Inflation Report

Second Quarter 2002

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OVERVIEW

1. Q2 2002 saw an unexpectedly rapid drop in inflation. The 12-month CPI went down from 3.3% in March to 1.6% in June.

This resulted from factors both on the supply and demand side. Growth of food supply caused an earlier than usual seasonal drop in its prices. At the same time lack of any major shocks in the world oil market was conducive to the stabilisation of domestic fuel prices at a low level. Inflation was further eroded by the weak growth rate of officially controlled prices (which resulted from a different pattern of their rises over time compared to the year before and also their lower scale). The persisting low rise in consumers' disposable income reduced the growth rate (which was weak anyway) of prices for non-foodstuffs and some services. Moreover, the pace of decline in the 12-month CPI in Q2 2002 was additionally amplified by the reference base effect – most evident in the group of food and officially controlled prices, whose growth rate clearly had gained pace the year before.

The decline of the Q2 2002 CPI was accompanied by a drop of all measures of core inflation, persisting since May last year, which pointed to the sustainability of disinflation trends in the economy.

12-month PPI rates after their Q4 2001 drop (reversed early this year) have shown an uninterrupted growth trend, albeit slight.

2. Despite the lack of any symptoms of Q1 2002 recovery in the Eurozone economy, particularly in Germany, Q2 2002 saw the reversal of the faltering trend in Polish exports. Growth in export revenues in that period was accompanied by stabilised import payments. Consequently, the negative trade balance narrowed down in Q2 2002 compared to its level the year before. Lower than the year before were also negative balances of income and services, while the surpluses of unclassified current transactions and transfers increased. As a result of these favourable changes the ratio of current account deficit to GDP declined in Q2 2002 to 3.7% (down from 4.1% in the Q1 this year and 5.3% in Q2 last year).

3. Given the still low level of domestic demand, the growth rate of the GDP in Q2 2002, at 0.8%, was nonetheless slightly higher than in the previous quarter. The growth rate of personal consumption went down to 2.9%. The falling trend in fixed investment persisted, although the rate of its drop declined.

Added value in Q2 2002 climbed 0.9%. Compared to Q1 2002 added value declined less in industry and construction. The growth rate of added value slipped in commercial services.

4. The situation in the labour market did not see any major improvement in Q2 2002. The trend towards employment shedding in the enterprise sector and growth in the number of unemployed was maintained. In June the unemployment rate went down to the level of 17.3% (from 18.1% in March this year), which was largely attributable to seasonality. In July business outlook survey entrepreneurs predicted further employment shedding.

The difficult situation in the labour market continued to hamper wage growth. In 1st HY 2002 a slower than last year rise in average nominal wages was noted in the enterprise sector. However, due to a considerable slackening of the CPI growth rate the rise in real wages was faster than last year.

5. The performance of the central government budget proceeded in Q2 2002 according to plan. But due to low privatisation revenues in the same period, this translated into a major growth in central government borrowing requirements. Consequently, the net value of T-securities issued on the domestic market in the quarter under analysis was 56% higher than in the corresponding period of the previous year. This crowded out enterprise funding.

The mounting debt incurred by components of the sector other than the central government Budget, primarily special purpose funds, was also a disquieting phenomenon in the public finance sector in Q2 this year. Combined with the expected high deficit of local government budgets this means that the public finance deficit may by year-end 2002 exceed the level of 5% GDP authorised in the Budget Act.

6. In Q2 this year a slight drop in the y/y growth rate of money supply (M3) coincided with a further fast expansion of notes and coin in circulation (except vault cash). The latter phenomenon followed largely from falling interest rates, which depressed the opportunity cost of holding cash. Q2 2002 saw a continued decline in bank deposits taken from households, this being traceable to the deterioration of the income status of households, as well as reduced interest rates on deposits in the banking system and taxation of bank interest.

* * *

In Q2 2002 the Monetary Policy Council carried out three NBP interest rate cuts, lowering the interest rates by a total 100-200 bps, of which the reference rate (key to the assessment of the degree of monetary policy restrictiveness) by 150 bps.

The Council was prompted to reduce interest rates in Q2 2002 by:

– a further steady decline in all y/y core inflation measures, which showed that the falling trend in the y/y CPI rate observable at the same time was not merely a blip;

– inflation expectations, both of consumers and bank analysts, which were good for inflation prospects;

– moderate growth rate of the average nominal wage in enterprises and lack of factors pointing to its possible acceleration in the coming months;

– negative y/y growth rate in lending to corporates and flagging growth rate in lending to households.

But the main consideration counselling caution in reducing interest rates in Q2 2002 was the persisting uncertainty as to the evolution of the economic deficit of the public finance sector both in 2002 and 2003. Although the period under analysis sparked no major threats to the implementation of the *2002 Budget Act*, there was a danger that the economic deficit would be higher than assumed in connection with the worsening situation of the special purpose funds. Also the next year's government fiscal policy plans gave rise to concerns. Pursuant to the *Guidelines for the Draft Central Government Budget for the Year 2003*, presented by the Ministry of Finance in June this year, the economic deficit of the public finance sector next year was to account for 4.9% of the GDP. In view of the forecasted acceleration of economic growth this would be tantamount to maintaining a loose fiscal policy.

Moreover the Council was also encouraged to reduce the scale of cutting interest rates by:

– the high growth rate of notes and coin in circulation persisting in Q2 2002, accompanied by uncertainty as to its reasons and inflationary consequences;

– flagging trend in the y/y growth rate of household deposits;

– awareness that the full effects of the interest rate cuts performed by the Monetary Policy Council since February last year have not yet made themselves felt.

The further monetary policy relaxation in Q2 2002 this year is reflected in the progressing decline of the Monetary Conditions Index (MCI), which takes into account movements of real interest rates and real effective exchange rate. In June this year the index slipped to a level approximating the one recorded in May 1999.

In June 2002 the Monetary Policy Council cut the 2002 inflation target to 3% – with the tolerance band of +/- 1 percentage point. This decision was justified by the much more favourable conditions for implementing the inflation target this year than they were predicted when it was originally determined in August 2001. There was a surprisingly positive evolution for inflationary processes of the supply factors (mainly with respect to food and fuel prices). Lower than anticipated was the rise in officially controlled prices. The growth of domestic demand was also lower.

In this situation the Council recognised that (with the exception of the extremely adverse supply shocks in 2nd HY 2002) despite the lowering of the NBP interest rates from August 2001 to May 2002 by a total of 6.5% year-end inflation would probably clearly slip below 4%. It would thus be lower than the lower bound of the originally adopted inflation target band. With a view to stabilising inflation at a low level, as well as retaining transparency as to the priorities of its monetary policy, the MPC took the decision to revise its inflation target for 2002.

At the same time the Council also set the inflation target for 2003 at an analogous level and, by the same token, fine-tuned the medium-term monetary policy target of bringing inflation below 4% in 2003. The new target is consistent with the inflation rate adopted in the *Guidelines for the Draft Central Government Budget for the Year 2003*.

* * *

After the unexpectedly fast coming down of inflation in Q2 2002 (by 1.7 percentage point) in 2nd HY 2002 one can expect more equilibrium between the opposing factors which, respectively, slow down and accelerate the growth rate of prices.

The low in 1st HY 2002 growth rate of domestic demand will gradually go up in subsequent quarters. The anticipated drop in the rate of investment and consumer demand staying at a level approximating the one registered in 1st HY 2002 should trigger a process of gradually bridging the demand gap (the degree of productive capacity utilisation and the rate of GDP growth will both go up). But this should not fuel a rise in inflationary pressure.

Inflationary pressure must not be expected from the labour market either. Both the lack of near-term prospects of a clear reduction of unemployment and the persisting drop in inflationary expectations of consumers make one justified in thinking that wage formation over the coming year will be conducive to a further reduction of inflation.

In 1st HY 2002 cheapening food was an important disinflationary factor. Whether in 2nd HY food prices will also be pulling inflation down will depend on this year's harvest. According to current estimates it will be lower than last year and will be at the average level of previous years.

As regards oil prices, the expected slow pickup in the economy world over should not expose us to their rise in 2nd HY 2002, nor indeed the next year. However, the persisting fears of a next Gulf War do not allow to significantly scale down the forecast of oil prices compared to their Q2 2002 level.

Neither do movements in broad monetary aggregates pose a threat to monetary policy implementation in the near future. Nor does it seem that the persisting high y/y M1 growth rate augurs inflationary threats. The reason is that the growth of demand for notes and coin in circulation is connected with falling interest rates and probably rising activity in informal economy.

Fiscal policy continues to be a source of high uncertainty when forecasting inflation. Admittedly, the implementation of this year's Budget proceeds according to plan, but the worsening situation of the special purpose funds and expected high deficit of local governments demonstrate that the economic deficit of the public finance sector may exceed at year end the level of 5% of GDP, scheduled in the Budget Act.

In turn, the *Guidelines for the Draft Central Government Budget for the Year 2003*, adopted by the Council of Ministers in July this year, imply that the economic deficit of the public finance sector for the next year is to stand at 4.5% of the GDP. Given the forecasted acceleration of economic growth this is a disquieting piece of information, as it is tantamount to maintaining a loose fiscal policy. This will be largely determined by a high deficit of the Budget. Add to this the danger that the ratio of public debt to GDP may exceed the 50% mark next year and conservatism in forecasting inflation and decisions on any further interest rate cuts seems necessary.

Among the factors pointing to the possibility of the price growth rate going movements in the PPI should also be considered. Admittedly still quite low, it has been going up (on a y/y basis) uninterruptedly since early this year. The PPI, which in recent years was on average 3 percentage point lower than the CPI, in June 2002 stood merely 0.4% lower. This can anticipate PPI growth in the near future and, consequently, an inflationary pressure as measured by changes in the CPI.

The behavior of commercial banks continues to remain an unknown when forecasting inflation. Once the economy is picking up, the banks, even with no base NBP interest rate cuts, may still reduce interest rates on loans due to consistently large differentials between the levels of interest on interbank and bank loans.

In sum, the impressive Q2 2002 drop of inflation was caused first of all by unexpectedly very big cuts in food prices. But this is not a lasting phenomenon. After it has ceased, the rate of inflation should gradually stabilise at a level slightly above the current one, which implies that the implementation of both this year's and next year's inflation target is highly likely.

Basic macroeconomic indicators

	2000				2000	2001				2001	2002	
	Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4		Q1	Q2
						real growth						
GDP	5.9	5.0	3.1	2.4	**4.0**	2.3	0.9	0.8	0.2	**1.0**	0.5	0.8
Domestic demand	5.1	3.3	1.4	1.7	**2.8**	-1.3	-1.8	-1.7	-2.8	**-1.9**	0.0	1.0
Total consumption	4.1	2.6	1.2	1.6	**2.4**	1.2	1.3	1.8	2.8	**1.8**	3.2	2.7
Personal consumption	4.8	2.9	1.1	1.7	**2.7**	1.5	1.6	2.2	3.3	**2.1**	3.5	2.9
Gross capital formation	10.4	5.7	1.6	1.7	**3.9**	-13.1	-12.5	-14.2	-14.5	**-13.8**	-18.4	-6.0
Gross fixed investment	5.4	2.8	2.0	2.1	**2.7**	1.2	-8.5	-12.5	-13.5	**-9.8**	-13.3	-8.4
Household savings ratio (%)[1]	9.2	10.2	10.4	14.7	**11.2**	12.2	10.9	9.6	11.6	**11.1**	8.2	9.9
Household financial savings ratio (%)[2]	5.5	3.6	4.3	8.5	**5.5**	9.0	5.2	4.1	6.0	**6.1**	5.2	4.5
Unemployment (%)	14.0	13.6	14.0	15.1	**15.1**	16.1	15.9	16.3	17.4	**17.4**	18.1	17.3
Disposable incomes												
(corresponding period previous year = 100)	102.9	102.2	100.9	103.7	**102.4**	104.7	101.6	101.3	100.1	**101.8**	98.9	100.1
Treasury debt (million zloty, nominal)[3]	270,144.9	279,507.8	287,984.3	266,816.8	**266,816.8**	273,192.9	271,584.9	291,795.1	283,939.5	**283,937.5**	309,388.4	
Central government deficit (million zloty)	6,927.4	10,650.2	14,041.9	15,391.0	**15,391.0**	14,992.5	18,805.5	21,865.0	32,358.3	**32,358.3**	16,436.8	24,922.5
Foreign debt (USD million)[3]	65,702	66,882	65,607	69,558	**69,558**	71,217	70,438	72,758	70,815	**70,815**	72,061	

[1] Household savings to gross disposable incomes. Savings represent that portion of gross disposable incomes not allocated to consumption.
[2] Household financial savings to gross disposable incomes. Financial savings represent the growth in household money stocks (the sum total of growth in bank deposits, notes & coin and investments in securities, less growth in household borrowings).
[3] Period end.

Source: GUS, Ministry of Finance & NBP figures; NBP estimates.

Basic monetary indicators

	2000				2000	2001				2001	2002	
	Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4		Q1	Q2
	corresponding period previous year = 100											
Consumer prices[1]	110.3	110.2	110.3	108.5	**108.5**	106.2	106.2	104.3	103.6	**103.6**	103.3	101.6
Industrial producer prices[1]	107.3	108.9	108.3	105.6	**105.6**	103.8	100.9	100.7	99.6	**99.6**	100.3	101.2
	nominal growth, period end balances (corresponding period previous year = 100)											
Money supply (M3)	114.0	120.3	114.7	111.9	**111.9**	114.7	107.8	112.6	109.0	**109.0**	103.2	102.5
Total money supply[2]	113.8	120.6	114.1	111.7	**111.7**	114.9	108.0	114.3	113.7	**113.7**	108.6	107.5
Deposits and other liabilities	115.6	122.9	116.7	115.5	**115.5**	116.4	108.9	113.6	108.7	**108.7**	101.7	100.5
of which:												
personal deposits	113.8	118.1	116.8	120.0	**120.0**	119.9	115.9	117.0	106.4	**106.4**	103.3	100.1
corporate deposits	117.5	121.4	110.0	98.5	**98.5**	105.1	99.8	105.3	116.5	**116.5**	104.9	112.9
Claims	125.3	132.0	123.7	116.9	**116.9**	114.1	104.8	111.4	109.3	**109.3**	107.0	109.4
of which:												
claims on persons	136.5	152.7	130.8	125.7	**125.7**	121.1	102.2	119.9	114.7	**114.7**	117.7	115.6
claims on corporates	115.1	117.4	114.5	112.0	**112.0**	111.2	106.8	106.0	103.7	**103.7**	98.2	102.1
	real growth[3], period end balances (corresponding period previous year = 100)											
Money supply (M3)	103.3	109.2	104.0	103.1	**103.1**	108.0	101.5	108.0	105.2	**105.2**	99.9	100.9
Total money supply	103.2	109.4	103.4	103.0	**103.0**	108.2	101.7	109.6	109.8	**109.8**	105.1	105.8
Deposits and other liabilities	104.8	111.5	105.8	106.4	**106.4**	109.6	102.5	108.9	104.9	**104.9**	98.5	98.9
of which:												
personal deposits	103.2	107.1	105.9	110.6	**110.6**	112.9	109.1	112.2	102.7	**102.7**	100.0	98.5
corporate deposits	106.5	110.1	99.7	90.8	**90.8**	99.0	94.0	101.0	112.4	**112.4**	101.6	111.1
Claims	113.6	119.8	112.1	107.8	**107.8**	107.5	98.6	106.8	105.5	**105.5**	103.6	107.6
of which:												
claims on persons	123.7	138.6	118.6	115.8	**115.8**	114.0	96.2	114.9	110.7	**110.7**	114.0	113.7
claims on corporates	104.3	106.6	103.8	103.2	**103.2**	104.7	100.6	101.6	100.1	**100.1**	95.0	100.5
Reference rate (minimum reverse repo rate) (%)[4]	17.5	17.5	19.0	19.0	**19.0**	17.0	15.5	14.5	11.5	**11.5**	10.0	8.5
Rediscount rate (%)[4]	20.0	20.0	21.5	21.5	**21.5**	19.5	18.0	17.0	14.0	**14.0**	12.0	10.0
Lombard rate (%)[4]	21.5	21.5	23.0	23.0	**23.0**	21.0	19.5	18.5	15.5	**15.5**	13.5	11.5

[1] In the last month of the quarter.
[2] Total money supply (M2) acc. to the definition in force by 30th March 2002.
[3] CPI deflated.
[4] As of the period end.

Source: GUS, NBP figures.

1

Domestic demand and supply[1]

According to tentative GUS (Central Statistical Office) estimates the Q2 2002 growth rate of the GDP under higher than in previous quarters domestic demand was slightly higher, at 0.8%, than in Q1 this year. The decline rate of added value in industry and construction was reduced. In connection with the reduction of the growth rate of sales in trade/distribution enterprises the growth rate of added value in commercial services was smaller too.

The lower growth of retail sales demonstrates that under a continued relatively low nominal growth of households' gross disposable income, the growth rate of personal consumption, high in Q1 this year, has now shrunk. It is estimated that there was a further drop of fixed investment, although it was lower than in previous quarters. Growth estimates of the GDP and domestic demand are presented in table 1.

Table 1
Growth rate of GDP and domestic demand

		2001				2002	
	2001	Q1	Q2	Q3	Q4	Q1	Q2
Total added value	**100.8**	**102.1**	**100.8**	**100.6**	**100.1**	**100.6**	**100.9**
Industry	99.4	103.3	98.7	98.5	97.5	98.0	99.1
Construction	92.4	94.8	92.0	91.8	92.0	87.1	89.7
Commercial services	103.9	103.5	103.7	104.1	104.2	104.0	103.5
GDP	**101.1**	**102.3**	**100.9**	**100.8**	**100.2**	**100.5**	**100.8**
Fixed investment	89.8	101.2	91.5	87.5	86.5	86.7	91.6
Personal consumption	102.1	101.5	101.6	102.1	103.3	103.5	102.9
Domestic demand	**98.1**	**98.7**	**98.2**	**98.3**	**97.2**	**100.0**	**101.0**

Source: GUS (Central Statistical Office), own estimates.

1.1. Domestic demand

Based on data on nominal rise in salaries and social benefits it is estimated that in Q2 2002 the real growth rate of **gross disposable income** in domestic households approximated the one recorded in Q1 this year.

The average gross monthly salary in the economy rose 2.7% compared to Q2 2001 (3.5% in the enterprise sector). Due to an approximately 4% drop of average employment the income from hired labour was nominally 1.2% lower than in the corresponding period of the previous year (of which 1.4% lower in the enterprise sector).

The growth rate of average pensions in Q2 2002 was still high. Income from social insurance benefits went up around 9% from Q2 last year. Despite the caps imposed in the Budget, the value of social insurance benefits exceeded the values recorded last year. It is estimated that total social benefits went up in Q2 2002 nominally by about 8%.

[1] Unless otherwise indicated, all growth rates in this chapter, are in real terms and y/y.

Despite the worsening price relations in agriculture a nominal growth of farmers' income was maintained thanks to rising production. The growth rate of income from non-agricultural business activities and from property slipped. The overall estimation is that the nominal growth of disposable income compared to Q2 last year was about 2%. Given a 2.1% fall in the quarterly growth rate of consumer prices, the purchasing power of households' disposable income approximated the level recorded in Q2 last year.

During Q2 this year household deposits with banks declined PLN 1.3 billion[2], of which deposits with the original maturity of up to 2 years went down by PLN 3.4 billion. Lower than in Q1 2002 was the increment of loans (PLN 0.9 billion compared to PLN 3.2 billion). At the same time a very high growth of notes and coin in circulation was recorded (PLN 2.4 billion compared to PLN 0.6 billion). The total net monetary savings of households stood at PLN 0.3 billion, which constituted merely 7% of the value recorded in Q2 last year. It is estimated that financial savings outside the banking system went up almost twice on Q2 last year, while non-financial savings were about 5% lower. **Households' gross savings** in Q2 2002 were around 7% lower than the year before, while in Q1 2002 they were respectively lower by over 30%.

In these circumstances it is estimated that despite **the growth of personal consumption** still being higher than the growth of purchasing power of households, its growth rate of the former, at 2.9%, was nonetheless lower than in Q1 this year. A drop in the growth rate of consumption is also marked by the weakening of the growth rate of the retail sales volume in medium-sized and large distribution enterprises (from 5.8% in Q1 2002 down to 0.8% in Q2 2002).

Based on data about construction sector output and supply of investment goods it is estimated that the scale of decline in **fixed investment** has shrunk. The level of completed construction (investment) projects in medium-sized and large enterprises in Q1 2001 was 18.3% lower than the year before, and in 1st HY 2002: 15.5% lower, respectively. The drop of production sold of industrial enterprises manufacturing mainly investment goods declined from about 6% to about 5%. Up went the share of investment imports in total imports.

The performance of the **central government budget** went in Q2 2002 according to plan, however, due to the very high level of deficit – this was connected with considerable State Treasury borrowing requirements.

The Budget deficit in Q2 2002 stood at almost PLN 8.5 billion (up from PLN 3.8 billion the year before). Such a big difference in the level of deficit resulted primarily from the lack of extraordinary non-tax revenues, such as occurred in Q2 of the previous year[3].

On the other hand, a high growth rate was displayed by tax revenues of the Budget, which in Q2 2002 were 13.5% higher than in the corresponding period last year. This largely resulted from high receipts from indirect taxes. Particularly high receipts on this account were recorded in April (fuelled largely by a high growth rate of retail sales in March 2002) and also in June, the latter case in turn influenced by the prolongation (enacted last March) of the period for reimbursing tax due VAT payers.

Budget spending in Q2 this year was 6.0% higher than in the corresponding period of the previous year. But it should also be noted that central government budget spending, on the rise since the beginning of the year, has been accompanied by adverse changes in its structure, for an increasing role in the spending is played by social expenditures. And thus, in 1st HY the Budget transferred over 27% more grants to the Labour Fund than the year before and 16.5% more to the Social Insurance Fund. On the other hand, the fixed investments of the Budget in the period from January to June were 9% lower than in the corresponding period of the previous year.

[2] This figure pertains to total deposits. In the remaining chapters of the *Report* the category "deposits" covers only current deposits and term deposits with original maturities up to and including two years.

[3] In June 2001 the Budget received PLN 0.8 billion in UMTS license payments and PLN 4.9 billion in the NBP's out of profit payments (exceptionally high due to changes in accounting principles). This year the payment was almost half that and was transferred in July rather than in June.

1

Table 2
Central government budget completion

	1st HY		Growth rate	Growth rate	Completion	
	2001	2002	I-VI/I-VI	IV-VI/IV-VI	2001 completion	2002 plan
REVENUES, of which:	**67,729.7**	**65,111.1**	**96.1**	**93.7**	**48.2**	**44.9**
Tax revenues	53,783.7	59,314.4	110.3	113.5	45.2	45.0
Indirect taxes	38,995.8	43,646.1	111.9	116.6	47.3	47.8
Corporate income tax	5,401.1	6,227.4	115.3	117.7	40.9	45.0
Personal income tax	9,386.7	9,440.8	100.6	98.6	40.0	35.6
Non-tax revenues	13,946.0	5,796.7	41.6	34.1	65.0	43.2
EXPENDITURES, of which:	**86,535.2**	**90,033.5**	**104.0**	**106.0**	**50.1**	**48.6**
Debt service	11,081.2	12,426.2	112.1	109.4	53.0	48.4
Grant for the Labour Fund	1,673.1	2,128.7	127.2	97.3	63.1	58.6
Grant for the Social Insurance Fund	10,460.1	12,190.5	116.5	128.3	48.6	44.7
DEFICIT	**-18,805.5**	**-24,922.5**	**132.5**	**222.5**	**58.1**	**62.3**
Financing	18,805.5	24,922.5	132.5	222.5	58.1	62.3
Domestic financing	**17,818.7**	**23,179.0**	**130.1**	**131.0**	**40.8**	**59.7**
Treasury bills	5,833.4	10,455.9	179.2	136.8	54.0	178.7
Bonds	7,651.0	16,244.7	212.3	176.6	28.5	61.0
Privatisation revenues	1,969.9	677.3	34.4	6.3	30.4	10.3
Foreign funding	**986.9**	**1,743.5**	**176.7**	**-222.9**	**-8.7**	**147.8**

Source: Ministry of Finance.

The high Budget deficit recorded in Q2 2002 combined with low privatisation revenues in that period translated into an increase in the Budget's borrowing requirements. These have been largely covered from foreign sources. But despite the funding of over PLN 2.2 billion of the total amount of deficit with a Eurobond issue, the net value of T-securities issued on the domestic market rose 56% in Q2 2002 on the corresponding period of the previous year. Thus the possibility of financing enterprises by banks was constrained further still compared to the situation last year.

Yet another negative phenomenon in the public finance sector in Q2 2002 was a growing indebtedness of extrabudgetary parts of the sector, first of all special purpose funds. This year, the Social Insurance Fund has recorded lower receipts from insurance premiums than last year and simultaneously has accrued more arrears to Open Pension Funds (in 2002 pension funds will probably fail to receive the amount scheduled in the Budget Act, i.e. PLN 11.7 billion). One can also expect an increased indebtedness of the Labour Fund, which (despite a much higher than last year budget grant) is still short of funds for the payout of benefits. A novel element contributing to the indebtedness of the public finance sector will be the Guaranteed Employee Benefit Fund[4]. The above factors as well as an expected deficit of local government budgets demonstrate that the economic deficit of the public finance sector may by the end of this year exceed the level of 5% of GDP scheduled in the Budget Act.

[4] The possibility of drawing bank loans by the Guaranteed Employee Benefit Fund was introduced in July 2002 under the Employee Claims Protection under Employer Insolvency Act of 29th December 1993; in previous years the Fund had no such possibility.

1.2. Domestic supply

According to initial estimates in Q2 2002 added value climbed 0.9%. Compared to Q1 2002 there was a lower drop of added value in industry and construction. The growth rate in commercial services declined.

Industrial production sold (in large and medium-sized enterprises) in Q2 this year was 0.3% smaller than in the corresponding period of the previous year (in Q4 last year its drop was 2.6%, while in Q1 this year 1.6%). The output of the manufacturing sector was at a level approximating the one recorded in Q2 of the previous year (drop by 0.1%). The relatively low level of industrial output persisting for over one year followed from continued low domestic demand, in addition to which the shrinking of investment demand and less robust growth in consumer demand were recorded. The decline in the output of enterprises manufacturing mainly investment goods fell from about 6% in Q1 2002 to about 5% in 1st HY 2002, while the rise in the output of enterprises manufacturing consumer goods went down from about 3% to 2%. The situation has improved in sectors considered as vehicles of technological progress, large part of whose output is sold on foreign markets. In Q1 the output of these industries was 6.8% lower than last year, in 1st HY 2.9% lower.

The growth rate of added value in commercial services was lower than in Q1, mainly as a result of a lower sales growth rate of distribution, real estate and business activity enterprises. After a 5.8% growth in Q1 this year, the Q2 2002 retail sales volume was merely 0.7% higher than the year before. Higher than in Q1 2002 was the sales growth of transport and communication services. According to tentative data the situation of insurance companies improved, but the situation of other financial intermediation businesses deteriorated.

A rising procurement of livestock and milk and high headcount of pigs early this year do confirm earlier projections that the growth of livestock production would be maintained in 2002. The current estimates indicate that crop and livestock production will at previous years' average, i.e. they will be lower than last year. In total, it is estimated that this year the growth of global and added value in agriculture will be maintained, although it will be smaller than in 2001.

Q2 2002 witnessed a drop in added value in construction. The output of medium-sized and large construction enterprises in Q1 2002 was 15.6% lower than in the corresponding period of the previous year, while in 1st HY: 13.4% lower than in the corresponding period. New construction went down 15.5% in 1st HY 2002, while refurbishment – 7.3%. A smaller drop in demand for refurbishment, which is mostly carried out by small enterprises, has this consequence that the drop in the output of the whole construction sector was lower then the one recorded in medium-sized and large enterprises.

2

2
Foreign trade, balance of payments

In Q2 2002 the current account deficit went down USD 650 million from the corresponding quarter of the previous year (figure 1). This resulted first of all from the narrowing down of the negative trade balance. The improvement of the balance resulted, on the one hand, from the growth of export revenues and, on the other, from the stabilisation of import payments. Changes in the remaining components of the current account also contributed to lowering the deficit: the negative balances of income and services were lower than the year before, while surpluses on unclassified current transactions and transfers – higher.

