3Q	*37.1*	*33.6*	*37.0*	*0.1*	*0.0*
	4Q	*41.3*	*37.2*	*43.6*	*-2.3*	*-1.1*
2001	*1Q*	*36.3*	*32.7*	*40.5*	*-4.2*	*-2.4*
	2Q	*37.5*	*33.3*	*41.2*	*-3.7*	*-1.9*
	3Q	*41.1*	*37.3*	*40.0*	*1.0*	*0.5*
	4Q	*45.8*	*41.4*	*47.0*	*-1.2*	*-0.5*

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

Social Insurance Board (ZUS)

Despite high efficiency of collecting contributions in November and December, ZUS has been able to fully utilise all of the 4 billion zlotys loan coming from the government budget, and has repaid only 0.4 billion of commercial credits with 1.5 billion zlotys reduction planned in the Act. During the last few months of 1999, the pace of transferring ZUS contributions to Open Pension Funds (OPF) was also low. In general, the total amount of money in the form of contributions transferred to FUS was as low as 2.3 billion zlotys against the forecast of 4.5–5.5 billion zlotys from as many as 10 billion people covered by the insurance scheme in theory.

The amount of 1.5 to 2.5 billion zlotys underestimated in the budget of ZUS transfers to OPF, or the so-called supplementary aid, will be regarded as a hidden liability of the state budget against OPF, which will not affect, however, the growth of domestic demand. If we disregard the underestimated number of insured joining OPF, in 1999 ZUS generated a total deficit of 7.3 billion zlotys (1.2% of GDP), which had a direct impact on the rise in domestic demand.

In autumn 1999, the ZUS deficit exceeded that predicted by Mr Alot, the former ZUS President, by 5.3 billion zlotys. This meant that the contributions in the Budget Act for 1999 were overestimated by at least 4.3 billion zlotys as a result of both the poorer collection of premiums and slowdown in economic growth. What becomes a crucial factor contributing to the gradual improvement of the financial standing of ZUS is the question of more consistent policy of collecting premiums. However, a policy of this kind could eventually cause bankruptcy of large 'politically sensitive' corporations such as Polish railways or coal mines, which is not very likely to occur despite the relatively large amount of support for this action on the part of the ruling coalition. Within one month of announcing the programme to redress the situation in ZUS, only 7 declarations for bankruptcy were filed. As an unfortunate result of the programme of redress a battle against small and medium-size entrepreneurs (often bordering on the 'grey' sphere in their activities) may be waged with concomitant leniency with large state-run establishments.

In the 2000 Budget the scope of problems involving ZUS had been more extensively taken into account since the initial subsidy of 14 billion zlotys had been augmented by 2.7

Table 18. Revision of the draft Budget Act for 2000: consequences for the budget deficit (PLN billion)

Higher subsidy to the Social Insurance Fund	Other tax solutions	Higher prices and exchange rate		Costs of privatisation (wider scale of programmes)	Others	Total
		VAT, customs, duties, concessions	Foreign debt servicing			
2.7	0.1	-0.5	0.6	0.1	-0.3	2.7

Source: Authors' calculations.

Table 19. Budgetary consequences of changes in the draft taxation system for the year 2000 (PLN billion)

Revenues	Maintenance of tax relief for companies employing disabled people	Changes in PIT (large tax relief on construction)	Changes in CIT	Total
	-0.3	-0.6	-0.3	-1.1
Expenditures	**No subsidy to companies employing disabled people**	**Lack of introduction of some part of support programme for construction**		**Total**
	-0.7	-0.3		-1.0
Deficit				0.1

Source: Authors' calculations.

billion zlotys and the collection of premiums had been estimated more realistically by having their overall proportions reduced from 98.9% to 96.9%. However, the financial standing of ZUS has continued to be difficult; with high costs of debt servicing of about 1 billion zlotys and the collection of premiums at the level of 95%, the debt on the part of ZUS may be expected to rise by some 2.1 billion zlotys in 2000. Thus the 2 billion PLN loan will be designated to pay out current benefits rather than to repay the debt.

Public Finances

In 2000, the consolidated budget deficit will be lower than in 1999 (see Table 22). At the same time, the adverse effect of the public finances sector on domestic savings and demand will be reduced. We expect that the effect of tightened fiscal policy will become quite significant, whereas the anticipated reduction in negative savings will amount to 1.4% of GDP.

Table 20. Analysis of ZUS liabilities against OPF in 1999 (PLN billion)

Funds from budget to pay off ZUS transfers to OPF	Funds transferred from ZUS to OPF	Total of contributions from ZUS that should reach OPF
(1)	(2)	(3)
3.0	2.3	4.5 - 5.5
Underestimated funds from the budget to pay off ZUS transfers to OPF	**Misdirected funds from the budget**	**Total increase in ZUS liabilities against OPF**
(3)-(1)	(1)-(2)	(3)-(1)
1.5 - 2.5	0.7	2.2 - 3.2

Source: Authors' calculations.

Table 21. Components of the increase in the ZUS debts in 1999 (PLN billion)

Commercial credits	Increase in liabilities against OPF	Loan from the state budget	Total amount of ZUS liabilities	Underestimated transfers to OPF in the budget	Corrected increase in ZUS debts
(1)	(2)	(3)	(1)+(2)+(3)	(4)	(1)+(2)+(3)-(4)
2.6	2.2-3.2	4	8.8 - 9.8	1.5 - 2.5	7.3

Source: Authors' calculations.

