

Main trends in the economy

In November, as in October and September, external determinants of the macroeconomic situation of EU countries deteriorated. However, compared with the average for the EU-27 and the average for the new EU member states, the weakening of economic conditions in Poland was not as sharp.

The current assessment of economic conditions in Poland is based on the following observations:

- The decrease in the economic growth rate in the third quarter of 2008 was lower than projected;
- Data on sales in the industrial, construction and retail sectors in October show that the rate of growth was still weakening;
- The economic outlook surveys conducted in November by the Central Statistical Office (GUS) and the National Bank of Poland (NBP) confirmed earlier projections that the economy would be slowing down;
- November was another month in a row to see a drop in the consumer price index (CPI);
- The Monetary Policy Council has reduced central bank interest rates;
- In September 2008, growth in Polish exports was relatively high and outpaced growth in imports;
- In August the NBP-registered receipts from exports were lower than the figure projected by main banks.
- In October employment growth was slightly slower than projected while wage growth was slightly faster than projected;
- Corporate results worsened in the third quarter of 2008 but were still relatively good;
- In October growth in the national budget deficit accelerated but the deficit for the year as a whole is expected to be lower than planned under the 2008 budget law.

The Polish economy and the global financial crisis

Compared with the United States and western European countries, the financial crisis poses only a slight threat to Poland in a direct way. Banks' short-term liabilities account for 8% of Poland's GDP while in the United States the ratio is 15% of GDP. And in such countries as Iceland, Switzerland and Belgium, it is up to 200-300% of GDP. The involvement of financial institutions operating in Poland in the risky operations which caused the credit crunch in the United States and Britain has been only marginal in recent years. As a result, the quality of the loan portfolio held by Polish banks is incomparably higher than is the case with many western financial institutions.

But this does not mean that Poland is not exposed to negative consequences of the crisis. The reason is that the crisis is global in its economic dimension, which means it affects all countries of the world, including those which are not directly involved in its financial aspect, like for example Poland. At the same time, the fundamentals of the Polish economy are much stronger compared to the economies of the countries affected by the crisis. The economic growth projections for Poland prepared by the IMF and OECD for the years 2008 and 2009 are around 5% and 3% respectively. Meanwhile, western European countries, like Germany, Britain and Ireland, are expected to record growth rates close to 0% or negative. International institutions predict that economic growth in Poland in 2009 will probably be lower than the

long-term average but at the same time much higher than in other EU countries and therefore the rate of real convergence with the EU-15 will be maintained.

However, the situation on international markets and economic growth prospects for the world and Europe for coming years are very uncertain. Additionally, the global crisis has overlapped with the cyclical economic slowdown seen in the euro zone since 2007. As a result, foreign direct investment in Central Europe has decreased sharply, costs of external financing have significantly increased, while the diminishing propensity to consume in developed countries has had a negative impact on imports, including imports of goods made in Poland.

Additionally, historical observations indicate that Poland's business cycle lags that of the EU-15 by six or eight quarters. A major threat to the real economy in Poland is the restricted access to loans due to liquidity tensions on the interbank market and financial markets on the one hand and banks' great aversion to credit risk on the other.

As a result of these developments, 2010 may also turn out to be a year posing outstanding challenges to Polish businesses, households and public administration due to the overlapping of several unfavourable economic phenomena. One of two scenarios is likely to unfold. In the first scenario, the global financial crisis would be gradually spreading to include Poland and would overlap with a cyclical slowdown. As a result, GDP growth would be slowing gradually in 2009 and 2010. In the second scenario, the global financial crisis would give Polish businesses an additional boost to adjust as early as 2009 so the sharper slowdown this year would be followed by a relative improvement in economic conditions next years.

As the situation on international financial markets is unstable, the government and the National Bank of Poland have taken firm measures aimed to strengthen stability and economic growth in Poland. These include instruments designed to enhance confidence on the interbank market and reduce borrowing costs as well as mechanisms aimed to boost investment funded from public and private sources. Additionally, a considerable increase in consumer spending is to be achieved thanks to consistent tax cuts in 2009. Compared to 2007, they are to reach over 2.5% of the GDP projected for 2009. (Introduction to "Stability and Development Plan," Nov. 30, 2008; www.kprm.gov.pl)

Monetary Policy Council on reasons behind slowdown in production

NBP (Monetary Policy Council): Recent data indicate that Poland's economic growth rate will be diminishing in successive quarters. The economic slowdown will be sharper than previously expected due to the considerable weakening of economic growth in other countries, increased uncertainty about future economic developments, more difficult access to credit and higher borrowing costs (...). At the same time, data on labour market developments show that wage growth is still high and that the relationship between wage growth and labour productivity growth is still unfavourable. The slowing growth in employment is a signal that tensions on the labour market will be eased in coming quarters and that the upward pressure on wages will diminish. Growth forecasts for the global economy have been revised downwards since the Council's October meeting due to the continued turmoil on global financial markets and the growing impact of this turmoil on the real economy. At the same time, the sharp slowdown of the global economy – especially recession in the United States, euro zone and Britain – coupled with a drop in the prices of raw materials and food on world markets, contribute to a fall in inflation, something which has persuaded many central banks to make further interest rate cuts. The turbulence on global financial markets has led to a rise in risk aversion and the consequent weakening of the currencies of many countries, including countries of Central and Eastern Europe, and a higher volatility of these currencies. (Minutes of the Monetary Policy Council Meeting, November 25-26, 2008; www.nbp.pl)