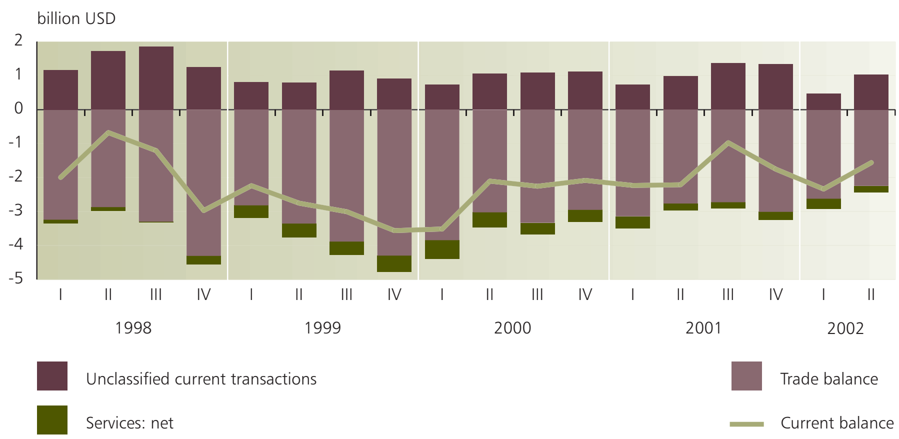
As a result of these favourable changes the ratio of current account deficit to GDP went down to 3.7% in Q2 this year (compared to 4.1% in Q1 2002 and 5.3% in Q2 2001).

Statistics on a cash basis demonstrate that Q2 2002 saw the reversal of the downward trend in Polish exports observable in the two previous quarters (figure 2). Due to a significant strengthening of the euro vs. US dollar in Q2 this year (average rise by almost 6% in the quarter), this can be most clearly seen from dollar denominated figures. While USD denominated export revenues went up 6.5% in Q2 2002 on the corresponding quarter of the previous year (in Q1 they shrunk 7.3%), the euro denominated exports rose in the same period by merely 1.2% (compared to the 2.4% drop in Q1 this year). Given a simultaneous drop in import payments, this contributed to the narrowing down of the negative trade balance by over USD 500 million (746 million euros).

Cash-based foreign trade results in all of 1st HY 2002 point to a stagnation of export revenues (in dollar terms those fell 0.7% compared to 1st HY of the previous year, while in euros they rose 0.5%) with a strong decline in import payments (which shrunk 5.4% both in dollar and euro terms).

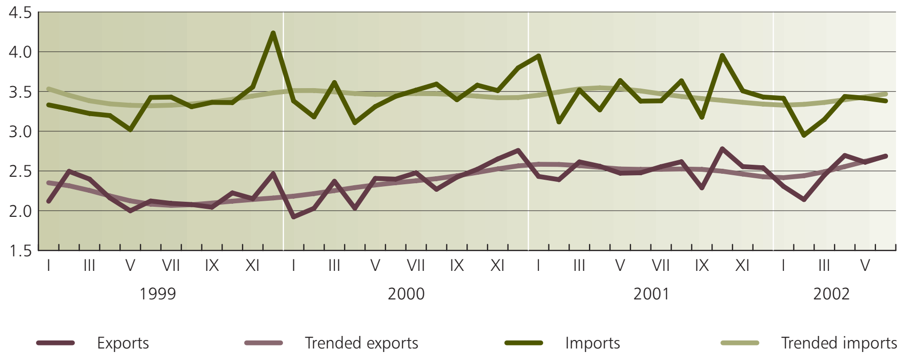
In turn, according to GUS data (figure 3) the dollar value of foreign trade in the period from April to June this year climbed 10.2% compared to the corresponding period of the previous year (while in Q1 this year it fell 1.6%, respectively). There was also a similar trend in imports, whose value increased 8.5% (in Q1 2002 it dropped 4.2%).

Figure 1
Current balance 1998–2002 (quarterly figures, billion USD)



Source: NBP.

Figure 2
Foreign trade, cash basis (monthly figures, billion USD)



Source: NBP.

Figure 3
Foreign trade, customs statistics (monthly figures, billion USD)

Source: GUS.

Table 3
Growth in GDP & its components, Eurozone and Germany
(percentage change on corresponding period previous year, constant prices)

	Eurozone				Germany			
	2001			2002	2001			2002
	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Gross domestic product	**1.6**	**1.4**	**0.4**	**0.3**	**0.7**	**0.4**	**0.0**	**-0.2**
Domestic demand	**1.2**	**0.7**	**-0.4**	**-0.4**	**-0.5**	**-1.4**	**-2.0**	**-2.0**
Personal consumption	1.7	1.7	1.5	0.7	1.2	1.2	1.0	-0.3
Social consumption	2.2	2.4	2.2	2.2	1.7	1.8	1.8	1.1
Gross fixed investment	0.1	-1.5	-2.0	-1.6	-3.6	-6.3	-6.0	-4.6
Movements in inventory*	0.1	-0.2	-0.6	-0.9	-0.6	-1.0	-0.6	-1.7
Exports	**4.3**	**1.0**	**-2.7**	**-2.0**	**7.2**	**4.4**	**-0.1**	**1.7**
Imports	**3.4**	**-0.8**	**-5.1**	**-4.0**	**3.8**	**-1.0**	**-6.0**	**-3.5**
Added value in industry	1.2	0.5	-2.1	-2.3	1.1	-1.3	-3.1	-3.7
Added value in construction	-0.3	-0.6	-0.6	0.0	-6.2	-6.1	-4.7	-1.3

* % GDP.
Source: Eurostat.

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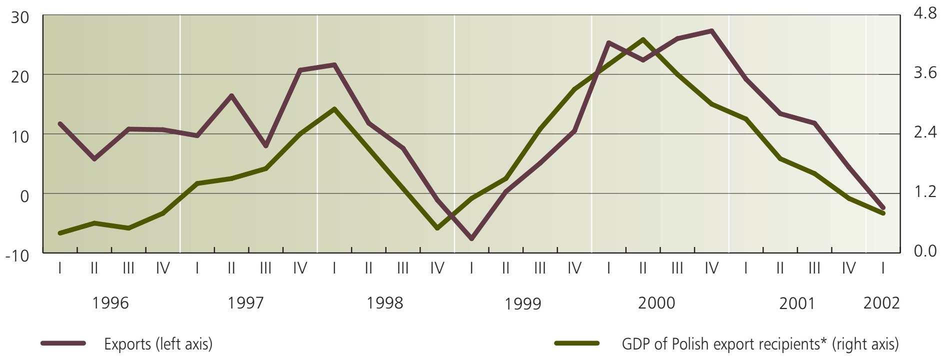
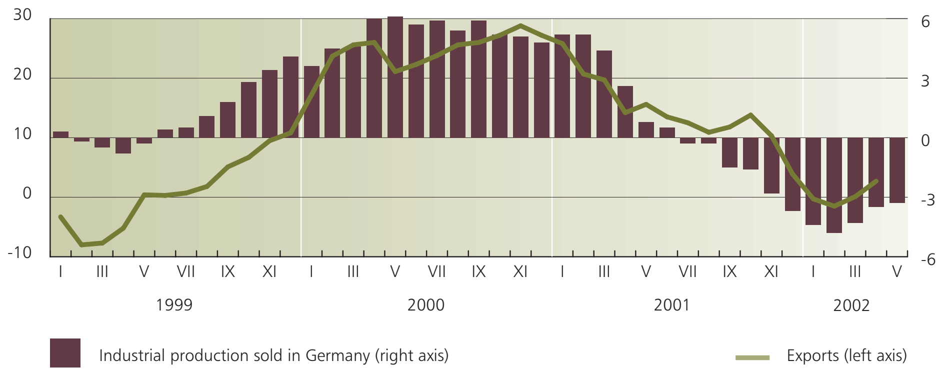
Figure 4
Polish exports vs. GDP in 15 main recipient countries
(% change on corresponding period previous year, constant prices)



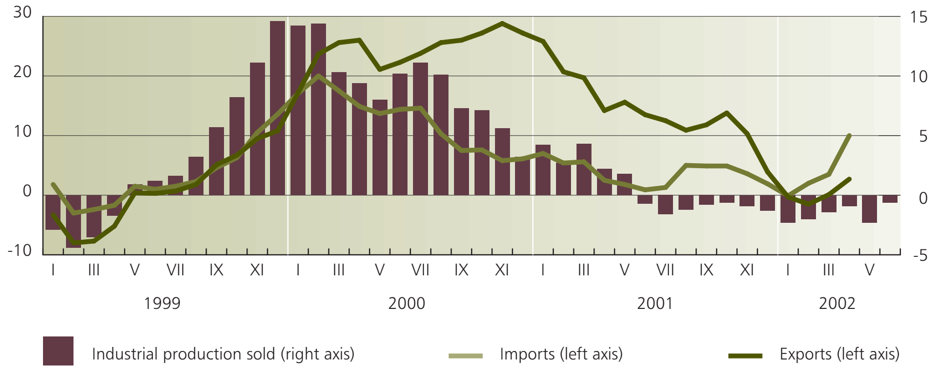
* weighted by structure of Polish exports.
Source: GUS and Bloomberg.

Figure 5
Polish exports vs. Industrial output in Germany
(% change on corresponding period previous year, constant prices)



Source: GUS and Deutsche Bundesbank.

Figure 6
Polish exports, imports and industrial production sold
(% change on corresponding period previous year, constant prices)



Source: GUS.

As shown by table 3, there are virtually no symptoms of an improved outlook in the Eurozone economy. As Polish exports are dominated by producer goods, they are most sensitive to changes in the industrial output of our main trade partner, i.e. Germany (figure 5). In 1st HY 2002 German industrial output fell 3.2% compared to the corresponding period of the previous year, which triggered a further decline in Germany's import demand. Consequently, the value of Polish exports to that country fell 3.1% compared to the corresponding period of the previous year.

On the other hand a high growth rate in the first six months of 2002 continued to be shown by Polish exports to Eastern markets. For example, our exports to Russia in that period rose almost 40%. This was contributed to first of all by favourable trends in demand on that market (in Q1 Russia's GDP went up 3.7%).

2

Table 4
Export growth by major commodity groups
(percentage change on corresponding period previous year)

	2001				2002		2002		
	Q1	Q2	Q3	Q4	Q1	Q2	April	May	June
Total	**21.3**	**14.7**	**12.1**	**8.8**	**-1.6**	**10.2**	**14.3**	**3.4**	**13.0**
Unprocessed	**21.2**	**18.6**	**11.4**	**11.5**	**-9.9**	**-3.1**	**1.0**	**-13.0**	**2.9**
Foodstuffs and agriculture	22.3	14.9	7.9	9.4	-5.8	2.6	10.8	-8.5	5.8
Raw materials	0.2	-4.1	8.3	3.6	-10.6	1.9	4.1	-8.2	10.6
Mineral fuels	31.3	37.9	19.4	19.3	-14.7	-11.8	-11.3	-20.1	-3.7
Processed	**21.4**	**14.0**	**12.3**	**8.3**	**0.0**	**12.7**	**16.8**	**6.6**	**15.0**
Chemicals	24.4	10.2	-4.2	-3.2	-11.1	7.4	9.5	0.5	12.3
Machinery and transport equipment	33.8	21.1	19.6	10.7	3.0	19.3	23.3	11.6	23.8
Other industrial	12.0	9.1	9.1	8.1	-0.9	7.9	12.4	3.0	8.2

Source: GUS.

Table 5
Import growth by major commodity groups
(percentage change on corresponding period previous year)

	2001				2002		2002		
	Q1	Q2	Q3	Q4	Q1	Q2	April	May	June
Total	**5.5**	**1.1**	**2.7**	**1.8**	**-4.2**	**8.5**	**13.8**	**1.8**	**10.1**
Unprocessed	**7.0**	**8.2**	**-7.9**	**-8.4**	**-9.0**	**-9.1**	**-7.8**	**-8.6**	**-11.0**
Foodstuffs and agriculture	6.5	16.8	-7.0	12.7	3.8	-11.6	-11.7	-7.8	-15.2
Raw materials	1.4	-3.1	-9.2	-1.2	-9.2	1.0	2.4	-1.7	2.3
Mineral fuels	9.3	7.7	-7.9	-20.4	-16.1	-11.0	-8.7	-11.5	-12.6
Processed	**5.1**	**-0.6**	**5.5**	**4.6**	**-2.9**	**12.9**	**19.5**	**4.2**	**15.5**
Chemicals	7.2	2.2	5.3	12.2	1.5	9.1	8.9	8.9	9.5
Machinery and transport equipment	3.7	-4.8	6.2	0.3	-6.5	18.9	33.8	2.4	22.4
Other industrial	5.9	3.7	4.7	6.8	-0.6	7.5	8.1	4.2	10.2

Source: GUS.

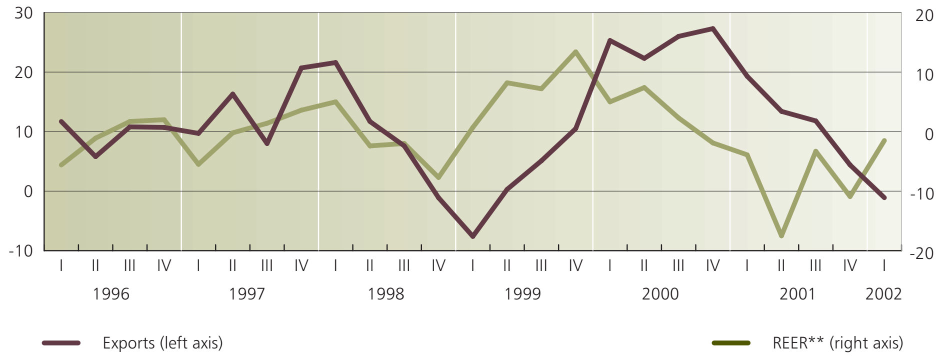
Growth of exports in Q2 2002 resulted first of all from increased sales of processed goods, especially machinery and transport equipment (table 4). Favourable trends were maintained in most sectors with a large share of foreign investments. This was true first of all of engines, TV-sets and furniture. On the other hand, a drop in exports was noted in the group of non-processed products and was caused mainly by a clear decline in coal sales.

In imports, like in exports, machinery and transport equipment were the group which displayed the highest Q2 2002 growth rate. In the remaining sections covering processed products the growth rate of imports was also much higher than in Q1 2002 (table 5). However, a steep decline in imports, just like in Q1 2002, was recorded in mineral fuels. Q2 2002 also saw a significant decline in foodstuffs and agriculture products.

2

It is noteworthy that competitiveness in Polish foreign trade clearly improved in 1st HY 2002 (table 6). This is shown in particular by a further widening in that period (both with respect to Q1 2002 and Q4 2001) of the differential between the indices of the real effective exchange rate, as measured by changes in unit labour costs, and movements in export prices. This testified to a clear improvement in price and cost terms of foreign trade. In Q2 2002 due to a strengthening of the euro in the world market a clear trend emerged towards depreciating the nominal and real zloty rate. Given the lag in exports' response to movements in the

Figure 7
Exports (constant prices) vs. zloty real effective exchange rate*
(% change on corresponding period previous year)



*deflated by unit labour costs.
** fall = appreciation.
Source: GUS and NBP.

Figure 8
Zloty real effective exchange rate 1993–2002 (quarterly figures, 1993 = 100)

Source: NBP.

Table 6
Zloty effective exchange rates in 2001–2002 (previous quarter = 100)

Zloty rate index	2001				2002	
	Q1	Q2	Q3	Q4	Q1	Q2
Nominal	5.6	6.9	-6.7	2.7	0.3	-1.5
CPI deflated	5.8	7.9	-7.1	3.5	0.8	-2.1
PPI deflated	3.8	6.0	-6.3	2.9	0.0	-1.0
Unit labour cost deflated	9.0	4.4	-10.9	9.5	-0.2	n.a.
Export price deflated	3.1	0.2	-1.1	-1.1	2.8	n.a.

„+" – equals zloty rate appreciation
„n. a." – figures not available
Source: NBP.

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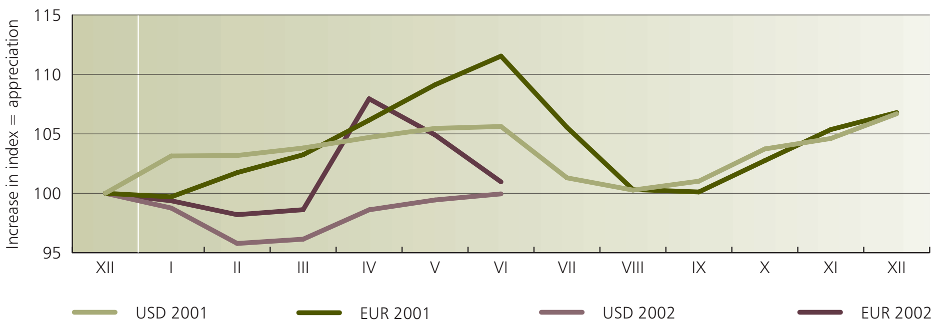
Figure 9
Zloty REER against the euro and the dollar in 2001–2002
(December previous year = 100)



Source: NBP.

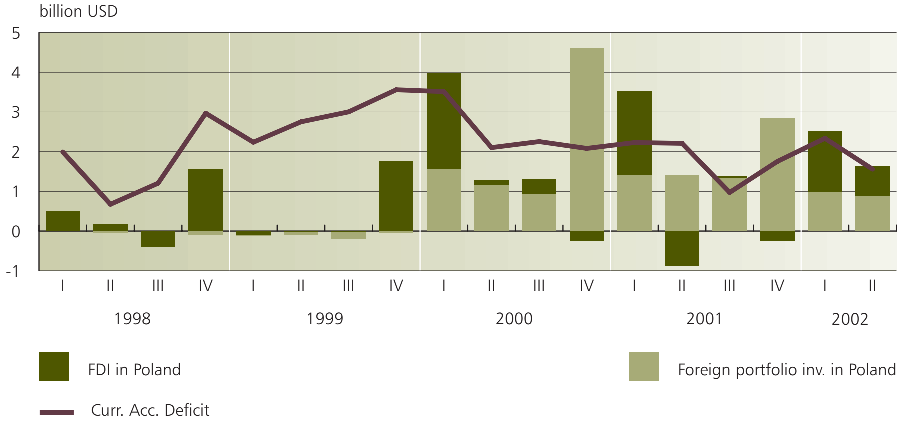
exchange rate (figure 7), improvement of exchange rate terms can be expected to further improve export dynamics in 2nd HY 2002.

The inflow of long-term foreign direct investments financed almost 59% of the current account deficit in Q2 2002. This compares with 43% in Q1 2002 and 66% in Q2 last year. However, it should be noted that the rise of this indicator in Q2 2002 resulted from a significant narrowing down in that period of the current account deficit, with a simultaneous drop in the surplus of direct investments. The structure of FDI capital was less favourable in Q2 2002 than in the corresponding quarter of the previous year, because loans received from direct foreign investors accounted for 24.8%, compared to 15.7% the year before and 25.5% in Q1 this year.

The importance of net portfolio investments as a source of funding the current account deficit lessened in Q2 2002. The reasons included a high (compared to the previous quarter) outflow of Polish capital, as well as net outflow of foreign capital both from investments in equities (the outflow persisted throughout the quarter) and from investments in debt instruments (the outflow occurred only in June). In sum, the net inflow of capital in the form of portfolio investments in Q2 2002 was USD 332 million compared to USD 1 469 million in the previous quarter and capital outflow of USD 950 million in Q2 2001.

Selected warning signals of probable shocks in financial markets (safety ratios) in connection with the scale of external disequilibrium and manner of its funding were less severe in Q2 2002 than in the previous quarter (table 7). The sole exception was the ratio of official reserve assets as months of imports, which despite its deterioration is still high.

Figure 10
Current account deficit and inflow of foreign investments in 1998–2002 (quarterly figures billion USD)



Source: NBP.

Table 7
Selected safety ratios

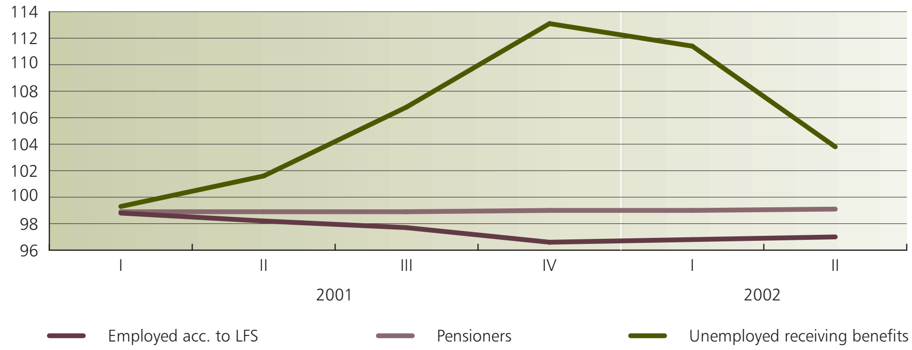
Safety ratio	2001				2002	
	Q1	Q2	Q3	Q4	Q1	Q2
Current balance/GDP (%)	-5.4	-5.3	-4.4	-4.1	-4.1	-3.7
Trade balance/GDP (%)	-7.8	-7.3	-6.8	-6.6	-6.3	-6.0
FDI/Current balance (%)	60.4	65.6	134.5	161.0	42.7	58.8
(Current balance less FDI)/GDP (%)	-2.2	-1.7	0.8	2.2	-3.2	-1.5
Foreign debt service/exports (%)	42.0	46.1	40.6	79.1	37.3	-
Official reserve assets – in import months	8.0	8.0	8.3	7.5	8.4	8.1

3
The labour market

Q2 2002 brought a slight easing in the decline of employment in the enterprise sector compared to Q1 this year. However, the drop was still steep compared to the corresponding period of the previous year.

Over the year (Q1 2001 – Q1 2002) the labour force ratio[5] fell 1 percentage point, while the employment ratio[6] – almost 2 percentage points.

Figure 11
Growth rate of employed, pensioners and recipients of unemployment benefits (corresponding quarter previous year =100)



Source: GUS.

In Q2 2002 – despite the deterioration of the employment ratio and the further decline of the employment level – there were nevertheless symptoms of some recovery in the labour market. These included for instance:

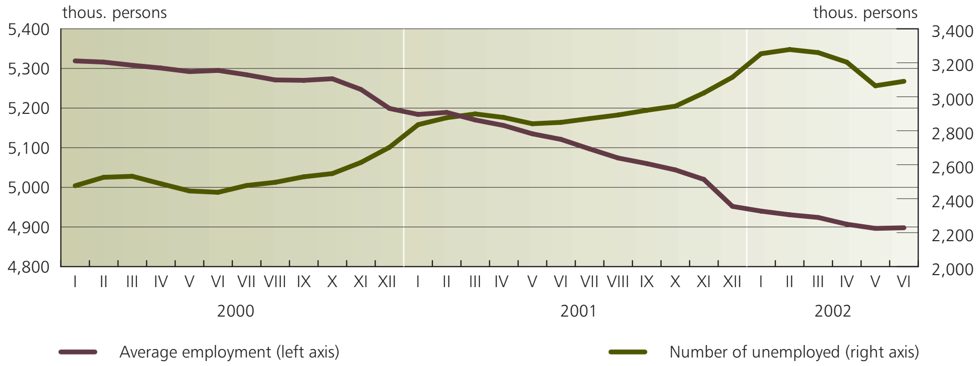
- fewer than in the previous three quarters new unemployment registrations,
- number of deregistered unemployed over 30% higher than the number of the newly registered,
- the fact that almost 55% of those deregistered took up work,
- average number of job offers highest in five quarters.

At the moment it is difficult to assess the sustainability of these trends. It follows from GUS data that June 2002 is the first month since February 2001, in which average employment in the enterprise sector did not contract compared to the preceding month; it rose 2.0 thousand from May. At the same time more people than in May were registered as unemployed and fewer deregistered. Also fewer persons from among those registered started to work at the time and the number of job offers fell compared to May.

[5] The share of the labour force in population aged 15 years or more (in the total and in a given group).
[6] The share of those employed in population aged 15 years or more (in the total and in a given group).

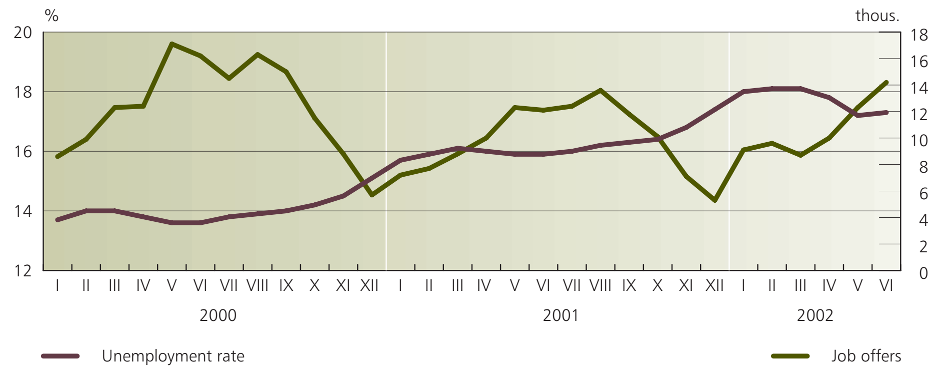
3

Figure 12
Average employment in the enterprise sector and the number of unemployed



Source: GUS.

Figure 13
Unemployment rate and number of job offers (end of month)



Source: GUS.

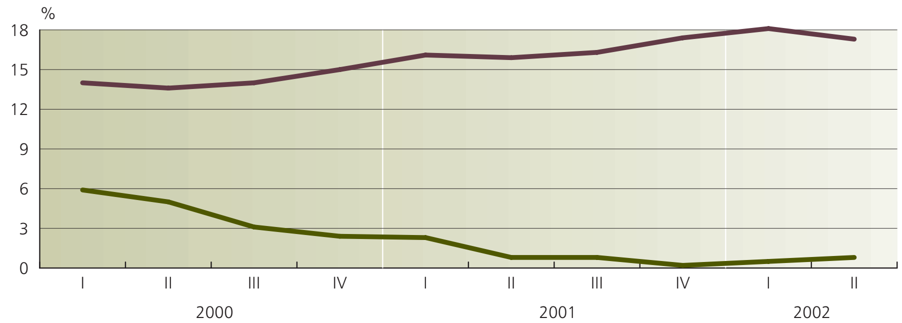
Changes in employment recorded in Q2 2002 differed from sector to sector. In such restructured sectors as hard and brown coal mining, manufacture of metals, manufacture of machinery and equipment, the drop in employment was much slower than in the preceding quarter and in the corresponding quarter of the previous year. There was a faster drop in employment in other restructured sectors, namely in transport (PKP – Polish Rail, PKS – Coach Transport) and in postal and telecommunications services. However, the commercial services sector saw a recovery throughout 1st HY 2002 – growth of employment was much faster here than the year before.

It follows from a tentative business outlook survey by GUS[7] that in July 2002 entrepreneurs envisaged further cuts in employment. Whereas the scale of layoffs was to be supposedly slightly lower in manufacturing and trade/distribution compared to earlier estimates (although differing from sector to sector), projections in construction were more pessimistic than in June. However, positive effects are generally expected to result from government initiatives (already implemented or slated for implementation in the near future) oriented to enterprise promotion, active labour markets and reducing unemployment.

The fast rise of unemployment in Poland comes from many years of neglect in lifting barriers to enterprise development, lack of deep changes in the labour code and the tax system, failure to instill new forms of professional ethics. The effects of this neglect were in recent years additionally aggravated by demographic factors (entry into the labour market of eighties baby boomers). In

[7] *Koniunktura w przemyśle, budownictwie i handlu w lipcu 2002 r.*, GUS. (*Outlook in industry, construction and trade in July 2002*, GUS).

Figure 14
Unemployment and GDP Growth



Source: GUS.

these conditions faster economic growth alone will not suffice to achieve considerable and lasting improvement in the labour market.

As shown by the experience of the countries which succeeded in effectively bringing down unemployment, the first thing those countries did was to streamline their tax systems and cut taxes both for corporates and persons. They did not employ any exemptions or breaks apart from the general amount of exemption (Germany, UK, Holland, Ireland). A thorough reform and liberalisation of the labour law is the second direction of changes (Holland, Spain).