Table 22. Public sector balance (% of GDP)

	1998	1999 budget	1999 budget revised	1999 CASE	2000 draft budget	2000 budget	2000 CASE
Government budget balance	**-2.4**	**-2.1**	**-2.1**	**-2.0**	**-1.9**	**-2.3**	**-1.5**
Funds balance	0.1	-0.05	-1.2	-1.2	0.1	-0.3	-0.3
Regional Health Funds	-	0.0	0.0	-0.2	0.0	0.0	-0.1
Balance of local governments budget	-0.3	-0.3	-0.1	-0.3	-0.2	-0.2	-0.9
Balance of public finances	**-2.6**	**-2.5**	**-3.5**	**-3.7**	**-2.0**	**-2.8**	**-2.8**
Compensations	-	-	-	-	-0.5	-	-0.5
Second pillar	-	-	-	0.4	1.2	-	1.6
EU funds	-	-	-	-0.1	-	-	-0.3
Total effect on domestic savings	**-2.6**	**-**	**-**	**-3.4**	**-1.3**	**-**	**-2.0**

Source: Authors' calculations.

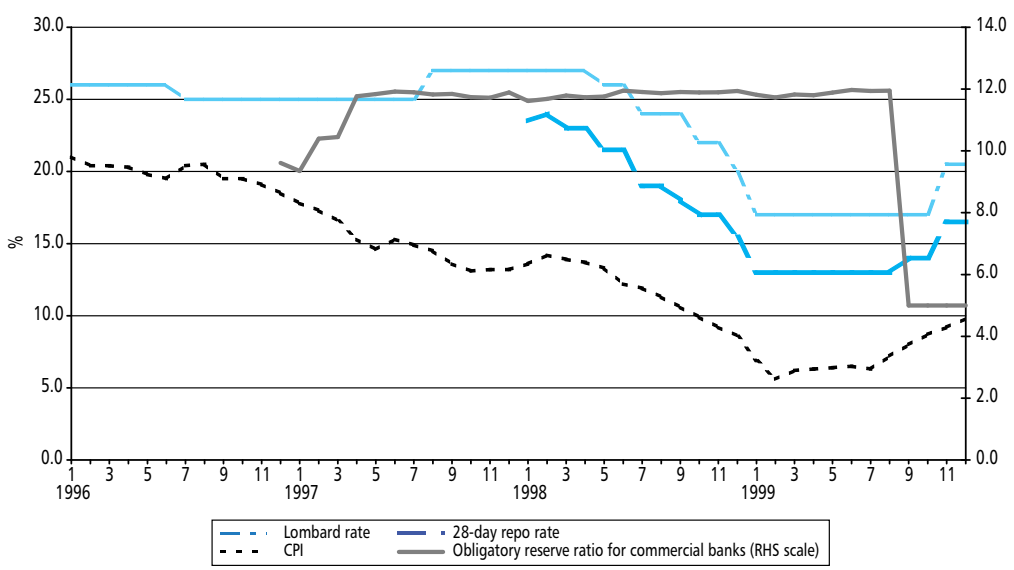
Monetary Policy

- **Missed inflation target in the first year of the medium-term strategy adopted by the NBP**
- **Decision to increase interest rates to December 1998 levels**
- **Tight monetary policy in 2000**
- **Reduction in nominal interest rates after 3Q00**

In the first year when its medium-term monetary strategy for the period of 1999–2003 was in force, the NBP failed to implement its direct inflation target. Due to the inopportune combination of external factors such as the rise in the cost of energy raw materials, weaker external demand and lower Polish exports, as well as the softened fiscal policy (increase in the deficit in the general government sector by 1 percentage point to 3.7% of GDP), the restriction on the import of foodstuffs and easing of the monetary policy since January 1999 have all resulted in cumulation of costs and demand leading to higher inflation. As a consequence, in mid-November 1999, the MPC took a decision to increase interest rates by 250–350 base points thus reaching December 1998 levels. The CPI inflation level in December 1998 was lower by 1.2 percentage points compared with December 1999. The predicted stabilisation of the inflation rate at 9–10% till July 2000 does not augur well for any reduction in NBP interest rates over this period. In this unusual situation when low households' propensity to save is expected to continue, the prices of food (especially those of meat) will rise at a faster pace and the current account deficit will also increase, the MPC is likely to take a decision to revise the NBP interest rates by some 100 base points at the turn of the first and second quarters of 2000. The above picture would correspond to the pessimistic inflationary scenario presented in the paragraph on the growth rate of the base price indices.

We expect that in a favourable macroeconomic situation it will not be until 3Q00 that the NBP starts to reduce nominal interest rates which will result in lower market nominal rates. We also expect that the 3-month WIBOR may fall from over 18% in late 1999 to 14.8% by end-2000. In our opinion, the high level of interest rates in the last week of 1999 represented the market's response to the risk associated with the 'millennium bug', and the downward trend in nominal market rates is likely to continue in 2001, whereas the 3-month WIBOR rate will fall to some 12% by year's end.

Figure 16. Monetary policy instruments, 1996–1999



Source: NBP and CASE.

In order to have a good understanding of monetary policy in 2000, one has to be aware of the priority of NBP's aims. The inflation target of 5.4–6.8% for 2000 decided on by the MPC in September 1999 seems to be quite unrealistic. As a result, we can expect that it will be changed which reminds us of a situation when the inflation target had been lowered in the previous year (from 8–8.5% in September 1998 to 6.6–7.8% in March 1999). On the other hand, the growth in the M2 supply is likely to be sustained within the range of 15–19% predicted by the NBP. We also assume that, by creating a special foreign currency account to accommodate privatisation proceeds, the increase in net foreign assets may turn out to be lower. This will make it possible to reduce overliquidity in the banking sector and to improve the efficiency of monetary instruments at the disposal of the central bank. The current account deficit is expected to become the main concern of the NBP which will be reflected in the policy of weakening the foreign exchange rate and postponing the decision of a full float. All these actions will be undertaken at the expense of the inflation target in 2000.