GUS on GDP growth in the third quarter of 2008

Central Statistical Office (GUS): According to initial estimates, gross domestic product (GDP) rose in the third quarter of 2008 by 4.8% compared with the corresponding period of last year. Domestic demand is still the main factor behind GDP growth. Growth in domestic demand was slower than GDP growth and reached 4.3% in the third quarter. Individual consumption contributed 3.2 pct points to GDP growth against 3.0 pct points a year before; investment demand contributed 0.7 pct points against 3.2 pct points in the third quarter last year. For the first time in two years the contribution of external demand (net exports) to economic growth was positive (0.3 pct points against -2.3 pct points in the third quarter last year). In the third quarter of 2008 domestic demand was higher by 4.3% than in the corresponding quarter of last year, with GDP growth rate at 4.8%. Total consumption was higher by 4.0%, with individual consumption higher by 5.1% and public consumption at last year's level. Gross fixed capital formation was higher by 3.5% compared to the corresponding period of last year. The investment rate (ratio of gross fixed capital formation to gross domestic product in current prices) was 20.4% against 20.7% a year before. (GUS report, Nov. 28, 2008; www.stat.gov.pl)

GDP growth estimates for 2007 and the first three quarters of 2008 (according to GUS data available on Nov. 28, 2008)

Growth in GDP* and foreign trade, % year on year

	2007	Q4 2007	Q1 2008	Q2 2008	Q3 2008	Q1-Q3 2008
GDP	6.7	6.5	5.8	4.8	5.5	
Domestic demand		8.6	7.8	6.2	6.0	4.3
Total consumption		4.7	3.3	4.0	3.9	4.0
of which:						
Individual consumption			5.0	3.5	5.6	5.5
Capital formation		23.7	18.5	17.4	13.9	5.6
of which:						
Gross fixed capital formation			17.6	15.2	15.7	15.2
Exports (acc. to national accounts)			9.1	6.4	11.1	8.5
Imports (acc. to national accounts)			13.6	11.5	11.5	8.7

*/ GDP non-seasonally adjusted (average annual prices of the year before)

Most of the new EU member states have experienced a sharper economic slowdown and higher inflation rates than Poland.

INE PAN, IBnGR and CASE: opinions and projections

Institute of Economics Polish Academy of Sciences (INE PAN): "The financial crisis has already arrived in Poland, borrowing criteria have been tightened, financial institutions have less confidence in each other and the price of money on the interbank market has increased. Much will depend on how fast the global financial markets will stabilise and how sharp the economic slowdown in European countries will be. If the financial markets stabilize relatively quickly, then the decrease in the economic growth rate will be smaller. Developments in the EU, our most important economic partner, are especially important for the Polish economy. Recession in such countries as Germany, France and Britain will definitely have an adverse impact on the size of our exports and the rate of economic growth. However, one may expect that the consequences of the financial crisis will be a bit smaller and less painful for Poland

than for rich industrialised countries and Poland's neighbours, like the Czech Republic and Hungary. There are several factors to support this argument: compared with industrialised economies, Poland is less dependent on loans; Polish businesses fund their investment projects from their own resources to a larger extent than businesses in other countries; banks operating in Poland were not involved in risky operations on the sub-prime market; Poland's ties with the global economy are weaker compared with the Czech Republic's and Hungary's; the economy is driven by domestic demand. (INE PAN report entitled "Poland's Economy. Projections and Opinions," November 2008; www.inepan.waw.pl)

Gdańsk Institute for Market Economics (IBnGR): (...) the projection has been made with the following assumptions: the negative impact of the global financial crisis on the Polish real economy will be limited while in the EU-15 the economy will slow considerably. (...) From a sectoral perspective, construction will still be growing the fastest. The increase in value added in this sector will reach 12.5% in 2008 and 8.9% in 2009. The financial crisis may become a major threat to construction growth because part of it is financed by bank loans. Demand for construction services, especially in the residential and industrial construction sectors, may be constrained by a reduction in the supply of loans and more difficult access to them. The industrial sector will be growing at a slightly slower pace than construction. The increase in gross value added in this sector is projected at 5.6% in 2008 and 4.4% in 2009. In industry, the risk factor now is the danger that exports will slow as a result of possible recession in European Union countries. The increase in value added in the market services sector is projected at 5.2% and 3.7% in 2008 and 2009 respectively. The sector is important for the economy because its contribution to GDP growth amounts to around 60%. Domestic demand is and will continue to be the driving force behind the economy in 2008 and 2009. IBnGR projects that domestic demand will increase by 5.9% in 2008 and 4.8% in 2009. A rise in investment spending will be the most important factor behind the increase in domestic demand. IBnGR forecasts that investment growth will be in a double-digit figure (13.1%) in 2008 but next year will drop considerably to 8.1%. There will be two reasons behind the slowdown in investment. Firstly, it is expected that the flow of foreign investment to Poland will slow. Secondly, the above-mentioned restricted access to bank loans will make some investors abandon their investment plans. Individual consumption is projected to grow by 5.1% in 2008 and 4.3% in 2009. The decrease in consumption growth in 2009 will also result from the reduced availability of loans and will be additionally due to a deterioration in consumer outlook and reduced propensity to buy. IBnGR projects that Poland's GDP will grow by 5.1% in 2008. The fourth quarter will be the weakest, with a growth rate projected at 4.2%. According to IBnGR, the possible impact of the financial crisis on Poland's real economy will not be seen before the first half of 2009. Then, one may expect the Polish economy to slow to 3.2% in the first quarter and 3.4% in the second quarter. In the second half of the year GDP growth should accelerate to slightly above 4%. As a result, IBnGR projects that the 2009 growth will reach 3.9%. (IBnGR report entitled "The State and Projection of Economic Conditions," October 29, 2008; www.ibngr.pl)

