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POLISH ECONOMIC OUTLOOK
TRENDS • ANALYSES • FORECASTS

Contents

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Micro contra Macro

Political events, structural changes, and the microeconomic environment all impact significantly on the functioning of the economy and developments in macroeconomic indicators. These factors have in recent months been further compounded by various scandals, which have led to a draining of investor confidence, stock exchange falls (and not only in the USA) and the weakening of the US dollar against the majority of other currencies. In the case of Poland, the unexpected change of Finance Minster and uncertainty surrounding his new economic program resulted in an abrupt weakening of the zloty.

The impact of such factors on economic developments in the medium term depends on the longevity of market volatility and also on the degree to which they reflect real economic problems and/or irrational market behaviour. In the long term, structural factors and microeconomic fundamentals

Table 1.1. CASE Outlook, 2002–2003

	2000	2001	2002	2003
GDP (% change)	4.0	1.0 ↘	1.3 ↘	2.3 ↘
Domestic demand	2.8	-1.9 ↗	0.7 ↗	3.7 ↘
Individual consumption	2.7	2.1	2.6 ↗	2.7 ↘
Investment	2.7	-9.8 ↗	-5.0 ↘	8.6 ↘
Unemployment rate (%)	15.1	17.4	18.8	18.9
CPI (% change, annual average)	10.1	5.5	2.2 ↘	2.9 ↘
Trade balance (US$ billion)	-13.17	-11.66	-10.46 ↗	-12.24 ↗
Current account balance (US$ billion)	-9.98	-7.05	-6.72 ↗	-7.63 ↗
Current account balance (% of GDP)	-6.3	-4.0	-3.6 ↗	-4.0 ↗
Central budget balance (PLN billion)	-15.4	-32.4 ↗	-38.0 ↗	-35.8 ↗
Public sector balance (% of GDP)	-2.7	-5.3	-5.8 ↗	-
Exchange rate (annual average)				
PLN/US$	4.35	4.09	4.07 ↘	4.12 ↘
PLN/Euro	4.01	3.67	3.86	4.10 ↗
Broad money supply M3 (% change)	12.0	8.8 ↘	5.0 ↘	6.2 ↘
Interest rate of NBP (28-day reference rate)	19.00	11.50	8.50	8.00 ↗
WIBOR 3M	19.6	12.5	8.5 ↘	7.6 ↘

Source: Data – CSO, NBP; forecasts – CASE.
Note: Arrows point the directon of changes compared with the previous outlook.

are the key concern, however. They shape limits on supply, any additional costs on economic activities and also the efficiency of economic entities. These in turn shape expectations and behaviour, for example, the propensity of producers to invest and households to save.

However, most economic forecasting models usually fail to take into account changes to microeconomic behaviour, or to anticipate unexpected political developments or short-term market volatility. This results from difficulties in any quantitative assessment of such factors and identification of transition mechanisms.

In the current issue of the PEO we have decided to make significant changes to our forecasting model. This results from changes in the relative influence of the roles of microeconomic and structural factors on macroeconomic interdependences. The changes refer above all to exports and investments. We are less optimistic than we were on the possibilities of strong recoveries in either indicator. Nevertheless, the lack of a clear picture of decline in enterprises' fiscal costs and the further division of enterprises' financial results, in our opinion negatively influences the export and investment capacities of Polish enterprises. Weaker export growth combined with a lack of strong domestic recovery may be an additional threat to revival in investment.

Besides this, we have revised our assumptions on exchange rates and interest rates. We expect a stronger zloty and euro against the dollar, and also higher real interest rates. We expect further cuts in NBP rates to be constrained by the loosening of monetary policy resulting from adjusting the reserve rate requirements to ECB standards.

In a line with the above changes we have significantly revised our GDP forecasts for 2002 and 2003, respectively down to 1.4% and 2.4%. Lower GDP growth is likely to impact negatively on wages. Added to this the rate of increase in social benefits will likely fall in 2H02 and, as a consequence, lower total household incomes. But the low savings rate will not last forever. The increase in net savings in the banking sector reached only PLN0.3 billion in 2Q02, against PLN3.7 billion in 2Q01. Nevertheless, personal consumption is likely to remain the most stable growth factor in 2H02 and 2003, though lower than in 4Q01 and 1Q02.

Not all so bad

Sustained disinflation is a clear plus factor. Since December 2001, CPI inflation has been systematically declining, reaching an historical low of 1.6% yoy in June. This resulted from positive supply factors (prices of foodstuffs and oil fell yoy) and the stable exchange rate against the basket of the euro and dollar, but also weaker domestic demand. The three measures of core inflation suggest disinflation of a fundamental character, which covers many goods and services in the economy.

Real interest rates on credits fell in 2Q02 (especially to consumers), despite the continued restrictiveness of monetary policy – measured by real interest rates. The three cuts in interest rates in 2Q02 were lower than the decline in inflation. As such, banks have shown a stronger propensity towards credit expansion compared to the previous quarter. This is also the lagged result of significant cuts (by 10.5 percentage points) in NBP rates from the beginning of 2001 to mid-2002.

The improvement in the budget position is also worth mentioning. Budget revenue collection rates increased in real terms across all categories, though unfortunately almost half came from higher revenues resulting from "creative accounting". Together with improvements in tax revenues we do not expect any significant threats to execution of the 2002 budget. The tax on profits from interest rates has not brought the expected results, and overall tighter fiscal stringency – together with weaker economic performance – has resulted in an increase in tax arrears to the budget and growth of cash in circulation. This latter fact can be clearly seen as reflecting the expansion of the grey economy in Poland.

We should stress that, despite the significant lowering of our GDP forecasts for 2002 and 2003, we still expect to see recovery, though it is unlikely to be as strong as earlier projected.

Growth perspect – structural underpinnings

In the discussion on the relative influence of microeconomic and structural factors it is worth noting the worsening growth perspectives for the Polish economy. Continuing declines in investment in fixed assets may negatively influence productive capacity and progress in the area of modernisation of Polish companies. In 2001, the investment rate fell to 22% of GDP (at current prices) from 25% in the years 1998–2000. Nothing indicates a reversal of this negative trend in 2002.

Lower FDI, important for growth and technical innovation, is also worrying. Besides delays in privatisation, this slowdown is due to worsening growth prospects in the Polish economy as well as the rising costs of running business. Poland's anticipated membership of the EU is not in itself enough to offset weakening foreign investor confidence.

This worsening perception of the Polish economy was reflected in Standard&Poors' lowering of its credit rating on Polish Treasury papers' denominated in zlotys. This was the first clear signal for investors that investment risk in Poland is on the rise. If we see further cuts in ratings, including on papers denominated in foreign currency (higher supply of which is expected in 2003–2008 to rollover restructured foreign indebtedness) it may be necessary to increase their profitability, which would then lead to market pressure for a rise in domestic interest rates.

Also of possible concern are those projects in Kołodko's new economic package which commit budgetary and banking resources for debt restructuring. The measures proposed would lead to an increase in bureaucratic entanglement in microeconomic decision making, preferential treatment of "strategic" enterprises, maximisation of employment, and the risk of only slightly delayed fiscal expansion. The measures may also turn out to be inconsistent with EU rules governing public support, something which would needlessly complicate the already crowded enlargement calendar for 2004. In our current forecast, we have not taken into account the impact of Kołodko's projects, due largely to the uncertainty surrounding the final outcome of legislative changes to his proposals.

Center for Social and Economic Research

Economy in 2Q02

Economic growth

Katarzyna Piętka

GDP and demand factors

• Stagnation

According to our estimates, GDP grew by 1.0% in 2Q02, exactly as predicted in our last forecast. It seems that there were no surprises to undermine our earlier prediction. Foreign demand remains the main growth push factor, at the same time lowering the foreign trade deficit. Domestic demand stayed at last year's level. The growth in consumption fully compensated for the fall in investments.

Estimates for individual consumption growth of 2.1% suggest a slowdown. The higher rise in consumption observed in 4Q01 and 1Q02 reflects the faster downward trend in the savings rate (consumption financed from the exchange of European currencies, as mentioned in earlier PEOs). We envisage no changes in the savings rate in 2Q02 from 1Q02 and consumption growth close to the rate of growth in real disposable incomes. The main reason for incomes staying on an upward trend was social benefits, though their rate of growth fell off slightly (to below 8% in real terms). The slower growth in benefits resulted from the newly introduced (in June) indexation of wages and pensions, which was a mere 0.5% above inflation. At the same time, the on-going reduction in employment, together with the ever slower increase in the average wage, contributed to the real fall in the wage fund and thus lowered growth in incomes. As households preferred to invest in private construction rather than increase their monetary savings the savings rate remained unchanged from last year's level. Consequently, the increase of net savings in the banking sector (i.e. the difference between the increase in deposits and credits) amounted to a mere PLN0.3 billion, against PLN3.7 billion in the corresponding quarter of 2001. This is due to two factors – firstly, the weak accumulation of credits (under PLN0.7 billion), and secondly, a fall in deposits (by PLN1.5 billion), offset by significant growth in cash outside of the banking system.

According to our estimates, the growth of individual and public consumption once again managed to offset the total fall in investment. Additionally, with the slowing of consumption growth, as compared to the previous quarter, we appear to have seen a parallel slower fall in investment. We estimate that investments in fixed assets decreased by about 9%. 2Q02 brought a lower fall in sold construction output (measured at the voivodeship level). On the other hand, the number and overall floor area of dwellings completed (private construction) grew significantly. Therefore we assume that investment in buildings continued to decline, although at a lower rate than before. The situation in production of investment goods sectors (machinery, vehicles, etc.) improved slightly. This (after taking into account also foreign trade figures) indicates a weakening of the fall in investment in fixed assets. At the same time, credits to enterprises increased by PLN5.5 billion. That constitutes growth in comparison to the previous year. Our estimates additionally reveal that the financial situation of enterprises in 2Q02 at least did not worsen.

Despite a satisfactory fruit harvest investments in inventories in 2Q02 were limited. In light of our estimates, firms operating outside the agriculture sector were very cautious when it came to building stocks, though one might have expected them to do so after the deep fall in stocks in 2Q02 combined with growing trade during the first four months 2002.

Unfortunately the dynamic increase in exports in 2001 was checked at the beginning of 2002. 2Q02 will most probably see moderate growth in this area. Lower export trends, together with stagnation of domestic demand, were the key factors lowering imports. As a result we can again observe positive tendencies on the balance of trade account expressed in real terms. These trends have prevailed since 4Q01, that is since net exports started to positively contribute to GDP growth.

Katarzyna Piętka

Real sector

- **Favourable outlook in services**
- **Continuation of recession in industry**

Growth in the service sector's value-added remains the key factor pushing the growth of value-added in the wider economy. Construction and industry sectors, on the other hand, continue to fall.

2Q02 saw some significant monthly fluctuations in sold output, which were partially the result of seasonal factors (differences in the number of working days per month). The record June figure for output growth (2.2%), which was the highest for several months, mainly related to the manufacturing and energy sectors. The biggest falls were observed in the printing industry, production of coke and refined petroleum, electronic equipment, transportation equipment, clothes and leather products. These are mostly investment goods and only a few are consumer products. The sectors involved directly in food and durables production performed much better – real sold output grew significantly. Overall industrial production in 2Q02 slightly declined, resulting in turn in a fall in the value-added figure.

Construction in 2Q02 continued to experience recession, despite sales falling at a slower pace than in previous quarters. This should see a return to the above-mentioned improvement in individual construction.

We estimate the value-added growth in market services at 3.5% – at the level close to our latest estimates. The factor most positively influencing that growth is still an upward trend in trade and repair underline by the fact, of the significant rise in the value of wholesale trade that partially offset slower growth in retail sales. Eventually, the lower increase in value-added for transportation and communication was the result of several factors – negative, for example the fall in passenger transport, and positive – the rise in the volume of goods transportation and a rise in the number of communication connections.

Despite the real increase in taxes (including indirect taxes and duties) their rate of growth – according to our assumptions – should be close to zero. This is based on 1Q02 results, when net indirect taxes decreased, even despite a real increase in indirect taxes. This allowed value-added growth to surpass GDP growth. It seems that it were the higher subsidies paid on goods and thus diminishing VAT, excise and other duties and import fees were most probably behind this.

Anna Myślińska

Enterprise finances

- **Signs of improvement in financial situation of enterprises**
- **Slightly better estimates for 2Q02**

The financial results of enterprises employing over 49 persons from sales of products, goods and materials improved in this period – not only against the difficult situation at the beginning of last year but also compared with the corresponding period of 2000. The overall improvement in financial results stemmed largely from the extremely good situation in the power, gas, water supply and manufacturing sectors. Relatively good results from sales (achieved despite declining revenues) provide evidence to suggest that enterprises are restructuring effectively and adapting to weaker demand. The situation in the construction sector continues to be critical – the sector is showing even bigger losses than in 2001.

Net financial results were higher – though considerably less than financial results from sales. This was due to poor results on other operating activity, financial operations, and unplanned events. Profitability significantly improved in the public as well as the private sector. Both sectors achieved practically identical results. It should also be underlined that the public sector showed negative profitability in 4Q01. A sectoral analysis of profitability shows substantial improvement in the power and manufacturing sectors, and poor figures in construction. Recovery in mining and quarrying (up to 3.1% from 1.1% at the end of 2001) results from higher sales and ongoing debt restructuring.

Diminishing inventories would seem to be another sign of the improving situation of enterprises. This situation may be explained by the recovery in retail sales in 1Q02.