Reserve money and monetary policy instruments

The fall in reserve money throughout 1999 stemmed from the fall in official foreign currency reserves. This was due to the contribution of foreign assets, lower than in the previous years, and to the decrease in the net liabilities of the budget sector against the NBP in 3Q99 and 4Q99. This coincided with the growth of debts in the public sector in commercial banks and the population (issue of treasury bonds), which represented a continuation of the trend in 3Q99. In 4Q99, the component of credits for the net financial sector increased. The fall in overliquidity in the banking sector in 1999 was used by the NBP to convert the non-transferable or passive liabilities of the State Treasury due to restructuring credits (for Bank Gospodarki Żywnościowej, among others) into active instruments in the form of open market operations. In 2000, the NBP wishes to have these roles totally reversed; that is to say it would like to have both operational (short-term) and structural (short- and long-term) shortfalls in liquidity which would appreciably increase the efficiency of monetary policy instru-

Table 23. 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	6.15	-3.65	-2.79	-0.87	-16.45
	4Q	-1.57	18.30	12.99	-3.73	16.72	-32.88

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.

ments. By end-2000, as the NBP's final aim, the reference interest may lose its importance in favour of the repo rate which may be achieved only by the elimination of overliquidity in the banking sector.

The successful reduction, uniformisation and conversion of the obligatory reserve rates into a passive financial instrument have increased the NBP monetary policy's degrees of freedom. First, the uniform rate of obligatory reserves at a level more than twice as high as that in EU countries has remained an essential monetary policy instrument at the disposal of the NBP. Second, the non-transferable NBP bonds, with the maturity date of between 6 and 10 years and the interest rate equal to CPI rate, into which the funds released from the obligation to create reserves had been converted, may help, if need be, to be used by the NBP to carry out open market operations. What is supposed to hamper the renewed overliquidity of the banking sector is the opening of the foreign currency account at the disposal of the monetary authorities. Both the NBP and Ministry of Finance can implement a policy of well-coordinated flows in this account, the effect being neutral for the banking system. Or else, they may be obliged to choose between the movements in the foreign currency (see exchange rate paragraph) and/or monetary market. In the latter case, the unused foreign currency assets balance would still have to become offset by the passive instruments restricting downward the flexibility of NBP instruments. Anyway, sterilisation is a costly operation which will bring about a rise in market interest rates. However, the present policy mix may prove beneficial for actions mentioned above provided a more restrictive fiscal policy is maintained than that of the previous year. Under these conditions, the NBP would be able to allow for a possibility of exerting pressure on the growth of market interest rates and weakening the zloty exchange rate if the latter tends to be excessively appreciated.

The banking system and broad money

In 1999, the growth of broad money supply was slower than in previous years due to the low share of net foreign assets and lower share of credits for the budget sector. The share of credits for the private sector showed a similar upward turn in 1999 to that in 1998.

Table 24. 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	11.42	2.45	0.14	13.06	-4.23
	4Q	19.48	7.83	1.44	17.09	-6.88

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 give period to account for fluctuations of the exchange rate of the zloty.*

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

Table 25. Calendar of the most important events in the monetary policy of the NBP over the period 1Q99–4Q99

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 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 13	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 zloty 20 billion and interest rates indexed to inflation
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 at least 14%
P.M. 32	22 September	Announcement of monetary policy guidelines for 2000
J. NBP 20	17 November	NBP rediscount rate 19% Lombard rate 20.5% Refinancing rate 20.5/21.5% 28-day repo rate at least 16.5%
J. NBP 21	19 November	Interest rate on NBP current deposits 6.15%

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

Since mid-1999, credits for individuals have grown in nominal terms at the monthly rate of 4–4.5%, its annual growth rate being close to the levels at the turn of 1997 and 1998. Thus, the demand for money from households was stable and in fact quite high. During the first two months of 4Q99, money demand from households was augmented by that from private companies. However, in December 1999 it recorded a significant downturn. The above facts cannot be attributed to the larger amount of funds in corporate accounts since the funds' rapid growth at year-end resulted from book-keeping by the so-called 'money-on-the-way' (that is between the borrower's and creditor's accounts) at

the additional clearing session of the National Clearing House (KIR). At the beginning of each new year, the above sums return to their "normal way", whereas the companies' liabilities against banks become lower.

In 2000, the trends prevailing on the credit market are expected to become reversed. The upward trend in credits granted to households will fall from more than 53% in 1999 to about 34% and 22% in the two years, whereas that of credits granted to companies will increase from some 22% in 1999–2000 to more than 24% in 2001 (see also Table A11).

Individuals have continued to show marginal interest in time deposits. However, the rise in nominal interest rates and the economic revival in 2000 may cause reversal of this trend. We expect that in the years 2000 and 2001 zloty-denominated deposits will register the respective growth of more than 35 and 38 billion zlotys. By way of comparison, these gains in 1998–1999 were 28.7 and 14.7 billion zlotys, respectively. The above trend may even be more marked in the face of rising inflation and an additional rise in interest rates.

Outlook for exchange rate policy

Polish zloty cannot wait for floatation

Since 1997, the exchange rate policy pursued by the National Bank of Poland (NBP) has been consistent in its aim of establishing a market exchange rate mechanism. This policy was based on the gradual widening of permissible bands against the central exchange rate and on lowering the pace of creeping devaluation of the central parity. At present, the monthly devaluation rate stands at 0.3%, whereas the range of permissible movements varies between +15% and -15%. In mid-1999, the National Bank of Poland applied to the Ministry of Finance for permission to take a further step, that is to eliminate the central rate and abandon the method of establishing permissible market currency bands provided its right to intervene in the market is secured. Although the Ministry of Finance does not seem to be opposed to these changes it has been taking a long time to grant such permission. Thus the question arises as to when the permission will eventually be given and what consequences this would entail for the Polish economy as a whole. Within the next few months the economic situation will only marginally be dependent on the proper answer to the first of the above two questions. Even though the NBP has shown some restraint as regards its policy of intervention in the currency market for quite a long time now, the fluctuations around the central rate have not exceeded a few percentage levels. For example, even at the time of the Russian crisis the real exchange rate movements were confined to a band of less than 10%. That is why the decision to free the exchange rate should not lead to any significant swings in the foreign exchange market. The Ministry of Finance's delay in granting the permission to float the rate albeit it may be explained to some extent by the still relatively unstable position of the zloty, hopefully it does not reflect the true intentions of the Ministry. In our opinion the situation vis-a-vis the zloty seems to be quite stable, and the contention that the zloty cannot be floated unless its exchange rate undergoes any considerable fluctuations does not seem very logical. Thus the question arises as to the real nature of the whole problem.