Appropriate wage formation is a major factor in bringing down unemployment. The wage bargaining employed in EU countries between the social partners pertains essentially only to the

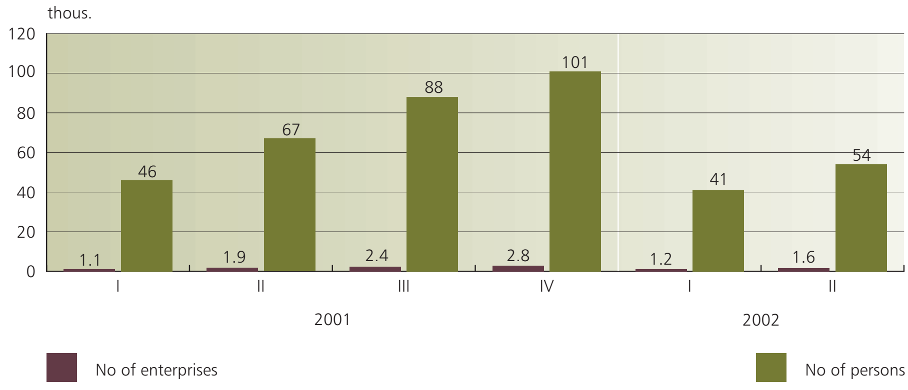
Table 8
Changes in employment in the enterprise sector by section (thousand persons)

	I-VI 2001	I-VI 2002	
	change on I-VI 2000	average employment	change on I-VI 2001
Total enterprise sector	**- 139**	**4,928**	**- 248**
Mining and quarrying	- 21	211	- 13
Manufacturing	- 102	2,045	- 164
Production and distribution of electricity,			
gas and water	- 4	228	- 2
Construction	- 34	427	- 57
Trade/distribution & repairs	- 8	837	7
Hotels & restaurants	1	85	3
Transport, storage & communication	- 23	518	- 41
of which:			
post & telecommunications	-	177	- 5
land and pipeline transport	- 19	275	- 36
Real estate and business activities	31	410	10
Others	40	167	9

Source: GUS, own calculations.

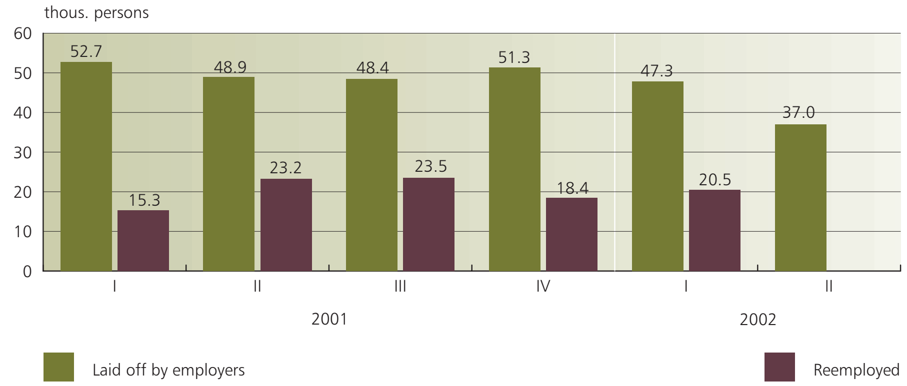
3

Figure 15
Group lay-off declarations by quarter



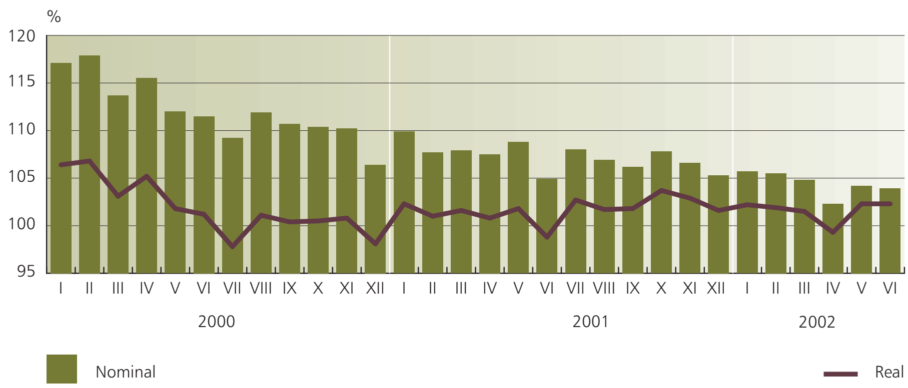
Source: GUS.

Figure 16
Those laid off by employers, of which reemployed



Source: GUS.

Figure 17
Nominal and real growth rate of wages in the enterprise sector (corresponding month previous year = 100)



Source: GUS.

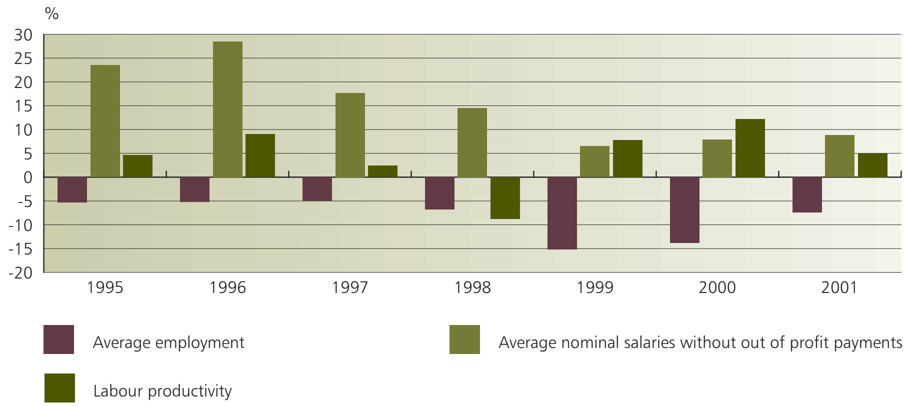
minimum or guaranteed wage. It allows to fairly freely set wages in an enterprise, but these are always linked to its financial performance.

Until the end of Q2 2002 in Poland no agreement could be achieved between the government, employees and trade unions on these issues, thus ruling out comprehensive reforms making the operation of the labour market flexible and, consequently, effectively combating unemployment [8].

The difficult situation on the labour market continues to suppress wage growth. In 1st HY 2002 a much slower rise in average nominal wages was recorded than the year before. But the slowdown of the CPI growth rate resulted in a faster than in the corresponding period of the previous year rise in real wages.

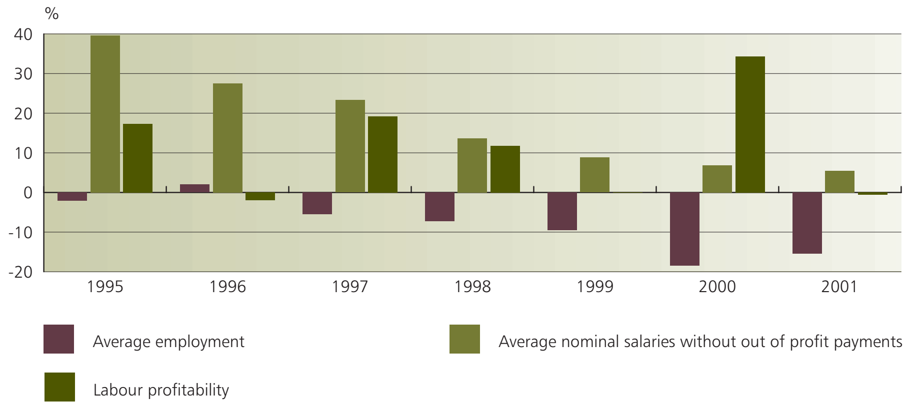
Average employment and salaries in selected[9] sections and divisions of the enterprise sector (y/y change rate) – figure 18–23.

Figure 18
Hard and brown coal mining



Source: GUS.

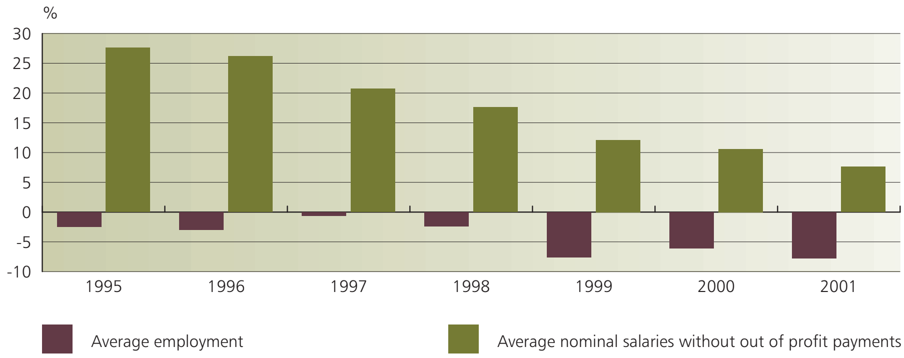
Figure 19
Production of metals



Source: GUS.

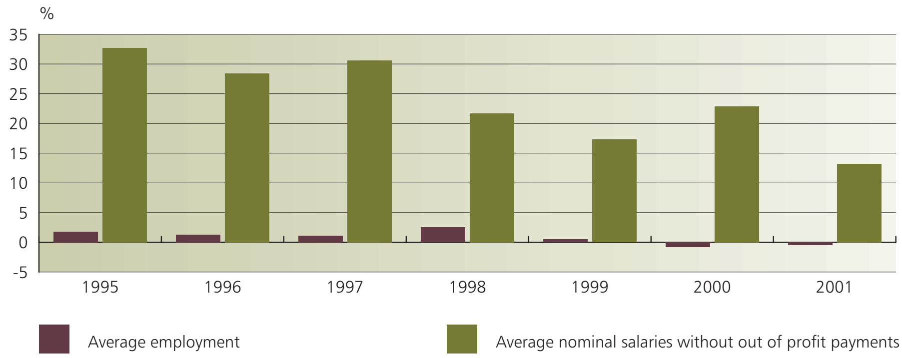
[8] On 26 of July this year Sejm amended the Labour Code (Act on Amending the Labour Code and Some Other Acts, Journal of Laws no 135 of 28.08.2002, p 1146). The new provisions are more flexible. They reduce the burden on the employers and encourage them to create new jobs. Amendments introduced to the Labour Code – in the NBP's estimation – will contribute to reducing the degree of employee protection by about 10%, which will contribute to softening inflationary pressure in the long run.
[9] These particular sections and divisions are selected for their substantial importance to the labour market: not only because of their considerable share in total employment in the enterprise sector (in total over 30%), but also due to the restructuring and privatisation processes which have been under way in them for some years now.

Figure 20
Land and pipeline transport



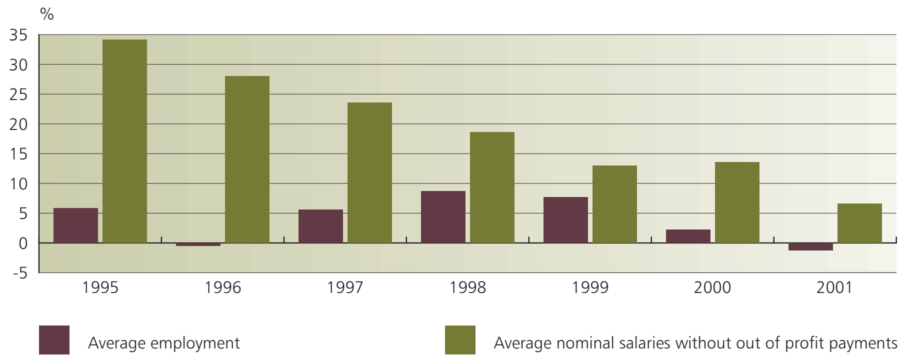
Source: GUS.

Figure 21
Post and telecommunications services



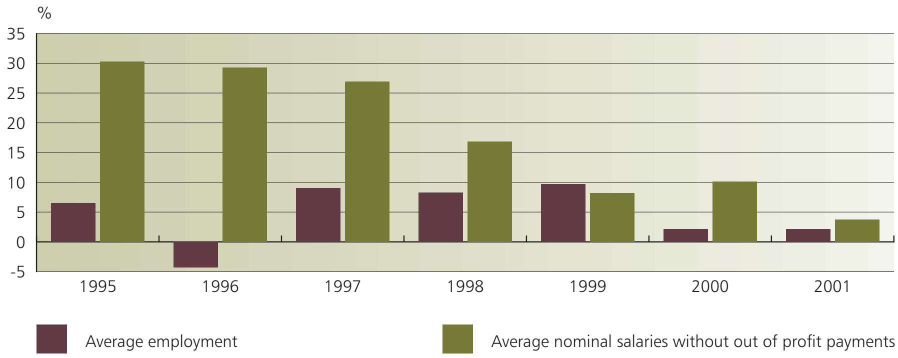
Source: GUS.

Figure 22
Distribution and repairs



Source: GUS.

Figure 23
Hotels and restaurants



Source: GUS.

4
Other supply factors

4.1. Structural factors

The current plans of the government pertaining to structural changes in the economy are presented in table 9.

The effecting of a path of structural transformations through privatisation processes is often hampered by:

– adoption of the principle of making privatisation contingent on a prior implementation of state-led restructuring (which implies the change of the existing approach and considerably delays privatisation),

– trend towards the consolidation of state-owned enterprises without its linking to privatisation; this is treated as a way of withstanding international competition,

– still open discussion concerning the desirable size of the public sector in the economy.

Owing to the above factors, progress in restructuring processes is currently small, while the privatisation processes (having been considerably slowed down in 2001 and 2002) continued in Q2 2002 at a slower pace. The State Treasury gained in 1st HY 2002 merely PLN 825 million in privatisation revenues, representing 12.5% of the planned amount[10].

The least advanced are privatisation processes in the infrastructure and producer sectors, which require both deep restructuring and decision as to the desirable share of the State in such sectors (table 10).

The financial situation of the sectors of the economy which have made least progress in ownership changes is very adverse (table 11). In fact, this does not concern the power and gas sectors, which exploit their monopolistic position in the market. In turn, the better performance of hard coal mining in 1st HY 2002 compared to previous years does not reflect the sector's real financial situation, but comes from its privileged position of a state budget assistance beneficiary. Suffice it to point to the amount of short-term indebtedness of the hard coal sector, which is over three times the value of its current assets (table 12).

Privatisation processes are more and more frequently suppressed and replaced by consolidation processes[11]. This pertains mainly to sectors with a state majority shareholding and consists in the setting up of state corporations which consolidate vertically, horizontally, by product or geographically. This trend has emerged (or such solutions are planned to be introduced) in:

– the power sector (Południowy Koncern Energetyczny – South Energy Corporation, consolidation of 32 distribution enterprise into five power distribution groups),

– mining (Polski Węgiel – Polish Coal company),

– steel (Polskie Huty Stali SA – Polish Steel Company),

– fuel sector (incorporation of Gdańsk Refinary by PKN ORLEN),

[10] The amount of privatisation revenues budgeted for the year 2002 reaches PLN 6.6 billion.
[11] In many cases consolidation is one way to avoid bankruptcy by underperforming enterprises which are amalgamated in a single structure with highly efficient enterprises. For instance, once the concept of mining and energy holdings has been implemented, inefficient coal mines will disappear.

Table 9

Table 9 The main elements of structural transformation programmes in basic sectors of the economy

Sectors	General characteristics
Power sector	The policy adopted in April 2002 envisages the consolidation of 32 distribution companies into 5 groups, each of which will be assigned 13–15% of the domestic distribution market. This is to happen in 2003 and will only be possible after the privatisation of power and CHP plants. The consolidation will not cover privatised plants from Central and Northern Poland (the so-called Group G-8) or Warsaw STOEN company. Moreover, the plan envisages the merger of the power plants into two large corporations – one based on hard coal and the other on brown coal. The partial privatisation of the Polish Power Grid S.A. is to happen after 2005, at the earliest.
Gas sector	Last May the Ministry of Treasury presented a timetable of the sector's restructuring programme, which entails that in 2002 PGNiG S.A. would be split into a upstream and downstream part. PGNiG would be a network operator providing network access to gas trading enterprises. Would be also responsible for the storage of strategic stocks of gas. In 2003–2004 the distribution enterprises hived off from the PGNiG S.A. structure would be privatised.
Fuel sector	In Q2 2002 the exercise focused not on the completion of a planned restructuring, but on the development of the final concept of the whole oil and chemical market. The future of PKN ORLEN and Rafineria Gdańska S.A. privatisation has not been yet decided owing to considerable differences of views on their privatisation path.
Hard coal mining	Ministry of Economy proposals for the sector in 2002 focus on the debt restructuring of mining enterprises. The debt restructuring is considered a precondition of organisational changes in hard coal mining, which are to consist in the establishment of two coal corporations and one coal & coke corporation. The mining reform programme is to achieve in 2006 sector profitability (having taken into account the planned cancellations of liabilities). According to the latest estimates the total cost of the mining reform to the budget will be PLN 4.7 billion. Moreover, the coal corporations are to spend PLN 1.7 billion for this purpose over the coming four years.
Iron and steel plants	In accordance with another steel restructuring programme adopted in March 2002, the holding Polskie Huty Stali S.A. was established in June 2002 (consisting of four steel plants: Katowice, Sendzimir, Cedler and Florian; in future they are to be joined by Huta Częstochowa). The remaining steel plants will prepare rehabilitation programmes. The proposed programme is connected with a considerable financial injection due to the critical condition of the steel sector (PHS S.A. debt stands currently at PLN 4.5 billion). It is also necessary to modernise the product structure of Polish steel production in order to maintain its competitiveness on world markets. Already problems have been noted with the operation of the PHS holding on the scheduled terms. The reason is that no settlement of Huta im. Sendzimira has been concluded, as planned, with its creditors, relating to the reduction of its debt.
Heavy chemicals	A new approach to the companies of the sector was presented in June 2002. Privatisation is to start in 2003 and will be preceded by product consolidation. The programme of product consolidation and privatisation will be developed by the holding NAFTA Polska S.A. The privatisation of the whole sector is to be completed within 5 years.
Rail transport	As a result of the reform of the rail services market in 2001 a dozen or so daughter companies have been hived off from the PKP structure and the employment has been restructured. This year changes have been made to the railway restructuring programme. A speeding up of the privatisation of PKP transport companies is envisaged, which is to happen in 2003–4. What has not been made precise are plans for further changes in infrastructure companies – most likely they will not be privatised. Meanwhile, the state of the railway infrastructure is deteriorating. Financial restructuring has not succeeded. The programme of the restructuring of real estate utilised by the PKP has not been implemented either.

4

Table 10
Status of ownership structure changes

Privatisation completed	Privatisation advanced	Restructuring and privatisation commenced
– Banking	– Insurance	– Hard coal mining
– Distribution and services	– Steel	– Energy
– Telecommunications	– Shipbuilding	– Gas
– Household appliances	– Pharmaceuticals	– Railway transport
– Automotive industry	– Sugar	– Armament industry
– Construction	– Spirits	– Heavy chemicals
– Electric machinery industry	– Transport (LOT, PKS)	
	– Oil sector	
– Non-ferrous metals	– Spas	
– Timber		
– Food		
– Tobacco and breweries		

Source: Ministry of Treasury.

Table 11
Net profitability and current ratio, selected sectors (%)

	a) Net profitability* b) Current ratio**	2000	1st HY 2001	2002
Total industry	**a**	**1.2**	**0.4**	**0.8**
	b	**11.7**	**12.5**	**14.9**
Manufacturing	a	1.4	0.3	0.7
	b	11.8	11.6	12.1
Hard coal mining & agglomeration	a	-7.8	-3.9	0.0
	b	1.7	3.3	3.4
Manufacture of coke & refined petroleum products	a	2.2	1.1	1.0
	b	5.3	8.9	5.1
Manufacture of basic chemicals	a	1.7	0.7	-2.6
	b	7.8	9.9	7.3
Manufacture of metals	a	-2.1	-7.2	-7.5
	b	3.2	2.7	3.0
Shipbuilding and repair of ships	a	0.0	-2.6	-6.4
	b	33.9	27.2	20.0
Production and distribution of electricity	a	0.6	1.4	1.3
	b	20.9	29.1	21.7
Production and distribution of gas fuels	a	4.6	2.5	1.3
	b	7.6	9.2	135.1
Rail transport	**a**	**-13.8**	**-18.0**	**-12.5**
	b	**8.5**	**12.5**	**4.2**
Post and telecommunications	**a**	**1.5**	**5.5**	**0.3**
	b	**38.7**	**27.5**	**19.9**

* Net earnings to revenues from total operations.
** Short-term investments to short-term liabilities.
Source: GUS data from financial statements submitted on the F-01 report by companies employing a staff of over 49.

Table 12
Basic sources of current asset financing, selected sectors (%)

Proportion of current assets financed by: a) total short-term liabilities, of which: b) short-term bank loans c) payables d) tax, customs and insurance liabilities		2000 at year end	2001 at year end	2002 at the end of 1st HY
Total industry	**a**	**93.6**	**92.6**	**93.3**
	b	**21.3**	**21.3**	**22.7**
	c	**41.0**	**39.5**	**39.6**
	d	**14.7**	**12.8**	**14.0**
Manufacturing	a	82.9	85.9	88.7
	b	21.7	22.3	23.0
	c	39.7	39.0	41.2
	d	9.4	9.2	10.7
Hard coal mining & agglomeration	a	358.9	352.3	351.7
	b	5.1	4.7	9.6
	c	48.3	56.1	52.0
	d	191.2	143.5	141.9
Manufacture of coke & refined petroleum products	a	71.8	72.1	79.7
	b	20.6	20.5	19.6
	c	32.4	26.4	31.3
	d	14.7	16.4	20.2
Manufacture of basic chemicals	a	86.9	96.9	101.2
	b	19.3	28.5	31.7
	c	38.6	40.8	45.3
	d	4.9	3.5	4.7
Shipbuilding and repair of ships	a	91.5	92.0	98.2
	b	52.3	49.4	47.9
	c	23.1	23.3	26.9
	d	3.4	3.1	5.2
Production of metals	a	150.8	182.8	188.3
	b	21.8	27.5	31.1
	c	84.0	91.5	97.7
	d	14.8	24.7	30.9
Production & distribution of electricity	a	93.1	84.8	84.3
	b	22.7	17.6	24.0
	c	52.5	51.2	42.6
	d	6.3	6.9	9.5
Production and distribution of gas	a	173.7	58.1	34.2
	b	68.9	7.3	7.0
	c	82.0	21.0	9.9
	d	8.7	6.1	6.6

4

Rail transport	**a**	**209.7**	**138.9**	**143.7**
	b	**17.4**	**29.5**	**24.0**
	c	**35.8**	**53.0**	**65.9**
	d	**119.1**	**19.7**	**27.8**
Post and telecommunications	**a**	**66.6**	**67.3**	**127.9**
	b	**10.0**	**9.9**	**26.2**
	c	**23.3**	**23.5**	**28.8**
	d	**4.2**	**3.2**	**8.9**

Short-term bank loans, payables and taxes, customs and insurance constitute the core of short-term liabilities (e.g. as of the end Q1 2002 they accounted for 86% of short-term liabilities in manufacturing).
Source: GUS.

– heavy chemicals (consolidation of fertiliser manufacturing companies),

– telecommunications (proposed setting up of the so-called TP S.A.-bis from the merger of Tel-Energo and NOM),

– sugar industry (Polski Cukier SA – Polish Sugar Company),

– pharmaceuticals (corporation consisting of companies which manufacture and sell pharmaceuticals),

– rail transport (holding of local rail operators transformed from the company Przewozy Regionalne S.A. – Regional Transport Company),

– shipbuilding industry (holding consisting of Stocznia Szczecińska SA, Stocznia Gdynia SA (shipyards) and Zakłady im. H. Cegielskiego Poznań),

– armaments (two product holdings: munitions/armoured vehicles and electronics/aerospace).

The consolidation of enterprises under way in the state-owned sector will lead to an increasingly monopolised economy and attendant intensification of price growth pressure.

4.2. External prices

Q2 2002 witnessed a continued growth trend in world markets (which was observable already in the previous quarter) in basic raw material prices (table 13), in connection with the improvement of the outlook in the world economy.

However, the demand pressure for the growth of industrial raw material prices was relatively small. This can be clearly seen in the case of metal prices, which are particularly sensitive to change in the current and anticipated level of business activity (figure 24). After all, this year's recovery in industrial production has so far been moderate and largely limited to the IT sector.

However, oil prices rose much faster than metal prices. The average price of Brent oil per barrel in Q2 this year oscillated around USD 25.1, compared to USD 21.2 per barrel in Q1 this year (figure 25); volatility of oil prices has also grown significantly – these fluctuated from USD 22 to 27 per barrel. However, the steepest rise of oil prices in Q2 2002 was noted in April (it constituted a continuation of the growth trend started one month before). It was triggered first of all by political considerations: war between Israel and the Palestinian Authority and the threat of an American intervention in Iraq. In those conditions a question mark over the continuity of supplies[12] fueled speculative transactions in the oil market.

[12] The rise in crude oil prices in April and June this year was also influenced by the situation in Iraq, which first in protest against the occupation of Palestinian towns by Israel suspended oil exports for a month, and subsequently, in default of an agreement with the UN on setting the prices of oil under the "oil for food" programme considerably curtailed its supply. As a result of the above-mentioned shocks Iraq exports in Q2 2002 declined by about 40% compared to the previous quarter.

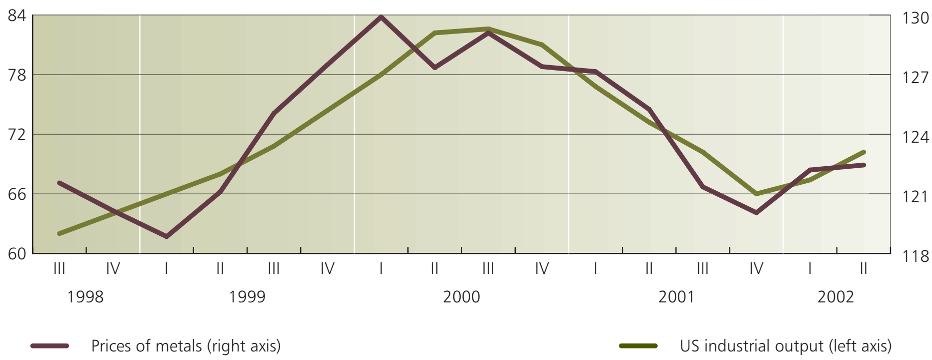
Table 13
Changes in prices of basic raw materials (in %)

	Compared to corresponding quarter previous year				Compared to previous quarter			
	2001		2002		2001		2002	
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Non-energy raw materials	**-6.1**	**-10.6**	**-4.4**	**-0.8**	**-3.0**	**-5.2**	**6.0**	**1.6**
of which:								
Foodstuffs	-1.1	-5.9	-2.2	2.9	2.1	-3.2	3.4	0.7
industrial raw materials	-12.3	-16.9	-7.2	-5.5	-9.3	-8.0	10.1	2.9
of which:								
agricultural commodities for industry	-2.9	-14.5	0.2	-3.0	-8.0	-12.9	14.5	5.7
Metals	-18.8	-18.6	-12.6	-7.5	-10.4	-3.9	6.7	0.6
Oil (Brent)	**-17.3**	**-35.2**	**-18.1**	**-8.1**	**-7.2**	**-23.5**	**9.2**	**18.6**

Source: "The Economist" and Reuters.

4

Figure 24
Metal prices and industrial output in the USA (1995 = 100)



Source: The Economist and Bloomberg.

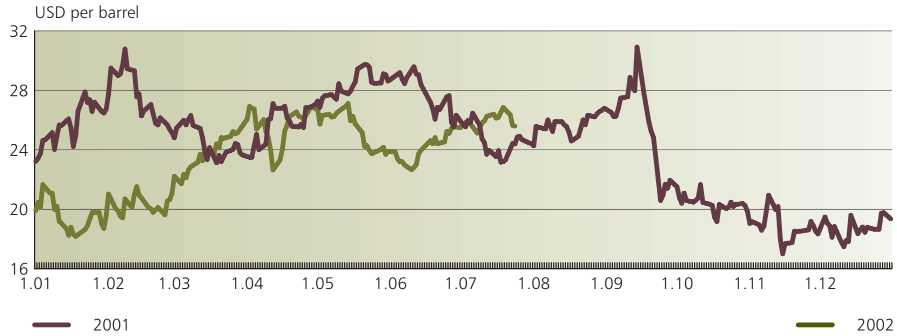
On the other hand, OPEC supply policy in Q2 2002 did not significantly contribute to the rise in oil prices. The reason was that despite the restrictions maintained by the cartel (in Q2 2002 OPEC upheld the production ceiling established at the beginning of the year, lowest in ten years), member countries produced much more oil than in the previous quarter (on average by 300 thousand barrels a day, thus the production was 1.3 million barrels a day). Russia, which had formally joined the OPEC agreement to cut oil production, also increased it in the same period.