Large enterprises surveyed by the CSO noticeably increased their demand for credit. Bank loans increased by 15% (yoy), against 2.2% in the previous quarter. Smaller firms were more reserved – according to the NBP, total loans to enterprises fell by approximately 2%. However, demand for foreign loans grew. Though foreign trade loans slightly decreased (yoy), other loans incurred by non-government and non-bank sectors continued to rise. Nevertheless, the rise was not as rapid as before – loans increased by 19.5% (compared with 19.8% and 30.7% in the preceding quarters). Company decisions in 1Q02 were most likely affected by speculation on a weakening of the zloty.

One should expect to see a fall in labour costs in 2Q02. A small fall in sold industrial production in real terms was accompanied by accelerating prices. As such, a small increase in revenues from sales was possible. In the face of weak export and domestic demand forecasts other branches of the economy are unlikely to show a significant improvement in results. The uncertain mood among entrepreneurs is also a key concern. In the CSO survey of business trends the overall economic climate index was higher in 2Q02 than in 1Q02, though worsened again in July.

Piotr Bujak

Labour market

- **Seasonal fall in unemployment**
- **Rate of employment reductions continued**
- **Slower growth of wages**

Unemployment

Having reached a level of 18.1% in February and March the registered unemployment rate seasonally dropped in 2Q02. In May unemployment plunged to 17.2%, before slightly increasing in June to 17.3%. By the end of 2Q02 the number of registered unemployed stood at 3.09 million – 170 thousand fewer than at the end of 1Q02. This temporary improvement in the situation on the labour market was stronger than last year, which means that the number of unemployed is growing more slowly. Apart from factors which cause a seasonal decline in unemployment every spring (i.e. construction and agricultural works), this year one should also

[1] The public sector is comprised of central and local government enterprises. The private sector consists of privately owned units, both domestic and foreign. In the case of enterprises with "mixed" ownership the dominance of either private of public stakes is the key determining criterion for statistical classification purposes.

mention the National Census. CSO's temporary employment of surveyers resulted in the deletion of about 70 thousand people from labour office registers. Consequently, the annual rate of deletions due to finding employment increased to over 66%, for the first time in several months exceeding the rate of overall unemployment deletions. At the same time, it turned out that the significant rise in job offers in 1Q02 was a one-off. In 2Q02 the rate fell significantly, which confirms the short-term character of the fall in unemployment.

LFS results for 1Q02 confirm the negative trends on the labour market. The number of unemployed in 1Q02 rose to 3.48 million, with the unemployment rate going over the 20% mark. Unemployment increased across all social groups regardless of levels of education or age. The number of unemployed grew fastest among the youngest (15−24 year olds), reaching a level of 45.5%. The average job-searching time rose by 1.5 months yoy to 14.7 months. Once again, the share of unemployed that had been dismissed from the private sector increased, and totaled 73.6%.

On 26 July 2002, the Lower House (Sejm) approved amendments to the Labour Code. The changes have not yet been finalised, with the Senate currently working on them. If they are approved most changes will come into effect from the beginning of next year or three months after the publication of the new law in the Journal of Laws (Dziennik Ustaw). The most important changes aimed at making labour law more elastic and decreasing labour costs are the following:

- up to the moment of EU accession employers will have no obligation to sign a third agreement with employees for a specified time;
- employees will have no right to payment for the first day of any sick leave that lasts up to 6 days;
- employers will have greater freedom in shaping traveling allowances that correspond to the character of work;
- the period for which wages are paid by employees, rather than the Social Security Office, is to be cut to 33 days from 35 days;
- the settlement period for working time is to be increased from 3 to 4 months;
- over-time working bonuses for the third and consecutive overtime hours during working days will be cut from 100% to 50% of normal wages;
- regulations concerning group dismissals will be obligatory only for firms that employ over 20 employees.

The Labour Code amendment approved by the Sejm may introduce greater elasticity into the labour market. However, it has been significantly delayed and not come into force any earlier than 2H03. Moreover, it is not aimed at decreasing labour costs to any significant extent.

The government expects a substantial improvement on the labour market due to the introduction of new Finance Minister Grzegorz Kołodko's "Anti-crisis package". The minister even announced that from November onwards unemployment will begin to fall. This would appear far from likely given the seasonal hike in unemployment every autumn. However, the legislative proposals presented by Kołodko are in fact unlikely to enhance job creation. They are instead more likely to lead to a temporary maintenance of employment in economically ineffective enterprises. The one-off character of the plans will furthermore most likely not lead to a decrease in unemployment at all, and for sure not this year.

Employment

Labour demand trends in 2Q02 remained largely unchanged. On average, employment in the enterprise sector dropped by 4.6% yoy, only 0.2 percentage points lower than in the previous quarter. The diverse spread of annual employment rates within different sectors of the economy continued in 2Q02. Unemployment trends in industry and construction remained negative. On the other hand, employment in trade and repairs grew for the second consecutive month and in hotels and restaurants positive trends even increased. Employment growth in real estate and business activities was slightly lower.

LFS results for 1Q02 confirmed data on the situation in the enterprise sector previously released by the CSO. The working population (employed and self-employed) dropped by 3.2% yoy in 1Q02, amounting to 13.697 million. The effective fall in labour supply resulted also from the shortening of the average working weekly and the fall of the number of people with more than one job.

Wages

All the employment trends described above significantly constrain wage increase pressures. In June the average wage in the enterprise sector increased by 3.9% yoy. The equivalent average increase in 2Q02 was 3.5% yoy. The purchasing power of wages in 2Q02 was on average 1.3% higher yoy. This means that the annual growth rate of wages fell again, despite lower-than-expected inflation. As a result, 2Q02 was marked by drop in the wage bill in the enterprise sector, which was even slightly deeper than in 1Q02.

Prices

Mariusz Jarmużek

Main price indices

• **Disinflation continues**

Inflation measured by the CPI index continued to fall in 2Q02. This was due to weak domestic demand, favourable supply factors and a stable exchange rate of the domestic currency against the basket comprising the US dollar and the euro.

Favourable supply-side factors were critical to the disinflation process. Both cereal and meat prices were substantially lower than in the analogous period of 2001. Gas price rises were lower than expected, with the Energy Regulatory Office (URE) accepting an average increase in retail prices of 4.3%. The oil price on international markets also didn't impact on import prices, as they remained in the expected range of US$22–US$28 per barrel.

Restrictive monetary policy offset demand factors shaping inflation. This enabled a retention of control over both internal and external balances. The low growth in wage rises also confirms the lack of wage pressure. The difficult situation on the labour market encourages cautious setting of wage contracts.

During the analysed period, the impact of the exchange rate on domestic prices was insignificant, as the zloty slightly appreciated against the basket. Moreover, continued weak demand did not allow a proportional transfer of changes in the exchange rate on to domestic prices.

Trends on the PPI index stayed close to zero. This was largely due to the low prices of raw materials on international markets and the stable exchange rate of zloty against the currency basket. One could observe a slight increase in manufacturing prices. This may see some recovery in the future. One should note further deceleration in other sectors such as mining and quarrying as well as in electricity, gas and water supply.

Katarzyna Zawalińska

Agricultural commodity prices

• **Agricultural prices continue to fall**

Poland experienced an untypical – for this time of the year – excess supply of commodities on most of agricultural markets in 2Q02.

The ample supply of crops outstripped domestic demand causing a further fall in prices in this period. Wheat procurement prices decreased on average by 2% qoq and by 16.6% compared to the same period last year, while rye prices fell by 1% and 14.3%, respectively. The unusually early harvest also contributed to this year's low crop prices, and this is expected to continue in 3Q02. This expectation is based on the fact that there are ample crop stocks (estimated at the beginning of this season at a level of about 1 million higher than last year), low turnover of crops at the agricultural boards of trade, and relatively low prices on foreign markets. In addition, imports of crops have contributed to higher domestic supply, although compared to last year this is relatively small. According to Agricultural Market Agency (ARR) imports of crops in the 2002/2003 season should remain at a level close to the previous season (about 1 million tons), which should meet levels of domestic consumption (estimated to exceed domestic supply by 4.5%) and retain a safe level of stocks.

The meat market saw a similar situation, with prices also decreasing in 2Q02. The dynamic increase in pork supply, together with weak demand, caused a fall in pork prices both in procurement and market trade (procurement prices fell by 11% qoq and 17.5% yoy). In 2Q02, beef procurement prices also fell, on average by 4.6% against the last quarter, and by 4.3% against last year. News of the detection of a BSE case in Poland also contributed to the fall in beef prices, after various countries (including Russia, Ukraine, Lithuania, and Estonia) banned beef imports of Polish origin. An unfavourable trade balance also remains in the pork market. Imports to Poland doubled during the first five months of 2002 while at the same time exports fell by half.

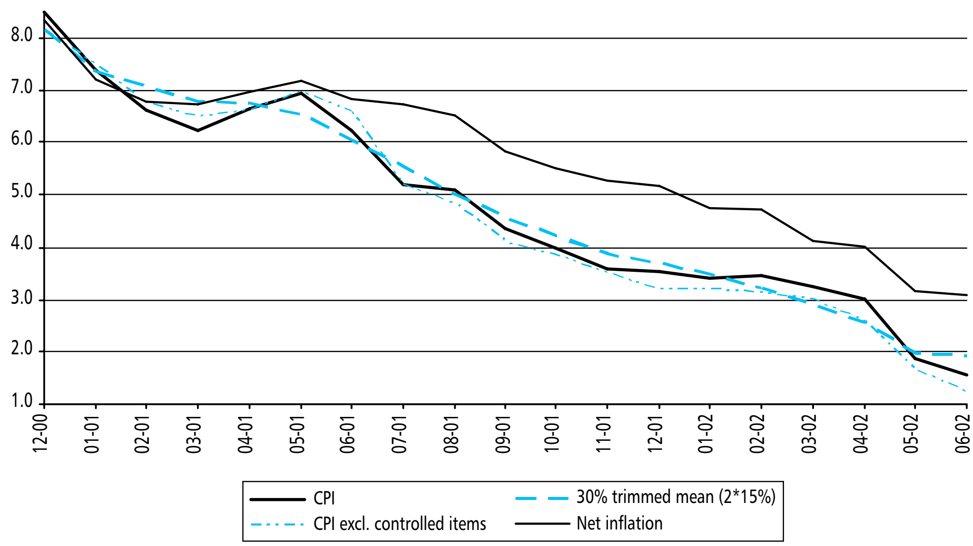
Przemysław Woźniak

Core inflation

• Sustainable disinflation fundaments

2Q02 saw a continuation of the falling trend in core inflation. All inflation indicators fell significantly, though core indices fell far less than the headline index. In 2Q02, the dynamics of core inflation excluding administratively controlled items registered the largest fall. For over a year this index had been running below the headline index, which points to a slight pro-inflationary effect of administrative price changes. The largest administrative price increases, as of end-June 2002, were registered by: state administration fees (20.6% on an annual basis), court and lawyers' fees (11.6%), public television and radio subscription fee (11.9%), hot water (9%), electricity, gas and hot water (6.5%) and cigarettes (5.5%). These increases were balanced by drops in the price of fuel (a 3.2% drop on an annual basis), telecom services (3.7%) and stable prices of railway transport. The deviation of headline inflation from core inflation

Chart 2.1. Core inflation, 2000–2002 (% changes, yoy)



Source: CSO, NBP, and CASE.

excluding administratively controlled items has been hovering in a range of 0.2–0.4 percentage points for a year now and is predicted to remain in this range in the coming months.

Since mid-2001 net inflation has been registering the highest dynamics of all core inflation indices. This is due to price developments in the markets for food and fuel, both of which are eliminated from net inflation. The annual rate of retail prices of fuel has been declining for over a year now. This is the source of strong disinflationary pressures, both direct (fuels account for almost 4% of consumer expenditures) and indirect – through car, water and air transportation prices and their impact on all consumer goods. Similar price drops on an annual basis were registered in the food sector. Furthermore, good fruit and vegetable harvests as well as favorable grain crop prospects will contribute to sustaining high supply and consequently low prices in the market for agricultural goods over the next year or so. Thus, the deviation of net inflation from headline inflation has exceeded 1 percentage point and lately even risen slightly.

The trimmed mean is the best indicator of trend price changes and hence is the most stable core series (see chart 2.1). The trimmed mean was above headline inflation in June 2002, although the alignment of the two measures has switched several times over the past year. The dynamics of both indicators have been similar for over a year. This reflects the fact that core price movements are not significantly different from the price movements of the entire consumer basket, which in turn points to the fundamental and comprehensive character of the disinflationary processes in the Polish economy.

These tendencies are also confirmed by the two remaining core inflation measures: core inflation excluding the most volatile prices and core inflation excluding the most volatile prices and the price of fuel (not represented in the figure). Both measures indicate the direction of the most stable group of consumer goods and – like the remaining indices – suggest consistent disinflation stretching beyond those sectors that are prone to supply shocks.