Centre for Social and Economic Research (CASE): In the baseline scenario, which assumes that banks will resume financing the real economy, the NBP will cut interest rates to offset the increase in margins on loans and the global recession will turn out to be shallower than pessimistic forecasts, our economy should grow at a rate of 3-4% in 2009. However, if these assumptions prove to be wrong, especially the first one, the economy may even succumb to stagnation. But parallels with the year 2001 are deceptive because the Polish economy is now much more balanced. We still assess the latter scenario as less probable than the baseline scenario. If the first scenario becomes a reality, then employment will stay at the present level

and unemployment will not be increasing, although there will be more redundancies on the labour market. These, however, will be offset by a rise in new jobs. (CASE report entitled “Trends. Analyses. Forecasts,” end-November, 2008; www.case.research.eu)

Macroeconomic projections for 2009

2009	GDP, % change year on year previous year=100	CPI inflation, % change year on year previous year=100	Current account deficit as % of GDP
Ministry of Finance, Sept. 2008	4.8	2.9	-5.8
Ministry of Finance, Nov. 2008	3.7	2.9	-5.8
NBP, Nov. 2008	2.8	4.1	
PKO BP, Nov. 2008	3.5	3.1	-5.2
IBnGR, Nov. 2008	3.9	3.4	-6.0
CASE, Nov. 2008	3.4	3.0	-4.5
European Commission, Nov. 2008	3.8	3.5	-6.1
IMF, Nov. 2008	3.8	3.3	-5.7

Source: Ł. Tarnawa of PKO BP, presentation at PTE, Nov. 6; www.ptc.pl

Investment growth slowed markedly in the third quarter of 2008 after being relatively high in the first half of the year. Investment growth has been affected by the crisis on financial markets, restrictions in access to loans, reduced foreign investment and psychological barriers to investment caused by uncertainty about future economic developments.

In January-September 2008 investment spending in constant prices by companies employing more than 49 people was by 7.9% higher than a year before. Investment growth has been slowing: in the first half of the year investment increased by as much as 18.6%. Investment in electricity generation, gas and water supply increased. Companies also invested in oil processing but investment was much smaller than last year in almost all sectors of the economy. Investment by foreign-owned companies accounted for around 38% of the total investment spending in January-September 2008. The share and the value of investment by foreign-owned companies was lower than a year before.

In October 2008 industrial sales were only 0.2% higher than in October 2007. In October 2007 the increase was 10.8 year on year. This weak result shows that Polish industry is not immune to the downturn on global and European markets.

In recent months industrial production figures changed considerably from month to month. After weak results in May, industrial production rose by 7.2% year on year in June, which suggested the sector's return to a growth path. August saw a drop in production but in September production was up 7% year on year. The results for October were very weak. Many segments of the market are unstable, which affects production figures. In October 2008 industrial sales were higher by only 0.2% than in October 2007. In the manufacturing industry output was up by 1.3% year on year, in the mining and quarrying industry down by 8.3% and in the electricity, gas and water supply sector down by 9.7%.

In October, output was higher year on year in 13 industrial sectors of the total 29 sectors. Thanks to strong growth in previous months, in the 10 months to October industrial sales were up by 6% year on year. A high increase in production, though lower than in January-September, was recorded by manufacturers of medical and precision instruments, radio and

television equipment, machines and equipment, and transport equipment. The tobacco, textile, clothing, leather, and wood industries recorded a drop in production in January-October 2008. Labour productivity in the industrial sector measured by sales per employee was by 3% higher than in January-October 2007, with employment higher by 2.9% and the average gross monthly wage up by 10.5%. In 2006 labour productivity rose by around 10% and in 2007 by 6%. Statistics for successive months of 2008 suggest that the rate of growth in labour productivity is weakening. It is disquieting that wage growth outpaces growth in productivity as this may make Polish companies less competitive and reduce their profitability.

In November 2008 the outlook for the manufacturing sector was negative for the first time since December 2002. Domestic and foreign orders were expected to decrease in the next three months. The outlook for the financial situation was negative. A three-month employment projection was pessimistic and the scale of job cuts will be larger than expected in October.

Manufacturers signalled a drop in orders, due to the weakening of foreign and domestic demand. Stocks of finished products were regarded as too high, with surpluses recorded in stocks of wood products, metals and metal products and chemicals. Producers of radio, television and telecommunications equipment said their stocks were not high enough. Companies expected a drop in prices.