Q2 2002 world demand for oil (as estimated by the International Energy Agency) was lower both compared to Q1 this year and Q2 last year. Consequently, just like in 2001, it was lower than oil supply (figure 26). The lack of demand pressure on oil prices was also evidenced by a high level of oil stocks maintained over the whole Q2 this year.

An expected growth of demand in the world economy in Q3 2002 and the maintaining by OPEC of its production ceilings unchanged have caused the price of oil to rebound at the end of June this year. In the first weeks of July the American Petroleum Institute reported a clear reduction of oil stocks in the USA (figure 27), which would be indicative of rising demand for this raw material.

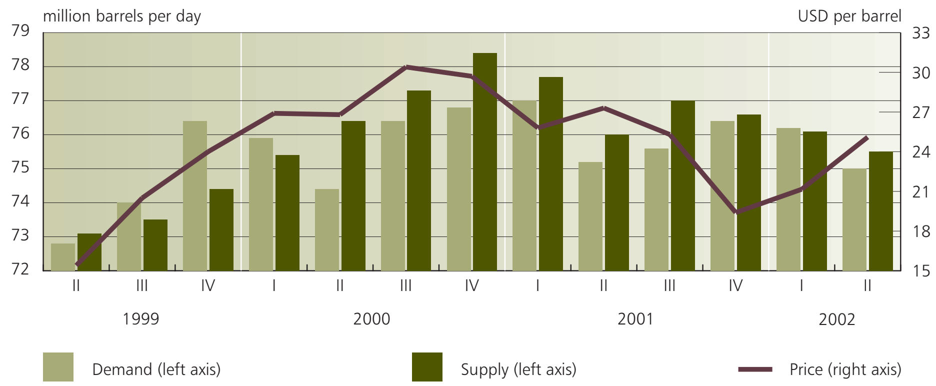
The stabilisation of oil prices in May and June helped reduce the producer and consumer prices in the Eurozone, i.e. with our main trade partners. The y/y PPI in the Eurozone went down from -0.8% in March 2002 to -0.9% in May. In contrast, the Harmonised Consumer Price Index declined in the Eurozone from 2.5% in March to 1.8% in June 2002, i.e. to the lowest level since early 1999 (figure 28).

Figure 25
Oil prices (Brent) 2001 & 2002 (daily quotes)



Source: Reuters.

Figure 26
Oil demand, supply and prices (Brent)



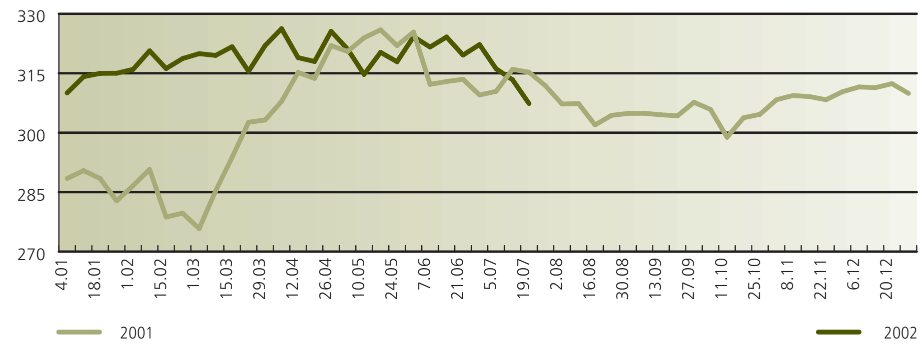
Source: International Energy Agency.

During the first four months this year[13] a downtrend in transaction prices continued to persist in Polish imports (albeit at a slower rate of decline), and simultaneously the falling trend of zloty transaction prices was halted in exports (figure 29). This led to a further improvement in Poland's *terms of trade*: in the period from January to April 2002 these stood at 106.5, as opposed to 101.6 in the corresponding period of the previous year. The biggest impact on the rise of export prices came from rising prices of machinery and transport equipment and agricultural produce. However, the lower import prices were mainly contributed to by a further drop in fuel prices and lower than in the previous year prices of machinery and transport equipment.

Movements in transaction prices in Polish imports are a derivative of movements in Brent crude oil[14]. In turn, movements in import prices are transmitted to domestic consumer prices both directly (through prices of consumer imports), as well as indirectly – through changes in producer prices. The total transmission index of external prices to the CPI[15] stands at 0.14. The supply impulse (change of oil prices) is fully absorbed by the CPI over the space of two years, about 4% of the impulse being absorbed in Q1, 14% after two quarters, 65% after 3 quarters and 80% after a year. In view of the above structure of lags, the Q2 CPI reacted most strongly to the drop in Q3 2001 transaction prices. In total, price movements in the world market resulted in a 0.17 per cent drop in the y/y CPI at the end of June 2002.

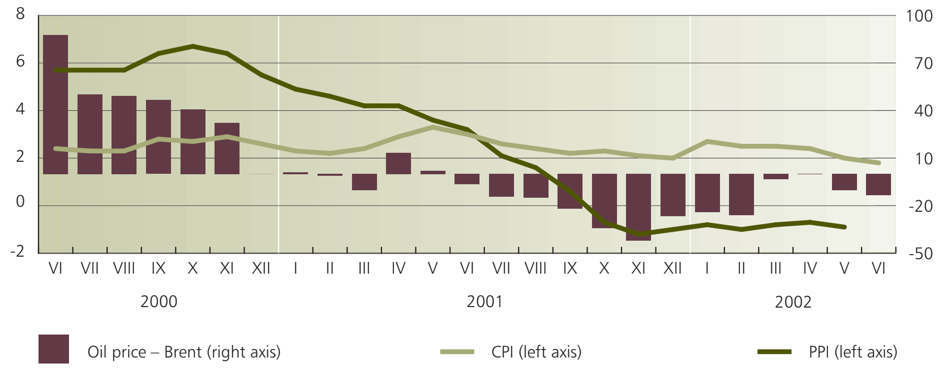
[13] This period is covered by GUS data now available.
[14] This follows from the dominant share of oil in world trade and attendant high volatility of its prices, which is the highest of all the tradables.
[15] The index is not adjusted for exchange rate movements.

Figure 27
US oil stocks in 2001 and 2002 (million barrels)



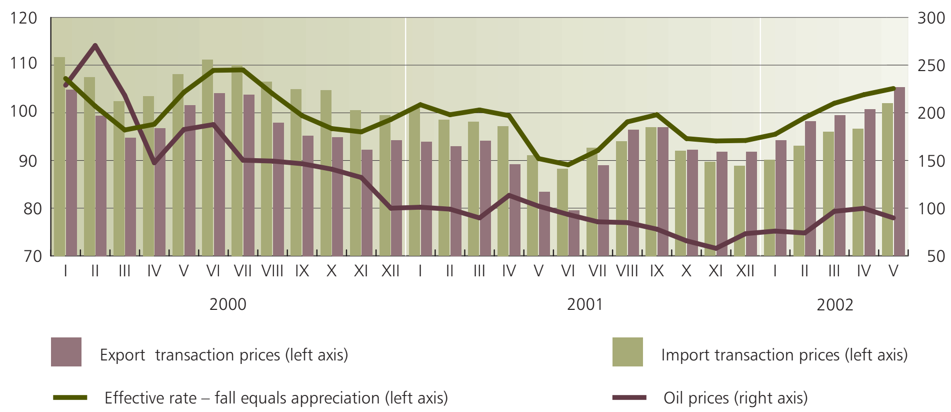
Source: American Petroleum Institute.

Figure 28
Eurozone CPI & PPI vs. oil prices
(percentage change on corresponding period previous year)



Source: Eurostat and Reuters.

Figure 29
Movements in indices of transaction prices in Poland's foreign trade, and nominal effective exchange rate and oil prices
(percentage change on corresponding period previous year)



Source: GUS, NBP and Reuters.

5
Trends in inflationary processes

5.1. Consumer prices

Over Q2 2002 disinflation trends strengthened in the Polish economy. Inflation, as measured by the 12-month CPI rate, continued to rapidly trend downwards, thus reaching 1.6% in June 2002. The drop was preceded by almost half a year (from last November to March this year) of the 12-month CPI rate steadying at the level of 3.6–3.3%. In June 2002 inflation was already half of its March 2002 level and four times lower than in June of the previous year. This resulted from the interaction of both supply and demand factors, most of which had been assisting to lower inflation for many months. However, at the end of 1st HY 2002 their impact markedly intensified.

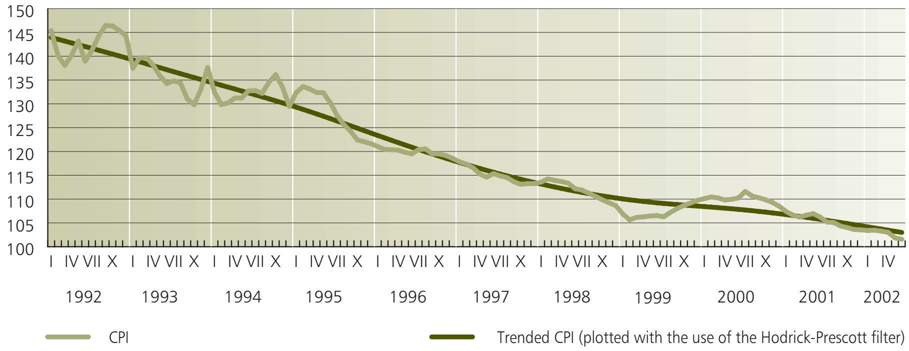
First of all, there was an increase in the agricultural production of basic crop and animal-based food groups, which resulted in an earlier than usual seasonal decline in food prices. At the same time the lack of any major shocks in the oil market in that period helped suppress fuel prices at a low level.

In addition to favourable supply shocks a low growth rate in officially controlled prices contributed to beating inflation in the period under analysis. Most prices from that group, due to a different than last year distribution of their rises over time, and also their lower scale, stayed in Q2 2002 at a moderate level, without disturbing the disinflation trends in any major way.

A sustainably low rise in personal disposable incomes was another major factor in suppressing the rise of inflation. First of all, it contributed to the further curtailing of the already weak growth rate of prices for non-food articles, most sensitive to market mechanisms, and also prices for some services, which strongly respond to changes in demand.

The scale of inflation reduction in Q2 2002 was also amplified by the reference base effect, most evident in the group of food and officially controlled prices. It should be borne in mind that in the corresponding quarter of the previous year the growth rate of those prices clearly gained pace. This contributed to a relative deepening of the drop in their y/y growth rates in Q2 this year.

Figure 30
CPI and trended CPI in 1992–2002 (corresponding month previous year = 100)



Source: GUS, NBP calculations.

Table 14
Monthly growth of particular categories of consumer prices (previous month = 100)

	2001					2002				
	Rates				Contri-bution to CPI growth percen-tage points	Rates				Contri-bution to CPI growth percen-tage points
	IV	V	VI	IV-VI	IV-VI	IV	V	VI	IV-VI	IV-VI
Total, of which	**100.8**	**101.1**	**99.9**	**101.8**	**1.8**	**100.5**	**99.8**	**99.6**	**99.9**	**-0.1**
Officially controlled prices	100.7	101.5	100.0	102.2	0.5	100.9	100.0	100.0	100.8	0.2
of which: fuels	100.0	102.1	99.5	98.7	-0.1	103.1	99.8	99.4	102.3	0.1
Non-food articles (excluding officially controlled prices)	100.1	100.5	100.0	100.7	0.2	100.3	100.0	100.0	100.3	0.1
Services (excluding officially controlled prices)	100.6	100.5	100.4	101.5	0.3	100.3	100.3	100.2	100.8	0.1
Food and non-alcoholic beverages	101.5	101.6	99.5	102.6	0.8	100.5	99.0	98.5	98.1	-0.6

Source: GUS and NBP calculations.

As a result of the interaction of all these factors the 12-month CPI in Q2 2002 was still below the trend line (figure 30).

The monthly inflation rate over Q2 this year displayed much volatility. Seasonal deflation, caused by a drop in food prices, kicked in as early as May (up to then it would come no earlier than in June) and persisted throughout June. Cumulatively, from March to June 2002 inflation fell 0.1%, while in the corresponding period of the previous year it rose 1.8% (table 14).

The screeching to a halt of the y/y CPI in Q2 2002 was contributed to by a drop in food prices and softening (albeit diversified) of the growth rate of other principal CPI groups (figures 31, 32 and table 15).

Prices for food and non-alcoholic beverages were the only group in Q2 2002 which displayed a y/y drop. As a result they contributed 0.4 percentage point to the lowering of the CPI in Q2 2002, while the year before they stimulated a 2.2 percentage point rise in inflation.

Whereas as late as Q1 2001 the rise in prices for food and non-alcoholic beverages stood at 2.0–2.2% y/y, April 2002 brought it down to 1.3%, while in subsequent months prices for food and non-alcoholic beverages fell below the level from the year before (in the corresponding quarter of the previous year food prices went up 7.0–7.8% y/y).

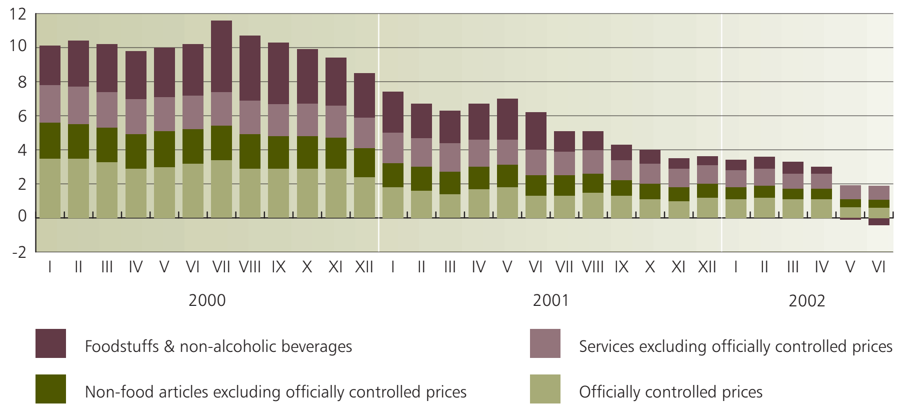
This was a consequence of a high supply of food (which resulted from a speeded up growing process of plants in the spring 2002 due to favourable agrometeorological conditions and from maintaining a growth trend in livestock production) and a steady decline of prices for all basic inputs, with fairly stable consumption during the period.

The most contribution to the fall of prices for food and non-alcoholic beverages in Q2 2002 was made by prices of meat and milk. The downtrend in the meat market has been with us since October last year. Initially it was connected with a high surplus of poultry, but for some months now the supply of pork has been growing faster than that. In Q2 2002 prices for animal-based foodstuffs were lower than the year before (prices of meat – by about 3%, prices of milk, cheeses and eggs – by about 2%), and the fall was steeper than in Q1 2002.

Figure 31
CPI and principal price categories, 2001–2002 (corresponding month previous year = 100)

Source: GUS, NBP calculations.

Figure 32
Contribution of particular price categories to CPI growth, 2000–2002 (corresponding month previous year = 100)



Source: GUS, NBP calculations.

The falling trend was also displayed by prices of cereals (with high stocks and expected big harvest in 2002). Consequently, the price rise in cereal-based food in all of 1st HY was negligible.

The magnitude of the drop of food prices in Q2 2002 was limited to a point by prices of fruits and vegetables subject to much seasonality, as their distribution over time, due to this year's speeded-up vegetation period (by almost one month) was different than last year.

From among the remaining price categories making up the CPI basket which grew in Q2 this year, albeit more slowly than last year, CPI growth was least stimulated by **prices for non-food articles excluding officially controlled prices**. They contributed merely 0.5 percentage point to Q2 2002 CPI growth compared to a 1.2 percentage points the year before.

Prices for non-food articles excluding officially controlled prices rose in Q2 2002 at a y/y rate approximating headline inflation, which means that they were rising even more slowly than in the previous quarter, and their level halved compared to Q2 of the previous year.

Table 15
y/y rates of CPI and its principal price categories
(corresponding month previous year = 100)

	2001					2002				
	weight in % CPI	rates			share in CPI	weight in % CPI	rates			share in CPI
		IV	V	VI			IV	V	VI	
Total, of which	**100.0**	**106.6**	**106.9**	**106.2**	**6.2**	**100.0**	**103.0**	**101.9**	**101.6**	**1.6**
Officially controlled prices	25.7	106.7	106.9	105.2	1.3	27.1	104.2	102.4	102.4	0.7
of which: fuels	3.5	97.4	95.0	87.8	-0.4	3.7	99.2	96.9	96.8	-0.1
Non-food articles (excluding officially controlled prices)	27.0	104.7	104.7	104.6	1.2	26.1	102.4	102.0	101.9	0.5
Services (excluding officially controlled prices)	17.1	109.1	109.0	108.7	1.5	17.1	105.1	104.8	104.7	0.8
Food and non-alcoholic beverages	30.1	107.0	107.8	107.2	2.2	29.7	101.3	99.6	98.7	-0.4

Source: GUS and NBP calculations.

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For example, prices for clothing and footwear declined 0.5–0.9% y/y in Q2 2002 (compared to a 0.1–0.5% drop in the previous quarter and 1.9–1.6% growth in Q2 of the previous year), prices of audio and video equipment fell almost 4% (compared to a roughly 3% drop in the previous quarter and almost 1% the year before), and prices of furnishings and household equipment went up, but only slightly over 1% (compared to a roughly 2% rise in the previous quarter and about 4% the year before).

The strongest Q2 2002 rise in the group under discussion was displayed by prices for pharmaceuticals. Their 8.7–5.6% y/y rise clearly diverged from the scale of rises in prices of other products in the group. This was connected among others with the April 2002 modifications in the system of selling pharmaceuticals (which e.g. saw a revision of the list of refundable drugs). However, even in that case the growth of prices was slightly weaker than in the previous quarter and slightly weaker than the year before (5.7–9.4%).

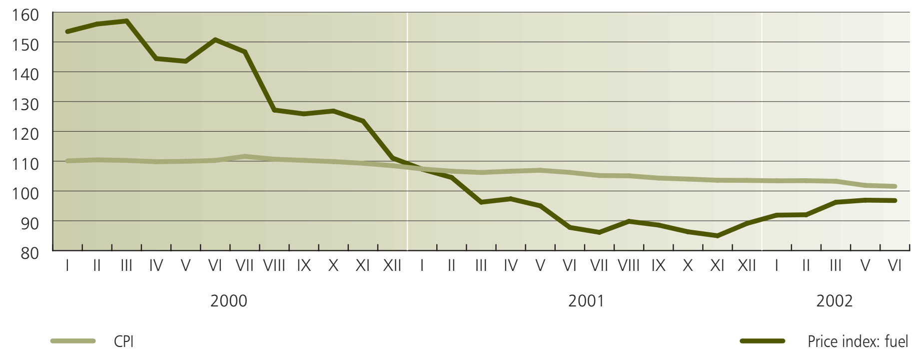
Prices for non-food articles excluding officially controlled prices constitute the group most sensitive to market mechanisms. Thus the slackening of their growth or their stagnation demonstrate the persistence of weak consumer demand.

Q2 2002 also witnessed a drop in the y/y rate of ***officially controlled prices***; they were rising more slowly than in the previous quarter and almost twice as slowly as the year before. Consequently, they contributed 0.7 percentage point to the y/y growth of the CPI compared to 1.3 percentage point the year before.

This resulted among others from the absence of price rises in electricity and telecommunication services in 1st HY 2002, merely a token rise in the price of gas in April this year and minimum rise in central heating and hot water charges, as well as public transport fares. In Q2 2002 the CPI was also less influenced by the rises in officially controlled prices carried out early this year.

In Q2 2002 prices for energy carriers (y/y) climbed 6.0–5.8% (compared to 12.1–9.2% the year before), postal services 4.1% and 8.3% respectively, public transport services 3.7–3.5% and 10.8–10.5%, and telecommunication services 4.3% in April and minus 3.7% in June compared to 1.7% and 10.1% in the corresponding months of the previous year. However, the Q2 2002 price movements in alcoholic beverages and tobacco products were at a level approximating the previous year (3.8–4.1%).

Figure 33
CPI and price index: fuel (corresponding month previous year =100)



Source: GUS.

The y/y drop in Q2 2002 ***fuel prices*** (due to their temporary 3% rise in April) was lower than in Q1 2002 and indeed than the year before (figure 33). The bottom line is that fuel prices contributed merely 0.1 percentage point to the drop of the CPI in Q2 2002 compared to 0.4 percentage point the year before.

From March to June this year fuel prices rose 2.3% (compared to a 0.1% fall in the CPI), i.e. 0.6 percent more than the year before. This primarily resulted from the April rise in world fuel prices, falling exchange rate of the dollar and a considerable growth (by about 21%) of the trade margin, calculated as the difference between the retail price and the selling price. The impact of these factors on the movement of the retail price for fuels in particular months of Q2 2002 is presented in table 16.

Of the principal groups of prices making up the CPI basket ***service prices excluding officially controlled prices*** were at the highest level in Q2. They too, however, showed a falling trend, both in the quarter under analysis and longer-term (they declined from an average level of about 10% in Q2 of the previous year and about 6% in Q1 this year to about 5% in Q2 this year). Despite having been assigned a smaller weight in the basket than the remaining groups, it was precisely this group of prices which propped up the strongest the Q2 2002 headline inflation rate, by contributing 0.8 percentage point to it compared to 1.5 percentage point the year before.

This is a heterogeneous group. On the one hand it includes services demand for which is fairly inelastic or indeed rigid (and to which the effects of price rises in officially controlled prices are largely transmitted, e.g. rising maintenance costs of business premises) and on the other hand – services which strongly react to the change of demand, e.g. domestic and foreign package holidays, catering and hospitality services).

Table 16
Contribution of selected factors to movements in retail prices for Eurosuper 95 petrol in Q2 2002 (%)

Period	World price	USD exchange rate	Import price	Impact of import price on retail price (percentage points)	Domestic factors	Impact of domestic factors on retail price (percentage points)
April	15.7	-1.5	14.1	**3.4**	8.0	**0.8**
May	-3.7	-1.7	-5.4	**-1.4**	18.3	**1.9**
June	-2.2	0.2	-2.0	**-0.5**	-2.3	**-0.3**
Q2	9.0	-3.0	5.8	**1.4**	24.9	**2.9**

Source: Nafta Polska S.A., NBP calculations.

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Of the first type of services in Q2 this year utility prices went up the most (due to the price rises early this year). Those included occupancy, refuse collection, sewage and water supply. Their total average annualised growth in the quarter under analysis stood at about 6% (compared to 7% in Q1 2002 and 10% the year before) and was the highest in the whole group of services excluding officially controlled prices.

However, in the case of services with much demand elasticity price rises were lower. For instance, Q2 prices in restaurants and hotels increased, on average, 3% (about 4% in Q1 this year and almost 7% the year before), while prices of domestic and foreign package holidays (despite the appreciation of the dollar and the euro) went up 2–4%, i.e. similarly as in Q1 2002 and the year before.

5.2. Core inflation

In Q2 2002 the 12-month growth rate of all the measures of core inflation displayed a falling trend. However, while these changes followed the same direction as the CPI, their scale was much lower: in the quarter under analysis the y/y CPI rate went down 1.7 percentage point (from 3.3% to 1.6%), while most measures of core inflation declined 0.7–1.0 percentage points. Faster than the CPI declined only the core inflation excluding officially controlled prices (1.8 percentage points), which slipped below the CPI rate (figure 36). In March this year only the "net" inflation exceeded the CPI rate, while the remaining measures – slipped below it.

The uninterrupted drop of all core inflation rates since May last year has demonstrated that disinflation trends in the economy are sustainable and not merely affected by temporary phenomena. On the other hand, the slowdown of the rate of core inflation indices in Q2 2002 may anticipate the halting of the falling inflation trend. At the end of Q2 2002 most core inflation indices exceeded the CPI growth rate by 0.3–1.5 percentage points.

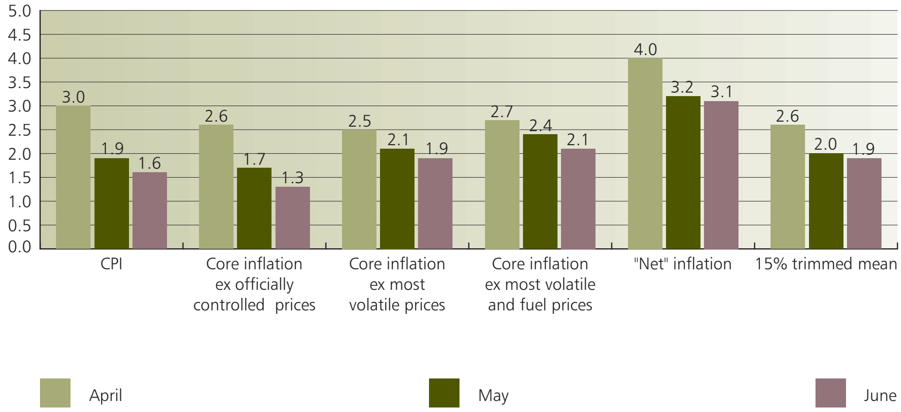
In June this year only ***core inflation net of officially controlled prices*** slipped below the CPI rate. This means that the growth rate of consumer prices subject to administrative controls was higher in Q2 2002 than the headline price rises. However, the exclusion of officially controlled prices did not cause a sharp decrease in the pace of core inflation growth compared to the CPI, because what remained intact were both the factors which significantly fuelled inflation (like energy carriers) and slackened its rise (e.g. fuels, telephone calls). Thus, the measure of core inflation under analysis remained throughout 2001 and also in the 1st HY 2002 at the level most closely tracking

Table 17
Measures of core inflation

	2001												2002					
	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	I	II	III	IV	V	VI
	changes on corresponding month previous year = 100																	
CPI	7.4	6.6	6.2	6.6	6.9	6.2	5.2	5.1	4.3	4.0	3.6	3.6	3.4	3.5	3.3	3.0	1.9	1.6
	Core inflation measures after exclusion of:																	
Officially controlled prices	7.5	6.8	6.5	6.6	7.0	6.6	5.2	4.8	4.1	3.9	3.5	3.2	3.2	3.1	3.0	2.6	1.7	1.3
Most volatile prices	7.8	7.2	6.7	6.8	6.5	5.3	4.5	4.2	3.6	3.2	3.0	3.1	2.9	2.8	2.6	2.5	2.1	1.9
Most volatile prices & fuels	7.8	7.3	7.1	7.2	7.0	6.2	5.4	4.9	4.3	4.0	3.8	3.7	3.4	3.3	2.9	2.7	2.4	2.1
Food & fuels ("net" inflation)	7.2	6.8	6.7	7.0	7.2	6.8	6.7	6.5	5.8	5.5	5.3	5.1	4.7	4.7	4.1	4.0	3.2	3.1
15% trimmed mean	7.4	7.1	6.8	6.8	6.5	6.0	5.5	5.0	4.6	4.2	3.9	3.7	3.5	3.2	2.9	2.6	2.0	1.9

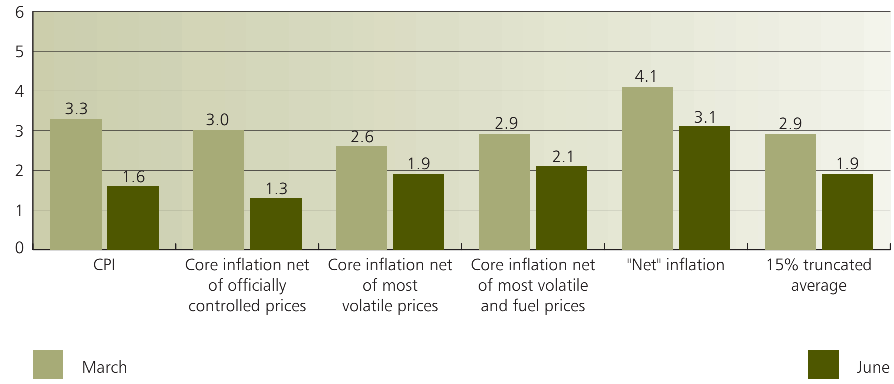
Source: GUS, NBP calculations.

Figure 34
CPI and core inflation in 2002 (corresponding month previous year = 100)



Source: GUS, NBP calculations.

Figure 35
CPI and core inflation (corresponding month previous year = 100)



Source: GUS, NBP calculations.