External sector

Rafał Antczak

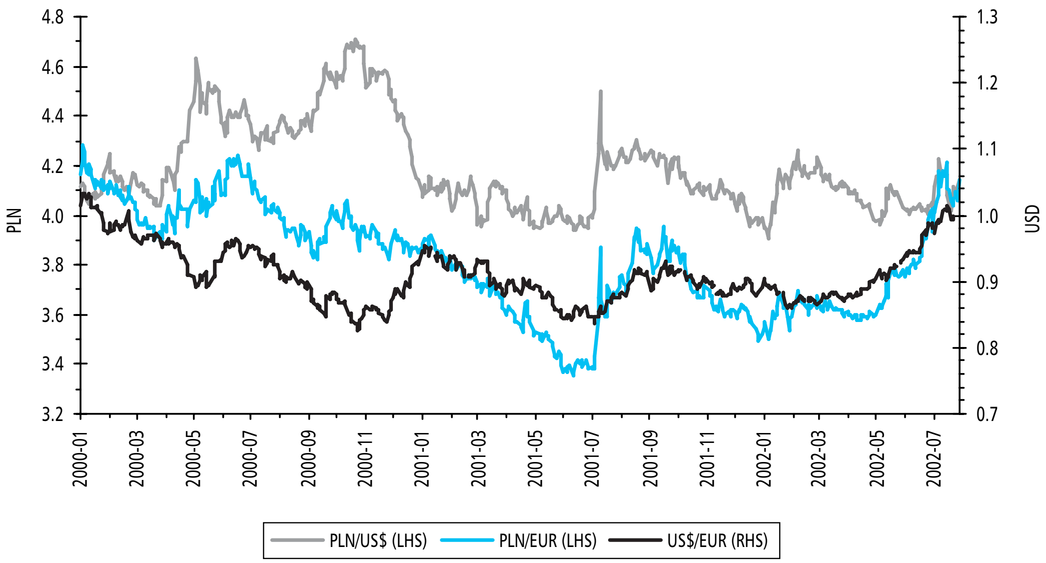
Exchange rate

- **Three months of stabilisation and .... strong euro appreciation**
- **Political factors once again the source of exchange rate fluctuation**

The end of 2Q02 brought stabilisation on the exchange markets, both foreign and domestic. Since 3Q00 the euro-dollar exchange rate has remained at an average level of below 0.9 US$/EUR. Nominal appreciation of the euro against the dollar reached 5.3% in 2Q02 compared to 1Q02 and 16.3% yoy in June. On July 15, 2002, after almost 2.5 years, the euro again reached parity with the dollar. Each new "creative accounting" scandal that hit American corporations, both in the old and new economies (Enron, WorldCom), was a lead to dollar flight on the financial markets. Investors' escape to liquidity has resulted in higher euro and Swiss franc deposits. Fundamentals were of secondary importance. Nevertheless, GDP growth was 1.7% in the USA compared to 0.4% in the euro zone, while inflation and unemployment were lower in the USA than in the euro zone (respectively, in 1Q02, inflation was at 1.5% and 2.5%, and unemployment 5.3% in the USA and 8.2% in the euro zone). Interest rates remained unchanged: the Fed rate at 1.75% since December 2001 and the ECB rate at 3.25% since November 2001.

In Poland, the zloty strengthened against the dollar by almost as much as it weakened against the euro (2.1% and -2.6%), thus leaving the exchange rate of basket almost unchanged, as in the previous quarter. The zloty weakened against the dollar yoy in June by 1.4% and by as much as 13.5% against the euro. At the beginning of July the unexpected resignation of Finance Minister Marek Belka, followed by the appointment of a new minister, Grzegorz Kołodko, and speculation surrounding his new economic program, added to the prevailing

Chart 2.2. Exchange rates, 2000–2002



Sources: NBP.

global economic uncertainty. From July 2 (the day of Belka's resignation) to July 9, 2002 the zloty lost 5.6% against the dollar (reaching 4.23 PLN/US$) and 6.3% against the euro (4.18 PLN/EUR). This was the zloty's weakest point against the dollar since February 2002, and weakest against the euro since June 2000.

As far as fundamentals are concerned, the triple cut in NBP rates in 2Q02, altogether by 150 basis points, did not cause an outflow of foreign portfolio investors, only a slower increase in their market share, which on the bonds market increased to 26.5% in June compared to 23.9% in March. Cuts in NBP rates in the previous quarter had resulted in periodical fluctuations in foreign investors' share in the Treasury market. The lowering profitability of Treasury papers during 2Q02 was compensated by a decline in inflation that left real interest rates unchanged in 1Q–2Q02.

The uninterrupted inflow of portfolio investments also compensated for the decline in FDIs (including from privatisation). Together with the decline in the current account deficit (by almost PLN550 million in 1H02 compared to 1H01), this resulted in an inflow of foreign currency to Poland and a growth in international reserves to US$28.2 million.

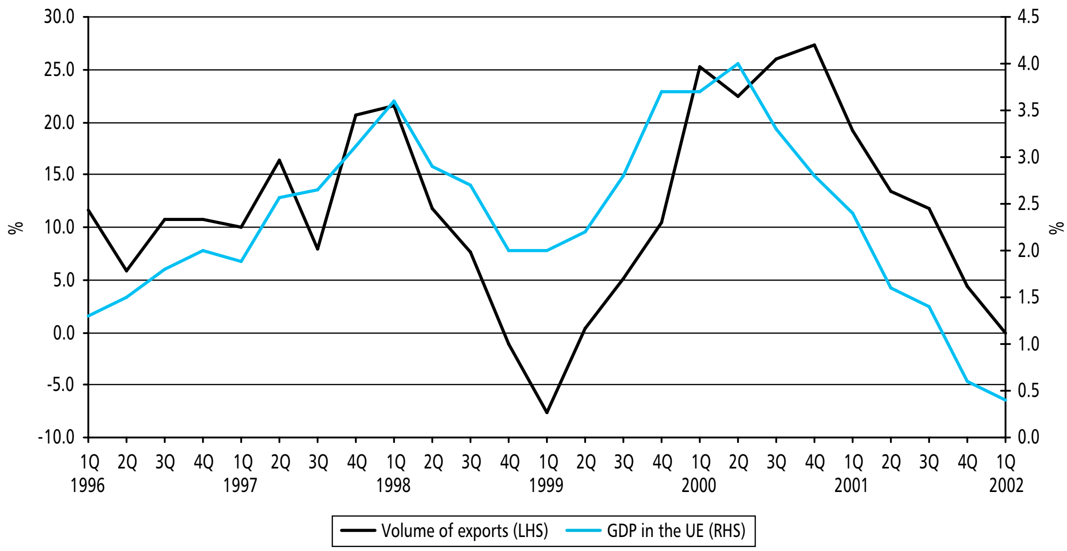
Łukasz Rawdanowicz

Foreign trade

- **Slowdown in exports**
- **Imports broadly in line with expectations**
- **Improvement in the terms of trade**

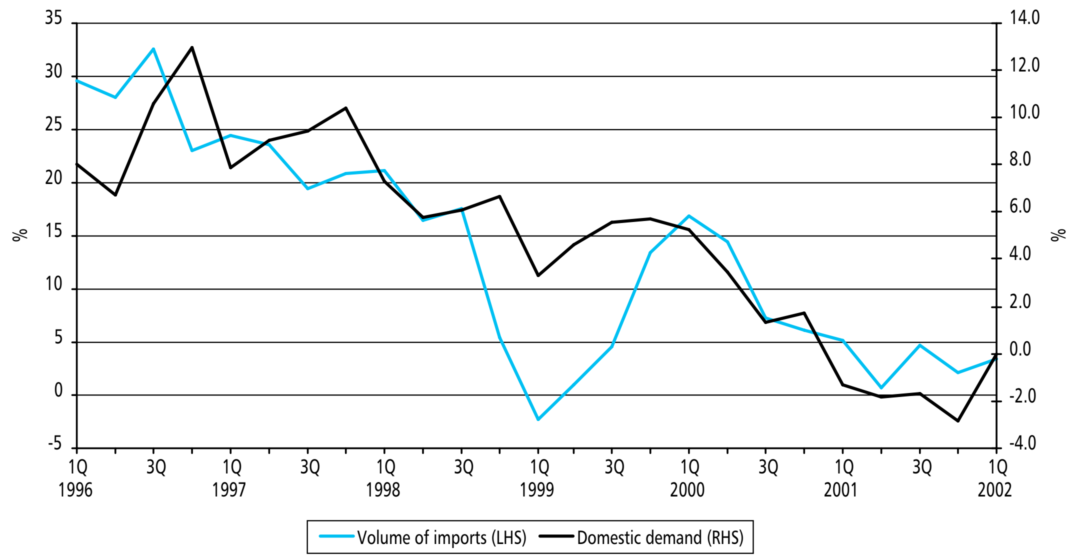
1Q02 saw a slowdown in exports. This was evident both in the CSO data on merchandise exports as well as national accounts and balance of payments data. We estimate that export growth edged up slightly in 2Q02 though not as fast as previously expected. Good export figures in the balance of payments in 2Q02 bode well for the future. The US$8 billion of exports were higher than we expected. This may, however, stem to some extent from the appreciation of the euro against the dollar (roughly

Chart 2.3. Volume of exports and GDP growth in the EU, 1996–2002 (% change, yoy)



Source: CSO and Eurostat.
Note: Volume of merchandise exports only.

Chart 2.4. Volume of imports and domestic demand growth, 1996–2002 (% change, yoy)



Source: CSO and Eurostat.
Note: Volume of merchandise imports only.

60% of export turnover is invoiced in euros) and not from an increase in export volume.

Growth in nominal exports to Russia, Ukraine and France accelerated significantly over the January-May period. On the other hand, turnover with Germany (Poland's main trading partner) and Italy declined.

Moderate growth in imports in 1Q02 and 2Q02 was more in line with our expectations. Despite robust household consumption, continued declines in investment dampened import demand.

2Q02 saw a further improvement in the merchandise trade deficit in the balance of payments. It stood at US$2.3 billion, a record low since 1997 (when comparable quarterly data came into existence).

Contrary to our expectations the terms of trade improved in 1Q02, increasing to 106.2. Import prices were declining at a faster rate than export prices. In 1Q02 oil prices did not increase as much as expected and remained below the level observed last year. On the other hand, 2Q02 saw an acceleration in oil price growth and the weakening of the zloty. We expect that in 2Q02 export prices (denominated in zlotys) fell, while import prices of oil and other commodities rose (or declined at a slower annual rate). Consequently, the terms of trade may have deteriorated against the previous quarter.

Łukasz Rawdanowicz

Balance of payments

- **Lower current account deficit**
- **Deterioration in the structure of current account deficit financing**

In 2Q02 the current account deficit declined both in annual and quarterly terms. This was attributable not only to the record-low merchandise trade deficit but also to the smaller deficit in trade in services. The unclassified current transactions surplus continues to be low. It seems that the poor readings on this item stem not only from the recent changes in tax legislation, but are also driven by a structural shift.

The US$900 million inflow of FDI into Poland in 2Q02 was the lowest since 1998. The slowdown in privatisation process seems to be the reason behind this situation. The picture is consistent with data on foreign investment from PAIZ (Polish Agency for Foreign Investment). It indicated a 30% decline in foreign investment inflows in 1H02. Portfolio capital invested in stocks continued to flow out of Poland, while portfolio capital invested in debt securities flowed in during 2Q02. One should note that 2Q02 saw an increase in Polish portfolio capital investment abroad.

At the end of June gross reserve assets stood at US$28.2 billion, sufficient to cover over 8 months of average imports.

Małgorzata Markiewicz

Public finances

- **High tax revenues**
- **New Finance Minister**

The execution of the 2002 budget in 1H02 was largely in line with the government's annual assumptions. On the revenue side 44.8% of the annual quota was met, with 48.6% on the expenditure side and 62.5% of the planned annual deficit. The transfer of NBP profits to the budget was delayed, however, which meant that non-tax revenues were under-executed in H202. Execution of tax revenues was impressive, up in real terms in all tax areas. In 2Q02 indirect taxes were 15.6% higher in real terms in comparison with 2Q01, CIT revenues were up 11.3% and PIT up 19.8%. The high rate of indirect tax revenues was due to excise taxes. Growth in VAT tax revenues was a consequence of the one-off change in rules on tax reimbursement and

[2] For more details please see: W. Skrok "Budget revenues in 1H02 and forecast for 2002".

resulted from high retail sales in 1Q02. The high collection rate of CIT revenues was due to the improved financial results of enterprises. Legal amendments to the PIT tax introduced in November 2001 resulted in higher tax collection rates. However, inflows from tax on interest were lower than planned (PLN1.2 billion in March-December 2002). Revenues from tax levied on interest income equaled PLN23 million in March and PLN59 million in April. In light of these figures the amount planned for the year as a whole seems to be overestimated.

The highest rate of execution was seen in inflows to the Labor Fund (58.6% of the annual plan) and to local governments (57.2% of the annual plan). The level of Labor Fund financial obligations grew, which was largely a consequence of the relatively low expected inflows to the Labor Fund assumed in the budget.

In 1H02 the Social Security Fund (FUS) received only 44.7% of inflows approved in the budget. This was reflected in the level of transfers to the pension funds and in FUS's growing liabilities to the banking sector. In 1H02 FUS transferred PLN4.6 billion to the pension funds (40% of the annual plan). Liabilities towards the banking sector grew in 1H02 by PLN330 million in comparison with the repayment of FUS credits of PLN570 million in 1H01. A new system of recording individual and fund accounts in ZUS was finally mobilized after a 3-year delay. This will make possible identification and transfer of revenues to the pension funds on time.

Privatization revenue remains insignificant. In 1H02 only 10.3% of the annual plan had been raised. The high state budget deficit of PLN25 billion had therefore to be financed mainly on the domestic market. This led to a high supply of government securities in 1H02.