Innovation activity of industrial companies in 2005-2007

Research on innovation activity in industry shows that in 2005-2007 the share of businesses introducing innovative products and processes was lower than in 2004-2006: 36.7% against 42.5%.

In 2005-2007 the highest share of innovation companies was recorded in the tobacco, oil processing and chemical industry: respectively 77.8%, 76% and 65.2%.

In 2007 outlays on innovation activity in industry were higher by 21.7% compared with 2006 but the percentage of companies spending on innovation was lower. Average spending per company was much higher: PLN7.1 million in 2007 against PLN4.9 million in 2006. The largest amount of money was spent on machines and technical equipment (58.8% of all outlays). Only 8.1% was spent on research and development. The companies financed their innovation activity mainly from their own resources (74.1% of all outlays) while bank loans accounted for 14.3% of the outlays.

The following industries had the largest share in total spending on innovation in 2007: car industry (12.6%), energy industry (12.4%), food industry (11.1%), metallurgical industry (8.3%). In 2005-2007 around 21% of industrial companies worked on joint research and development projects or other innovation projects with other companies and institutions against 23.9% in 2006. Almost one third of the companies worked with suppliers of equipment, materials, components and software.

Construction has recorded the highest growth of all economic sectors but signs of a slowdown are increasingly noticeable.

In the first half of 2008 construction was growing at a faster pace than other economic sectors, growth in construction prices was slowing, the increase in wages was higher than in other sectors, recruitment problems were diminishing and growth in building materials sales was slowing.

After the first six months of the year, projections for construction were better than at the beginning of the year. The increasingly high growth figures permitted cautious optimism. In June the value of output was by 21% higher year on year. But in the next months this favourable trend came to a halt and worrisome signs started to emerge: construction output was increasing at a slower pace, and companies reported a deterioration in economic conditions. In November construction companies reported a major drop in orders. In the first half of 2008 all groups of construction companies recorded a rise in output but in the third quarter and in October construction activity slowed. In 2007 around 133,000 homes were completed and home permits and starts were on the increase. This trend was expected to continue and 2008 was projected to be a record year in terms of home completions. In January-October 2008 the number of newly completed homes reached 122,000, 18.7% more than in the corresponding period of last year, but signals have emerged indicating a downturn on the housing market, especially the developers' market. Home sales have collapsed. Banks have adopted stricter lending criteria, developers are stopping projects already started and investors do not have money to start new projects. Home permits and starts are on the decrease. Despite these problems, wage growth in construction is still very high, the highest of all sectors of the economy. In 2007-2008 average wages in construction grew by 15% or more annually. According to experts, in coming quarters construction will remain the sector recording the highest growth but the huge tasks it faces will not be carried out by the deadlines planned. The tasks include the construction of roads and motorways, projects related to the Euro 2012 football tournament, and the Infrastructure and Environment Programme partially funded from EU sources. In the 10 months to October 2008 the construction growth rate was 14.4% and there is a slim chance for a sharp acceleration in construction activity in coming months. Although construction companies are ready to carry out more projects, there are problems with organisational work due to a lack of local development plans, problems with the purchase of land for development and long tendering processes. These problems are exacerbated by the crisis on financial markets and reduced foreign investment.

Business climate in construction

In November the general economic climate in construction was at the lowest level since March 2006. Construction companies were less optimistic about demand and production. In November companies suffered from competition from other companies and insufficient demand more than in previous months while constraints created by costs of materials and a shortage of skilled workers diminished. Skill shortages are now becoming less of a problem because of rising wages and smaller workloads in construction, and returns of labour migrants to Poland.

In November 4.3% of the surveyed companies reported no barriers to their construction and assembly operations. The barrier created by competition from other companies was indicated by 60% of construction companies against 49% in November 2007. The second most serious barrier was labour costs. Compared to November last year, the barrier created by insufficient demand increased the most: from 15% to 26%.

In October 2008 growth in retail sales slowed compared to September 2008 and October 2007. In the third quarter the increase was 8%. Retail sales were higher by 5% year on year in October and by 11.1% year on year in the 10 months to October.

The slowdown in retail sales in October was due to weak results recorded by retailers selling motor vehicles (a drop in sales by 7.7%), solid, liquid and gaseous fuels (a drop by 4.6%), and

food, beverages and tobacco products (a drop by 1.3%). In January-October all groups of retailers recorded a rise in sales because sales growth was very strong in the first part of the year. The lowest increase was noted by retailers selling food, beverages and tobacco products (2.7%). The highest increase in sales (39.6%) was noted by retailers selling clothes and footwear. Retailers selling furniture, radio and television equipment and household appliances recorded an increase of 29.5%. Other groups recording high sales were retailers selling press and books (21.2%), pharmaceuticals, cosmetics and orthopaedic equipment (16.4%), motor vehicles, motorcycles and parts (8.4%), and solid, liquid and gaseous fuels (4.4%). In October 2008 wholesale sales (in current prices) by companies employing more than nine people increased by 5.4% compared to October 2007. In October 2008 transport companies employing more than nine people recorded a decrease in sales in constant prices of 1.8% year on year. In the 10 months to October 2008 sales of transport services were higher by 0.3% year on year.