What is more important for the economy are the instruments as opposed to the direct target of monetary policy

The main reason underlying the policy of the Finance Ministry is probably the fear that once the zloty has been floated the Ministry will have no clout on the currency exchange rate. Not is it clear what kind of monetary policy the Ministry intends to follow in the next few years. The adoption of the direct inflationary aim as a principle of a medium-term monetary policy seems to be sound and reasonable, however new questions arise again concerning several problems such as the policy's boundary conditions which define such factors as the permissible macro- and micro-economic costs, or requirements for the fiscal policy defining the extent of current account deficit, balance of payments and the exchange rate risk for companies, as well as the level of real interest rates, or the money supply growth rate.

For some time now, the strategy of establishing credible monetary policy has consisted of attempts at restricting macro-economic phenomena that the NBP claims to control: no stable interest rates are foreseen, nor is the permissible range of interest rate fluctuations or minimum permissible current account balance determined. Moreover, it seems that the spread of the inflation target tends to expand. One is reminded of an old story about Mr Gomulka, the former Secretary General of the Polish Communist Party, who was supposed to state that "The Party has never made any promises to the nation, and it has kept those promises". NBP's promises have boiled down in effect to reducing the inflation rate to 4% in 2003. The above aim, quite sound and reasonable, would be difficult to accept, and what is more the costs of its implementation must be paid in advance although the expected results are not quite so unequivocal. Initially, the 1999 inflation target was supposed to stand at 8–8.5%. In March 1999, it became reduced to 6.6–7.8%, whereas in fact it turned out to be as high as 9.8% at year's end. Admittedly, the macro-economic conditions in the second-half of 1999 were not conducive to any attempts at curbing inflation, but the NBP was fully aware of the situation writing in its Report on 1998 inflation (Raport o inflacji 1998), published in June 1999, that "... Would this situation [of external determinants of inflationary processes] prove to be exceptionally harmful for any efforts to hamper the rate of price rises, the National Bank of Poland has at its disposal all the necessary instruments to help maintain the CPI within the pre-determined range". Unfortunately, the NBP failed to keep its promises and achieve the above target despite the real appreciation of the zloty against the euro and the current account deficit standing at a level of more than 7% of GDP, although only few months earlier the bank claimed to be able to keep the deficit at about 6%.

The declaration of intent that the inflation target for 2000 should stand at 5.4–6.8% has been associated with the statement of purpose to have the operational superliquidity eliminated. It meant that every possible effort would be made to lead to a stabilisation or moderate increase in currency reserves, in other words to the real exchange rate of the zloty at the level equal to that of the foreign capital inflow. Now the question arises as to the direction of the real exchange of the zloty in the nearest future, and the extent of the concomitant current account deficit. The NBP is not likely to refrain from issuing a declaration of intent, albeit in the form of a forecast, that in case the results of the inflation target exceed those predicted, the NBP would modify the priorities of the monetary policy and would have the instruments necessary to implement these priorities.

The author is of the opinion that an agreement between the NBP and the Ministry of Finance will finally be reached. The elimination of the creeping devaluation will undoubtedly diminish inflationary expectations. Theoretically, the NBP, deprived of formal exchange rate obligations, will enjoy greater freedom of operation in its policy involving interest rates. However, the real freedom of manoeuvre compared with the present situation will not appreciably increase the current level of the current account deficit. Even in the absence of any official declarations on the part of the NBP on the secure limits of the current account deficit, there is no doubt that an agreement with the Ministry of Finance will eventually be concluded. Any level of the deficit significantly different from the present one could hardly be regarded as secure. We can thus assume that such security levels are now being approached. However some improvement in the trade balance and a slight rise in foreign investment can be expected, which may push the security level somewhat higher, although the resulting permissible extent of the appreciation of the zloty will be marginal. In this situation, if the NBP finds it necessary to introduce further interest rate hikes, it will have to risk intervention in the currency market and strengthen money sterilisation to offset the effects of higher reserves. This method may lead to some reduction in inflation although one may doubt if this is the best way to control the money supply in order to have inflation reduced to the levels in compliance with the Maastricht criteria.

A floating exchange rate is incompatible with the medium-term inflation target

Even though the NBP may be granted the right to accept the permissible current account levels higher than the present ones there is no guarantee that inflation will be permanently reduced to the value below 4% in 2003. Assuming that Poland joins ERM2 in 2004 at the latest, possible failure to achieve the above aim will end in consequences far more serious than those resulting from unsuccessful implementation of the inflation target in 1999. Due to the Balassy-Samuelson effect, the 4% inflation target may require nominal appreciation of the zloty. Capital inflows will be – on average – always high and so will the current account deficit. However, in this situation the NBP response is quite likely to be replaced with a market response to the high deficit, capital outflow and seriously weakened position of the zloty. This state of affairs must not necessarily be referred to as a currency crisis since even serious weakening of the zloty accom-

panied by a floating exchange rate should not be judged a crisis, especially when the extent in the euro exchange rate against the dollar in 1999 provides new standards of "normal movements of the exchange rate". However, the inflationary consequences of the weakening of the zloty should not be neglected. Having all this in mind, one cannot but expect that the floating exchange rate will eventually stabilise, which will lead to a proper market central parity at the time Poland joins ERM2. This is because what should be taken into account is the rising and falling tide of capital and thus considerable volatility in exchange rates.