Finance Minister Marek Belka resigned in early July and just before he left the macroeconomic indicators for the 2003 budget had been approved by government. According to the plan, revenues in 2003 are expected to equal PLN149.5 billion, expenditures PLN192.5 billion and the deficit PLN43 billion. Expenditures are expected to grow by PLN7.4 billion in nominal terms and this will be designated for debt servicing, growth in Ministry of Defense expenditures and payments to FUS, KRUS and the Labor Fund. It was also planned to introduce new rules governing pension indexation, an idea proposed by the Ministry of Labor. Today, indexation is based on forecast inflation increased by the ratio of assumed wage growth. This is expected to be changed to indexation by inflation increased by the wage growth rate for the previous year. This change in indexation should be neutral for budget expenditures, according to the government. Macroeconomic indicators for the 2003 budget may be changed, according to new Finance Minister Grzegorz Kołodko.

Parliament passed various legislation in 2Q02 which will have implications for the budget. In line with the government's program, "Entrepreneurship First", parliament revised the tax law covering PIT, CIT and lump-sum income tax. Originally, higher amortization rates were proposed, which would have meant a contraction in tax revenues of PLN0.9 million in 2003. Secondly, Changes in the obligatory frequency of submitting tax declarations were also proposed as well as limits allowing for lump-sum taxation and increasing the base level. Small companies will be able to calculate VAT on a quarterly basis as of January 2003. VAT will also be possible to calculate on a cash basis (payment obligation is based on date of payment rather than date of delivery or the writing out of the invoice, though no later than 90 days after the goods or services are delivered).

On July 26 Grzegorz Kołodko presented to parliament a packet of anti-crisis measures. The first law assumes the possibility of canceling enterprise debt towards the state budget and extra-budgetary funds, provided that enterprises present a restructuring plan or pay a restructuring fee equal to 15% or 1.5% of the value of their debt (the lower ratio is for ”strategic” branches such as mining and the steel and shipyard industries). The second project concerned the role of banks in enterprise restructuring. Banks will be allowed to classify reserves set aside for impaired debts as costs. They will also be able to cancel credits to restructuring enterprises and deduct part of the cancelled amount from their taxable income. In order to use all these instruments banks will be obliged to extend new credits to poorly performing enterprises. The third project is the introduction of tax credit for small enterprises employing from 5 to 50 people who start activity after the introduction of the law. In their second year such enterprises will be exempted from payment of income tax advances.

The government has said the financial implications of these projects will not affect the budget. The key factor, however, is certain to be the number of enterprises paying restructuring fees on their debts to the budget and extra-budgetary funds. The Finance Ministry's forecast neglects the moral hazard of enterprises and lower fiscal discipline in the longer-term. The biggest reservations on the project centre on the way in which it promotes non-market incentives. Banks would be allowed to cancel bad debts at the price of extending new credits on the basis of non-market rules. Small enterprises would be rewarded in effect for paying taxes (which should in fact be a normal practice). This would signal that paying taxes is not a good idea, as it is rational to expect a future cancellation of outstanding obligations. The ideas also introduce differential treatment of economic entities and are an attempt to delay privatization and stave off the bankruptcy of inefficient state enterprises.

Local governments

The financial results of local governments in 2001 were better than expected. The recorded deficit of PLN3.1 billion was half of the planned amount (PLN5.9 billion after the last revisions). A lower deficit led to lower growth in debts. At the end of 2001 outstanding debts stood at PLN12.3 billion, 78% of the planned PLN15.8 billion. Local government debt should be increased by other debts (PLN2.6 billion in the end of 2001), including local funds, public health institutions and cultural institutions at the local level. According to the plan, the local government deficit in 2002 will be almost PLN5 billion. The growing deficit may be explained by the drop in payments transferred from the state budget – nominal growth in 2002 was assumed at 1.9% in comparison with 13.8% in 2001. In 1Q02 local governments recorded a surplus of PLN3.2 billion and debt remained almost unchanged.

Rafał Antczak

Monetary policy

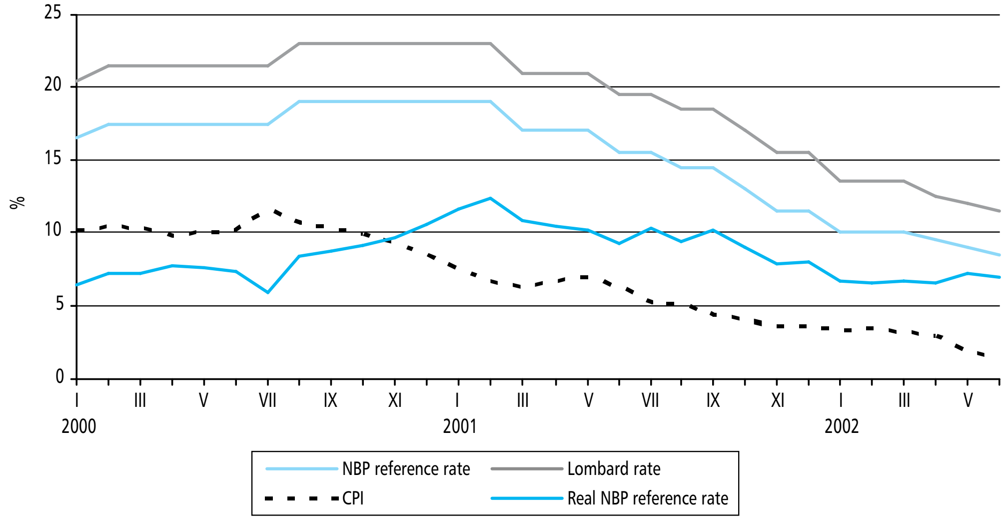
- **Fulfilment of fine-tuning interest rate strategy**
- **Negative trends from previous quarters continued**

During 2Q02 the MPC cut rates three times, fulfilling the fine-tuning interest rate strategy that we anticipated, alongside announcing its planned scale of cuts for the rest of 2002. The frequency of the cuts resulted from deflation deeper than expected as well as favourable forecasts for supply and demand factors, which did not indicate strong inflationary pressures in 2H02. The rate cuts lagged behind the pace of disinflation, which caused real interest rates to increase from 6.7% in March to 7.2% in June.

The growth in base money in 1H02 resulted from a strong increase in the component of net foreign assets (increase in international reserves), which was compensated by a decline in the component of net domestic credit – to the government sector and financial sector. A further, small, decline in credit to the government in 2Q02 (after a drop by PLN9.5 million in 1Q02) followed the reduction in government papers in the NBP's account by PLN3.5 billion, on one side, and a decline in government deposits by PLN3.1 billion on the other. The financial sector saw growth in NBP credits to banks in June due to a decline in open market operations to PLN5.6 billion (from a two-three times higher level in the previous year) and the growth of lombard credit to PLN2.7 million.

The negative trends in monetary aggregates continued. Currency in circulation rose on average by 1.5% monthly in 1H02 (three times higher than in the same period of the previous year) and cash increased by 18% yoy in June. As a result it reached 19.5% of the M3 aggregate – the highest level since 1999. In our opinion this confirms the steady growth of the grey economy in Poland. Also, current deposits of all types (households and individuals, companies and financial institutions) grew (on an annual basis), but were compensated

Chart 2.5. Monetary policy instruments, 2000–2002



Source: NBP and CASE.
Notes: The real NBP reference rate is calculated as a difference between NBP reference rate and CPI inflation.

Table 2.1. Contribution to money supply dynamics, 2000–2002 (cumulative, %)

	2000				2001				2002	
	I	II	III	IV	I	II	III	IV	I	II
Reserve money (RM)	-14.4	-1.8	-3.2	-7.6	-1.0	-0.5	-1.0	22.4	-2.8	5.1
Net foreign assets (NFA)	2.3	2.0	9.3	33.9	-16.7	-25.5	-22.9	-25.0	-7.2	8.2
Net domestic assets (NDA)	-1.9	9.2	1.0	-9.5	-5.9	-3.3	-7.3	5.6	-33.0	-33.7
Net claims on government (NCG)	-1.6	9.8	1.5	-9.1	-6.7	-4.8	-11.7	7.7	-15.9	-16.6
Claims on deposit money banks (CDMB)	-0.3	-0.7	-0.6	-0.4	0.8	1.5	4.4	-2.1	-17.1	-17.1
Other items net (OIN)	-14.8	-13.0	-13.5	-32.1	21.6	28.5	29.1	41.9	37.4	19.3
Broad money (M3)	0.3	8.6	7.5	11.9	2.9	4.6	8.3	9.0	-2.6	-1.7
Net foreign assets (NFA)	2.2	2.1	3.1	12.9	-2.0	-4.2	-4.2	-0.7	-2.9	0.0
Net domestic assets (NDA)	0.0	6.8	6.5	3.4	-0.1	0.0	4.1	2.4	-2.4	-0.3
Net claims on government (NCG)	-2.5	-1.3	-1.4	-4.5	-0.8	0.2	0.4	4.4	-2.0	-1.0
Claims on deposit money banks (CDMB)	2.6	8.1	7.6	7.9	0.9	0.0	2.9	-3.1	-0.4	0.4
Other items net (OIN)	-1.8	-0.3	-2.1	-4.4	5.0	8.8	8.4	7.2	2.8	-1.4

Source: NBP and CASE.
Note: Contributions to money supply dynamics are calculated using the following formula: $\Delta M/M_{-1} = \Delta NFA/M_{-1} + \Delta NCG/M_{-1} + \Delta CDMB/M_{-1} + \Delta OIN/M_{-1}$ 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.

Table 2.2. Calendar of the most important events in the NBP's monetary policy, 2001–2002

Source	Date of the resolution	Events
J NBP No. 9	June 29	Interest rate on NBP current deposits 5.85%
J NBP No. 12	August 22	Rediscount rate 17.0% Lombard rate 18.5% Refinancing rate 18.5/19.5% Reference rate at min. 14.5%
J NBP No. 13	August 24	Interest rate on NBP current deposits 5.55%
MP No. 34/562	September 26	Release of the monetary policy guidelines for 2002, inflation target for end-2002 set as 5% +/- 1percentage point
J NBP No. 17	October 25	Rediscount rate 15.5% Lombard rate 17.0% Refinancing rate 17.0/18.0% Reference rate at min. 13.0%
J NBP No. 20	November 28	Rediscount rate 14.0% Lombard rate 15.5% Refinancing rate 15.5/16.5% Interest rate on NBP current deposits 7.5% Reference rate at min. 11.5%
J NBP No. 23	December 19	Reserve rate requirement at 4.5% since January 1, 2002
J NBP No. 2	January 30, 2002	Rediscount rate 12.0% Lombard rate 13.5% Refinancing rate 13.5/14.5% Interest rate on NBP current deposits 6.5% Reference rate at min. 10.0%
J NBP No. 3	February 8	Conversion of 6-, 7-, 8-year NBP bonds into 10-year bonds worth PLN7.8 billion
J NBP No. 6	March 15	Changes in system of calculation and maintaining required reserves (in compliance with ECB standards)
J NBP No. 7	April 25	Rediscount rate 11.0% Lombard rate 12.5% Refinancing rate 12.5/13.5% Interest rate on NBP current deposits 6.5% Reference rate at min. 9.5%
J NBP No. 8	May 29	Rediscount rate 10.5% Lombard rate 12.0% Refinancing rate 12.0/13.0% Interest rate on NBP current deposits 6.0% Reference rate at min. 9.0%
J NBP No. 9	June 26	Rediscount rate 10.0% Lombard rate 11.5% Refinancing rate 11.5/12.5% Interest rate on NBP current deposits 5.5% Reference rate at min. 8.5%

Source: Journal of the NBP, Monitor Polski and own compilations.

by an equal decline in long-term deposits (PLN8.8 billion versus -PLN8.3 billion). Household deposits, including deposits of individuals, saw an especially strong decline, respectively, by PLN3.4 billion and PLN3.0 billion, in 2Q02, and on an annual basis a decline of around 3.3% at end-June 2002 (compared to a more than 22% increase at end-June 2001). Enterprises also lowered their deposits by PLN3.3 billion in 2Q02.

Banking system and broad money

The supply of broad money increased by 2.5% yoy in June, though after two quarters still registered a decline of 1.7%. This resulted from a drop in credit to the government and only a small rise in credits to the private sector. The decline in government debts in the banking system in 2Q02 was solely the effect of a decline of indebtedness vis-a-vis the NBP, and rose in commercial banks, both from credits granted and sold Treasury papers. This therefore repeated developments from the previous quarter.

Neutrality of the net foreign assets component in M3, compared to the strong growth of this component in base money after two quarters, resulted from the net outflow of foreign currency from commercial banks. The outflow was composed of an increase in foreign currency deposits abroad (by US$450 million), a decline in Polish enterprises' foreign currency payables and a negative balance on derivatives (-US$472 million).

During the first five months of the year the scale of the decline in credit interest rates was for the first time higher than cuts in NBP rates. The decline in credit interest rates was also deeper than in deposit interest rates. As a result, the interest rate spread was went down, reaching around 750 basis points, a level not observed since mid-2001. Cuts in credit interest rates to consumers (by 250 basis points) and enterprises (by 174 basis points) were especially strong. Banks thus began more expansionary credit policy, irrespective of worsening credit portfolios and stagnation.

Piotr Bujak

Financial markets

- Flattening of the yield curve
- Investor interest – the impact of disinflation

Short-term interest rates

Interest rates on both monthly and annual maturity interbank deposits and currency swaps were fairly stable at the start of April. Expectations that the MPC would cut rates in April were priced into FRA contract rates, which declined slightly against March rates. However, they were higher than expectations for an official rate cut at the previous MPC meeting a month earlier. Expectations of rate cuts in 6- and 12-month horizon fell at the beginning of April compared to a month earlier. The currency swaps market experienced a further flattening of its yield curve, mainly due to the continued increase in rates with longer maturities after mid-January. This led to a decrease in market expectations for rate cuts over the 12-month period. Negative investor sentiment was reflected in relatively low demand for Treasuries at the auction on April 3, 2002 and led to an increase in rates on the money market.