The use of information and communications technologies by businesses, households and individuals in 2008

In 2008 the share of Polish businesses using computers was 95%. The share of businesses and employees using computers with Internet access was respectively 93% and 26%. 58% of businesses had a local area network and 20% has a wireless local area network. Large and medium-sized businesses were more likely to use LAN, Intranet and Extranet than small businesses. In 2008 one in two businesses in Poland used an ERP (Enterprise Resource Planning) information system. Such systems were used by 25% of medium-sized businesses and around 10% of small businesses.

CRM software used to collect, combine, process and analyse customer data may be operational or analytical. Software of the first type, used by 19% of Polish businesses, integrates business processes at the interface with the customer. Software of the second type, used by 12% of businesses, analyses customer data to acquire knowledge about the customers and possible ways to meet their needs.

In 2008, 59% of Polish businesses had broadband Internet access and one third used analogue modems. Almost all large companies (95%) and 53% of small businesses had broadband Internet access.

On-line public services are poorly developed in Poland. In 2007 Poland had the lowest e-government index of all EU countries. E-commerce is becoming increasingly popular in Poland as are e-invoices.

Surveys on ICT use by households and individuals show a rise in computer ownership, and Internet access and use levels. In 2008, 59% of households had computers, 48% had Internet access and 38% had broadband Internet access. Half of the population aged 16-74 use a computer regularly – at least once a week – and 44% are regular Internet users. Most households use the Internet to send and receive electronic mail, find information about products and services, and take part in chats and discussion forums.

In November 2008 the general climate in the retail sector was at the lowest level since January 2007.

As in previous months, the smallest businesses, those employing up to nine people, were the most pessimistic about their situation and sales. Larger retailers also expected a deterioration in the economic situation and their sales. Expectations for food, clothing, footwear and motor

vehicle sales were pessimistic. The outlook for the furniture, household appliance and radio and television sector was optimistic.

The major barriers to business activity have not changed much from the previous month. The main barriers were still: market competition (signalled by 71% of the surveyed retailers), high labour costs (63%) and high fiscal burdens (56%). Retailers chose the following sources to finance their working capital: own resources (68%), bank loans (27%) and open account (26%).

In November the general climate in the service sector was less optimistic than in previous months. Companies providing financial services were the most optimistic but still their outlook was worse than in October. The hotel and restaurant sector was much less optimistic than in previous months.

In November 42% of the surveyed financial companies reported an improvement, down by 5%. Only 4.2% of the surveyed companies reported no barriers to their operations. Competition from Polish and foreign companies was indicated as the most important barrier respectively by 80% and 55% of the surveyed companies. Competition was stronger than a month before.

In the transport, warehousing and communications sector, 19% of the surveyed businesses signalled an improvement and 14% a deterioration in business conditions. Managers signalled a deterioration in their financial situation. In November, 4.6% of the surveyed companies reported no barriers to their business operations. Competition from Polish companies and labour costs are the most serious barriers – indicated respectively by 57% and 55% of the surveyed companies.

Companies in the real estate, rental, education and business services sector were less optimistic in November than in October. They expected a drop in current demand and a deterioration in their companies' financial situation. 19% of the surveyed businesses signalled an improvement and 10% a deterioration in business conditions. 11.8% reported no barriers to their operations. The largest percentage of companies, 52%, pointed to labour costs as the most serious barrier.

The outlook in the hotel and restaurant sector was worse than in October. Expectations for current and future demand and sales and the companies' financial situation worsened. 18% of the surveyed businesses signalled an improvement and 17% a deterioration in business conditions. Only 2.7% of the surveyed companies reported no barriers to their business activity. The most serious barriers were labour costs (indicated by 69% of the companies), competition from Polish companies (52%) and fiscal burdens (51%).

In November consumer confidence continued to weaken, which was reflected in both consumer confidence indices – the current index, which describes current trends in individual consumption, and the forward-looking index, which describes trends expected in the next months. The readings of the two indices in the past two months indicate that growth in individual consumption may slow as early as the fourth quarter of this year and the first months of next year.

The readings of the two indices dropped due to a deterioration in the households' outlook on the country's general economic situation in the past 12 months and especially job prospects for the next 12 months. There was a slight improvement in the outlook on the households' financial situation in the past 12 months and the next 12 months, the general economic situation in the next 12 months, the current potential to buy and the potential to save in the

next 12 months. It is noteworthy that the outlook on job prospects worsened sharply in November, reaching a level recorded three years ago.

In October 2008, CPI inflation fell from 4.5% in September to 4.2%. The price index increased slightly in the industrial sector but fell in construction.

In October consumer prices were mainly driven by household services (including energy). CPI inflation was still above the inflation target set by the Monetary Policy Council. Inflation stayed 1.3 pct points above the upper limit of deviation from the NBP inflation target of 2.5% +/- 1 percentage point in August, 1.0 pct point above the limit in September and 0.7 pct points above the limit in October.