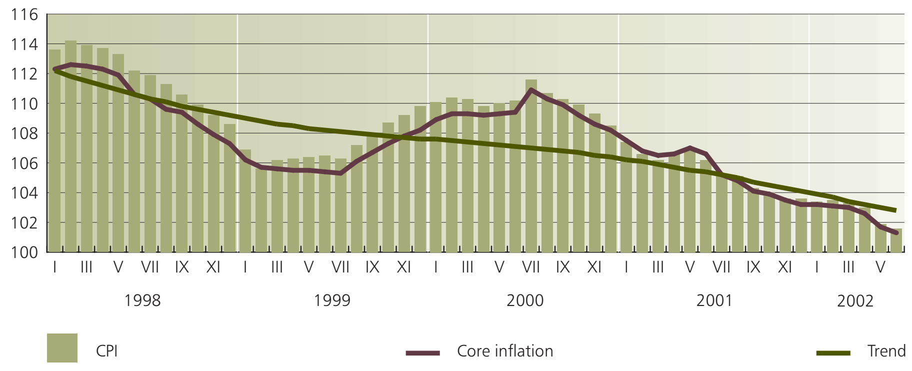
the CPI. This demonstrates the increasingly lower scale of rises in officially controlled prices compared to other consumer prices and points to a different than in previous years pattern of such price rises over the year.

Core inflation after the elimination from the CPI *of the most volatile prices* in the period from March to June this year fell 0.7 percentage point, and the measure of core inflation which approximates it most (namely the one which in addition to the most volatile prices excludes fuel prices from the CPI) declined 0.8 percentage point. The weak consumer demand persisting in the market translated in Q2 2002 to a low rise in prices, among others in such groups as clothing, footwear, household durables, services relating to leisure, culture, restaurants and hotels.

Core inflation, the so-called 15% trimmed mean, stripped off the 15% of extremely high and extremely low price movements, declined 1 percentage point over Q2 2002. This is a confirmation of a marked trend towards constraining the growth rate in groups displaying a relatively low amplitude of price oscillations.

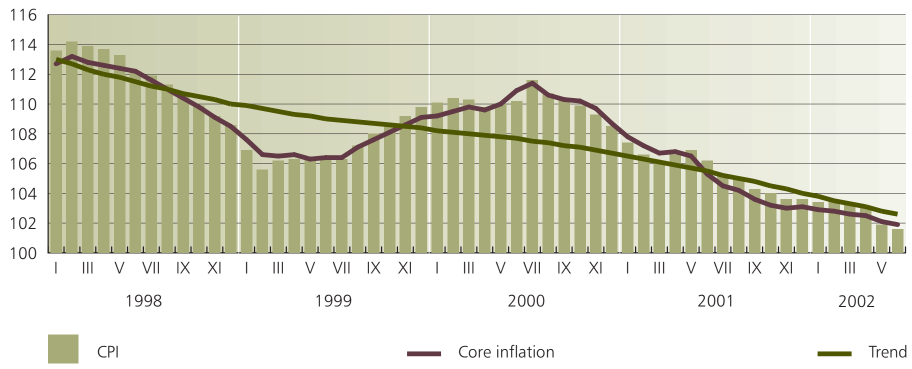
“Net” inflation, i.e. measure created by pruning the CPI of food and fuel prices (which for almost a year now have particularly strongly contributed to the fall of inflation) continued in Q2

Figure 36
Core inflation rates ex officially controlled prices
(corresponding month previous year = 100)



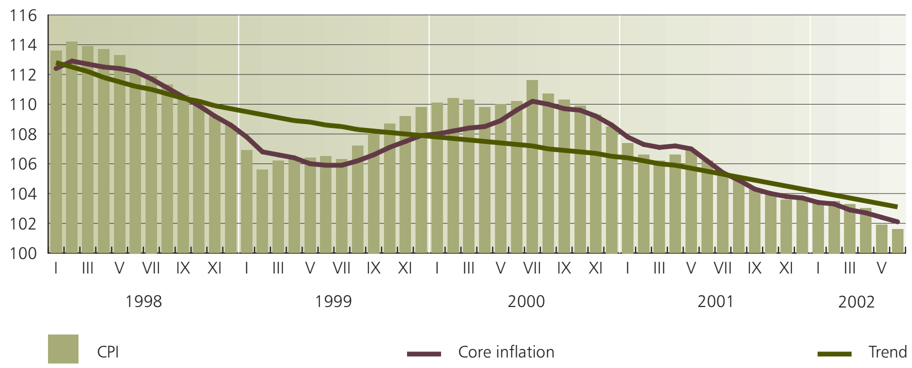
Source: GUS, NBP calculations.

Figure 37
Core inflation rates ex most volatile prices
(corresponding month previous year = 100)



Source: GUS, NBP calculations.

Figure 38
Core inflation rates ex most volatile and fuel prices
(corresponding month previous year = 100)



Source: GUS, NBP calculations.

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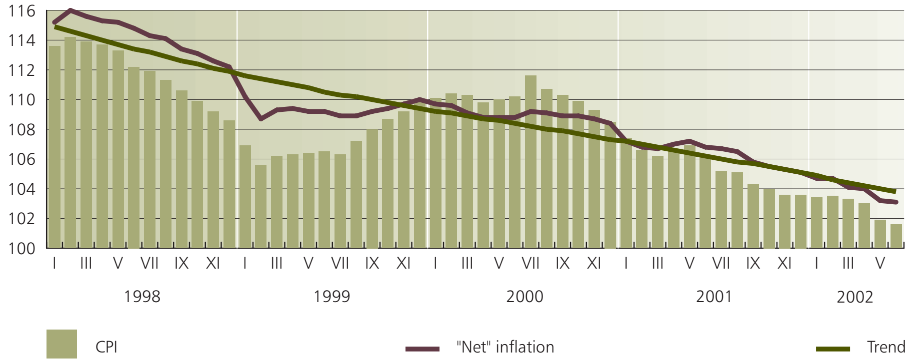
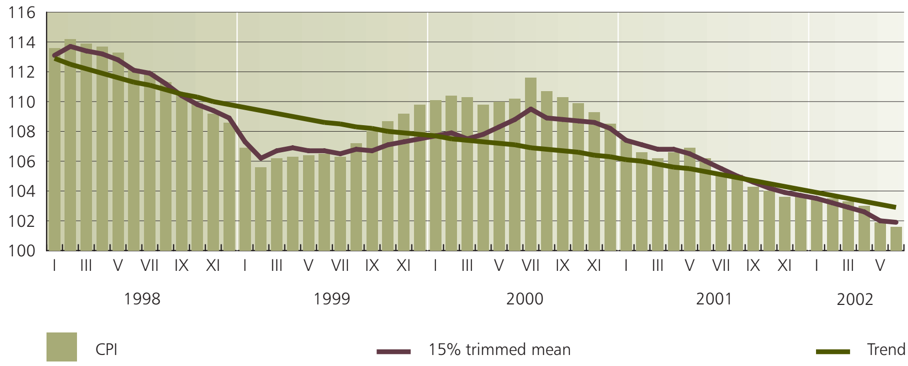
Figure 39
"Net" inflation rates ex prices of food and fuels (corresponding month previous year = 100)



Source: GUS, NBP calculations.

Figure 40
Core inflation rates – 15% trimmed mean (corresponding month previous year = 100)



Source: GUS, NBP calculations.

Figure 41
CPI and core inflation rates (corresponding month previous year = 100)

Source: GUS, NBP calculations.

2002 to remain the highest of all the core inflation measures (this trend has persisted since May last year). Starting from February last year the rates of net inflation have also clearly outpaced the CPI rate. In Q2 2002 those were boosted by rising occupancy rates (rises in prices for cold water, electricity, gas, central heating) and rise in prices of pharmaceuticals. Despite which in June this year net inflation went down on March 2002 by as much as 1 percentage point. This means that in addition to the drop in food and fuel prices the period also saw a clear limitation in price rises in the remaining groups of consumer prices (of goods and services).

The low inflation rate in Q2 2002 came primarily from very favourable price trends in the food market (drop in prices of poultry, fruits and vegetables) and fuels. Both groups have considerably impacted the evolution of inflation. But this carries the risk that the falling trend of inflation can be reversed, should the positive impulses in the two areas disappear. However, the fastest rises in Q2 2002 was displayed by occupancy and energy carrier charges (cold water, electric power, gas, central heating), as well as prices of pharmaceuticals. In total, they contributed 1 percentage point to the overall rise of prices in that period.

5.3. Producer prices in industry and construction

Q2 2002 witnessed major changes in the growth rate of *producer prices in industry (PPI)* and its sections. Compared to Q1 2002 the 12-month PPI rates showed a clearly accelerating trend, as well as reversal of the falling growth rate of prices in the manufacturing section and a considerable lowering of the growth rate in the section: production and distribution of power, gas and water (table 18).

But compared to the corresponding quarter of the previous two years the 12-month PPI growth rates in industry and its three sections were still markedly lower in Q2 2002 (figure 42).

Similarly to the situation the year before, the growth rate of the PPI in Q2 2002 was influenced mainly by the growth rate of prices in the sections: manufacturing and production and distribution of power, gas and water. But unlike the year before the price growth rate in the manufacturing section[16] was negative, i.e. it contributed to the reduction of the PPI (figure 43).

In particular months of Q2 2002 the 12-month PPI rates displayed an upward trend (figure 44). It was already marked as early as Q1 this year, after a declining trend in these prices persisting throughout Q4 2001. In June this year the PPI (industrial producer prices) was 1.2% higher than in June 2001.

The evolution of price growth in the manufacturing section is particularly noteworthy. After 12 months of systematically sagging prices (compared to the prices in the corresponding months of the previous year) June 2002 saw their growth rate achieve a positive value, at 0.2%.

However, it should also be noted that in most sections of manufacturing the y/y price growth rates in the successive months of Q2 2002 still showed a downward trend, the exception (just like in Q1 2002) being such sectors as: tobacco products, publishing, printing and reproductions, clothing and furriery, timber and wood products and manufacturing of other transport equipment. All of them saw a rise of the rates. At the end of Q2 2002 the upward price trend was also displayed by the sections: manufacturing of furniture, transport vehicles and trailers, manufacture of rubber and plastic products, and manufacture of machinery and equipment.

Trends in industrial producer prices in Poland in 1st HY 2002 deviated from the trends observable at the same time in many of our trade partners (figures 45 and 46). Starting from Q4 2001 a falling PPI has persisted in Germany, Eurozone, USA and also in Hungary. A similar trend – but only since mid Q1 2002 – has been in place in the Czech Republic. But in Poland the fall in the PPI recorded in Q4 2001 was overcome early this year and the prices have shown an upward trend since.

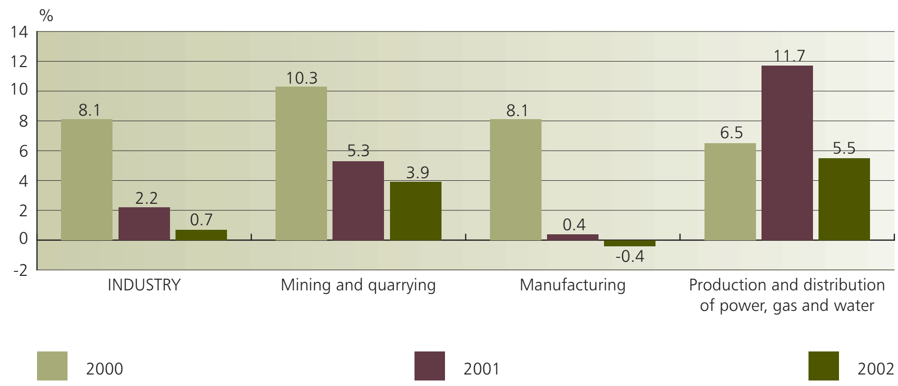
[16] The share of production sold of the manufacturing section in industry's total output stood at 83.1% in Q2 2002.

Table 18
PPI in industry and construction

	2001		2002		2001	2002
	Q1	Q2	Q1	Q2	Q2	
	Corresponding quarter previous year = 100				previous quarter = 100	
INDUSTRY						
of which:	104.2	102.2	100.2	100.7	100.1	100.7
– mining and quarrying	108.9	105.3	103.4	103.9	98.7	99.2
– manufacturing	102.7	100.4	98.4	99.6	99.5	100.7
– production and distribution						
of power, gas						
and water	111.5	111.7	109.0	105.5	104.5	101.1
CONSTRUCTION	106.3	104.4	102.0	101.4	100.8	100.2

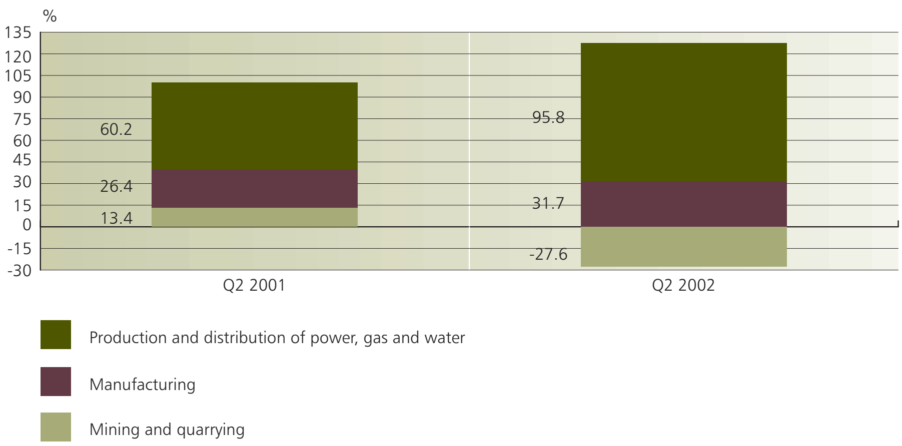
Source: GUS.

Figure 42
PPI in industry and its three sections in Q2 2000–2002
(corresponding quarter previous year = 100)



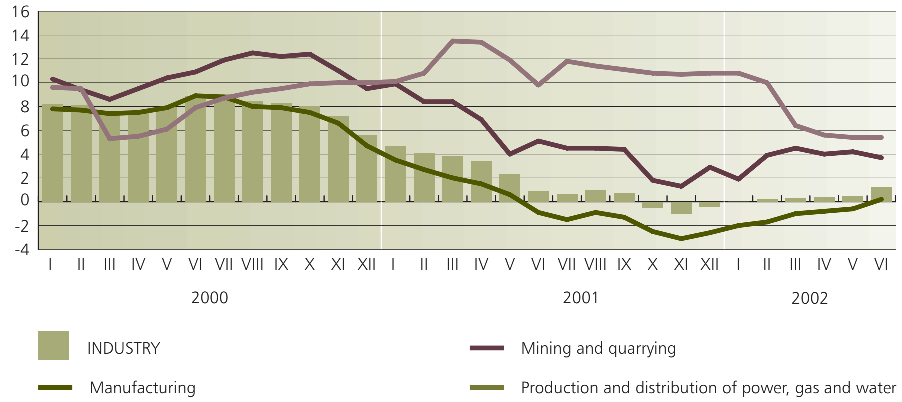
Source: GUS.

Figure 43
Contribution of growth rates of particular sections of industry to PPI growth
(corresponding quarter previous year = 100)



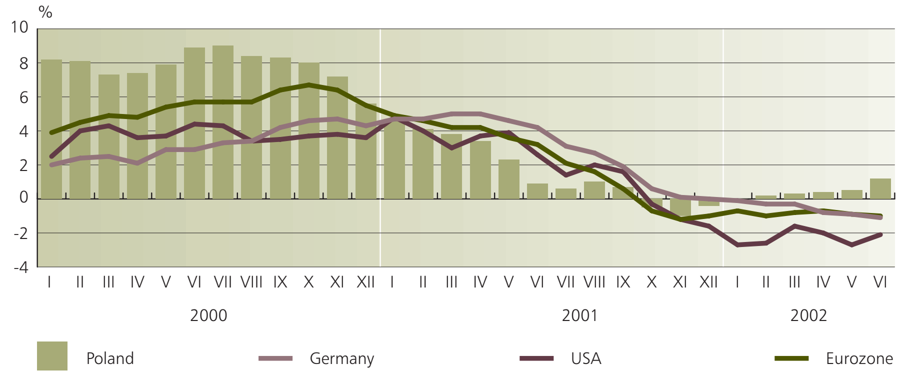
Source: GUS.

Figure 44
PPI in industry and its sections
(corresponding period previous year =100)



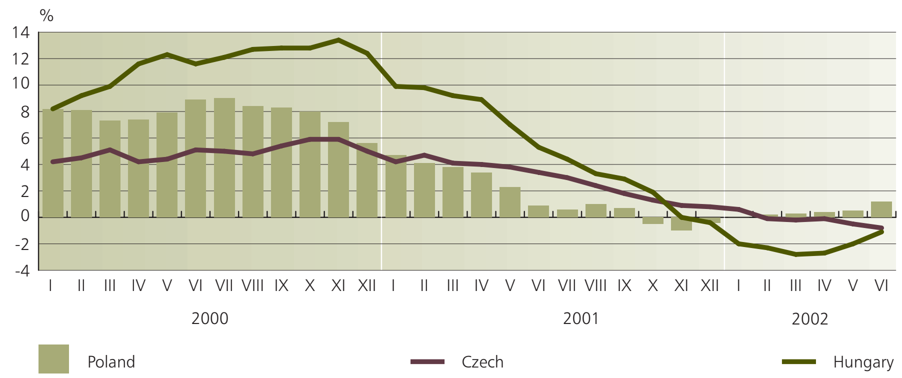
Source: GUS.

Figure 45
PPI in USA, Eurozone, Germany and Poland (corresponding month previous year = 100)



Source: Bloomberg.

Figure 46
PPI in the Czech Republic, Hungary and Poland (corresponding month previous year = 100)



Source: Bloomberg.

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The above differentials in the evolution of the PPI in Poland and the Czech Republic/Hungary followed mainly from the fact that although the growth rate of prices in the section: production and distribution of power, gas and water and in the section: mining and quarrying largely outperformed the growth rate of prices in manufacturing in all those countries, in the case of Poland the share of prices of the two sections in the PPI was larger than in Hungary and the Czech Republic. An additional boost to Poland's PPI growth in Q2 this year was a considerable weakening of the zloty exchange rate.

The waning trend of the growth rate of *construction prices*, observable since mid-2000 persisted in Q2 2002. In June this year the prices were 1.3% higher than the year before. The low growth rate of the PPI in construction results from consequently low demand for building services, in connection with the general contraction of investment activity in the economy. The price growth in construction has also been also hampered by growing competition in the building services market.

6
Monetary policy and implementation of inflation target

6.1. Monetary policy in Q2 2002

In Q2 2002 the Monetary Policy Council on three occasions lowered NBP interest rates (table 19). On 25th April the yield rate for 28-day open market operations key to estimating the degree of monetary policy tightening was lowered 50 bps (basis points) – from 10% to 9.5%, rediscount rate – 100 bps – from 12% to 11%, while the lombard rate was lowered 100 bps – from 13.5% to 12.5%. But the deposit rate was left unchanged at 6.5%. Another reduction of interest rates happened on 29th May; all the rates were then cut 50 bps. For the third time the Monetary Policy Council reduced interest rates in Q2 2002 on 26th June, again cutting the rates by bps.

An important rationale behind the three decisions on interest rate cuts in Q2 2002 was the decline of all the y/y measures of core inflation recorded in March, April and May this year. The drop demonstrated that the downward trend of the y/y CPI rate, observable at the time, was anything but temporary phenomenon. The strengthening of factors conducive to good inflation prospects was also marked by such signals as declining food price projections, the y/y PPI growth rate staying at a low level and also a diminishing risk of oil price rises.

The Council was also encouraged to cut interest rates by the results of a survey of inflation expectations declared both by consumers and bank analysts in Q2 this year. Consumer expectations,

6

Table 19
Most important decisions of the Monetary Policy Council in the 1st HY 2002

Date [a]	Decision
30th January 2002	Minimum 28-day reverse repo rate lowered from annual 11.5% to 10%
	Rediscount rate lowered from 14% to 12%
	Lombard rate lowered from 15,5% to 13,5%
	Deposit rate lowered from 7,5% to 6,5%
25th April 2002	Minimum 28-day reverse repo rate lowered from annual 10% to 9,5%
	Rediscount rate lowered from 12% to 11%
	Lombard rate lowered from 13,5% to 12,5%
29th May 2002	Minimum 28-day reverse repo rate lowered from annual 9,5% to 9%
	Rediscount rate lowered from 11% to 10,5%
	Lombard rate lowered from 12,5% to 12%
	Deposit rate lowered from 6,5% to 6%
26th June 2002	Minimum 28-day reverse repo rate lowered from annual 9% to 8,5%
	Rediscount rate lowered from 10,5% to 10%
	Lombard rate lowered from 12% to 11,5%
	Deposit rate lowered from 6% to 5,5%
	2002 inflation target lowered to 3% with a tolerance band of +/-1 percentage point

[a] Date decision taken.

largely influenced by current inflation levels, systematically improved. Their so-called objectivised measure (adjusted by y/y inflation) went down from March to June by a total of 0.8 percentage points, i.e. to the level of 2.3%. In contrast, bank analysts in successive months of Q2 this year expected the December 2002 y/y inflation to be at the level of 4.4%, 4.1% and 3.3%, respectively, and y/y inflation in March, April and May 2003 at the level of 4.4%, 4.2% and 3.6%, respectively. All in all, inflation projections evolved favorably in terms of inflation prospects.

The lowering of interest rates in Q2 2002 was also justified by the moderate in that period growth rate of the average nominal wage in enterprises. The persisting low level of on-going economic activity and expectations of gradual improvement of the outlook only in 2nd HY 2002 did not point to a possible acceleration of wage rises in the coming months.

On the side of monetary factors Q2 2002 brought no major threats to future inflation. Loans to corporates from March to May 2002 displayed a negative y/y growth rate. In contrast, the y/y growth rate of lending to households, after a significant rise in March 2002, declined in the next months.

However, Q2 2002 continued to witness a high growth rate of cash (notes and coin in circulation), accompanied by uncertainty as to its reasons and inflationary consequences. This encouraged conservatism in cutting interest rates.

Such attitude was also justified by a downward trend displayed by the y/y growth rate of household deposits, which had persisted since Q3 of the previous year. This was a consequence of a dwindling growth rate of personal incomes, as well as flagging returns on depositing funds with the banking system, as interest rates were cut and capital gains taxed.

The Council's conservative approach to lowering interest rates was also rooted in the awareness that certain effects of the cuts made by it since February last year had not yet made themselves felt, while their forecasts were subject to much uncertainty.

But the main limitation in monetary policy-making in Q2 this year was the persisting uncertainty as to the scale of the economic deficit of the public finance sector both in 2002 and 2003. Although in the quarter under analysis the implementation of the *2002 Budget Act* was not under any major threat, there was nonetheless the danger that the economic deficit would be higher than anticipated, in connection with the worsening situation of the special purpose funds. Under those circumstances the falling transparency of the public finance sector was particularly ominous, for the principles of calculating expenses and revenues of the public sector employed by the government enabled public spending to be increased in a manner not reflected in the sector's income statement.

The government's fiscal policy plans for the next year also gave rise to concern. In accordance with the *Guidelines for the Draft Central Government Budget for the Year 2003*, as presented by the Ministry of Finance in June 2002, the next year's economic deficit of the public finance sector

Figure 47
Monetary Conditions Index*

* base period = December 1994.
Source: NBP.

6

was to stand at 4.9% of GDP. In view of the projected acceleration of economic growth, this would be tantamount to maintaining a loose fiscal policy, determined by a wide Budget deficit. This situation warranted the scaling down of interest rate cuts.

A further easing of monetary policy in Q2 2002 was reflected in the gradually falling value of the MCI index, which takes account of the level of real interest rates and real effective exchange rate. In June this year the index lowered to a level approximating the one recorded in May 1999 (figure 47).

* * *

On 26th June 2002 the Monetary Policy Council reduced the level of the inflation target for 2002 to 3% – with a tolerance band of +/- 1 percentage point. This decision was justified by the much better conditions for implementing the inflation target this year than predicted when the inflation target was set in 2001. The supply factors were surprisingly favourable for the operation of inflationary processes (mainly with respect to food and fuel prices). Lower than expected was the rise in officially controlled prices and there was also a lower growth rate of domestic demand.

In those conditions the Council decided that (with the exclusion of adverse supply shocks in 2nd HY 2002) despite the NBP interest rates having been cut from August 2001 till May 2002 by a total of 6.5 percentage points, year-end inflation would probably be markedly lower than 4%, i.e. than the lower bound of the originally adopted inflation target band. With a view to stabilising inflation at a low level and also retaining transparency as to the priorities of its monetary policy, the Monetary Policy Council took the decision to revise the inflation target for this year.

At the same time the Council also set the inflation target for 2003 at an analogous level, thereby fine-tuning the target adopted in the September 1998 Medium-Term Monetary Policy, which was to lower inflation to the level below 4% in 2003. The new target is coherent with the inflation rate adopted by the Government in the *Guidelines for the Draft Central Government Budget for the Year 2003.*

6.2. The M3 money supply

In Q2 2002 a slight growth in the M3 broad money aggregate was accompanied by a considerable expansion of the narrow M1 aggregate, which included notes and coin in circulation (except vault cash). The opposing trends in the evolution of M3 and M1, especially in the last two quarters, have also been shown by the y/y growth rates of the aggregates (figure 48).

The M3 money supply at June end 2002 stood at PLN 322.4 billion and rose PLN 3.1 billion (1.0%) at the end of March this year. The y/y growth rate of M3 at the end of June 2002 stood at 2.5% (0.9% in real terms). The M3 growth in Q2 2002 resulted from its strong growth in May (by PLN 4.8 billion); in April and June a drop in M3 was recorded (by PLN 1.4 billion and 0.3 billion, respectively).

An important consideration in the expansion of M3 in Q2 2002 was the weakening of the zloty against the euro and the dollar, as recorded in May and June. Assuming the currency structure of deposits to be constant, the growth of M3 in the quarter under analysis (resulting merely from exchange rate fluctuations) would equal PLN 1 billion. But the growth of the total money supply recorded in that period resulted primarily from a rise in notes and coin in circulation by PLN 2.4 billion. Deposits and other liabilities edged up merely PLN 0.6 billion.

The low growth of total deposits and other liabilities in Q2 2002 resulted from the shrinking of household deposits in the same period by PLN 2.1 billion. At the same time corporate deposits surged PLN 2.4 billion, while the remaining items, representing about 10% of total deposits, rose PLN 0.3 billion. Of those items a growth of deposits of non-monetary financial institutions and social insurance funds was recorded totalling PLN 0.9 billion (11.7%) and a decline in deposits of non-monetary institutions servicing households and self-government institutions totalling PLN 0.8 billion (-4.1%). The remaining M3 components went up PLN 0.1 billion (36%). Should we strip off the impact of exchange rate differences, the decline in household deposits would be PLN 0.3 billion higher, while the growth of corporate deposits: PLN 0.6 billion lower.

Figure 48
Nominal growth rate of M3 and M1 (corresponding period previous year =100)

Source: NBP.

The drop in the annual growth rate of deposits taken from households has persisted since Q3 last year. The main causes of this trend include: deterioration of the income situation of households and decrease of the interest rate on deposits in the banking system, additionally compounded by tax on bank interest (figure 49).

The y/y growth rate of notes and coin in circulation at the end of June this year, at 17.9%, was the highest since December 1999, when the so-called "millennium effect" occurred. The rapid expansion of notes and coin in circulation largely followed from falling interest rates, which lowered the opportunity cost of holding to cash. Moreover, the growth of notes and coin in circulation at the end of particular months of Q2 this year was given additional boost by the "long" weekends at the end of April and May, and also the "vacation effect" occurring in June. At the same time by June end the amount of notes and coin rose again (in real terms) to its level of the second half of 1999, after its considerable lowering in 2000–2001 (figure 50). The share of cash in M1 went down from 33.8% at the end of March 2002 to 32.7% at the end of June 2002.