Once the mechanism of a floating exchange rate policy allowing central bank intervention has been introduced, Polish membership in ERM2 may constitute a temptation to start intervening in the currency market to defend the zloty until the membership in the Monetary Union is accomplished. Even when new standards of "normal exchange rate movements" have been introduced the above policy may lead to a currency crisis and thus defer Poland's entry into the common currency area. However, provided the trend towards nominal appreciation of the zloty is maintained during the ERM2 transfer and the entry into the Union successfully carried through the transfer exchange rate would probably be strongly overvalued, which would have adverse consequences for the rate of economic performance, extent of unemployment, etc.

All these problems may be alleviated but not solved satisfactorily by a more restrictive fiscal policy. It is because the most important threat to the implementation of the inflation policy is the potential variability of capital inflows, the consequences of which could only be offset by constant adaptations to the directions of capital inflows rather than by some future improvement in the budget balance.

All in all, the policy of floating the zloty will prove to be a short-lasting solution, which will only widen the freedom of manoeuvre and weaken inflationary expectations, thus making it easier to achieve the short-term inflation targets. Regardless of whether the exchange rate is fully floated or corrected for by the NBP interventions the inflation cannot be expected to fall to less than 5%. Still, the 5% level would require tightening of the fiscal policy and further real appreciation of the zloty, or in other words paying the costs of the relative slow-down in economic growth. These costs will have to be paid as long as the NBP does not take the decision to use a fixed exchange rate. At the same time, Poland will not be able to join the Monetary Union, since, in the author's opinion, the NBP will not risk to peg the zloty exchange rate to meet the ERM2 criteria.

Alternative

The only way out of this deadlock is to use a fixed exchange rate against the euro, that is the currencies of Poland's most important trade partners. The more radical is the solution adopted the lower become both the "expected" price of joining the Monetary Union and the risk that this country will face a deep economic crisis rather than all the reap benefits of the common currency area. Nonetheless, the above risk cannot be completely eliminated, and again the more radical is the solution adopted the more difficult it will be to abandon it. Thus the potential crisis would have even more serious repercussions. Unless it succeeds in obtaining considerable easing of the ERM2 inflationary criteria, Poland will have no alternative but to either give up the common currency or take the risk. That is why, in the author's opinion, the best solution is to eliminate the zloty and unilaterally adopt the euro when Poland becomes a member of the European Union. This solution, compared with that of a currency board, makes it difficult, even impossible, to speculate on the Polish currency.

In the author's opinion, those who criticise the above idea overestimate the threat of asymmetric shocks that may undermine the competitiveness of Poland's economy. No future shock seems to pose a more serious threat to the Polish economy than that which was due to the Russian crisis. Since the labour productivity in Poland is likely to exceed that in the European Union, we may expect that the potential shock would be quickly offset without any need to devaluate the currency. On the hand, the inflationary consequences of capital inflows, which may not materialise in the absence of own currency, would be also offset by a tighter fiscal policy and money sterilisation. In this situation, the above policy would seem to be more effective than the policy of using our own currency with a floating exchange rate. As for money sterilisation, the sale of the NBP bonds coinciding with strong capital inflows and repurchase of bonds coinciding with capital outflows would even bring in profits due to changes in interest rates. It is clear that, without the possibility of issuing our own money, all the NBP operations would then have to be secured financially by the Budget. These prospects, understandably, are not very good for the central bank which is proud of its independent stance. However, the prospects of an impotent monetary policy much more openly pursued by the NBP under conditions of liberalised capital flows, together with Poland becoming increasingly attractive for foreign investment, are even poorer.

Threats

1. The greatest threat to the Polish economy in 2000 is the high current account deficit. If this should increase, macroeconomic stability may be endangered in the absence of the deficit being financed by higher long-term investment.
2. Low propensity to save and the high level of foreign investment do not make it possible to strengthen investment demand. Assuming that the potential investment boom is financed by higher corporate foreign debt, additional excessive strengthening of the zloty and consequent deterioration in relative competitiveness of Polish manufacturers would pose quite a real threat.
3. The dynamics of exports will continue to be dependent, to a large extent, on external factors. The economic growth in Germany, mainly in the field of industrial production, will be of greatest importance. Unless this rate of growth is fast and the euro becomes stronger, Polish exports will only recover slowly, and consequently there will be lower GDP growth in the second-half of 2000.
4. In 2000, weaker tensions in the general government budget can be expected compared with 1999. However, uncontrolled increase in local governments' budget deficits may be expected, leading to some additional demand boost. As a result, domestic demand could become excessively high, thereby posing a threat to overall macroeconomic stability.

Recommendations for economic policy

1. In 2000, a restrictive budget policy combined with high levels of real interest rates would constitute the best *policy-mix*.
2. In the situation when a new price 'surprise' leads to the maximum forecast inflation rate of more than 11% and the annual current account deficit does not show any downward trend a new rise in basic interest rates may be called for.
3. It is only after the Polish economy has stabilised and inflationary pressures (in terms of both CPI and current account balance) start to drop that basic interest rates can be reduced, which is expected by end-3Q00.
4. If the current account deficit continues to rise in 1Q00, public consumption and the transfers from the budget directly leading to the growth of domestic demand should be temporarily reduced.
5. In the case of a weak and short economic recovery in the EU, Poland should pursue an economic policy of lowering growth in domestic demand rather than that of artificially supporting exports. The latter could finally prove to be more costly as it could lead to the deterioration in economic efficiency and, in turn, lower the long-run growth rate.
6. Economic policy should take into account the possibility of reducing long-term foreign investment – in particular after 2000 when revenues from privatisation are expected to become markedly lower.
7. The uncertain situation in the general government budget requires tighter fiscal discipline and avoidance of any additional financing of deficits in para-budgets (e.g. ZUS) from privatisation proceeds.
8. Economic policy should tend to increase domestic savings (e.g. by employing lower taxes imposed on entrepreneurs, tax relief for people placing their savings in social insurance companies of the 3rd pillar, etc), so that proper financing of investment essential for long-term economic growth is ensured.