Compared to October last year, the highest increase was recorded in prices of household services and energy (10.7%) and prices of food (4%). Prices of health care were higher by 3.4% than a year before, prices of education were higher by 4.2%, restaurant and hotel prices were higher by 6.7%, prices of recreation and culture were higher by 1.6%, transport prices were higher by 1.6%, and prices of communications were higher by 0.7%. Prices of clothing and footwear were lower by 6.2% compared to October 2007.

In October 2008 the annual producer price index (PPI) was 2.4% against 2.3% in September. A major increase in prices, though not as high as in September, was recorded in the mining sector (8.4%), and electricity generation, gas and water supply (9.8%). In October the average increase in producer prices in the manufacturing sector was 1.1%, with producer prices of oil products and chemicals having increased the fastest, while prices of most other products were lower than in October last year.

In the past two years construction prices were very volatile. In the first half of 2007 construction prices were increasing at a fast pace due to growing demand (companies had more orders than they were able to carry out) and upward pressure on wages in the building sector. In the third quarter of 2007 growth in prices slowed and this trend continued in 2008. Despite the increase in construction wages, which has been the highest of all sectors of the economy, construction prices have been falling due to a drop in prices of building materials. The construction price index amounted to 9% in mid-2007, 8.4% in December 2007 and 3.2% in October 2008. Average prices of mineral construction materials rose by 12% year on year in June 2007, 1.2% in June 2008 and in the third quarter were lower than a year before. Prices of metallurgical and wood products have been falling gradually for several months now.

Monetary Policy Council cuts interest rates.

At a meeting on November 25 and 26, the Monetary Policy Council reduced central bank interest rates by 25 basis points (by 0.25 pct points).

NBP (Monetary Policy Council): In October CPI inflation decreased in Poland again (to 4.2%), although it was still above the NBP inflation target of 2.5% and above the upper limit of deviation from the target of 3.5%. Inflation remained at a heightened level due to a further increase in energy prices and prices of many services, especially household services. The Council maintains its assessment that inflation will remain above the upper limit of deviation from the target in coming months, which will be largely due to a rise in regulated prices. But in the medium term inflationary pressure may be pushed down in Poland by the sharper than expected global economic slowdown, especially recession in countries which are Poland's main trading partners, and the resulting slowdown of the Polish economy. The falling GDP growth rate coupled with reduced demand for labour and deteriorating financial situation of

companies will ease pressure on wages and consequently inflationary pressure. Stricter borrowing criteria imposed by banks will be working in the same direction. Apart from a high annual increase in regulated prices, growing prices of some services may be a factor delaying the fall in inflation. This may result partly from a rise in energy prices. The Council assessed that in the medium term the probability of inflation running below the inflation target was higher than the probability of its running above the target and decided to cut interest rates. The Council's decisions in coming months will depend on prospects for economic growth and inflation in Poland and the world. Discipline in public finances may be a factor contributing to relaxing monetary policy. The Council will be analysing the impact of developments on the Polish interbank market on the transmission of monetary policy in Poland. The Council is sticking to its opinion that Poland should enter the ERM II and the euro zone as early as possible (...). ("Minutes of the Monetary Policy Council Meeting on November 25-26, 2008"; www.nbp.pl)

Inflation, money supply, exchange rates, interest rates

	December 2007	March 2008	June 2008	September 2008	October 2008	
Consumer Price Index (CPI), % change		4.0	4.1	4.6	4.5	4.2
Producer Price Index (PPI), % change		2.5	2.9	2.6	2.3	2.4
Construction Price Index, % change	8.4	7.1	4.8	3.6	3.2	
Total money supply, M3, in PLN billions at end of period		561.6	581.8	606.6	630.5	637.4
Cash money in circulation, in PLN billions at end of period		90.6	77.2	77.8	81.9	82.5
Total deposits, in PLN billions at end of period		472.2	492.4	513.6	537.2	536.5
Domestic receivables, in PLN billions at end of period		477.3	509.2	539.2	579.9	611.1
Average exchange rate PLN/EUR100 at end of period*		358.2	352.6	335.4	340.8	363.3
Average exchange rate PLN/USD100 at end of period*		243.5	223.1	211.9	237.1	284.7
Interest rate on lombard credit (%) at end of period	6.50	7.25	7.50	7.50	7.25	
Reference (intervention) rate (%) at end of period	5.00	5.75	6.00	6.00	5.75	
Yield on two-year bonds (%)	6.15	6.29	6.89	6.32	5.87	
Yield on five-year bonds (%)	6.11	6.12	6.78	6.02	5.77	
Yield on ten-year bonds (%)	5.88	5.96	6.61	5.84	5.88	

Source: GUS, Statistical Bulletins and NBP estimates; */exchange rate at close on the last day of the period.

Interest rates on November 30, 2008:

- reference (intervention) rate – 5.75%,
- lombard rate (official lending rate): 7.25%,
- deposit rate: 4.25%,
- rediscount rate: 6.00%.

On the Warsaw Stock Exchange, stock prices were very volatile in November. The WIG-20 blue-chip index and the WIG all-share index fell by around 4.5% in November. Compared to the end of 2007, the indices dropped respectively by around 49.6% and 51.3%.

Growth in imports faster than in exports.

According to GUS, in the nine months to September 2008 growth in merchandise exports in euro terms was slower than a year before but higher than in the eight months to August. Imports grew faster than exports. As a result, Poland's trade balance with most partners deteriorated. As last year, Poland had a positive balance in its trade with the EU, and negative balances with other partners.