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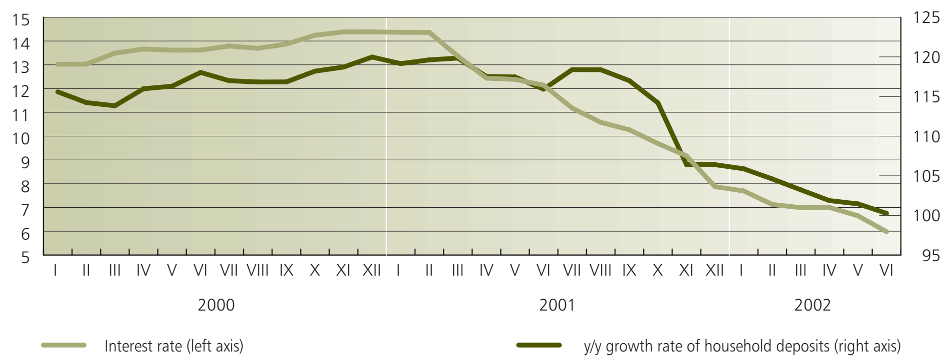
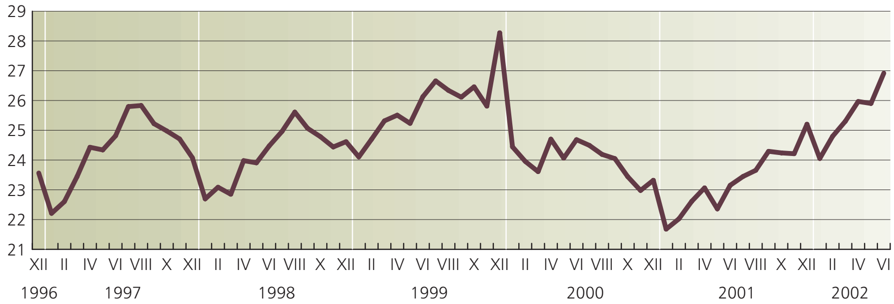
In the period from December 1996 till May 2001 (except 2nd HY 1999) term deposits were substituted for narrow money, i.e. notes and coin in circulation. The reversal of this trend occurred in June 2001 (figure 51). In analysing the changes of the relation of M1 to M3 from June last year to June this year it has to be borne in mind that starting from March 2002 data the reference base was diminished due to the elimination from M3 of deposits maturing in over 2 years. The real substitution effect of replacing term deposits with demand deposits and notes and coins in circulation was thus

Figure 49
Average interest on term deposits from persons and the growth rate of household deposits



Source: NBP.

Figure 50
Notes and coin in circulation in real terms (PLN billion of December 1996)



Source: NBP.

weaker in that period and pertained to the sum of PLN 14 billion, i.e. PLN 5 billion less than in the case of not taking into account the above change of the reference base. Should, in turn, other financial assets with a similar degree liquidity as bank deposit accounts (e.g. T-bonds, mutual fund units) be included in M3, it might turn out that the above-mentioned substitution effect would be weaker still.

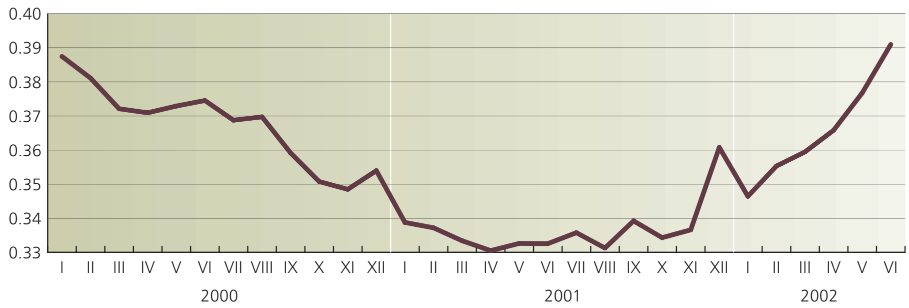
An analysis of movements in the y/y growth rate of notes and coin in circulation over the last year (moving back from the end of June 2002) shows that it largely resulted from the reference base effect. For it has to be noted that from January 2000 to June 2001 the level of notes and coin in circulation was stable and only afterwards it started to swell fast. Consequently, its y/y growth rate in the period from July 2001 to June 2002 also had to go up. In turn, starting from July this year the reference base effect should be expected to contribute to the steadying of the y/y growth rate of notes and coin in circulation.

Table 20
Money supply in Q2 2002

	At 30th June 2002	Change on 30th June 2001		Change on 31st March 2002	
	PLN billion	PLN billion	%	PLN billion	%
I. M1 money supply	126.1	21.0	20.5	11.3	9.8
II. M2 supply (according to old definition)	330.4	22.9	7.5	4.1	1.2
III. Total M3 supply	322.4	7.8	2.5	3.1	1.0
1. Notes and coin					
(non-vault)	41.2	6.3	17.9	2.4	6.3
2. Zloty deposits and other liabilities	280.7	1.4	0.5	0.5	0.2
2.1. Households	205.7	0.2	0.1	-2.1	-1.0
2.2. Non-monetary financial					
institutions	6.7	-1.7	-20.2	0.9	14.9
2.3. Corporates	48.6	5.6	12.9	2.4	5.2
2.4. Non-commercial institutions					
servicing households	8.2	-1.5	-15.2	-0.7	-7.8
2.5. Self-government institutions	9.5	0.1	1.5	-0.1	-0.7
2.6. Social insurance funds	2.1	-1.3	-38.7	0.1	2.6
3. Other components of M3	0.5	0.2	62.9	0.1	36.0

Source: NBP.

Figure 51
Share of M1 in M3



Source: NBP.

Counterparts to changes in money supply

In Q2 2002 a drop in the annual growth rate of money supply was accompanied by movements in the relative contribution of particular items to changes in money stocks. Claims[17], net indebtedness of central government and net foreign assets were drivers of growth in money supply, while the balance on "other items (net)" decreased it. What thus changed compared to the corresponding quarter of the previous year was the vector of the impact of net foreign assets and balance on "other items (net)".

Table 21
Counterparts to changes in money stocks

	2001		2002	
	growth over Q2 PLN billion	% share in growth	growth over Q2 PLN billion	% share in growth
Total money supply	**5.4**	**100.0**	**3.1**	**100.0**
Net foreign assets	-8.9	-166.3	1.7	56.2
Claims on persons & corporates	2.8	52.8	8.2	268.7
Net central government indebtedness	3.1	58.3	3.4	112.3
Other items (net)	8.3	155.2	-10.3	-337.2

Source: NBP – Banking System Statistics.

Claims represented at the end of June 2002 74.3% of the total money supply in the banking system (up from 69.3% the year before). The growth of claims in Q2 2002 compared to the previous quarter followed mainly (68.3% of the growth) from a growth of claims on corporates. The remainder was constituted by claims on households[18], non-monetary financial institutions, local government institutions, social insurance funds and non-commercial institutions servicing households.

[17] Claims consist of claims on households, non-monetary financial institutions, corporates, noncommercial institutions servicing households, local government institutions, social insurance funds. They cover all types of loans and money advances, purchased debt, realised guarantees, earned but unpaid interest, claims on purchased repo securities, debt securities and other claims. They do not cover stocks and shares.
[18] The category of households consists or private individuals, individual farmers and individual businessmen employing up to 9 persons (incl.).

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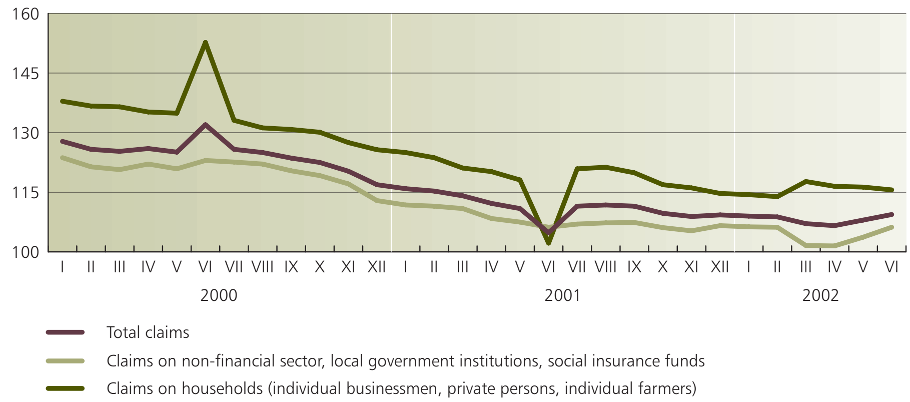
Table 22
Structure of claims in Q2 2002

	As of 30th June 2002	Change on 30th June 2001		Change on 31st March 2002	
	PLN billion	PLN billion	%	PLN billion	%
I. Total claims	239.6	20.5	9.4	8.2	3.6
1. Households	86.8	11.7	15.5	0.9	1.0
2. Non-monetary financial institutions	10.6	0.9	9.3	0.7	7.1
3. Corporates	130.1	2.7	2.1	5.6	4.5
4. Non-commercial institutions					
servicing households	0.8	-0.7	-48.7	0.0	0.7
5. Local government institutions	9.2	3.8	70.4	0.6	7.0
6. Social insurance funds	2.2	2.2	–	0.5	26.2

Source: NBP – Banking System Statistics.

Figure 52
Growth rate of claims – in nominal terms (corresponding month previous year =100)



Source: NBP.

The share of claims on households in total receivables at the end of June 2002 stood at 36.2% (23.8% the year before), while the share of claims on corporates – 54.2% (58.2% the year before).

Compared to the corresponding period or the previous year claims (in nominal terms) went up 9.4% at the end of June, of which claims on households: 15.5% and on corporates: 2.1%. In successive months of Q2 2002 the nominal annual growth rate of claims was rising (figure 52). In real terms[19] the growth of claims at the end of June stood at 7.6% y/y (their 1.4% drop was noted the year before).

Net central government indebtedness

Net central government indebtedness[20] in the domestic banking system rose PLN 3.4 billion in Q2 2002. The rise in net indebtedness resulted from:

[19] Having taken account of the y/y growth rate of the CPI at 1.6%.
[20] Net central government indebtedness comprises the balance of claims and liabilities of the banking system on and to units of the former "state budget" and "state budget special-purpose funds" subsectors, except health funds, ZUS (social insurance authority), KRUS (insurance fund for individual farmers) and funds reporting to them.

– rise in bank claims on central government institutions on account of loans and debt securities by PLN 1.0 billion, i.e. 1.2%,

– drop in government deposits by PLN 2.4 billion, i.e. 9.7%, including in particular central government budget monies deposited on the NBP foreign exchange account.

The Budget's high borrowing requirements were the main factor impacting the Q2 amount of net central government indebtedness. To finance them, in view of low privatisation revenues (merely PLN 55 million), the Budget allocated funds accumulated on accounts in previous months as well as current receipts from the sale of T-securities on the domestic market.

In the period under discussion the Budget used up the total of monies deposited on the NBP foreign exchange account coming among others from the issue of eurobonds in February this year. The high balance of funds (about PLN 4.2 billion at the end of March this year) allowed to settle foreign debt payments due in April, as well as perform an early redemption of a principal installment of USD denominated bonds issued for the NBP in connection with the operation of repayment of debt to Brazil performed in November last year.

In Q2 2002 thanks to the high balances on central government accounts the Ministry of Finance decreased the supply of Treasuries – their net sale came to PLN 7.9 billion, down from PLN 19.2 billion in Q1 2002. In connection with the continued high appeal of investing in Treasury securities, the demand for them almost doubled the offer, very high anyway. The issue of Treasuries secured the current liquidity of the Budget, allowed to fund its Q2 2002 commitments and secure funds for the Budget's future requirements. At the end of June zloty deposits on the central government account stood at PLN 9.7 billion, i.e. PLN 2.3 billion more than at the end of March this year.

Much interest in Treasuries (especially short-term ones), came in Q2, just like in Q1, from banks. At the end of June this year, the value of T-bills in bank portfolios stood at PLN 26.1 billion. This means that the Treasury debt to the banking system on account of T-bills surged almost PLN 4 billion (i.e. 18%) in Q2 2002. At the same time there was a considerable drop in the debt on other T-securities maturing in over one year. This resulted primarily from the redemption of the principal installments of US-denominated bonds. The reduction of the debt on this account by PLN 3.8 billion almost fully offset the growth of the Budget's debt on the issue of T-bills.

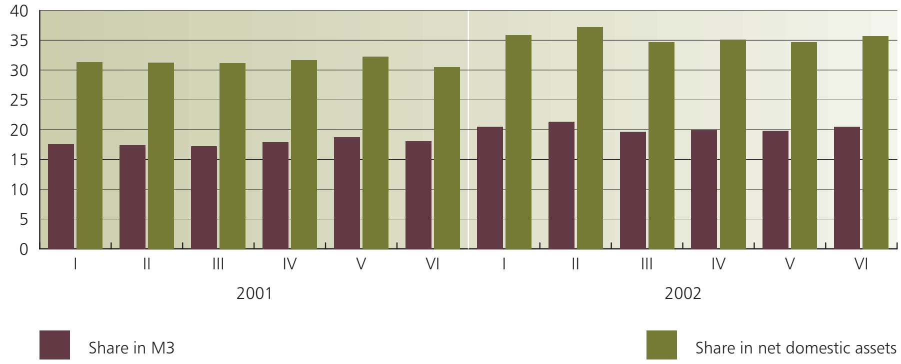
The rise of net central government indebtedness in Q2 2002 was also contributed to (apart from the Budget) by such central government institutions[21] as the Labour Fund and the Agency for Agricultural Markets. During the period under analysis their debt on account of loans and money advances increased PLN 0.8 billion and by the end of June 2002 was almost twice as high as at the end of March 2002 (in Q1 its slight fall was noted – PLN 0.1 billion).

The y/y growth rate of net central government indebtedness at the end of Q2 2002 stood at 116.2%,. It was thus lower than in December last year (123.4%), but considerably accelerated from June last year (87.8%).

Despite the rise in net central government indebtedness recorded in Q2, at the end of June 2002 its level was lower than in December last year and stood at PLN 65.9 billion. This means that in 1st HY 2002 the government institutions reduced their debt to the banking system by a total of 3.3 PLN billion (4.7%). However, in the corresponding period of the previous year, in view of a less favourable situation of the governmental sector, its debt to the banking system went up: the sector's debt surged then, on a net basis, by PLN 0.7 billion (1.2%). By the same token the share of net central government indebtedness in the total money supply decreased over the six months this year, however it significantly mounted compared to the corresponding period of the previous year (figure 53).

[21] Central government institutions comprise among others state special-purpose funds with the exception of those operating in the social insurance sector and agencies created under separate laws in order to carry out public tasks. These are at present: State Veteran Fund, National Fund for Environmental Protection and Water Management, Central Farmland Protection Fund, State Disabled Persons' Rehabilitation Fund, Creative Endeavor Promotion Fund, Labour Fund, Guaranteed Employee Benefit Fund, Agency for the Restructuring and Modernisation of Agriculture, Agricultural Property Agency, Military Assets Agency, Agency for Agricultural Markets, Military Housing Agency, Technology Agency, Material Reserve Agency.

Figure 53
Net central government debt in total money supply and in net domestic assets in 1st HY 2001–2002 (stock)



Source: NBP.

Net foreign assets

At the end of Q2 2002 net foreign assets[22] of the banking system reached the level of PLN 139.3 billion, i.e. they went up 1.3% during the quarter and 4.5% over the HY. This was contributed to by a growth of foreign assets (to the level of PLN 180.2 billion) and foreign liabilities (to PLN 40.9 billion). In dollar terms net foreign assets at the end of Q2 this year stood at USD 34.5 billion.

The share of *net foreign assets of commercial banks* in net foreign assets of the banking system was still declining: from 22.9% at year end 2001 it fell to 20.8% at the end of Q1 and 18.8% at the end of Q2 this year. The value of net foreign assets of commercial banks went down to PLN 26.2 billion (equivalent to USD 6.5 billion).

Net foreign assets at the NBP stood at the end of Q2 2002 at PLN 113.1 billion, i.e. they went up 2.7% compared to the end of Q1 this year and 9.0% compared to year end 2001. Expressed in zloty, official reserve assets, constituting the core of foreign assets at the NBP, went up in Q2 2002 to PLN 113.8 billion (equivalent to USD 28.2 billion). The change of their value was influenced first of all by: changes resulting from the revaluation of gold and securities, exchange rate differences and the balance of transitions performed by the NBP.

Balance on other items (net)

In Q2 2002 the negative balance on other items (net) shot up PLN 6.3 billion , i.e. 11.6% and stood at PLN -60 billion[23] at June end.

The scale and vector of change in this category were chiefly determined in Q2 2002 by *other assets (net) at the NBP.* In Q2 the liability balance of *other assets (net) at the NBP* surged PLN 4.6 billion, i.e. 15.8%, thus reaching at the end of June at PLN -34.1 billion. This growth was mainly caused by an increase on the item "currency translation reserve", as a result of the occurrence of gains from the difference between the valuation of foreign exchange assets and liabilities, repriced into zloties in connection with zloty depreciation. Movements in *other assets (net) at the NBP* were connected with the technical postings on the *"reserve..."* accounts, so they did not impact the money supply in Q2 2002, because they did not cause any money supply or its soaking up.

[22] The net foreign assets of the banking system comprise the foreign assets administered by the NBP (the official reserve assets and other assets denominated in foreign currencies) together with the foreign assets held by the commercial banks, less the foreign liabilities of the NBP and the commercial banks to non-residents, whether denominated in the foreign currency or in zloty.
[23] This item does not cover long-term financial obligations nor fixed assets (net of financial assets).

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Yet another element of the balance on other items (net) which also contributed to increasing the liability balance on other items (net) in Q2 2002 were *settlements on transactions in securities and derivatives,* whose assets balance decreased PLN 1 billion zloties over the quarter under analysis, i.e. 251.5%. The funds with maturities of up to 2 years, which as a result of these settlements were credited to the accounts of households, corporates, non-monetary financial institutions, self--government institutions and social insurance funds, increased the Q2 total money supply.

In contrast, the liabilities balance on other items (net) in Q2 2002 was reduced by *earnings of commercial banks*. These sunk in the space of the quarter by about 2 billion zloties, i.e. 47.8%. Their so large drop was the result of appropriate bodies' approving 2001 annual financial statements of commercial banks and, in consequence, distributing funds valued at 2.7 billion zloties, earlier posted under the item “earnings pending approval”. The sums (which in connection with the distribution of earnings increased the financial resources maturing in less than 2 years of among others households, corporates, non-monetary financial institutions (e.g. through disbursed dividends)), stimulated the total money supply.

Movements in other components of the balance on other items (net) of the consolidated banking system, recorded on the basis of the data at the end of March and June this year, did not significantly deviate in terms of value from the changes observed in previous quarters and did not have any major impact on the value of the balance on “other items (net)”.

6.3. Monetary policy transmission

6.3.1. Interest rate

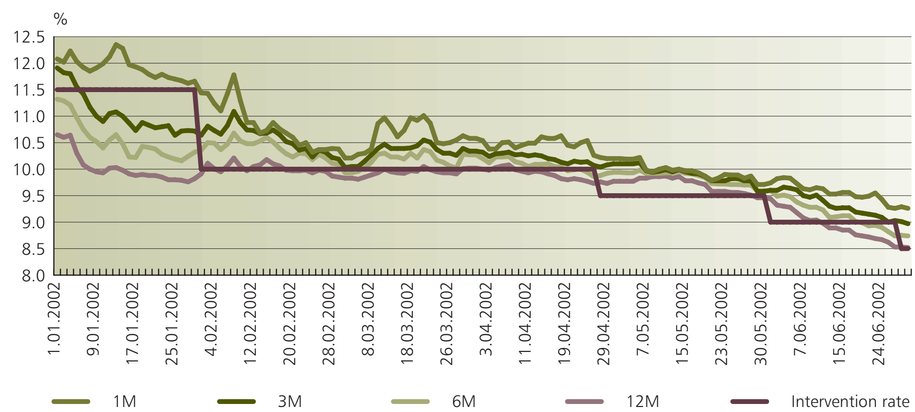
Monetary policy and interest rates in the interbank market

6

In Q2 2002 the main factors contributing to the drop of interest rates on interbank deposits were the expected and the carried out by the NBP cuts in interest rates, as well as the declining rate of inflation and forecasts of its further drop in the summer months.

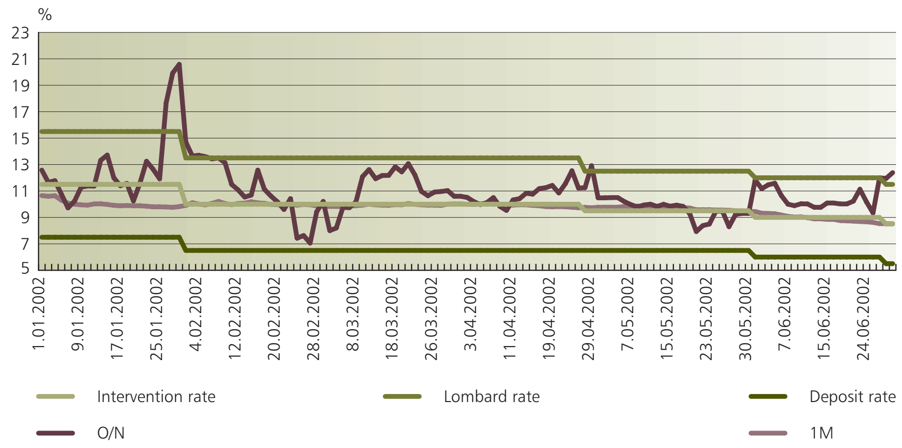
Interest rates on deposits with longer maturities kept lowering in Q2 2002 faster than interest rates on deposits with short maturities. In consequence, the yield curve in the interbank deposit market was increasing its negative slope. This process was halted in the first half of May, when following the April MPC meting the market revised its expectations as to the scale and timing of further NBP rate cuts. The effect of the changes in market expectations was a rise in interest rates

Figure 54
Intervention rate and interest on interbank deposits: 1M, 3M, 6M, 12M



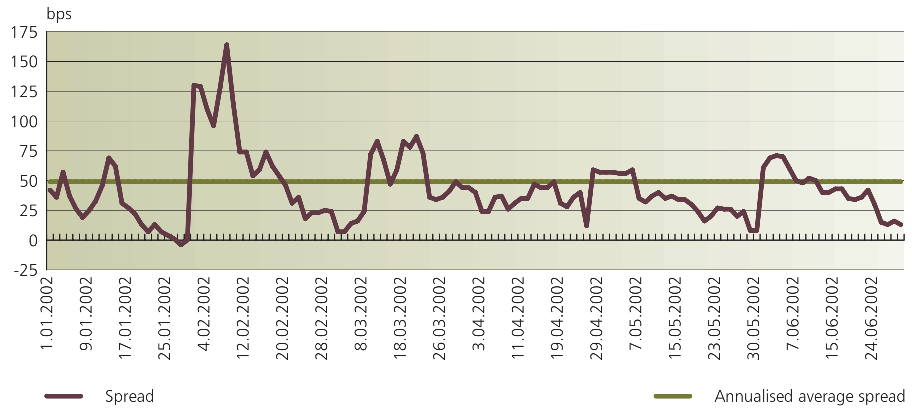
Source: Reuters, NBP.

Figure 55
NBP interest rates and O/N and 1M interest rates on interbank deposits



Source: Reuters, NBP.

Figure 56
Differential between the reference rate and 1M WIBOR rate



Source: Reuters, NBP.

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on interbank deposits with maturities over 6 months. The yield curve on the interbank deposit market was then much flattened. This had been the biggest change of this kind since early 2001, i.e. since the beginning of the current round of central bank interest rate cuts.

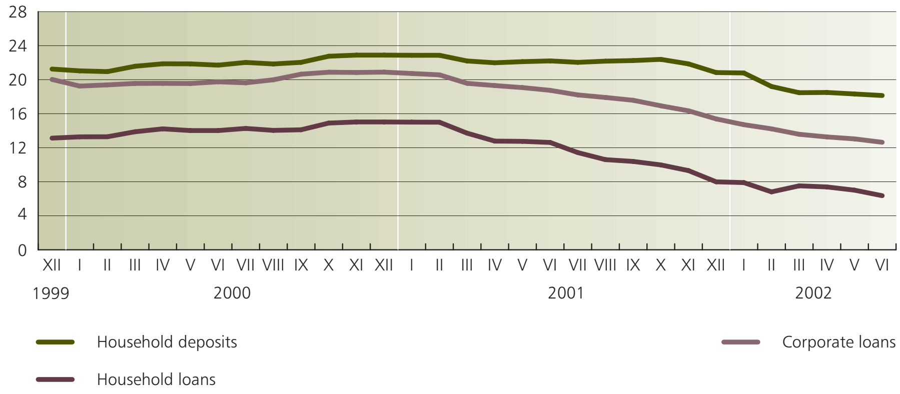
The falling trend in interest rates on interbank deposits returned in the second half of May. Again, this increased the negative slope of the money market yield curve, reflecting the rising market expectations of more NBP interest rate cuts.

The temporary rise, after MPC meetings, of interest rates on interbank deposits with maturities up to 3 months (observable also in Q2 this year) results from the banks' mounting demand for funds in order to carry out the purchase of NBP money bills prior to expected interest rate cuts. Compared to the previous quarters the rise in interest rates on interbank deposits in Q2 2002 was nevertheless relatively moderate.

Banks' response to central bank policy

In Q2 2002 the NBP Monetary Policy Council on three occasions cut central bank base interest rates. The cumulative change of the rates varied from 150 bps in the case of the reference rate to 200

Figure 57
Weighted average nominal interest rates on 1-year corporate and household deposits and loans



Comments:
1. Due to changes of definition in bank reporting, interest rates prior to 31st March 2002 and after the date cannot be compared.
2. Category of "loans to households" prior to the changes covered cash loans, and after the changes: consumer loans.
Source: NBP data.

bps in the case of the rediscount credit. Despite the banks having rather quickly reacted to NBP moves, the changes have not been (so far) fully transmitted to deposit and lending interest rates. The relatively sharpest cuts of the rates were made in June, which followed from the existence of lags in the banks' response, as well as from the adjustment of particular market players to consumer reaction.

In Q2 2002 the banks continued their strategy of asymmetric adjustment of own interest rates to market rates and (in the wake of NBP rate cuts) they made deeper interest cuts on deposits than on loans.

6

The interest rate on term deposits taken from households decreased in Q2 2002 by an average of 110 bps (to the average level of 6.0% in June 2002), and on loans to households it decreased 33 bps (to 18.15)[24]. Consequently, the interest rate margin, taken as the difference between the average interest rate on loans to households and the interest rate paid for their deposits, went up 82 bps during the quarter under analysis, to over 1200 bps.

The interest rate on term deposits taken from corporates went down in that period 97 bps on average, while in the case of loans to corporates – 90 bps. The interest rate margin has thus increased in this case by 7 bps, i.e. to about 670 bps.

Banks were induced to be conservative in cutting interest rates on loans by the difficult economic situation both of corporates and households, which resulted in a deterioration of credit portfolio quality in banks and, consequently, lower interest income. The non-parallel changes of interest rates on assets and liabilities allowed the banks to partially make up for the interest forfeited due to impaired loan quality.

Just like the previous quarters Q2 2002 saw the banks making more drastic cuts of interest rates on loans to corporates (on average 90 bps – to an average of 13% in June this year) than on consumer loans (30 bps and 18.1% respectively). The interest rates on housing loans fell by an average of 90 bps and stood at 10.2% in June this year, on average. The differences in the level of interest rates and pace of their cuts followed among others from a different perception of risk underlying loans extended to corporates and households. The interest rates on consumer loans included a higher risk margin, because the quality of loans extended to households (with the exception of housing loans) was deteriorating fast. Certain banks also seemed to pass some of the costs on to this group of borrowers, exploiting the fact that they were practically their sole lender. This policy allowed banks to perform relatively higher interest cuts on corporate loans.

[24] Weighted averages of interest rates at 11 biggest banks.

Responses to NBP interest rate cuts in Q2 2002 differed from bank to bank. The biggest banks somewhat lagged in their reactions compared to the other banks or even refrained from changing lending interest rates. Consequently, there was much diversity in loans offered by individual banks: interest on 1-year consumer loans varied in June 2002 from 11% to 24.4%, and on loans to corporates – from 9.6% to 13%. The differences followed from the implementation by banks of individual strategies, but first of all from the rationing of loans by the banks which offered them at the highest rates.