The situation changed in mid-April. The publication of inflation and industrial production data in March dampened hopes of an economic revival in 2H02. This in turn increased market expectations as to the scale of further rate cuts until the end of 2002. Positive data on the realisation of the budget after 3 months of the year also supported this.

Along with news on record low inflation in May and June, and no signs of economic revival, expectations for further monetary easing grew. Also, data on core inflation and a fall in inflation expectations fuelled market hopes of rate cuts. As a result, interest rates on the money market gradually but consistently fell during 2Q02. At the end of June the 3-month WIBOR stood at 8.97%, down from 10.34% at the end of the previous quarter.

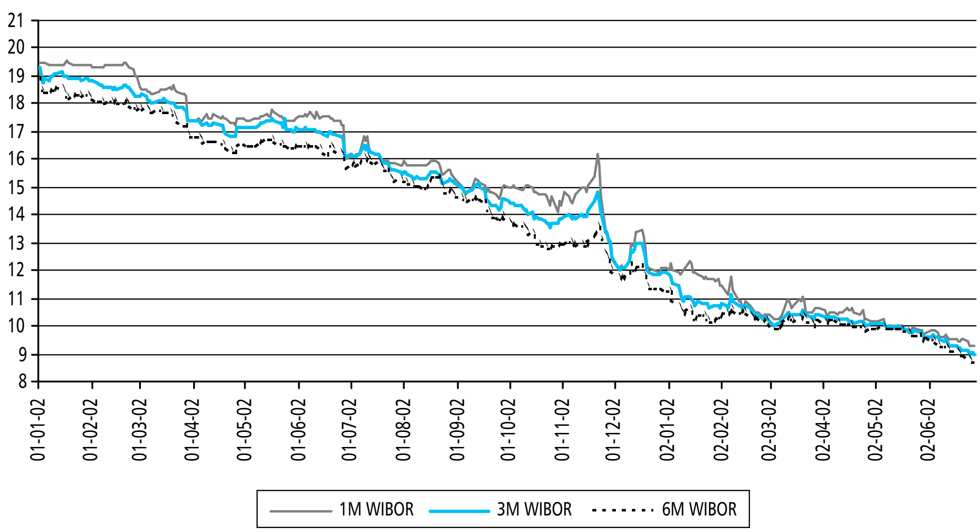
Long-term interest rates

The issuance of 20-year Treasury-bonds in April was the key event for the Polish debt market in recent months. The first auction was held on 17 April, where the Finance Ministry offered bonds with a nominal value of PLN0.4 billion, against investor demand of PLN2.651 billion. The relatively small size of the offer was due to the fact that the ministry wanted to anchor the yield of new bonds at a low level, thus lowering yields on 10-year bonds. Purchases were made by both domestic and foreign investors. The large surplus of demand over supply resulted in low yields, below market expectations, amounting to 7.215%. This was widely seen as stemming from investor attempts to push up the new instrument's price in order to push up the price on 10-year bond prices, in which many held long positions. The Finance Ministry declared its satisfaction with the auction's results and announced that the next auction of 20-year Treasuries would probably take place in 2Q02 or 3Q02.

It turned out that the market was clearly ready for an increased supply of Treasuries in 1H02. The only exception was at the 2-year bond auction on 3 April, where supply outstripped demand. In contrast to 1Q02, foreign investors were less active in 2Q02 on the T-bills and T-bonds primary market (their monthly average share fell from 10% to 6%), but were more active on the secondary market. As a result the share of T-bonds held by non-residents increased at the end of June to 26.5% from 23.9% at the end of March. The main factor influencing the fixed income market was expectations of rate cuts.

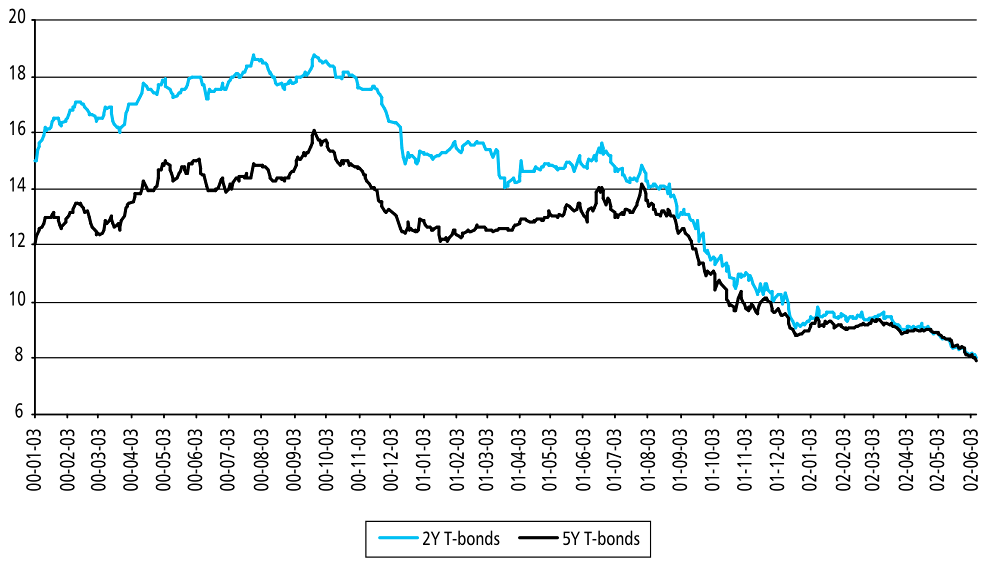
After a period of upward bond yields in the second half of March they started to fall off at the start of April. As was the case on the money market this was tied into inflation and industrial production data releases. At the end of April yields on Treasuries on the secondary market were by about 150 bps lower than at the end of March, which was consistent with the scale of the NBP's rate cuts in 2Q02. The large interest of investors in Polish Treasuries was maintained partly due to the already outlined factors driving the fixed income market (low inflation, expectations of rate cuts, Poland's closening membership of the EU), and partly due to the

Chart 2.6. 1-month, 3-month, and 6-month WIBOR, 2001–2002 (daily quotations, %)



Source: NBP.

Chart 2.7. Yield to maturity of 2Y and 5Y Treasury bonds, 2000–2002 (daily quotations, %)



Source: NBP.

negative sentiment on the world's stock exchanges, which induced investors to seek relatively safer instruments. Good news for fixed income market also came from the Polish president's support for maintaining the independence of the NBP, the healthy performance on balance of payments current account, stable oil prices, and the slow pace of economic growth in Germany.

At the end of June bank organisers of sales of Polish bonds abroad announced that the value of Yankee bonds would be increased from US$750 million to US$1 billion. Polish Yankee bonds were last sold in 1997. Yields on Treasuries issued at the beginning of July amounted to 6.358%, 158 basis points higher than yields on comparable US bonds.

Center for Social
and Economic Research

Outlook for the economy in 2002–2003

Łukasz Rawdanowicz

Economic growth

GDP and demand factors

- **Downward revision of GDP forecast – changes in appraisal of structural changes**
- **Worse prospects for exports and investment**

This quarter we have decided to lower significantly our forecasts for 2002 and 2003. Downward revisions refer primarily to net exports and investment. We are somewhat more sceptical about the feasibility of a quick boost in the two variables. The revisions stem primarily from changes in our model and in our estimation of the impact of structural factors that have not been explicitly modelled. Overoptimistic earlier forecasts are one of the reasons behind the modification of the model.

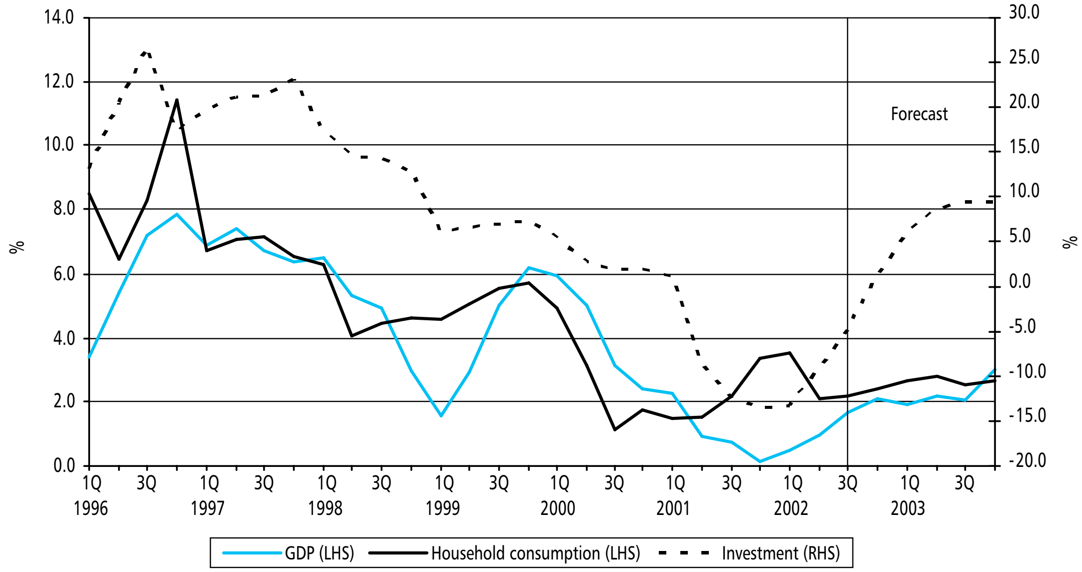
In the face of no prospects of a lowering of enterprises' fiscal burdens we expect any recovery in the global economy to translate to a lesser extent into higher exports in 2H02 and 2003. In addition to this we anticipate that growth in the EU in 2003 will be slightly lower than previously expected. These unfavourable developments will be mitigated to a small extent by a forecast weakening of the zloty against the euro.

Lower growth in exports is likely to impact negatively on investment prospects. In addition, we foresee slower declines in real interest rates – given the forecast of lower inflation and the expected pattern of cuts in NBP rates. Business confidence is also an issue worthy of discussion. So far there are no sings of any considerable growth in business optimism. Besides hopes for an improvement in financial conditions after plans announced recently by the newly appointed Finance Minister there appears to be little optimism among private enterprises, which account for over 2/3 of total investment in the economy. We forecast that any significant boost in investment will materialise no earlier than 2Q03. This is expected to result from the gradual improvement in foreign and household demand, cumulated declines in interest rates as well as a more optimistic mood in the enterprise sector.

We maintain our view on stable growth in household consumption. Lower GDP growth will diminish growth in nominal disposable incomes, but dampened inflation should to some extent moderate lower growth in real incomes. This, coupled with a low savings rate, should make it possible to secure stable but slowly growing household consumption.

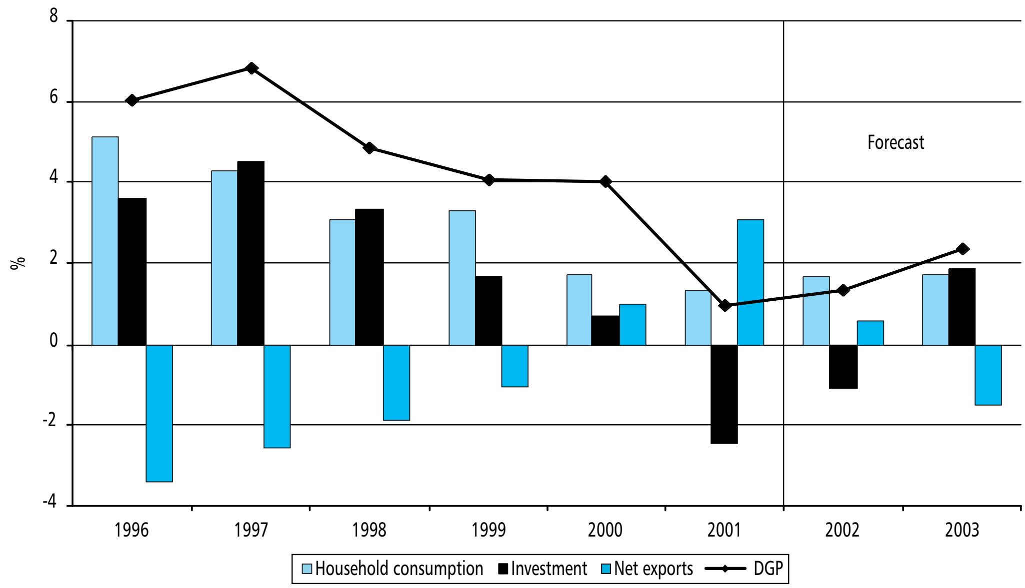
Due to amendments to our model and changes in some of its underlying assumptions we forecast GDP growth at 1.3% this year and 2.3% in 2003. Despite this significant downward revision we still forecast an improvement from the current doldrums, although weaker and delayed in comparison to previous forecasts.

Chart 3.1. GDP, domestic demand and investment, 1996–2003 (% change, yoy)



Source: CSO and CASE.
Note: CASE forecasts starting from 3Q02.

Chart 3.2. Contribution to GDP growth, 1996–2003 (%)



Source: CSO and CASE.
Note: CASE forecasts starting from 2002.

In making this forecast we do not take into account the structural reforms announced by new Finance Minister Grzegorz Kołodko. Any serious appraisal of the impact of the minister's new economic programme on macroeconomic performance is virtually impossible for the moment. Firstly, none of the plan's details are known. In addition, there is no guarantee that during the legislative process all the proposals will be passed by parliament in unchanged form. Secondly, the programme focuses primarily on the micro sector and a fundamental appraisal of the macro performance in the longer run is very difficult. Thirdly, given the time scale for needed for passing any new regulations and then implementing them one cannot expect the effects of any new laws to be visible any earlier than 2H03.