Central Statistical Office (GUS): In the three quarters of 2008, Poland recorded a slower growth in trade in zloty terms compared to a year before. Growth in imports outpaced growth in exports, leading to the deterioration of the negative trade balance compared to January-September 2008. The share of consumer goods and intermediate goods in total imports increased slightly, the share of investment goods decreased. The terms of trade index for January-August deteriorated as a result of unfavourable price relations in trade with Central and Eastern European countries. (GUS, "Report on the Country's Socio-Economic Situation, October 2008," November 25, 2008, p. 4 and 5; www.stat.gov.pl)

Exports and imports in January-September 2008 in current prices, EUR, according to GUS

	Jan.-Sept. 2008	Jan.-Sept. 2008/Jan.-Sept. 2007	Jan.-June 2008/Jan.-June 2007	% share	Jan.-Aug. 2008/Jan.-Aug. 2007
Exports, EUR billions	87.8	116.6	117.6	117.7	100.0
of which					
EU	67.9	113.9	114.9	114.7	77.4
Central and Eastern Europe	9.4	130.2	130.0	131.0	10.6
Imports, EUR billions	104.9	118.6	118.6	119.9	100.0
of which					
EU	65.0	113.6	113.6	114.6	62.0
Central and Eastern Europe	11.8	140.8	140.0	141.6	12.2

Source: GUS, preliminary data (www.stat.gov.pl); GUS, "Report on the Country's Socio-Economic Situation," 1st-3rd quarter 2008, November 25, 2008, p. 28; www.stat.gov.pl

Current account deficit close to projections

GUS, NBP: In September the balance on the current account was negative at EUR-1,967 million against EUR-881 million in September last year. The deficit widened by EUR1,086 million mainly due to the surplus of income over expenditure in current transfers being smaller than last year by EUR688 million. The merchandise trade deficit was EUR-1,124 million against EUR-1,024 million a year before. The deficit widened despite a rise in receipts for exports to EUR11,262 million, or by 22.5%, because payments for imports increased even more - to EUR12,386 million, or by 21.2%. In September 2008 the balance of services was positive at EUR128 million, compared to EUR156 million a year before. Receipts from service exports reached EUR2,071 million, up by 16.2% compared with September 2007. Payments for service imports reached EUR1,943 million, up by 19.5%. The balance on transport services was positive at EUR241 million, the balance on foreign travel was positive at EUR14 million while the balance on other services was negative at EUR-127 million. In September the income balance was negative at EUR-1,059 million against EUR-789 million a year before, with receipts at EUR818 million and expenditure at EUR1,877 million - respectively up by 11.4% and 23.2%. The balance on current transfers was positive at EUR88 million against EUR776 million a year before. Receipts decreased by 57.8% to EUR498 million compared to September last year. Expenditure increased by 1.2% to EUR410 million.

(GUS, "Report on the Country's Socio-Economic Situation," October 2008, November 25, 2008, p. 35; www.stat.gov.pl)

Selected balance of payments items, transaction-based

	September 2007	August 2008	September 2008		cumulative data		
			Oct. 2006-Sept. 2007	Oct. 2007-Sept. 2008			
Current account balance, EUR millions			-881	-1,306	-1,967	-13,080	-18,142
Exports, EUR millions	9,194	11,262	11,262	102,817		121,271	
Imports, EUR millions	10,218	12,386	12,386	113,071		135,903	
Foreign direct investment in Poland, EUR millions			1,322	1,135	1,085	19,957	15,197

Source: National Bank of Poland (NBP), Department of Statistics, revised data for August 2008, preliminary data for September 2008.

Changes on the labour market

At the end of October 2008 the registered unemployment rate (claimant count rate) dropped to 8.8%. Employment in the corporate sector was by 3.6% higher than in October 2007. Wages are still growing fast but the pace of growth has slowed. In October 2008 wages were higher by 9.8% than a year ago; in the 10 months to October they were higher by 11.1%.

Central Statistical Office (GUS): In October the situation on the labour market was still good: the registered unemployment rate dropped to 8.8% and jobs were on the rise (up by 3.6%), through the pace of growth was slower than in previous months. According to preliminary findings of the Labour Force Survey for the third quarter, the number of working people increased, the employment rate improved (up to 51.0%), the unemployment rate went down and the dependency ratio decreased. In October 2008, average gross monthly wages in nominal and real terms in the corporate sector grew at a slower pace year on year than in September and October 2007. The purchasing power of old-age and disability pensions grew at a similar rate as in September. (GUS, "Report on the Country's Socio-Economic Situation," October 2008, November 25, 2008, p. 4; www.stat.gov.pl)

Employment, wages and unemployment

	December 2007	June 2008	September 2008	October 2008
Average employment in the commercial sector */in thous.	5,241	5,391	5,404	5,406
Change in employment, % against previous year	4.9	4.8	4.1	3.6
Average gross monthly wage in the commercial sector */in PLN	3,242	3,246	3,215	3,172
Nominal wage change, % against previous year	7.2	12.0	10.9	9.8
Real wage change, % against previous year	3.3	7.4	6.3	5.6
Average gross monthly old-age pension in PLN	1,305	1,444	1,449	1,451
Registered unemployed, in thous.	1,747	1,455	1,377	1,352
Unemployment rate (in %)	11.2	9.4	8.9	8.8

Source: GUS, Statistical Bulletins; */in enterprises employing over nine people

In the third quarter profitability indicators in the main sectors of the economy worsened but in January-September profitability still stayed at a relatively high level. It was lower, however, than in the first half of the year. Some indicators worsened compared to last year's.