Appendix

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

		GDP	Gross value-added					
			total	agriculture and forestry	manufact-uring, 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	1.1	10.3	13.6	4.4	3.0
1998	1Q-4Q	4.8	4.7	6.1	4.3	9.1	4.6	1.9
1999e1	1Q-4Q	4.0	3.8	0.4	4.5	3.8	4.4	1.2
forecast								
2000	*1Q-4Q*	*5.4*	*5.2*	*-1.4*	*8.1*	*7.5*	*4.6*	*1.5*
2001	*1Q-4Q*	*6.3*	*6.0*	*1.1*	*8.9*	*10.0*	*5.1*	*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
1998	1Q	6.4	6.2	0.9	10.6	15.0	4.3	1.6
	2Q	5.4	5.1	4.6	5.6	11.7	5.6	-2.0
	3Q	5.0	4.7	5.4	3.6	9.9	5.8	-0.4
	4Q	2.9	2.7	13.0	-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
	3Qe1	4.9	4.7	-0.9	7.4	3.7	4.6	1.5
	4Qe2	6.1	5.7	-1.5	11.6	4.8	4.5	1.5
forecast								
2000	*1Q*	*6.8*	*6.5*	*-2.2*	*13.9*	*6.0*	*4.6*	*1.6*
	2Q	*5.3*	*5.1*	*-4.0*	*9.0*	*6.8*	*4.4*	*1.8*
	3Q	*4.7*	*4.5*	*-1.0*	*5.6*	*7.9*	*4.6*	*1.5*
	4Q	*4.9*	*4.7*	*2.0*	*5.1*	*8.3*	*4.8*	*1.3*
2001	*1Q*	*5.8*	*5.6*	*2.2*	*8.4*	*8.7*	*5.0*	*1.6*
	2Q	*6.5*	*6.3*	*1.4*	*10.3*	*9.1*	*5.1*	*2.0*
	3Q	*6.1*	*5.9*	*1.0*	*7.9*	*9.8*	*5.2*	*2.1*
	4Q	*6.6*	*6.3*	*-0.3*	*8.9*	*11.2*	*5.1*	*2.2*

Source: Data and estimates (e1) – CSO; estimates (e2) and forecast – CASE.
Note: 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
1998	1Q-4Q	549.47	578.47	433.47	342.88	90.58	139.20	5.80	-29.01
1999e1	1Q-4Q	618.52	660.46	489.06	387.85	101.21	164.93	6.47	-41.94
forecast									
2000	*1Q-4Q*	*712.82*	*759.84*	*553.93*	*439.10*	*114.83*	*199.20*	*6.72*	*-47.02*
2001	*1Q-4Q*	*802.87*	*856.25*	*611.04*	*485.09*	*125.96*	*239.27*	*5.94*	*-53.38*
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
1998	1Q	122.78	129.34	106.97	84.29	22.68	21.23	1.14	-6.56
	2Q	132.59	138.65	107.84	84.61	23.23	29.51	1.31	-6.06
	3Q	138.62	145.61	111.05	87.97	23.08	33.23	1.33	-6.99
	4Q	155.48	164.87	107.62	86.02	21.60	55.23	2.02	-9.39
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
	3Qe1	154.49	164.48	123.66	97.48	26.19	38.60	2.22	-10.00
	4Qe2	181.06	191.72	123.46	98.81	24.65	65.50	2.77	-10.66
forecast									
2000	*1Q*	*157.69*	*167.71*	*136.66*	*108.79*	*27.87*	*29.69*	*1.36*	*-10.02*
	2Q	*173.74*	*184.02*	*138.93*	*109.25*	*29.67*	*43.62*	*1.47*	*-10.28*
	3Q	*176.85*	*187.83*	*139.72*	*110.07*	*29.65*	*46.66*	*1.45*	*-10.99*
	4Q	*204.54*	*220.28*	*138.62*	*110.99*	*27.63*	*79.23*	*2.44*	*-15.74*
2001	*1Q*	*177.62*	*189.13*	*152.00*	*121.07*	*30.93*	*35.84*	*1.29*	*-11.50*
	2Q	*196.90*	*207.57*	*153.72*	*121.13*	*32.59*	*52.48*	*1.36*	*-10.67*
	3Q	*198.35*	*211.68*	*153.47*	*121.11*	*32.36*	*56.12*	*2.09*	*-13.33*
	4Q	*230.01*	*247.88*	*151.85*	*121.78*	*30.07*	*94.84*	*1.19*	*-17.87*

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
1998	1Q-4Q	4.8	6.4	4.1	4.7	1.6	14.2
1999e1	1Q-4Q	4.0	4.9	4.2	4.9	1.6	7.2
forecast							
2000	*1Q-4Q*	*5.4*	*5.1*	*3.3*	*3.6*	*2.0*	*10.9*
2001	*1Q-4Q*	*6.3*	*6.1*	*3.7*	*4.1*	*2.0*	*13.7*
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
1998	1Q	6.4	7.3	5.4	6.3	2.2	17.3
	2Q	5.4	5.7	3.4	3.9	1.6	14.6
	3Q	5.0	6.0	3.7	4.3	1.5	14.3
	4Q	2.9	6.5	3.7	4.4	1.2	12.7
1999e1	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
	3Qe1	4.9	5.7	4.7	5.4	1.9	7.1
	4Qe2	6.1	5.8	4.4	5.0	1.9	8.0
forecast							
2000	*1Q*	*6.8*	*5.2*	*3.4*	*3.8*	*2.0*	*9.2*
	2Q	*5.3*	*4.2*	*2.7*	*2.8*	*2.1*	*10.0*
	3Q	*4.7*	*4.4*	*3.2*	*3.5*	*2.0*	*10.9*
	4Q	*4.9*	*6.3*	*3.8*	*4.3*	*1.9*	*12.0*
2001	*1Q*	*5.8*	*5.4*	*3.9*	*4.4*	*1.8*	*12.8*
	2Q	*6.5*	*5.8*	*3.7*	*4.2*	*1.9*	*13.3*
	3Q	*6.1*	*6.4*	*3.6*	*4.0*	*2.0*	*14.0*
	4Q	*6.6*	*6.7*	*3.6*	*3.9*	*2.2*	*14.0*