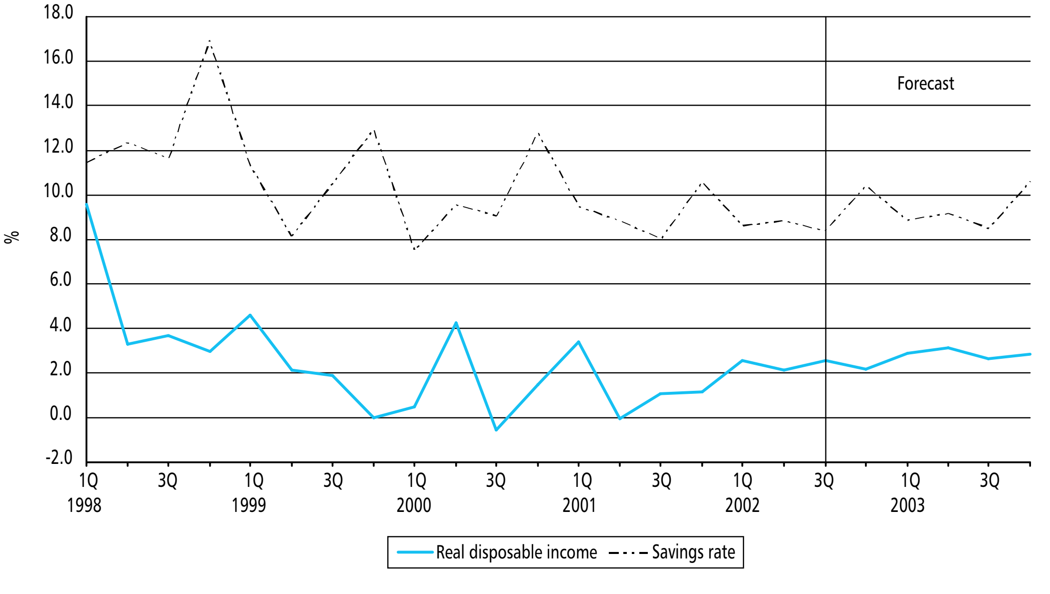
In analysing the risks associated with our forecast the prospects for exports and investment in particular need to be highlighted. On the one hand, it may turn out that our pessimism over export developments is exaggerated and after a temporary downturn in exports Polish enterprises will take advantage of the higher growth momentum in the EU. On the other hand, our faith in almost 10% growth in investment in 2003 may be overly optimistic. The growing gap in the performances of enterprises – between those improving their financial standing and those which remain on the edge of bankruptcy – is especially worrisome in this respect. If the trend is sustained, improved business optimism and exports may spur investment in only some enterprises. Consequently, the recovery in investment may be muted. In either case, the poorer financial condition of enterprises will impact on slower growth in wages and salaries and in turn on household consumption.

Real sector

• Revisions in the forecast for industry and construction

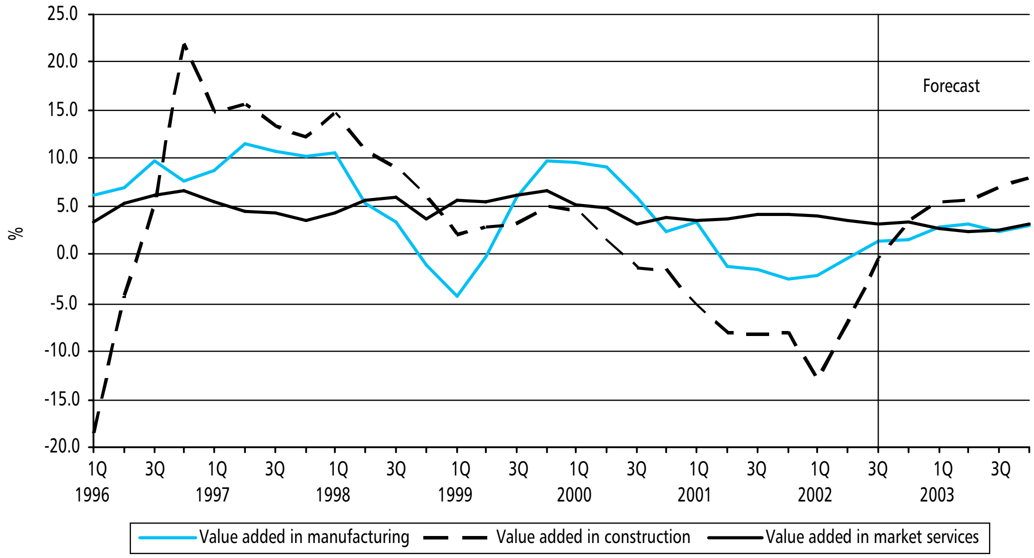
Our downward revision of economic growth prospects is expected in turn to impact on weaker performances in industry, in particular in manufacturing. Lower export and investment demand is expected to weaken industrial output in 2H02 and 2003.

Chart 3.3. Change in real household disposable income and the savings rate, 1998–2003 (%)



Source: CSO and CASE.
Note: CASE forecasts starting from 3Q02.

Chart 3.4. Value added in major sectors of the economy, 1996–2003 (% change, yoy)



Source: CSO and CASE.
Note: CASE forecasts starting from 3Q02.

Changes in the construction forecast are rather uneven. Despite worse investment prospects we expect declines in the construction sectors in 2H02 to be lower than previously forecast. 1H02 data indicate, surprisingly, faster growth in individual construction output (i.e. construction undertaken by households). This bodes well for performance in 2H02. However, in 2003 lower investment growth is expected to eventually dampen construction output as compared to our previous forecast.

Piotr Bujak

Labour market

• No prospects for unemployment to decrease

Despite a revision to our GDP growth forecast for 2002 and 2003, our unemployment forecast has not changed significantly. We still expect unemployment to grow to 18.8% by the end of 2002 and to 18.9% by the end of 2003.

We predict a further increase in the number of unemployed this year. The slow pace of unemployment growth in 2003 will enable only partial lowering of the unemployment growth trend. Growing productivity in enterprises enables them to increase planned production rates without needing to increase employment. Moreover, unemployment growth this year is expected to stem from the far higher than usual inflow of new entrants onto the labor market. As a result, the net growth of the labor force will amount to 250,000.

The forecast stabilisation of unemployment at close to 19% in 2003 results from only moderate economic revival predicted for next year. On the other hand, in the short-term one can expect some positive effects of the government's programs, "A first job" and "Entrepreneurship first". Also, recent changes to the Labour Code may enable some employers to increase employment. Some positive effects, although only short-lived, may stem from the "Anti-crisis" package proposed by the new Finance Minister. However, the impact of any government and parliamentary actions in the future are difficult to estimate, thus making any unemployment forecast for 2003 highly uncertain.

Mariusz Jarmużek

Prices

• CPI around 3%

The forecast for the CPI index was lowered due to the lower-than-expected tariffs, which were finally accepted by the Energy Regulatory Office (URE) (on average a 5.7% hike in July). One should also expect a good harvest this year and, bearing in mind the prevailing situation on the agricultural commodity markets, this will render a lack of inflationary pressure caused by supply factors.

Despite lowering the inflation forecast for 2002 we still regard that the dynamics of the CPI index will be increasing in the period 4Q02-1H03. This tendency will likely be a consequence of the gradual recovery in domestic demand and zloty depreciation. During this period the effects of interest rates cuts in 2002 should become clear. In our view, inflation should stabilise at 3% yoy in 2003. In 2003, the CPI and PPI indexes will likely converge, which should lead to an improvement in enterprises' results. We also envisage oil prices oscillating within OPEC's assumed range and a slight depreciate of the zloty. We expect an alternating harvest. In our opinion, the Energy Regulatory Office (URE) will allow an increase in tariffs of 4–5%.

External sector

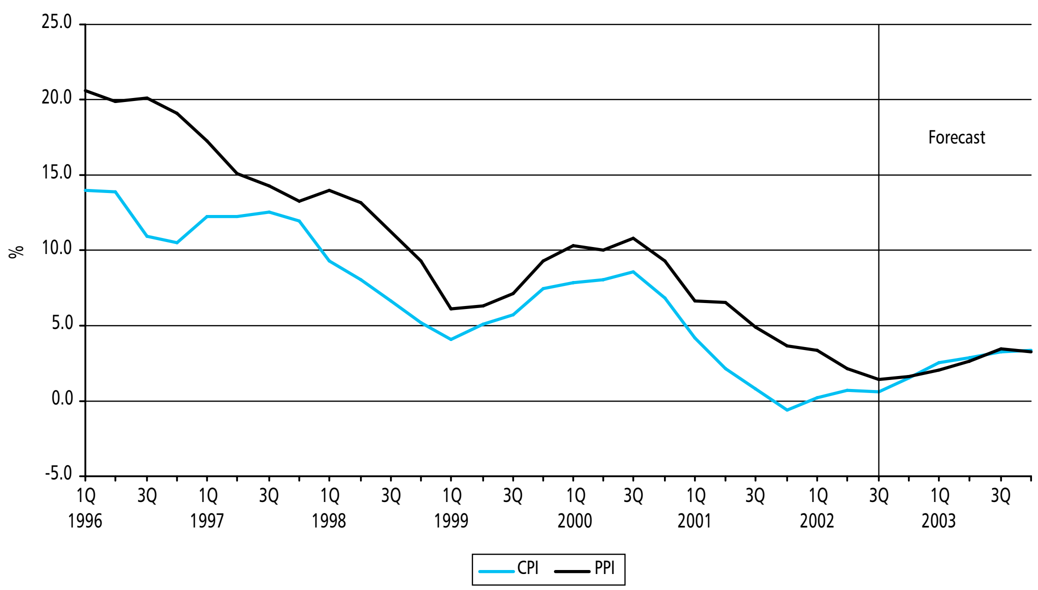
Rafał Antczak

Exchange rates

• Fundamentals versus speculation

Uncertainty over the relative strength of fundamental versus speculative factors and the direction they would take were reflected in both euro-dollar and zloty exchange rates. After 1Q02 it seemed that the two factors were pointing in opposite directions.

Chart 3.5. CPI and PPI, 1996–2003 (% change, yoy)



Source: CSO and CASE.
Note: CASE forecasts starting from 3Q02.

Macroeconomic indicators (fundamentals) indicated a strengthening of the dollar against the euro and a weakening of the zloty against both currencies. Speculative factors suggested an opposite direction. However, macroeconomic indicators after 2Q02 in the USA and EU are in line with speculative expectations. In the case of the US economy stock market falls were a factor behind worsening consumer confidence and could have led to a decline in investments. Instead, inflows of investments to the EU and the strengthening of the euro may lead if not to recovery then at least to import growth and stable consumption. It seems therefore that the current euro-dollar parity may last for a longer period.

In Poland, the strengthening of the euro should mean improvements in the profitability of Polish exports to the EU, though results after 1Q-2Q02 indicate the stronger importance of weak foreign demand. However, the ever more likely realisation of budget revenues in 2002 would not require additional issues of Treasury papers, which in turn would lower appreciation pressures on the zloty. Fluctuations in the zloty would reflect uncertainty surrounding Kołodko's and the government's economic policy.

Against the dollar and the euro speculative factors related to Poland's EU accession should stabilise the zloty and real appreciation should last. This despite likely weak economic recovery in 2002–2003. Any weakening of the zloty could result from the accumulation of negative fundamental and speculative factors, for example delays in the EU accession process or further downgrading of Poland's ratings.