Interest rates and demand for loans

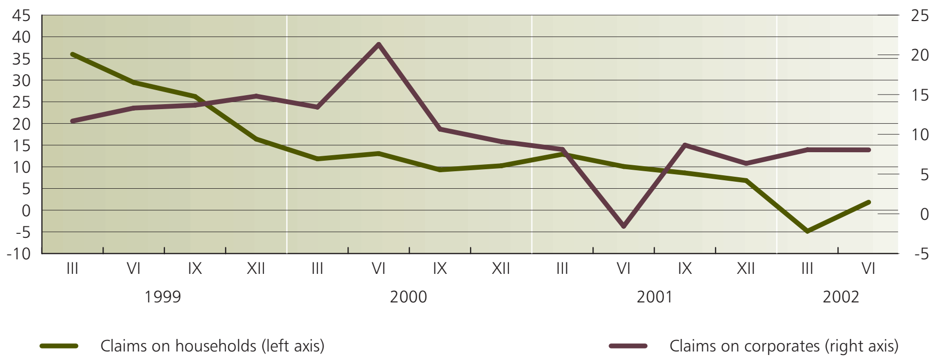
The real y/y growth rate of claims on the non-financial sector[25] went up in Q2 2002 compared to Q1 and reached 6.7%.[26] The growth was caused by an acceleration of the real growth rate of claims on corporates from -5.0% in Q1 this year to 0.5% in Q2 this year. The growth rate of claims on households remained at a level approximating Q1 2002, namely 13.7% (figure 58)

Just like in previous quarters Q2 2002 saw household demand for currency loans considerably outpacing demand for zloty loans. Pruned of the effects of zloty depreciation, the real growth of currency loans to households stood in Q2 2000 at about 8.9%, while the value of zloty loans to households fell in real terms 2.3%. The y/y real growth rate of currency loans to households increased from 80% in Q1 2002 to 86.8% in Q2 2002, while zloty loans to households fell respectively form 4.6% to 2.5%. The growth of currency loans to households in Q2 2002 followed first of all from a growth in housing loans, which accounted for 92% of the total growth of currency loans. There still persists a high real y/y growth rate in currency housing loans, oscillating around 260%. Despite the value of total zloty loans to households having fallen in Q2 2002, the value of overdraft credit increased PLN 1 billion, which resulted in the increase of their y/y real rate to 16.2%.

In the case of corporates demand for currency loans was also higher than demand for zloty loans. In Q2 2002 the value of zloty loans to corporates in real terms increased only 1.9%, while the value of currency loans net of exchange rate differences – about 3.9%. The real growth rate of zloty claims on enterprises in Q2 this year was -4.5%, while that of currency claims stood at 17.8%.

One of the main causes of the high demand for currency loans in Q2 this year was the persisting significant difference in interest on zloty loans and currency loans. It follows from an NBP-

Figure 58
Real growth rate of claims on households and corporates (on corresponding quarter previous year)



Source: NBP.

[25] According to a new definition of money supply introduced by the NBP as from March 2002 the non-financial sector includes households, corporates and non-commercial institutions which service households.
[26] The average weighted level of the CPI and PPI was used as the deflator; the weights were the shares of claims on, respectively, households and enterprises in total claims of the non-financial sector.

-conducted survey of enterprises[27] that interest rates on currency loans were on average 7 percentage points lower than interest rates on zloty loans. An additional reason for the appeal of currency loans, especially at the end of June this year, was the depreciation of the zloty vis a vis the euro, construed by the entrepreneurs as merely a temporary deviation from the zloty appreciation trend. Thus in the expectation of a speedy appreciation of the zloty, many of them elected to take out currency loans. A factor motivating to contracting debt in foreign currency has been already the year-long expectation of the zloty rate being stabilised in connection with the imminent prospect of Poland's EU and then ERM2 accession. Just like in previous quarters corporates hedged themselves against currency risk first of all by means of export revenues and then by the purchase of forward contracts. Households, on the other hand, have the possibility redenominating their borrowings (change their currency).

The dynamic rise in zloty overdraft debt of households is a consequence of the deterioration of their income situation. In these conditions they just smooth out the level of their consumption, by depleting their deposits and reaching for relatively easily available short-term credit. The credit interest rate on ROR overdraft accounts decreased in Q2 2002 merely 0.2 percentage point – down to the level of 17.8%, which should be considered relatively high.

The low growth rate of loans to corporates in Q2 2002 was primarily connected with the low pace of economic growth in Poland and abroad and with the falling degree of productive capacity utilisation. The deterioration of borrowing capacity was an additional factor weakening the rate of growth in lending for corporates. High interest rates, which as late as Q4 2000 were mentioned in second place among the bottlenecks in economic activity, clearly lost their relevance in Q2 2002. Only 8% of the enterprises polled under the business outlook survey conducted by the NBP in Q2 2000 mentioned them as a constraint on the operation of their company. Such attitude to interest rates was reflected in a slight increase of the y/y real growth rate of corporate loans which occurred in Q2 2002.

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Corporates have alternative to bank loans sources of funding. These include the issue of corporate bonds on domestic and foreign markets and taking out loans with foreign banks[28]. At the end of Q2 2002 the indebtedness of foreign corporates stemming from the issue of short-term debt securities stood at PLN 12 377.1 million and was 1.1% lower than at the end of Q1 this year. The indebtedness of corporates on bonds with maturities in excess of 1 year stood at PLN 2 481.4 million and was 10.2% higher than at the end of Q1 this year. The ratio of enterprise indebtedness on the issue of all debt instruments to total debt to the banking system at the end of June this year stood at 11.6%. It should be also borne in mind that a large part of debt instruments (about 30% according to NBP studies) issued by corporates is held by commercial banks, i.e. they constitute part of claims on the non-financial sector.

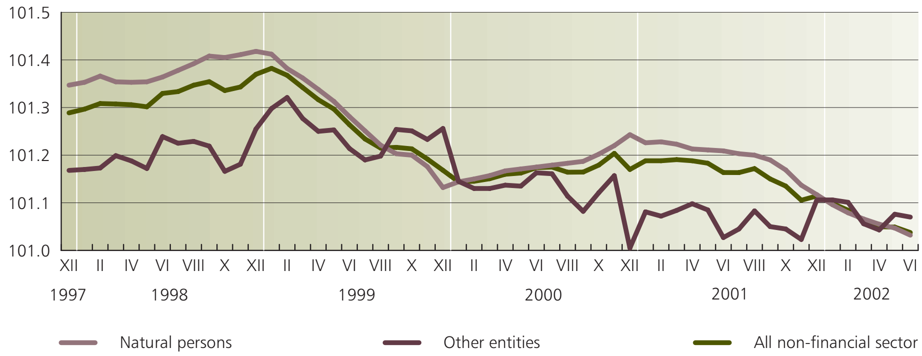
Impact of interest rates on deposits

Q2 2002 saw the persistence of a downward trend (which started in Q1 2001) in the y/y growth rate of non-financial sector zloty deposits. Early this year the 12-month growth rate of such deposits slipped below 10% for the first time since transition started; in June 2002 it stood at 3.7%. At the end of June 2002 non-financial zloty deposits were 0.3% (i.e. PLN 641 million) lower than at the end of March 2002.

Of decisive importance to the growth rate of those deposits were household deposits, whose share at the end of June this year was almost 80%. The accelerated drop of the growth rate of personal deposits, clearly evident since the turn of Q3 and Q4 2001 had this consequence that in June this year the 12-month growth rate of this category stood merely at 3.2%, as opposed to 20.9% the year before. Over Q2 2002 personal zloty deposits declined 0.5% by value, i.e. PLN 926 million.

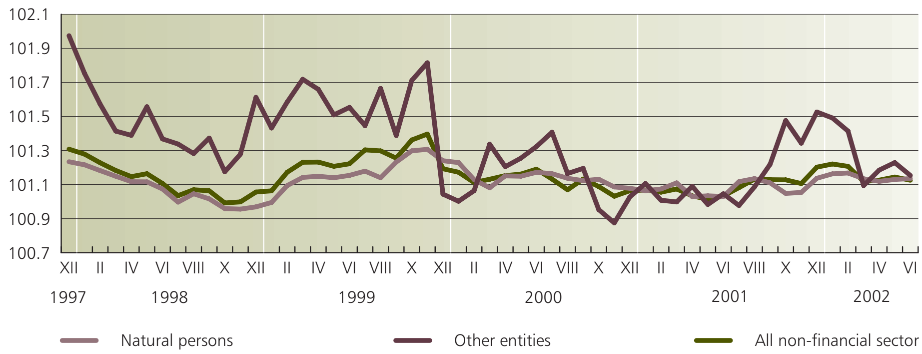
[27] *Wstępna informacja o kondycji sektora przedsiębiorstw ze szczególnym uwzględnieniem stanu koniunktury w III kwartale 2002 r. [Preliminary information of the condition of the enterprise sector with particular emphasis on the Q3 2002 outlook].*
[28] When this "*Report*" was going to the press we did not have data on foreign loans taken by corporates in Q2 2002.

Figure 59
Nominal growth rate of non-financial sector zloty deposits (corresponding month previous year=100)



Please note: Data on the graph (except for the "all financial sector" category) pertain to residents. Such approach allows to compare data from before and after 31st March 2002. The share of non-residents in zloty deposits stood in June 2002 at slightly less than 0.7%.
Source: NBP data.

Figure 60
Zloty expressed growth rate of non-financial sector currency deposits (corresponding month previous year=100)



Please note: Data on the graph (except for the "all non-financial sector" category) pertains to residents. The share of non-residents in currency deposits stood in June this year at 4.9%.
Source: NBP.

The sagging growth rate of non-financial sector zloty deposits constrains the availability of funds at banks, thus reducing the possibility of lending by the banking system.

The y/y growth rate of non-financial sector currency deposits showed a growing trend in Q2 2002: the 12-month growth rate of deposits stood at 12.5% in June this year, as opposed to 3.3% the year before. However, the growth rate of currency deposits in Q2 2002 was low: total currency deposits went up 0.5% (2.7% after taking out the exchange rate impact), while personal deposits 0.3% (2.6%) respectively[29].

The relatively low share of currency deposits in total deposits (18.7% in June this year) prevented the rise in currency savings from offsetting the declining trend in zloty deposits. In June the 12-month growth rate of **total deposits** in the banking sector came to 5.3% (13.8% the year before), while the quarterly rate was negative: -0.1% (1.7% the year before).

[29] The exchange rate of the USD at quarter end was used for calculations.

The persistence of the falling trend of total deposit growth in Q2 2002 ensued from similar factors as in the previous quarter, i.e. low growth of household disposable income and falling appeal of bank deposits (as a result of successive cuts in interest rates on deposits and subjecting interest income to taxation).

Expected interest rates

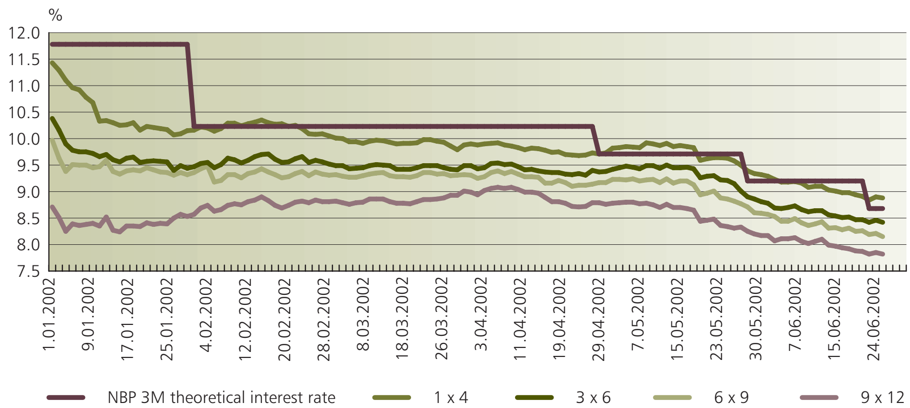
Short-term expectations

In Q2 last year expectations of further cuts in NBP interest rates still persisted, although their intensity fluctuated (figure 61 and 62).

Following the April meeting of the MPC down went the scale of NBP interest rate cuts expected by the market until the end of the year. The change was reflected in a parallel upward shift of the curve of 3-month interest rates expected in subsequent quarters of the year[30] (figure 63).

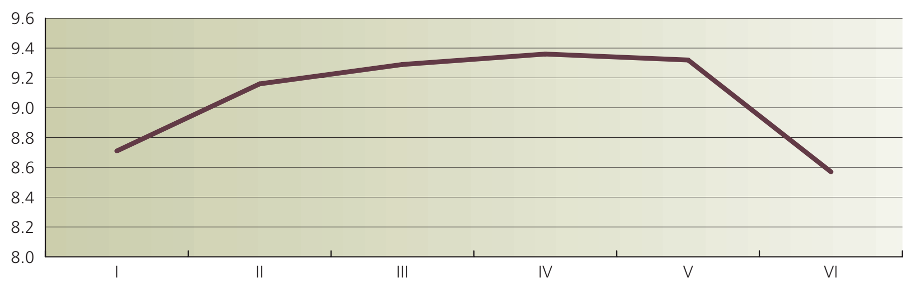
The market was induced to revise its expectations of the scale and timing of NBP interest rate cuts by the lower than expected April NBP rate cuts, as well as information coming from the MPC on scaling down future interest rate cuts.

Figure 61
3M FRAs



Source: Reuters, NBP.

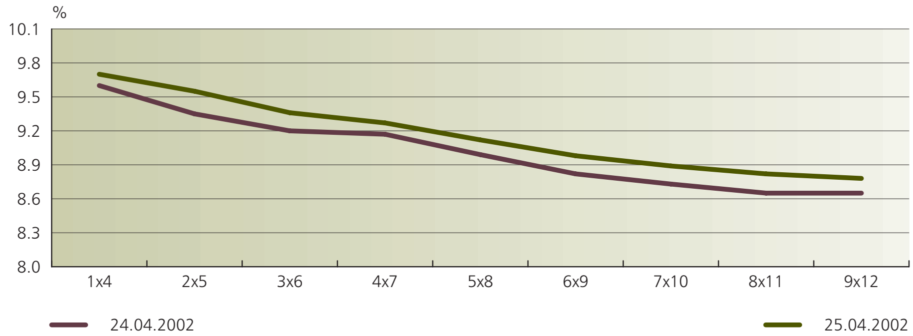
Figure 62
3-month forward rate based on contracts maturing at the end of July 2002



Source: Reuters, NBP.

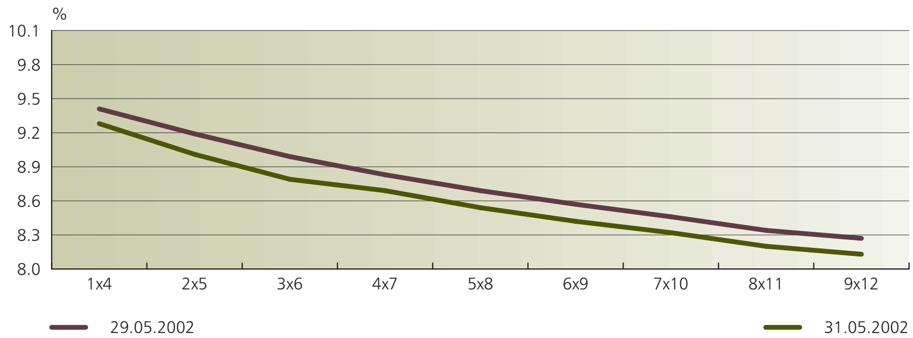
[30] The curve is based on interest rate FRA contracts (1x4, 2x5, 3x6, etc.) written with a reference rate of 3M WIBOR, where the settlement date for interest payments is set one month from conclusion of the contract (1*4), two months from that date (2*5) or three months from that date (3*6).

Figure 63
Shift of 3-month forward yield curve after MPC meeting in April 2002



Source: Reuters, NBP.

Figure 64
Shift of 3-month forward yield curve after MPC meeting in May 2002



Source: Reuters, NBP.

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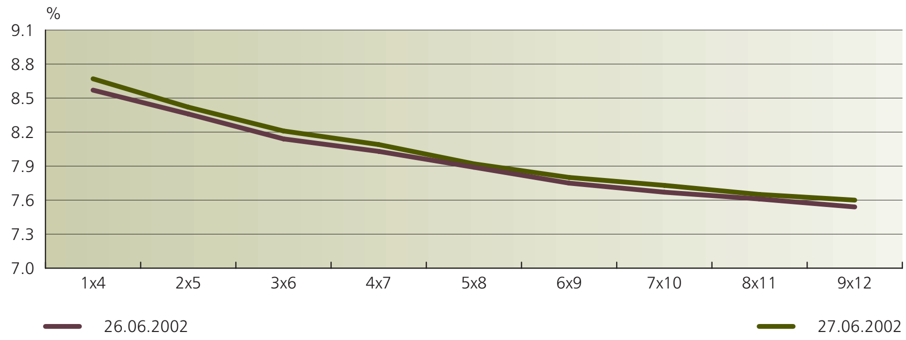
Worse than market-expected industrial output data for April and May and steeper drop of May inflation than predicted by the market contributed to a resurgence of expectations of further NBP rate cuts. In May the scale of NBP rate cuts mirrored market expectations. In response to this particular MPC decision the curve of 3-month interest rate cuts expected in the next quarters declined slightly (figure 64).

The strongest market expectations of interest rate cuts occurred prior to the June meeting of the MPC. It has to be noted, however, that FRA contracts, based on which market expectations of interest rate changes are estimated, extended back then also over the date of the July MPC meeting. It is thus hard to precisely estimate the strength of market expectations of interest rate cuts prior to the June MPC meeting. However, it is plausible they were stronger than the expectations of NBP rate cuts in May and comparable with the expectations of interest cuts in April. This finds confirmation in a Reuters survey of bank analyst forecasts of movements in interest rates on 28-day NBP money market bills[31]. The results of that survey confirmed that most analysts did not expect changes in NBP interest rates at the May meeting of the MPC. On the other hand, they expected those in April and June.

The MPC June decision to revise the inflation target for the current year contributed to the weakening of market expectations of further NBP interest rate cuts. The yield curve of 3 month interest rates expected in subsequent months underwent then a parallel upward shift. This meant that market participants again revised their expectations of further NBP interest rate cuts. The revision consisted in putting back further NPB interest cuts expected by the market, including the scaling down of the expected, cumulated NBP rate cut until the end of 2002 (figure 65).

[31] Reuters survey among the analysts of selected main banks operating in Poland is published on the 10th day of each month or the following business day.

Figure 65
Shift of 3-month forward yield curve following MPC meeting in June 2002



Source: Reuters, NBP.

Long-term expectations

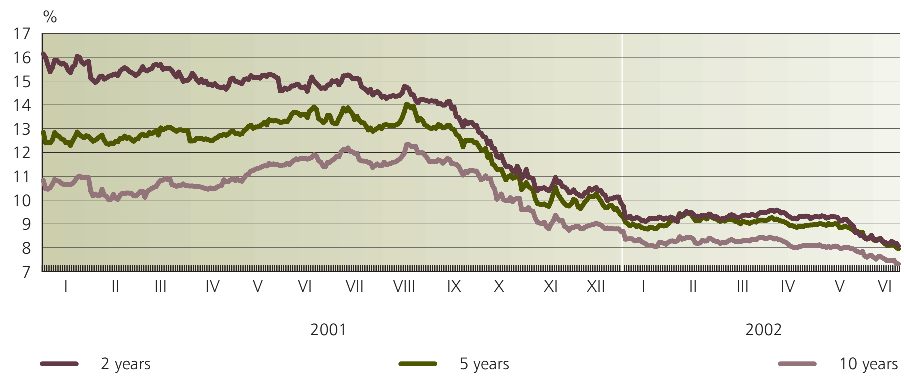
The evolution of Q2 2002 expectations of movements in future long-term interest rates was determined by the session cycle of the Monetary Policy Council. Lack of symptoms of an expected pickup with a simultaneous continuation of adverse inflationary trends induced investors to expect NBP rates to be cut.

Long-term interest rate cut expectations would escalate as the dates of MPC meetings came closer. They clearly intensified in the run-up to the day of decision announcement. In turn, after each MPC meeting the expectations would be revised, roughly in step with the scale of the actual reference rate cuts.

As a result of continued expectations of NBP interest rate cuts, bond yields were gradually going down (figure 66).

The lowering of the zerocoupon curve in Q2 2002 was accompanied by its flattening (figure 67). The scale of lowering of the short end of the curve (153 bps) roughly overlapped with the scale of NBP interest rate cuts in Q2 this year, while the long end went down 114 bps.[32]

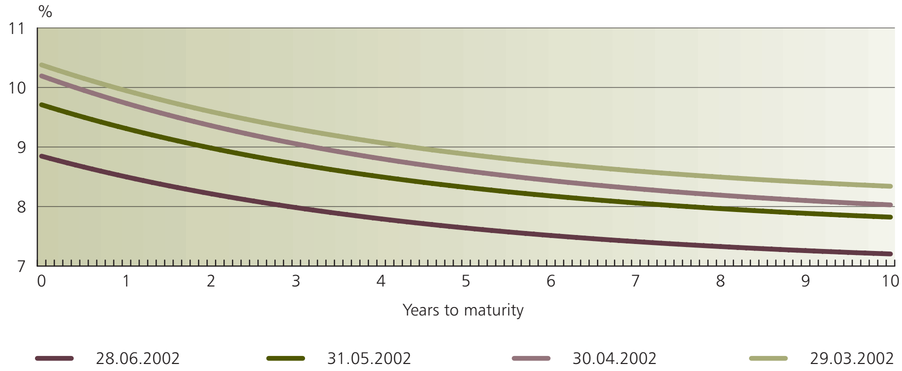
Figure 66
T-bond yield rates



Source: Reuters, NBP.

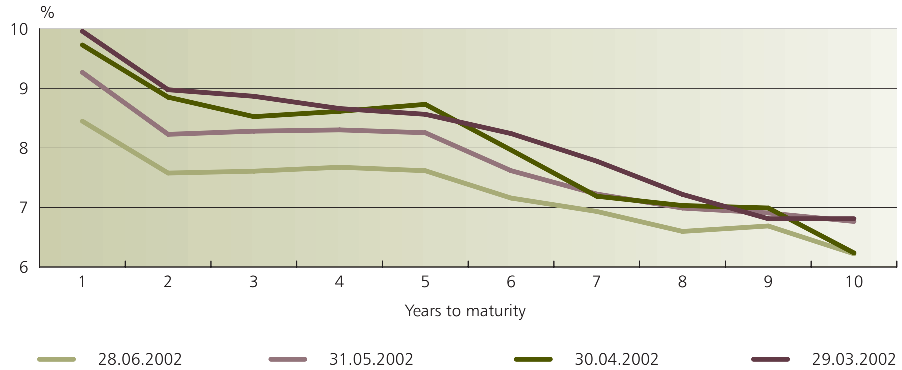
[32] Data on market bond yields (figure 66) demonstrate that the yield curve in Q2 2002 temporarily had a positive slope: yields of 2-year bonds sunk below 5-year bonds. This effect does not manifest itself in the case of the zerocoupon curve, as it mirrors only theoretical yields of zerocoupon bonds determined by market data.

Figure 67
Zerocoupon curve in Q2 2002



Source: Reuters, NBP.

Figure 68
1 year forward yield curve based on IRS contracts



Source: Reuters, NBP.

The non-parallel shift of the zerocoupon curve may be interpreted as an expression of investor uncertainty as to the scale of the Budget deficit in 2003 and resulting State Treasury borrowing requirements. These doubts intensified at the end of Q2 2002, influenced by news on the draft budget for the next year.

Investors' rising uncertainty is further attested to by the fact that the period under discussion saw the reemergence of the effect (signaled in the *2001 Inflation Report*) of the positive slope of the central segment of 1-year forward curve implied by IRS contracts (figure 68).

In sum, the evolution of long-term interest rates in Q2 2002 was primarily influenced by two factors:

• NBP rate cuts expectations, which were intensified prior to successive MPC sessions;

• gradual rise in uncertainty as to the next year's budget and, consequently, possibilities of its financing.

6.3.2. Zloty exchange rate

In Q2 2002 the zloty rate of exchange, both in nominal and real terms was subject to depreciation trends. The nominal effective zloty exchange rate a vis the currency basket of Poland's most important trade partners slipped on Q1 2002 by an average of 1.5% (figure 69). At the same time the existing trend of zloty exchange rate movements vis a vis the dollar and the euro were

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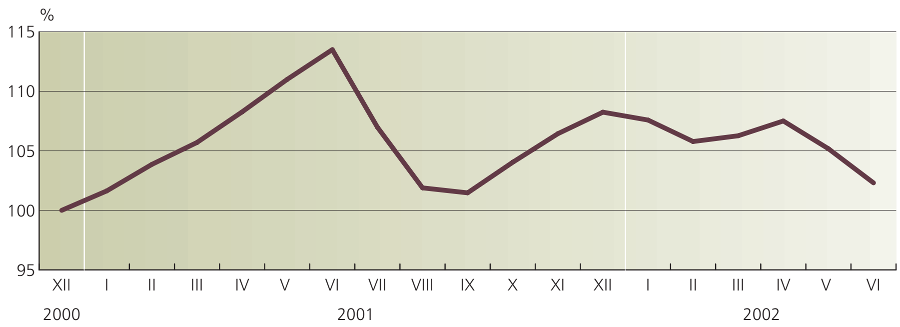
reversed. Over Q2 2002 the zloty, on average, appreciated 2.1% vs. the dollar, having fallen 1.2% in the previous quarter. But versus the euro it depreciated 2.6%, having gained 0.9% in Q1 this year. This was a function of strong appreciation of the euro in world markets. The exchange rate of the euro versus the dollar, which in March this year stood on average at 0.88, reached 0.96 in June. On average, the euro appreciated within the quarter 5% against the dollar. The impact of the euro/dollar relation on the movement of the zloty against the euro increased in Q2 2002[33] (figure 70).

Throughout Q2 2002 the zloty exchange rate was relatively stable – its relative volatility was about 2.4%, compared to 3.2% in the previous quarter (figure 71).

The set of factors impacting the zloty exchange rate in Q2 2002 remained similar to Q1:

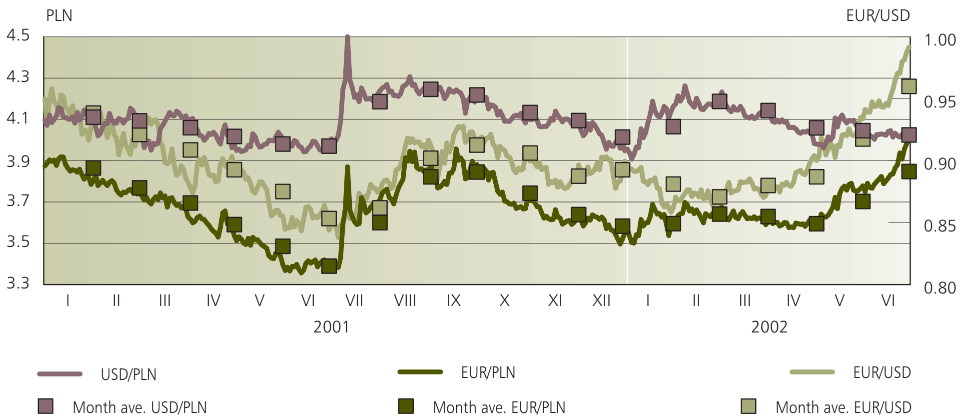
- movements in the euro/dollar rate in world markets were the most relevant factor to the level of zloty exchange rate; this was reflected first of all in a major depreciation of the zloty vs. the single currency;
- the main internal factor generating depreciation impulses was constituted by a series of verbal interventions in the form of statements of government representatives whose purpose was to weaken the Polish currency, as well as rising risk of limiting the independence of the central bank;

Figure 69
Zloty nominal effective exchange rate in 2001–2002 (monthly data, December 2000 = 100)



Source: NBP.

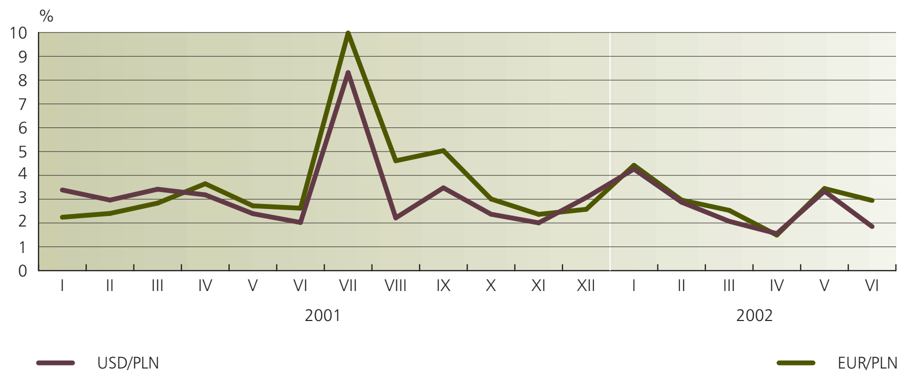
Figure 70
Zloty exchange rate versus USD and EUR and EUR/USD relation



Source: NBP.