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					
			of which employment	agriculture and forestry	manufact-uring, mining, etc.	construction	Market services	Non-market services
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	15800	8752	3969	3701	961	4798	2371
1999	1Q-4Q	15658	8705	3931	3535	957	4829	2407
forecast								
2000	*1Q-4Q*	*15601*	*8680*	*3907*	*3494*	*946*	*4836*	*2418*
2001	*1Q-4Q*	*15756*	*8750*	*3878*	*3469*	*980*	*4975*	*2455*
1994	1Q	14300	8486	3891	3634	797	3833	2145
	2Q	14431	8485	3895	3629	822	3933	2152
	3Q	14461	8517	3916	3630	829	3927	2159
	4Q	14706	8587	3904	3667	831	4004	2300
1995	1Q	14489	8507	3839	3739	800	3878	2233
	2Q	14711	8562	3835	3757	847	4039	2233
	3Q	14763	8534	3863	3752	855	4074	2219
	4Q	14977	8668	3856	3780	862	4172	2307
1996	1Q	14682	8487	4002	3714	737	3969	2260
	2Q	14932	8513	4001	3719	837	4120	2255
	3Q	15083	8522	4044	3730	879	4181	2249
	4Q	15386	8671	4038	3759	919	4326	2344
1997	1Q	15048	8567	3982	3753	788	4235	2290
	2Q	15374	8645	3980	3733	910	4440	2311
	3Q	15594	8675	4020	3735	952	4578	2309
	4Q	15739	8706	4006	3740	981	4656	2356
1998	1Q	15506	8717	3956	3717	864	4609	2360
	2Q	15819	8759	3953	3722	978	4804	2362
	3Q	15921	8714	3991	3676	1010	4901	2343
	4Q	15953	8817	3976	3688	992	4879	2418
1999	1Q	15423	8747	3900	3587	871	4635	2430
	2Q	15680	8717	3925	3543	973	4831	2408
	3Q	15748	8649	3960	3507	1001	4914	2366
	4Q	15782	8709	3940	3502	980	4937	2423
forecast								
2000	*1Q*	*15275*	*8680*	*3898*	*3480*	*855*	*4622*	*2420*
	2Q	*15538*	*8670*	*3890*	*3497*	*960*	*4781*	*2410*
	3Q	*15708*	*8640*	*3920*	*3490*	*990*	*4928*	*2380*
	4Q	*15885*	*8730*	*3920*	*3510*	*980*	*5015*	*2460*
2001	*1Q*	*15405*	*8720*	*3870*	*3470*	*860*	*4755*	*2450*
	2Q	*15678*	*8750*	*3860*	*3450*	*1000*	*4928*	*2440*
	3Q	*15888*	*8730*	*3890*	*3448*	*1040*	*5090*	*2420*
	4Q	*16055*	*8800*	*3890*	*3507*	*1020*	*5128*	*2510*

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
1999	1Q-4Q	2350	13.0		
forecast					
2000	*1Q-4Q*	*2367*	*13.0*	–	–
2001	*1Q-4Q*	*2337*	*12.7*	–	–
1995	1Q	2754	15.5	2491	14.7
	2Q	2694	15.2	2156	12.6
	3Q	2657	15.0	2227	12.9
	4Q	2629	14.9	2233	13.1
1996	1Q	2726	15.4	2349	14.0
	2Q	2508	14.3	2103	12.4
	3Q	2341	13.5	2018	11.6
	4Q	2360	13.2	1961	11.5
1997	1Q	2236	12.6	2176	12.8
	2Q	2040	11.6	1927	11.3
	3Q	1854	10.7	1853	10.7
	4Q	1826	10.3	1737	10.2
1998	1Q	1846	10.4	1896	11.1
	2Q	1688	9.6	1753	10.2
	3Q	1677	9.6	1786	10.3
	4Q	1831	10.4	1827	10.6
1999	1Q	2170	12.1	2141	12.5
	2Q	2074	11.6	–	–
	3Q	2178	12.1	–	–
	4Q	2350	13.0	–	–
forecast					
2000	*1Q*	*2439*	*13.5*	–	–
	2Q	*2337*	*13.0*	–	–
	3Q	*2338*	*12.9*	–	–
	4Q	*2367*	*13.0*	–	–
2001	*1Q*	*2449*	*13.5*	–	–
	2Q	*2337*	*12.9*	–	–
	3Q	*2298*	*12.6*	–	–
	4Q	*2337*	*12.7*	–	–

Source: Data – CSO; LSF estimates for 2Q99 and 3Q99, and forecasts – CASE.
Note: The CSO has stopped publishing LFS (labour force survey) statistics from 2Q99.