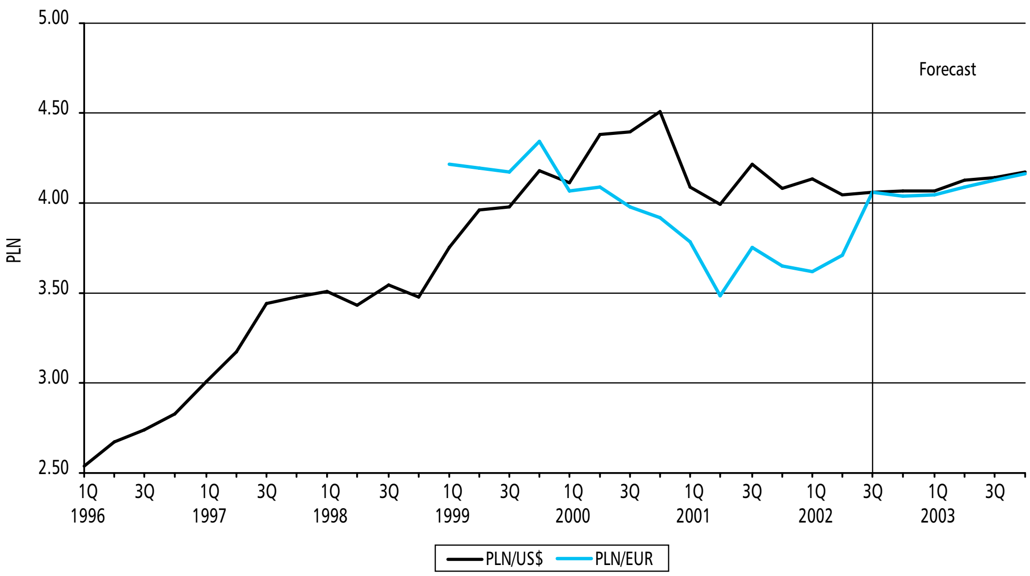
Łukasz Rawdanowicz

Foreign trade and balance of payments

- **Changes in forecasts – higher exports, lower imports**
- **Lower current account deficit**
- **Smaller inflows of FDIs**

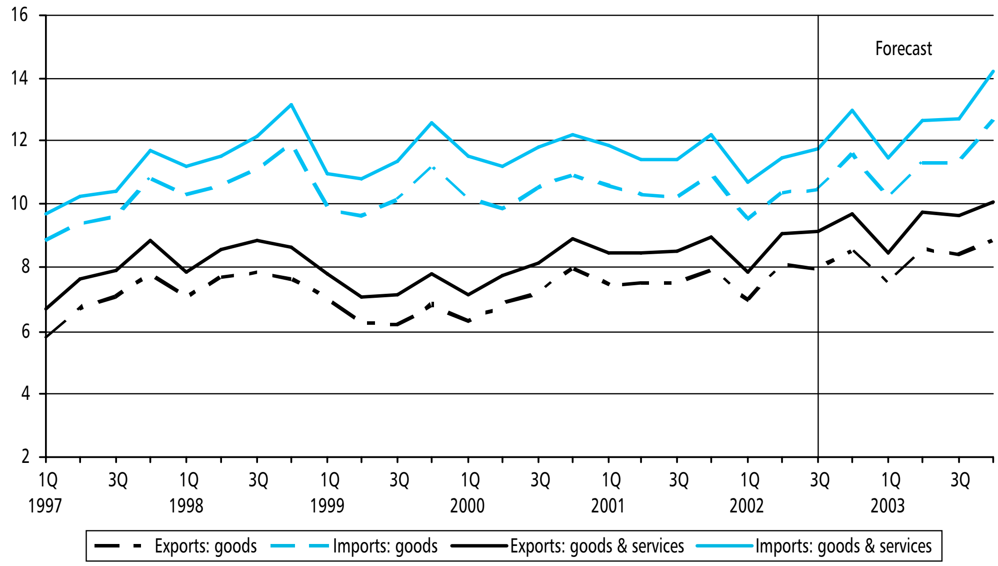
Changes in our model refer also to the balance of payments equations. At the moment we forecast that in 2H02 the nominal growth in exports denominated in US dollars will stay at the 2Q02 rate. At the turn of the year it should accelerate and then in 2H03 moderate. On the back of the forecast of lower domestic demand (in

Chart 3.6. Basic exchange rates, 1996–2003



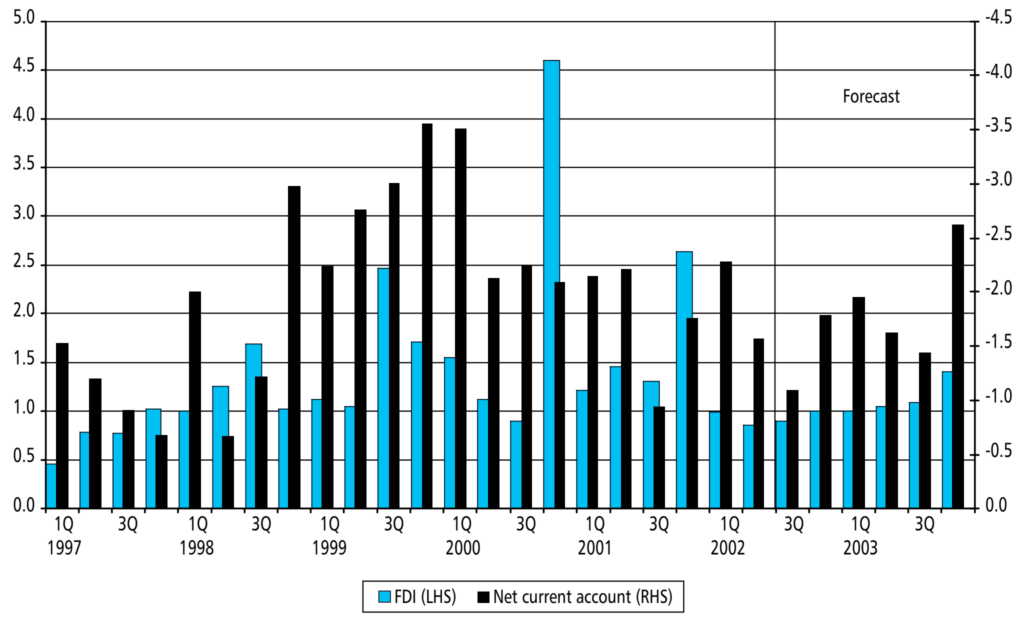
Source: NBP and CASE.
Notes: CASE forecasts starting from 3Q02.

Chart 3.7. Exports and imports, 1997–2003 (US$ billion)



Source: NBP and CASE.
Note: CASE forecasts starting from 3Q02.

Chart 3.8. Balance of the current account and FDI, 1997–2003 (US$ billion)



Source: NBP and CASE.
Note: CASE forecasts starting from 3Q02.

particular of investment) nominal growth in imports will be dampened. Finally, it should be stressed that any changes in the euro-dollar exchange rate will have an important bearing on the import and export readings.

Due to higher nominal exports and lower imports we should see some improvement in the current account deficit in the balance of payments. This should not be affected by the small decrease in the forecast for an unclassified current transaction surplus. The deficit is expected to be 3.6% of GDP in 2002 and 3% in 2003.

Results from 1H02 have obliged us to revise our assumptions on FDI inflows. At the moment we expect lower FDIs in 2H02 and 2003 on the back of slower privatisation and the worsening of the overall investment climate in Poland.

Małgorzata Markiewicz

Public finances

- **No risk of budget revision in 2002**
- **Changes in forecast for 2003**

2Q02's financial results have obliged us to revise our forecast for state budget revenues. The forecast for tax revenues presented below differs markedly from the previous one, especially in the area of indirect tax revenues. Data from 1H02 also obliged us to lower our GDP forecast. The relative contribution of different factors influencing the figures has also been changed. The share of domestic demand in GDP was higher than expected, which was reflected in growing tax revenues to the budget, mainly from indirect taxes (VAT on exports is equal to zero). A PLN620 million higher transfer of NBP profits than assumed in the budget will increase non-tax revenues. As a result we forecast budget revenues to come in at PLN2 billion over plan. This should allow for the execution of the planned expenditures and conditional expenditures in the budget law (education reform, growth in inflows to the Agriculture Fund, construction of roads and highways).

In forecasting next year's budget deficit we anticipate that expenditures will grow by 1% in real terms. As a result of this, in addition to our revenue forecast, we get a nominal deficit lower than this year. The forecast may be changed if macroeconomic assumptions are revised (and expenditures grow), or new legislation with consequences for the budget is passed. The biggest risk is connected with "frozen" expenditures, which were limited in 2002. This could lead to growth of expenditures by almost PLN10 billion.

Rafał Antczak

Monetary policy

- **Further loosening, alongside change in instrument**

A steady decline in real interest rates is expected to continue in 2H02 as a result of the anticipated rise in inflation. Further cuts in NBP rates in 3Q–4Q03 – in the range of 25 basis points (combined around 50 basis points) – would deepen its real decline. In our opinion, the NBP's restraint in cutting rates comes from the fact that the central bank has another monetary policy instrument up its sleeve – the reserve rate requirement. The NBP plans to lower this from the current level of 4.5% to 2% (the ECB level), to make banking costs in Poland on a par with banks abroad, including from the EU. The full liberalisation of foreign exchange regulations since October, which allows Polish citizens to hold deposits abroad, is significant in this respect. Changes in reserve requirements are a more efficient monetary policy instrument than interest rates, especially when loosening policy, as banks gain free resources available to credit expansion. Cuts in rates result in declines in deposit rates and a lower propensity to consume, whose net effect may not necessarily lead to a loosening of banks' credit policy. Such developments have already taken place in Poland, in 2001. The growing willingness of banks to grant credits, which started to appear in 2Q02 will also result in looser monetary and credit policy in 2002–2003.

During 2H02 and 2003 we expect a further rise in currency in circulation, though this trend should slow after 4Q02. We also expect any increases in household and individual deposits to be negligible, due to their utilization with the purpose of maintaining the level of consumption if only a slow growth in incomes takes place. The latter trend is likely to reverse no sooner than at the turn of 2002 and 2003. The pace of growth in enterprise deposits is likely to be uneven, with a likely change in structure from long-term to short-term. The slow recovery in demand for credits is likely to last, but should start growing on the back of higher enterprise demand, at the beginning of 2003. However, a recovery in demand for credits by households should be faster, thus strengthening consumer demand.

Rafał Antczak, Małgorzata Markiewicz

Co-ordination of fiscal and monetary policies

- **Continued expansion of Treasury papers**
- **Loose policy-mix**

Despite favourable developments in fiscal stance the emission of Treasury papers in 2Q02, as in 1Q02, was significant. In 1H02, PLN24.9 billion of T-bills and PLN28.2 billion of T-bonds were issued. PLN26.7 billion was used for deficit financing, PLN10.5 billion went on domestic debt repayment, which – together with government deposits in banks – gives a total of PLN47.7 billion. The surplus from the sale of government papers of PLN6.2 billion was used in Treasury papers auctions, where up to mid-2002 PLN11.2 in bonds were rolled over in longer maturity instruments. Modification of the sale plans of Treasury papers for the coming months indicates the Finance Ministry's desire to take advantage of low inflation in mid-year with its expected growth in 2H02 and possible lack of improvements in other macroeconomic indicators. In the event of this happening, emission of papers in 3Q-4Q02 would be more expensive, together with the higher return expected by investors. In the same way, the increase in emission of papers devoted to the US market increased by a third, from the preliminary amount of US$750 million to US$1 billion.

Looser monetary policy is expected to be accompanied by looser fiscal policy, with the deficit at 5% of GDP in 2003. The resulting need for government borrowing would inevitable push zloty appreciation (assuming the on-going interest of foreign investors) and crowd-out private investments. Pressure on the zloty would not be lowered by increased roll-over of foreign indebtedness starting from 2003.

The source of the biggest uncertainty for monetary policy and the policy-mix is likely to be undefined fiscal policy beginning from 2003. This also applies to the plan for introducing a mechanism that may result in delays of tax payments (reductions, preferences, tax payments on a cash basis, "tax credits", etc.). This could lead to the need for additional short-term borrowing and tensions in the co-ordination with monetary policy. Over-shooting the yearly plan on T-bills emissions by 78% already indicates unfavourable developments in the roll-over of domestic debt. A further downgrading in Poland's ratings, including on instruments denominated in foreign currency, may necessitate higher interest rates, both for instruments in foreign and domestic currencies (together with a constant growth in roll-over).

*Łukasz Rawdanowicz**

Global economy

- **US fundamentals still stronger than in Europe**
- **Falling stock markets, depreciating dollar**
- **Growth moderation in CEECs, Russia and Ukraine**
- **Inflationary pressures abating around the globe**
- **3Q02 expected to bring evidence of firming or staggered recovery**

2Q02 brought no significant changes to the global economic growth outlook. The US economy, after recording strong 1.7% yoy growth in 1Q02, is expected to follow a gradual recovery, as earlier anticipated. The accounting scandals in the US have led to falling stock markets. These could impact negatively on household

* The text based on the ***Global Economy 3/2002*** (http://www.case.com.pl/index.php3?page=pgtopge&lang=pl). ***Global Economy*** is a CASE quarterly publication (only in English) broadly covering the current world economic situation and outlook.

wealth and investment financing possibilities and thus pose a risk of derailing the recovery. According to Fed chairman A. Greenspan, however, "the fundamentals are in place for a return to sustained healthy growth". In addition, business and consumer confidence remains robust so far. The former is boosted by rising profits thanks to a rapid growth in productivity (the seasonally adjusted annual rate in the non-farm business sector amounted to 8.4% in 1Q02). On the other hand, high productivity makes any prompt improvement in the labour market less likely.

The EU economy has shown no clear signs of recovery. 1Q02 estimates point to 0.3% yoy growth in GDP in the euro-zone and 0.4% yoy in the EU. Investment and inventories contributed negatively to growth, while net exports and consumption contributed positively. In the case of exports, it should be noted however that they actually declined, though imports contracted at an even faster rate. Flash estimates point to stronger economic activity in 2Q02, though no extraordinary performance is expected.

As during past recoveries, the upturn this time is also starting out with a boost from net exports. However, no evidence for a pick-up in domestic demand is evident. This, coupled with the strengthening euro and sluggish performance in 1H02, suggests that the overall recovery may turn out softer than expected. In addition, lower consumer inflation, higher wage demands and low productivity growth point to erosion of corporate profits, which bodes badly for the recovery. However, a more optimistic inflationary outlook offers room for leaving monetary policy unchanged. On balance, developments in 1H02 pushed some forecasting institutions to lower their GDP projections for the euro-zone this year. As we didn't change our forecast last quarter on the back of a wave of general optimism, for the moment we leave our expectations broadly unchanged.

In Germany although the IFO survey readings were generally rising, declines were recorded in April and June. This may indicate that overall business confidence is not that buoyant. Unless domestic demand picks up in the near future, the scenario of staggered and protracted recovery in Germany may materialise.

The contagion effect of the US stock markets' declines impacted on stock markets in other parts of the world. Investors' dented corporate confidence led them to shy away from US shares and investment. As a result the dollar depreciated strongly against major currencies. In mid-July it hit parity with the euro. The strengthening of the yen against the dollar did not stem entirely from the dollar's general weakness but also from positive news on faster-then-expected recovery in Japan. The Bank of Japan, concerned about the strength of the yen, intervened on the foreign exchange market. On one occasion it was accompanied by the ECB.