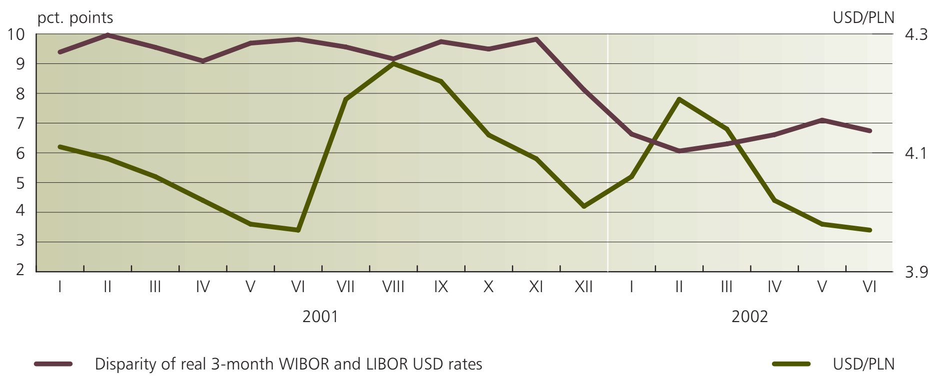
[33] The correlation coefficient in Q2 2002 for the dollar/zloty and euro/dollar relations stood at -0.36 (compared to -0.74 in Q1 last year) and for the relations euro/zloty and euro/dollar it stood at 0.96 (compared to -0.40 in Q1 2002).

Figure 71
Volatility of zloty exchange rate versus USD and EUR



Source: NBP.

Figure 72
Disparity of real interest rates and zloty exchange rate



Source: Reuters, NBP.

- the disparity of interest rates stayed at the level of Q1 2002 (figure 72). The gradual lowering of interest rates in Poland in 2001 and 1st HY 2002 with their 2002 level stable in the USA and Eurozone made Polish securities much less attractive compared to the situation the year before. This was conducive to zloty depreciation;
- the round of NBP interest rate cuts limited market expectations of further reductions (figure 73). A potential rise in such expectations was not helped by unchanged interest rates of leading central banks (figure 74). However, in the market's opinion the cycle of loosening monetary policy in Poland has not yet come to an end. This limited the process of zloty depreciation;
- one factor strengthening the zloty was (in the period under analysis) a high supply of Polish Treasuries in connection with increased government borrowing requirements given lack of privatisation receipts. In Q2 2002 a 44% rise was noted on the corresponding period of the previous year in the sale of Treasury securities, first of all bonds. The share of such securities held by non-residents increased by an average of 52% (figure 75). This was reflected in balance of payment statistics; in Q2 2002 the inflow of net foreign investments in debt securities came to USD 890 million. In the corresponding quarter of the previous year their outflow was recorded of USD 856 million (figure 76).

Movements in the zloty nominal effective exchange rate by affecting movements in import prices influence rate of the Consumer Price Index. NBP analyses demonstrate that about 3% of changes in the exchange rate are absorbed after the first quarter, 54% after two quarters, 87% after

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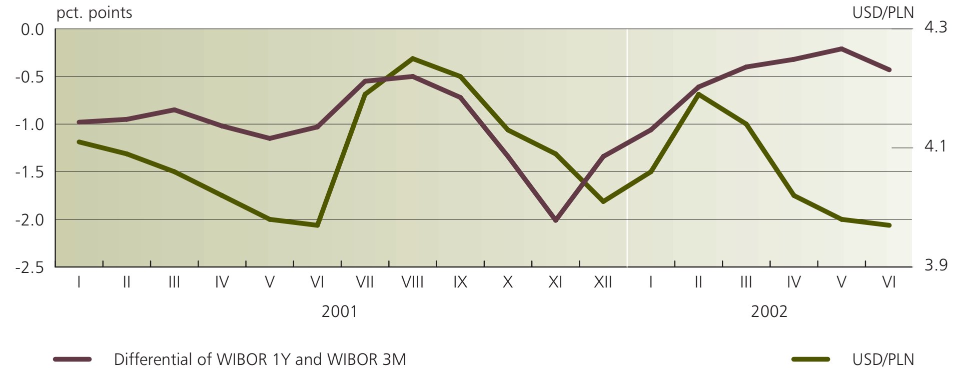
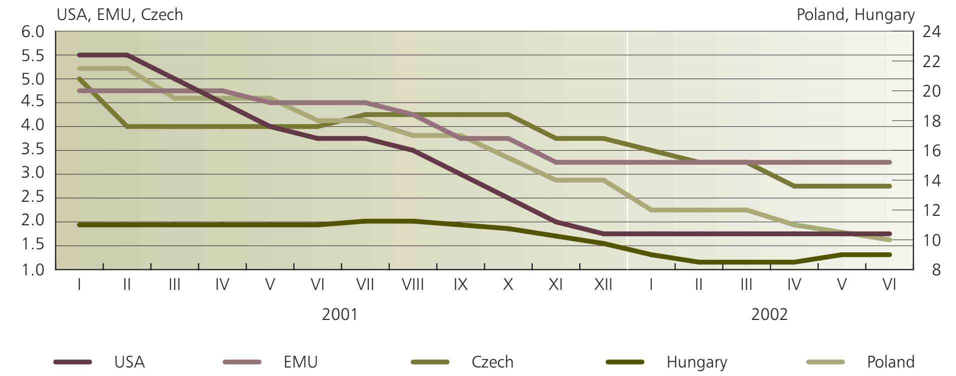
Figure 73
Interest rate cut expectations and zloty exchange rate



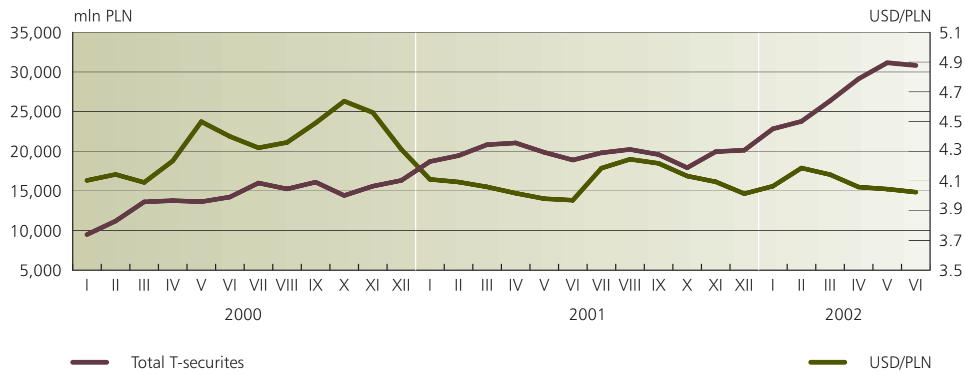
Source: NBP calculations.

Figure 74
Official interest rates



Source: Bloomberg data.

Figure 75
Non-resident T-securities portfolio



Source: NBP.

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Figure 76
Foreign portfolio investments

Source: NBP.

3 quarters, and almost 90% after four quarters. After four more quarters the CPI no more reacts to the exchange rate impulse.

Given the above structure of lags, the Q2 2002 movements in the CPI were influenced first of all by changes of the exchange rate which occurred in Q3 and Q4 of the previous year. In Q3 2002 a 10.6% depreciation of the nominal effective exchange rate of the zloty was recorded, while Q4 2002 saw its 6.7% appreciation. As a result, in Q2 2002 the exchange rate remained CPI neutral – its inflationary impact did not exceed 0.04 percentage point.

6.3.3. Inflation expectations

The evolution of the inflation expectations of consumers and bank analysts in Q2 was positive for inflation prospects. The way in which the consumer formulated his expectations improved further still and their level was scaled down. There was also a considerable reduction of the inflation expectations declared by bank analysts.

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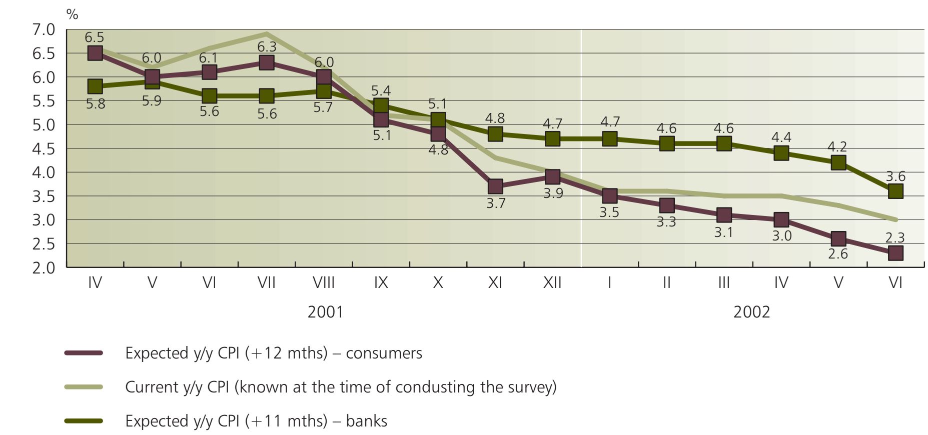
Figure 77
Inflation expectations of consumers and bank analysts in Q2 2002



Consumer inflation expectations and those of bank analysts are not fully comparable due to their different time horizons: bank analysts declare their predictions for the month which precedes the corresponding month of the following year, while consumers – for the corresponding month of the following year. Besides, it should be born in mind that consumer inflation expectations are objectivised, i.e. quantified under the assumption that those polled see the evolution of prices coloured by official inflation statistics (for more see *Inflation Report 2001*).
Source: Reuters, GUS, own calculations based on Ipsos-Demoskop data.

Inflation Expectations of Consumers

In Q2 2002 the objectivised measure of consumer inflation expectations which were declared about the 12-month inflation in the corresponding month of the following year, declined by a total of 0.8 percentage points from March 2002. In June 2001 it stood at 2.3%.

Let us recall that the objectivised measure of the inflation expectations of consumers is quantified using a probabilistic method based on qualitative data coming from an Ipsos-Demoskop poll[34]. The quantification method takes into account both the pattern of responses to the poll question and the current inflation rate to which those polled relate their future predictions in response to the question put out to them[35]. The quantification results are an objectivised measure of the price growth rate expected by consumers over the coming 12 months in the sense that the quantification procedure takes the official GUS-published inflation measure as the current inflation rate, potentially known to those polled at the time of responding to the survey question. As the Ipsos Demoskop survey is conducted in the first half of the month, i.e. before the GUS publishes the inflation rates for the previous month, the y/y inflation two months previously is taken to be current rate of inflation.

The drop in inflation expectations of consumers in Q2 2002 was caused by the lowering of the rate of current inflation (about 50% of the drop) and by shifts in the pattern of responses to the survey question (also about 50% of the drop). Figure 78 presents a decomposition of monthly changes in the quantified measure of inflation expectations of consumers into distinguished components. Whereas in April this year the sole factor conducive to a fall in inflation expectations was the improvement of the response pattern to the Ipsos-Demoskop survey question, in June the further lowering of inflation expectations of consumers resulted solely from the drop in current inflation. But in May this year the lowering of the level of the expectations was influenced by both components and, moreover, the effects of the improvement in the manner of formulating inflation expectations were three times stronger than the effects of the fall of the current inflation rate.

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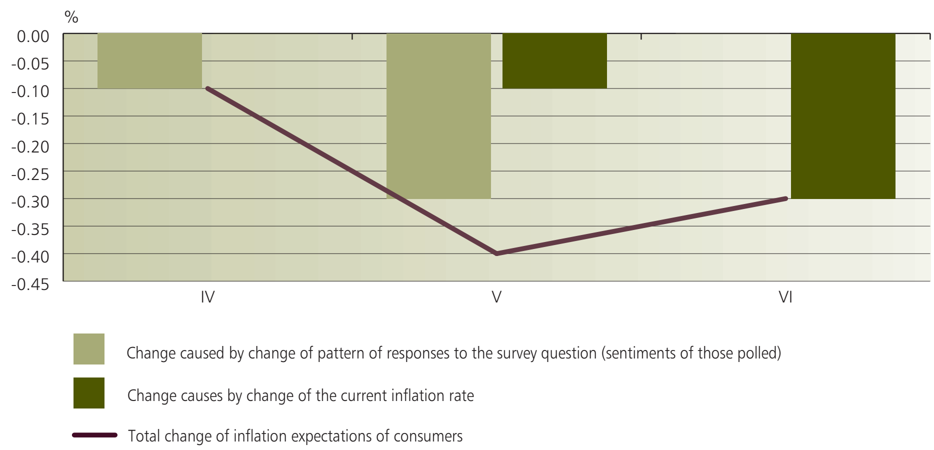
Figure 78
Decomposition of changes in the level of inflation expectations of consumers in Q2 2002

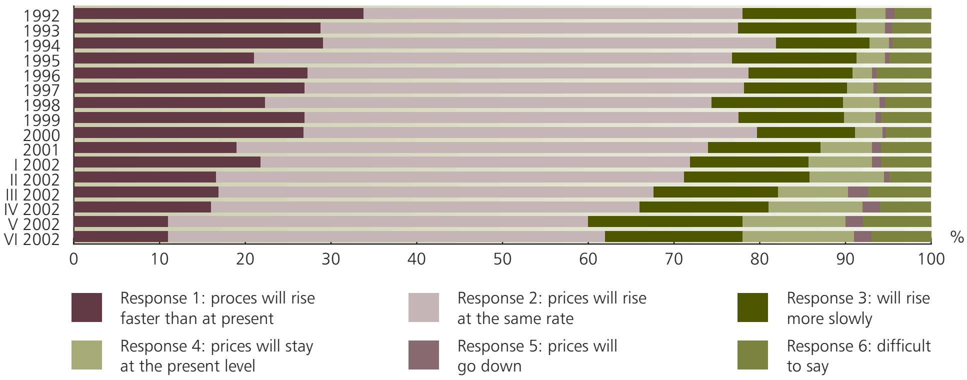


Source: own calculations based on GUS data, Ipsos-Demoskop.

[34] The adjusted Carlson and Parkin (1975) method is employed. Its description is presented in: T. Łyziak (2000), *Badanie oczekiwań inflacyjnych podmiotów indywidualnych na podstawie ankiet jakościowych.* {*Investigating consumer inflation expectations using qualitative surveys*} "Bank i Kredyt" no 6. Current information on consumer inflation expectations can be found on NBP website www.nbp.pl, in the section: Statistics/Time series.

[35] The question posed by Ipsos-Demoskop is framed in the following manner: "Given what is currently happening, do you believe that over the next 12 months prices will (1) rise faster than at present, (2) rise at the same rate, (3) rise more slowly, (4) stay at the present level. (5) go down, (6) difficult to say".

Figure 79
Pattern of responses to Ipsos-Demoskop question in 1992–2001 (year averages) and in 1st half 2002



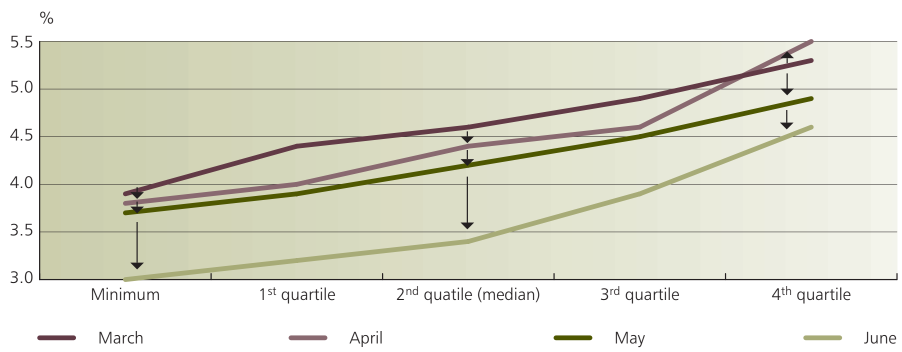
Source: Ipsos-Demoskop, own calculations.

In Q2 2002 the pattern of responses to the Ipsos-Demoskop survey question was considerably transformed, representing a clear improvement in the manner in which consumers declared their inflation expectations (figure 79). There was a clear drop in the share of the most pessimistic participants, who expected that over the following 12 months the prices would rise faster than before (response 1). In June this year the percentage of those polled who selected that option stood at 10.8% (drop by 6.1 percentage point compared to March 2002), the lowest level in the survey's history. At the same time there was a clear rise in the share of those polled who predicted that after the year the prices would remain unchanged (response 4). In June 2002 that response was selected by 13.3% of those polled (5.1% more than in March this year), the highest fraction since the surveys started.

Inflation expectations of bank analysts

Q2 2002 saw a major decline in the inflation expectations of bank analysts and shift in the pattern of their expectations towards lower growth rates of prices. In April this year the y/y inflation rate expected for the month preceding the corresponding month of the next year was at the level of 4.4% (02.% lower than in March this year), in May it declined further 0.2 percentage points and in June: 0.6 percentage points, to the level of 3.6%. As regards bank analyst expectations formulated with respect to the y/y inflation rate for December 2002, those were as follows: 4.4% in April 2002, 4.1% in May 2002 and 3.3% in June 2002.

Figure 80
Distribution properties of bank analyst inflation expectations in particular months of Q2 2002



Source: Reuters, NBP calculations.

April witnessed a slight rise in uncertainty among the analysts as to the trend of price processes in future. It manifested itself in a drop of the minimum value of the distribution of expected y/y inflation rates for the month preceding the corresponding month of the following year (from 3.9% in March this year to 3.8% in April this year), rise in the maximum value of such distribution (from 5.3% to 5.5%) and the consequent rise of the volatility co-efficient (from 8.4% to 10.7%). In May 2002 the situation was reversed: the narrowing down of the range of bank analyst declarations and decrease of the volatility co-efficient (from 10.7% to 8.6%) resulted from the drop in maximum declarations of bank analysts (from 5.5% in April this year to 4.99% in May this year). But in June 2002 the drop in the minimum value of the inflation expectation distribution (from 3.7% to 3%) was much stronger than the drop of maximum declarations (from 4.9% to 4.6%). Consequently, the range of declarations expanded and the uncertainty measures rose (the volatility co-efficient went up 5.3 percentage points, thus achieving 13.9%).

6.3.4. The wealth effect

The level of assets in the household sector, directly or indirectly disposed of by individual investors at the beginning of Q2 2002, is presented in table 23.

Throughout Q2 2002 the assets of pension funds were systematically going up and stood at PLN 25.1 billion at the end of June this year. At the same time the assets of investment funds rose to PLN 14.6 billion.

In view of a gradual decline of Stock Exchange valuations the bulk of household investments connected with the capital market was invested in Q2 2002 in Treasures.

A rising share of capital investments in the overall amount of personal savings in Q2 2002 resulted chiefly from a steady growth of assets held by pension and investment funds, with a simultaneous drop of personal savings kept on bank accounts. The low performance of investment funds resulted both from a diminishing yield of debt T-securities and falling share valuations.

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Table 23
Direct and indirect forms of personal capital market investment

Type of capital investment	PLN billion end of March 2002
1. DIRECT PORTFOLIO INVESTMENT – SECURITIES HELD ON PERSONAL ACCOUNTS (TOTAL)	22.6
Shares	9.8
Treasury securities (total)	12.8
a) market bonds	3.4
b) savings bonds	6.6
c) T-bills*	2.8
2. INDIRECT PORTFOLIO INVESTMENTS (TOTAL)	36.2
Open-ended investment funds (net assets)	22.8
Open-ended pension funds (net assets)**	13.4
Total (1+2)	58.8
Above investments (total) as proportion of bank liabilities to persons, in zloty & foreign currency (%)	28.3

* as reported by banks.
** in this table the total net assets of investment funds are taken as representing personal savings; from time to time, however, a significant part of the assets placed at these funds may in fact belong to juridical persons.
Source: MF, NBP, GUS, open-ended pension funds, investment fund companies.

7
Prospects for inflation

For almost two years now the Polish economy has been on a marked disinflation path. Since July 2000 the inflation rate has fallen 10 per cent, thus achieving in June 2002, at 1.6%, the lowest level since transition started. The slowdown of the disinflation rate witnessed from October 2001 to March 2002 (inflation dropped merely 0.7 percentage points) turned out a temporary phenomenon. Actually, in Q2 2002 alone inflation fell further 1.7 percentage points.

A faster than originally assumed disinflation prompted the Monetary Policy Council to lower in June 2002 the inflation target for the current year to the level of 3% with the tolerance band of +/- 1 percentage point and also to establish the year 2003 inflation target at a corresponding level.

The low in 1st HY 2002 growth rate of domestic demand will gradually go up in subsequent quarters. The anticipated drop in the rate of investment and consumer demand staying at a level approximating the one registered in 1st HY 2002 should trigger a process of gradually bridging the demand gap (the degree of productive capacity utilisation and the rate of GDP growth will both go up). But this should not fuel a rise in inflationary pressure.

Inflationary pressure must not be expected from the labour market either. Both the lack of near-term prospects of a clear reduction in unemployment and persisting drop in inflationary expectations of consumers (to 2.3% in June 2002, the lowest level since records began) make one justified in thinking that wage formation over the coming year will be conducive to a further reduction of inflation.

In 1st HY 2002 cheapening food was an important disinflationary factor. Whether in 2nd HY food prices will also be pulling inflation down will depend on this year's harvest. According to current estimates it will be lower than last year and will be at the average level of previous years.

As regards oil prices, the expected slow pickup in the economy world over should not expose us to their growth in 2nd HY 2002, nor indeed the next year. However, the persisting fears of a next Gulf War do not allow to significantly scale down the forecast of oil prices compared to their Q2 2002 level.

Also, movements in broad monetary aggregates do not seriously undermine the performance of monetary policy in the near future. At the end of Q2 2002 the y/y growth of M3 money supply went down to 102.5%. On the other hand, the y/y growth rate of M1 was still rising to achieve 117.9% in June this year. But this does not seem to augur rising inflation. The growth of demand for notes and coin in circulation was after all connected with a fall in interest rates, taxation of bank interest and probable growth of activity in informal economy.

In the medium to long-term horizon the steadying of the inflation rate will also be influenced by the NBP monetary policy. The mission of inflation stabilisation calls for maintaining real interest rates at a lower level than under disinflation. The real interest rate on 1-month loans in the interbank market fell from January 2001 (when the NBP embarked upon the process of relaxing its monetary policy) over 3 percentage points by June this year. In contrast, the banks in the period under analysis lowered interest rates on loans to a smaller extent. A differential has thus arisen between 1M WIBOR and the average interest rate on loans. It can be expected that over time, as the economy generally recovers, the banks will "make up for the lost time", which should lead to a further relaxation of monetary conditions.

In addition to considerations pointing to a further drop or stabilisation of the inflation rate, there are also ones based on which a growth of price dynamics can be predicted. These include first of all the evolution of the PPI. It has been growing (y/y) uninterruptedly since December 2001 and although it is still at a relatively low level of 1.2%, it should be borne in mind that the PPI in recent years was on average about 3 points below the CPI. But in June this year the differential narrowed down to 0.4 percentage points, which may point to PPI growth in the near future and, consequently, intensified inflation pressure, as measured by changes in the CPI.

Fiscal policy continues to be a source of much uncertainty when forecasting inflation. Admittedly, the implementation of this year's Budget proceeds according to plan, but the worsening situation of the special purpose funds and expected high deficit of local governments demonstrate that the economic deficit of the public finance sector may exceed at year end the level of 5% of GDP, scheduled in the Budget Act.

In turn, the *Guidelines for the Draft Central Government Budget for the Year 2003*, adopted by the Council of Ministers on 2nd July 2002, imply that the economic deficit of the public finance sector for the next year is to stand at 4.5% of the GDP. Given the forecasted acceleration of economic growth this is a disquieting piece of information, as it is tantamount to maintaining a loose fiscal policy. This will be mainly determined by a high deficit of the Budget. Add to this the danger that the ratio of public debt to GDP may exceed the 50% mark next year and conservatism in forecasting inflation and decisions on any further interest rate cuts seems necessary.

In sum, the impressive Q2 2002 drop of inflation was caused first of all by unexpectedly very big cuts in food prices. But this is hardly a lasting phenomenon. After it has ceased, the rate of inflation should gradually stabilise at a level slightly above the current one, which implies that the implementation of both this year's and next year's inflation target is highly likely.

Annex A
Voting of Monetary Policy Council members on resolutions adopted in Q2, 2002

Date of resolution	Subject	Decision by MPC	Voting of Council Members	
24.04.2002	Resolution approving the accounts of the NBP at 31st December 2001		**For:**	L. Balcerowicz M. Dąbrowski B. Grabowski C. Józefiak J. Krzyżewski W. Łączkowski J. Pruski G. Wójtowicz W. Ziółkowska
			Absent:	D. Rosati
25.04.2002	Resolution lowering the reference rate, rediscount and refinance rate by 1 percentage point and leaving the deposit rate unchanged	motion failed to receive a majority of votes	**For:**	J. Krzyżewski G. Wójtowicz W. Ziółkowska
			Against:	L. Balcerowicz M. Dąbrowski B. Grabowski C. Józefiak W. Łączkowski J. Pruski
			Absent:	D. Rosati
25.04.2002	Resolution concerning the rediscount, reference and refinance rate and term deposit rate at the NBP	to lower the reference rate by 0.5 percentage points, rediscount and refinance rate by 1 percentage point and leave the term deposit rate at the NBP unchanged	**For:**	L. Balcerowicz B. Grabowski C. Józefiak J. Krzyżewski W. Łączkowski
			Against:	M. Dąbrowski J. Pruski G. Wójtowicz W. Ziółkowska
			Absent:	D. Rosati

16.05.2002	Resolution approving		**For:**	L. Balcerowicz
	the report on the performance			B. Grabowski
	of monetary policy			C. Józefiak
	guidelines in 2001			J. Krzyżewski
				W. Łączkowski
				J. Pruski
				G. Wójtowicz
			Against:	D. Rosati
				W. Ziółkowska
			Absent:	M. Dąbrowski
16.05.2002	Resolution assessing		**For:**	L. Balcerowicz
	the activity of the NBP			B. Grabowski
	Management Board			C. Józefiak
	in implementing monetary			J. Krzyżewski
	policy guidelines in 2001			W. Łączkowski
				J. Pruski
				D. Rosati
				G. Wójtowicz
				W. Ziółkowska
			Absent:	M. Dąbrowski
16.05.2002	Resolution approving		**For:**	L. Balcerowicz
	the report on NBP			B. Grabowski
	operations in 2001			C. Józefiak
				J. Krzyżewski
				W. Łączkowski
				J. Pruski
				D. Rosati
				G. Wójtowicz
				W. Ziółkowska
			Absent:	M. Dąbrowski
29.05.2002	Resolution lowering	motion failed to	**For:**	D. Rosati
	the reference rate by	receive a majority		G. Wójtowicz
	0.75 percentage points,			W. Ziółkowska
	rediscount rate and		**Against:**	L. Balcerowicz
	refinance rate by			M. Dąbrowski
	1 percentage point			B. Grabowski
	and deposit rate			C. Józefiak
	by 0.5 points			J. Krzyżewski
				W. Łączkowski
				J. Pruski

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29.05.2002	Resolution concerning	to lower all interest rates	**For:**	L. Balcerowicz
	the rediscount rate,	by 0.5 percentage points		B. Grabowski
	reference rate, refinance			C. Józefiak
	rate and term deposit			J. Krzyżewski
	rate at the NBP			W. Łączkowski
				J. Pruski
				D. Rosati
				G. Wójtowicz
			Against:	M. Dąbrowski
				W. Ziółkowska
26.06.2002	Resolution lowering	motion failed to	**For:**	D. Rosati
	all interest rates	receive a majority of votes		G. Wójtowicz
	by 1 percentage point			W. Ziółkowska
			Against:	L. Balcerowicz
				M. Dąbrowski
				B. Grabowski
				C. Józefiak
				J. Krzyżewski
				W. Łączkowski
				J. Pruski
26.06.2002	Resolution concerning	to lower all rates	**For:**	L. Balcerowicz
	the rediscount rate,	by 0.5 points		B. Grabowski
	reference rate, refinance			C. Józefiak
	rate and term deposit			J. Krzyżewski
	rate at the NBP			W. Łączkowski
				D. Rosati
				G. Wójtowicz
				W. Ziółkowska
			Against:	M. Dąbrowski
				J. Pruski
26.06.2002	Resolution amending	change of the inflation target	**For:**	L. Balcerowicz
	the resolution concerning	for the year 2002 and		M. Dąbrowski
	the setting monetary	setting it at 3% +/-1		B. Grabowski
	policy guidelines for 2002	percentage point		C. Józefiak
				J. Krzyżewski
				W. Łączkowski
				J. Pruski
			Against:	D. Rosati
				G. Wójtowicz
				W. Ziółkowska

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