Table A6. Selected price indices, 1997–1999 (% yoy)

		CPI	PPI		Export price index	Import price index
			Manufacturing, etc.	Construction		
1997	01	17.8	12.9	14.5	12.5	16.0
	02	17.3	11.9	14.4	7.9	13.4
	03	16.6	11.8	14.5	12.7	9.8
	04	15.3	12.0	14.5	11.9	11.6
	05	14.6	12.4	14.4	9.2	17.0
	06	15.3	12.2	14.0	14.1	8.6
	07	14.9	12.0	14.3	14.5	14.1
	08	14.5	12.5	14.2	10.5	16.2
	09	13.6	13.0	14.1	15.2	14.7
	10	13.1	12.1	14.3	16.3	13.1
	11	13.2	12.1	14.2	12.9	14.8
	12	13.2	11.5	14.5	13.4	14.5
1998	01	13.6	9.2	15.7	9.8	7.9
	02	14.2	9.1	15.7	10.0	11.0
	03	13.9	9.2	15.4	11.5	10.4
	04	13.7	8.4	14.6	8.4	4.4
	05	13.3	8.2	14.4	8.2	0.7
	06	12.2	7.7	14.1	7.8	4.4
	07	11.9	7.0	13.6	6.9	1.5
	08	11.3	6.6	13.0	4.4	- 5.6
	09	10.6	6.4	12.4	7.0	3.3
	10	9.9	5.8	11.7	3.8	3.4
	11	9.2	5.1	11.1	3.2	- 2.3
	12	8.6	4.8	10.6	4.7	- 5.1
1999	01	6.9	3.9	9.9	2.9	-0.4
	02	5.6	3.7	9.4	9.7	1.6
	03	6.2	4.7	9.0	10.7	5.6
	04	6.3	5.0	8.6	9.9	9.0
	05	6.4	5.2	8.4	10.2	8.2
	06	6.5	5.2	8.1	1.1	4.8
	07	6.3	5.5	7.8	0.4	5.3
	08	7.2	5.9	7.8	7.1	10.4
	09	8.0	6.2	8.2	6.3	4.6
	10	8.7	6.8	8.3	11.4	7.6
	11	9.2	7.5	8.6	–	–
	12	9.8	8.0	9.1	–	–

Source: CSO.

Table A7. Exchange rates, 1997–1999 (in zloty)

		US$/zloty	DM/zloty	euro(ECU)/zloty
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	2.1927	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	2.0537	4.0166
	08	3.9510	2.1447	4.1946
	09	4.0799	2.1925	4.2881
	10	4.1092	2.2513	4.4031
	11	4.2527	2.2484	4.3974
	12	4.1696	2.1577	4.2200

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

Table A8. Foreign trade, 1997–1999 (US$ million)

		Exports		Imports		Net exports	
		CSO	NBP	CSO	NBP	CSO	NBP
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	2042	2119	3157	3331	-1115	-1212
	02	2096	2495	3239	3279	-1143	-784
	03	2452	2398	4033	3223	-1582	-825
	04	2166	2159	3632	3195	-1465	-1036
	05	2236	1989	3699	3020	-1463	-1031
	06	2153	2122	3665	3424	-1511	-1302
	07	2117	2092	3760	3414	-1643	-1322
	08	2191	2078	3651	3308	-1460	-1230
	09	2415	2044	4083	3353	-1668	-1309
	10	2536	2244	4276	3367	-1739	-1123
	11	2183	2148	4012	3717	-1829	-1569
	12	–	2498	–	4214	–	-1716

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	-783	-1230	142	429	1393	228	-26
	09	-1147	-1309	137	423	788	-388	442
	10	-849	-1139	130	426	363	451	76
	11	-1178	-1561	148	299	789	809	-116
	12	-1640	-1706	161	174	681	306	-120

Source: NBP.
Note: November and December data – preliminary.

Table A10. Interest rates, 1996–1999

		Rediscount rate	Lombard rate	3-month WIBOR	28-day repo rate
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	18.3	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
	10	15,5	17,0	16,6	14,0
	11	19,0	20,5	18,2	16,5
	12	19,0	20,5	18,0	16,5
forecast					
	1Q00	–	*20.50*	*17.27*	–
	2000	–	*16.50*	*13.49*	–
	2001	–	*14.50*	*11.55*	–

Source: Data – NBP and forecast – CASE.
Notes: 1. End-month except for WIBOR – monthly average.
2. End-month forecast.

Table A11. Monetary indicators, 1997–2001 (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
1999	1Q-4Q	47.9	263.8	38.1	186.0	124.3	61.7	39.7	176.3	36.6	139.6	64.5
forecast												
2000	*1Q-4Q*	*52.1*	*308.8*	*37.0*	*232.2*	*159.5*	*72.7*	*39.6*	*218.8*	*49.0*	*169.8*	*63.8*
2001	*1Q-4Q*	*60.7*	*360.0*	*39.6*	*278.0*	*198.0*	*80.0*	*42.4*	*270.7*	*60.0*	*210.7*	*67.0*
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	46.2	246.0	34.2	173.3	122.4	51.0	38.5	167.4	32.4	135.0	61.6
	4Q	47.9	263.8	38.1	186.0	124.3	61.7	39.7	176.3	36.6	139.6	64.5
forecast												
2000	*1Q*	*48.0*	*272.5*	*36.4*	*196.6*	*136.6*	*60.0*	*39.5*	*190.4*	*39.8*	*150.6*	*60.0*
	2Q	*49.0*	*281.7*	*36.0*	*207.1*	*144.3*	*62.8*	*38.6*	*198.7*	*42.9*	*155.8*	*61.0*
	3Q	*49.7*	*291.2*	*36.4*	*216.8*	*151.5*	*65.3*	*38.0*	*207.1*	*45.5*	*161.6*	*61.3*
	4Q	*52.1*	*308.8*	*37.0*	*232.2*	*159.5*	*72.7*	*39.6*	*218.8*	*49.0*	*169.8*	*63.8*
2001	*1Q*	*56.2*	*318.8*	*39.0*	*240.0*	*170.0*	*70.0*	*39.8*	*245.6*	*52.0*	*193.6*	*61.9*
	2Q	*56.7*	*326.0*	*38.8*	*247.0*	*178.0*	*69.0*	*40.2*	*251.1*	*54.2*	*196.9*	*62.8*
	3Q	*58.1*	*340.2*	*39.0*	*260.0*	*188.0*	*72.0*	*41.2*	*256.6*	*56.3*	*200.3*	*64.3*
	4Q	*60.7*	*360.0*	*39.6*	*278.0*	*198.0*	*80.0*	*42.4*	*270.7*	*60.0*	*210.7*	*67.0*

Source: Data – NBP and forecast – CASE.