Most of the CEECs, Russia and Ukraine experienced growth moderation in 1H02, but the outlook for the rest of 2002 and 2003 is brighter. Growth in the region remains strong compared to the EU. Most economies in the region are troubled by fiscal policy problems, which may impact on the fulfilment of the Maastricht criteria and potential growth in the longer term.

Many currencies gained against the dollar the recent rises in dollar oil prices have been muted. This, coupled with weak growth momentum that has not stimulated wage and price pressures, has kept consumer prices in advanced countries in check. Similar developments were observed in the CEECs, where low food prices were an additional factor. In many countries contained inflationary pressures made it possible to postpone interest rate hikes or to continue monetary easing. Neither the ECB nor the US Fed touched interest rates during 2Q02. If appreciation of the euro continues, interest rate hikes in the near future on the part of the ECB will be very unlikely in 2H02. In the case of the Fed, interest rate increases are limited by the poor condition of the equity markets and the fact that recovery is expected to be gradual. Thus, monetary tightening is likely to materialise only in the event of strong evidence of the upturn.

Looking to the future, developments in the three major currencies would appear to be key factor for the outlook of the main economies. If the dollar weakens further this could increase imbalances in the growth performance between the US on the one side and the euro zone and Japan on the other. The weak dollar will boost the US manufacturing sector via higher exports. It will also help to reduce the USs high current account deficit. The flip side of this scenario is poorer prospect for an upturn in the euro zone and in Japan as exports are important driving forces in these economies. If domestic

Table 3.1. GDP in selected countries, 1996–2003 (% change, yoy)

	1996	1997	1998	1999	2000	2001	2002f	2003f
OECD	3.1	3.4	2.7	3.2	4.2	1.1	*2.1*	*3.3*
USA	3.6	4.4	4.3	4.1	4.1	1.0	*3.0*	*3.7*
Japan	5.0	1.6	-1.1	0.7	2.4	-0.5	*-0.3*	*1.5*
European Union	1.7	2.6	2.8	2.6	3.4	1.5	*1.2*	*2.8*
Germany	0.8	1.4	2.1	1.8	3.0	0.6	*0.9*	*2.8*
United Kingdom	2.6	3.5	2.6	2.2	2.9	2.4	*2.1*	*3.3*
Russia	-3.5	0.8	-4.9	5.4	9.0	5.0	*3.5*	*3.5*

Source: Data – OECD, IMF, statistical offices; forecast (f) – market consensus and CASE.

Table 3.2. Inflation in selected countries, 1996–2003 (% change, yoy)

	1996	1997	1998	1999	2000	2001	2002f	2003f
USA	2.9	2.3	1.6	2.1	3.4	2.8	*1.4*	*2.1*
Japan	0.1	1.8	0.7	-0.3	-0.7	-0.7	*-0.8*	*-0.5*
European Union	2.1	1.8	1.8	1.2	2.5	2.5	*2.0*	*1.6*
Euro area (HICP)	2.2	1.6	1.2	1.1	2.4	2.5	*2.1*	*1.6*
Russia	22.0	11.0	84.4	85.7	20.8	18.6	*15.0*	*13.0*

Source: Data – OECD, IMF, statistical offices; forecast (f) – market consensus and CASE.

Table 3.3. The euro and yen exchange rate vs. the US dollar, 1996–2003

	1996	1997	1998	1999	2000	2001	2002f	2003f
Euro	1.270	1.134	1.121	1.066	0.924	0.896	*0.948*	*0.985*
Yen	108.8	120.9	130.6	113.8	107.7	121.3	*122.0*	*114.0*

Source: Data – ECB; forecast (f) – market consensus and CASE.

demand does not accelerate, the recovery in these countries may be delayed. However, we believe that fundamental factors (as proxied by growth performance) will start to play a more decisive role than psychological factors (such as the recent accounting scandals) influencing investors' decisions and, consequently, the dollar will not depreciate further in 2H02.

3Q02 is expected to bring evidence of a firming or staggering of growth momentum around the world and in the direction of the main exchange rates. This information will be crucial for shaping monetary policies and fiscal conduct.

Early crisis warning indicator

2Q02 witnessed an improvement in our early crisis warning indicator. Greater macroeconomic equilibrium stemmed foremost from significant lowerings of forecasts for the current account deficit and inflation. These come partially at the cost of lower GDP growth, which took a negative toll on our indicator. Lower, though still high, unemployment at the end of 2Q02 was undoubtedly a positive development. In addition, short-term foreign debt as a percentage of GDP declined.

We maintain our forecast of a high budget deficit as a percentage of GDP (5%) and this weakens our indicator significantly. On the negative side, further appreciation of the zloty (though at a lower rate), increase in total foreign debt, credit expansion as well as rising real WIBOR should be also noted.

We would like to draw your attention to changes in the past values of our indicator. These stem primarily from data revisions. Especially large changes took place in the case of the M3 aggregate and its components. Also, data on foreign debt were subject to changes.

Table 3.4. Early warning crisis indicator

	weights	1Q00	2Q00	3Q00	4Q00	1Q01	2Q01	3Q01	4Q01	1Q02	2Q02
1. Annual GDP for 4 consecutive quarters	0.10	4	4	6	6	4	4	6	6	4	6
2. Annual unemployment rate (end of quarter)	0.05	10	4	6	10	10	4	6	10	6	0
3. Annual average CPI forecast for 4 consecutive quarters	0.06	4	4	4	0	0	6	0	4	4	0
4. Government deficit forecast as a % of GDP	0.10	5	5	5	6	6	10	10	10	10	10
5. CA balance forecast for 4 consecutive quarters as a % of GDP	0.15	10	0	4	4	6	0	4	0	10	0
6. Real effective exchange rate	0.15	6	6	6	6	10	10	6	6	6	6
7. Credit expansion as a % of M3 (end of quarter)	0.07	4	6	6	4	4	6	6	4	6	6
8. Polish foreign short term debt as a % of liquid reserves (end of quarter)	0.15	6	4	6	4	4	6	6	4	6	4
9. Total Polish foreign debt as a % of GDP	0.07	6	6	6	6	6	6	6	6	6	6
10. Real 3M WIBOR	0.10	4	6	6	6	6	4	6	4	0	6
Indicator		6.04	4.28	5.48	5.10	5.80	5.60	5.74	4.94	6.08	4.54

Source: CASE.
Notes: 1. The methodology of indicator calculation is available at the CASE web site: http://www.case.com.pl/index.php3?page=pgtopwsk&lang=pl&submenu=6
2. The annual forecast for the budget deficit in a given year is introduced in every fourth quarter of the previous year.
3. Changes in the historical values of the indicator due to official data revisions.

Witold Skrok[1]

Center for Social
and Economic Research

Budget revenues in 1H02 and forecast for 2002

Realisation of budget revenues in 1H02

State budget revenues (indirect taxes, PIT, CIT, excises and duties) amounted to PLN61 billion in mid-2002. This was in line with planned budget revenues for 2002. Special attention should be focused on the increase in VAT revenues in June.

Revenues from indirect taxes came in at PLN43.8 billion, PLN4.5 billion more than in 2001. Any analysis and conclusions based on a comparison of revenues after June with respective revenues in previous years is misleading, however, as registered growth this year resulted from a one-off change in tax repayments. Revenues from VAT in June were artificially increased by an additional PLN1.8 billion (which explains the over 80% of jump in VAT revenues between 2Q02 and 2Q01). This resulted from shifting the period of VAT refunds by tax inspectorates from 25 to 60 days. Only for this measure revenues in 2002 would be higher, as VAT would not be refunded in a single month.

Despite the slowdown in household incomes there was no decline in demand for some excise goods, for example revenues from excise on fuel were more than 6% higher in 1H02 compared to the previous year, tobacco goods were higher by over 12%, beer by over 6%, and only revenues from alcoholic beverages and cars fell (respectively by 4% and 23%), which explains the new Finance Minister's decision to cut excise taxes on the latter goods by 30%.

Revenues from CIT came in at PLN6.1 billion, PLN0.7 billion higher against the same period of 2001. Taking CSO data on the financial situation of enterprises as an indicator of developments in revenues subject to CIT tax there is no doubt that higher revenues have resulted from profitability growth (profits on sales in enterprises covered by CSO statistics improved by over 70% and gross profitability went up by 0.8 percentage points in 1Q02) and a probable increase in the number of taxpayers.

Revenues from PIT were PLN9.4 billion, which is roughly the same level as in the previous year and below the figure forecast in the budget act. This occurred despite the freeze on tax breaks and the introduction of tax on income from interest. The question is how can this be explained? First of all, taxing incomes from interest was a mistake, if one takes into account the achieved revenues. Secondly, the announced plans to eliminate tax exemptions on house building resulted in an increased number of exemptions, higher than the plan's projections. The final factor, which I treat as a hypothesis, is decline in the number of taxpayers as a result of a change in

[1] An Associate of the CASE Foundation. Former Head of the Department of Financial Policy and Analysis at the Finance Ministry. The article presents solely the opinions of the author.

legal status from physical persons to legal persons involved in business activities. If this hypothesis materialises it would once again provide evidence (after the tax on income from interest) that rational economic decisions have won the political motivation.

Tax revenues were collected in the context of lower economic indicators than projected in the budget act and lower efficiency of tax collection (a worsening of the efficiency of the tax system), which resulted from a significant increase in tax arrears to the budget. Unfortunately, rises during the first four months of 2002 (PLN1.4 billion) already reached half of the rise observable in 2001 as a whole and have nothing to do with lowering fiscal stringency and the alleged "setting aside" of ever more resources in the economy to support its development. It only provides more evidence of the growing asymmetry and the shift in the tax burden onto more efficient subjects.

Forecast of budget revenues for 2002

Based on the budget realisation figures for January-June, assuming a macroeconomic scenario not significantly different from that presented in the current PEO and an unchanged tax collection rate, budget revenues for 2002 will be almost PLN4 billion higher than planned.

The above conclusion is not very optimistic, as this rise has been 40% achieved by "creative accounting" methods in the area of VAT, limited successes in tightening fiscal stringency on excise tax and a complete failure in PIT, and especially tax on incomes from interest. A 16% share of CIT in the improved

Table 1. Stocks and flows of tax arrears, 1998–2002

	Total	+/- *)	VAT	+/- *)	Excise duty	+/- *)	CIT	+/- *)	PIT	+/- *)
1998	**5 286.0**		**2 640.6**		**209.0**		**674.9**		**1 761.6**	
1Q99	5 734.6		3 033.2		212.3		697.2		1 791.9	
2Q99	6 228.8		3 348.6		284.4		714.0		1 881.7	
3Q99	6 474.4		3 607.6		326.1		689.5		1 851.2	
1999	**6 998.0**	***523.6***	**4 106.1**	***498.6***	**281.2**	***-44.8***	**679.3**	***-10.2***	**1 931.3**	***80.1***
1Q00	7 747.3	***749.3***	4 654.4	***548.3***	300.6	***19.3***	751.7	***72.4***	2 040.6	***109.3***
2Q00	8 233.9	***486.6***	5 062.0	***407.6***	380.2	***79.6***	698.1	***-53.6***	2 093.6	***53.0***
3Q00	8 581.3	***347.4***	5 301.7	***239.6***	402.5	***22.3***	765.3	***67.2***	2 111.8	***18.2***
2000	**9 574.7**	***993.5***	**6 083.7**	***782.0***	**495.9**	***93.4***	**826.3**	***61.0***	**2 168.8**	***57.0***
1Q01	10 202.9	***628.2***	6 525.4	***441.7***	548.3	***52.3***	901.7	***75.5***	2 227.5	***58.7***
2Q01	10 825.8	***622.9***	7 047.0	***521.6***	652.0	***103.8***	815.4	***-86.3***	2 311.3	***83.8***
3Q01	11 448.4	***622.6***	7 530.7	***483.7***	738.4	***86.4***	834.4	***19.0***	2 344.8	***33.5***
2001	**12 263.5**	***815.1***	**8 167.8**	***637.1***	**786.1**	***47.7***	**904.3**	***69.9***	**2 405.2**	***60.5***
2002-01-31	12 821.7		8 668.6		795.0		912.4		2 445.7	
2002-02-28	13 160.5		8 701.9		815.8		1 184.3		2 458.6	
2002-03-31	13 322.8	*1 059.3*	8 821.8	*654.0*	844.9	*58.8*	1 191.3	*286.9*	2 464.8	*59.6*
2002-04-30	13 622.9		9 000.0		893.3		1 253.5		2 476.1	

**) Comparing to the previous period.*
Source: Ministry of Finance.

revenue figures took the form of a "reward" and "incentive" to enterprises to further restructure costs, including employment. The significant increase in tax arrears to the budget, taxpayers' shifts from PIT to CIT, and also increases in cash transactions and growth in the shadow economy suggests taxpayers' broadly low perception of the tax system in Poland. Without deep reform of the tax system the Polish economy would not only lose the ability to compete with the USA or EU economies but also with the Russian economy.

Table 2. State budget revenues in 2002

	Budget Law 2002	Forecast 2002	*PLN million*	%
Total revenues	**145.1**	***149.0***	***3.9***	***2.71***
Indirect taxes	91.3	*94.1*	*2.8*	*3.04*
CIT	13.8	*14.7*	*0.9*	*6.51*
PIT	26.5	*25.7*	*-0.8*	*-3.17*
Duties	3.5	*3.8*	*0.3*	*9.23*
Off-budgetary revenues	6.1	*6.4*	*0.3*	*5.33*
Other revenues	3.8	*4.3*	*0.5*	*11.74*

Source: Budget Law 2002 – own calculations.