In January-September 2008 financial results recorded by the surveyed companies, except for net profit/loss, were slightly better than in the corresponding period of last year. But basic economic and financial indicators worsened, despite the better results. In January-September the financial condition of enterprises was characterised by the following trends:

- Revenues from overall business operations were by 13.3% higher than a year before; business expenditures were higher by 14.2%. As a result the cost index worsened from 93.6% to 94.3%;
- The companies generated a gross profit of PLN79.4 billion, compared to PLN79.2 billion in the corresponding period of the previous year. The net profit reached PLN63.7 billion compared to PLN64.6 billion. A total of 73.5% of enterprises showed a net profit, which means that 26.5% of businesses was still loss-making. The share of profit-making companies in revenues from overall operations amounted to 84.2%;
- Net return on sales amounted to 4.5% versus 5.2% a year before;
- Of the surveyed companies, 49% reported exporting activity. The share of exports in total revenues was 19.8%. The financial situation of exporters was better than that of the surveyed companies as a whole but their financial results were not as good as a year before;
- All major sectors of the economy were profitable, but profitability differed greatly from sector to sector and indicators were lower than a year before.

Financial results in the corporate sector

	Jan.-Sept. 2006	2006	Jan.-Sept. 2007	2007	Jan.-Sept. 2008
Gross return on sales (in %)	5.8	5.8	6.4	6.1	5.7
Net return on sales (in %)	4.7	4.7	5.2	5.0	4.5
Financial liquidity index	34.3	35.1	33.1	33.8	33.1
Gross profit/loss in PLN billions		63.1	86.3	79.2	104.9 79.4
Net profit/loss in PLN billions		50.7	69.8	64.6	86.2 63.7

Source: GUS, Statistical Bulletins

Budget deficit was low in the 10 months to October.

In the 10 months to October 2008 national budget revenue was PLN213.8 billion and expenditure was PLN225.3 billion. The budget deficit amounted to PLN-11.6 billion, or 42.8% of the total deficit of PLN27.1 billion planned under the 2008 budget law.

Selected items of the national budget (in PLN billions)

	2008 budget law	Jan.-June 2008	Jan.-Sept. 2008	Jan.-Oct. 2008
Revenue (indirect taxes, income tax, receipts from customs) in PLN billions	127.7	192.4	213.8	281.8
Expenditure	308.9	131.1	196.6	225.3
Balance	-27.1	-3.4	-4.2	-11.6

Source: GUS, Statistical Bulletins

The parliament is working on the 2009 budget bill. The government is determined to keep next year's budget deficit at the planned level.

Government: Keeping next year's budget deficit at PLN18.2 billion as planned is important because:

- It will create room for interest rate cuts by the Monetary Policy Council and this instrument is the healthiest method to combat a potential crisis. The government's determination to keep the deficit at the planned level has already produced results: the Monetary Policy Council was able to reduce interest rates this week because it got the feeling that the relaxation of monetary policy (pursued by the NBP and the Monetary Policy Council) would not coincide with the relaxation of fiscal policy (government decisions on budget deficit);
- Poland's public finances will be kept on the track which makes it possible to reduce debt service costs. It is especially important now when creditors are keeping very close tabs on developing countries. Any decision resulting in a rise in budget deficit in such a country could lead to a sharp decrease in the valuation of its debt's worth. In the extreme case, the increase in the deficit could be fully consumed by an increase in debt service costs, which would produce a result contrary to the one desired.

The GDP growth projection in the 2009 budget bill has been revised down from 4.8% to 3.7%. As a result, budget expenditure will be reduced by PLN1.7 billion mainly in reserve items, which will make it possible to flexibly shift funds between tasks if necessary. Changes will be made to excise tax on alcoholic beverages, resulting in a rise in the price of one bottle of beer by PLN0.07 and one bottle of vodka by PLN1.0, and on passenger cars with an engine capacity of over 2,000 cubic centimetres to 18.6%. This will generate PLN1,140 million for the national budget to be set aside as a Social Solidarity Reserve. ("Stability and Development Plan," p. 5, November 30, 2008; www.kprm.gov.pl)

The goal of the "Stability and Development Plan" is to strengthen the Polish economy and stabilise the financial market.

Government: The government has presented the "Stability and Development Plan," whose objective is to strengthen the Polish economy in the face of the global financial crisis. The document details the government's measures to date and anti-crisis measures planned. Thanks to the government's action, the economy may be supported with up to PLN91.3 billion. (...) All these measures will be taken without undermining the stability of public finances. Therefore, the government has decided to keep the 2009 budget deficit at PLN18.2 billion, which creates room for interest rate cuts by the Monetary Policy Council and enables reducing the debt cost. (...) Consumer demand will rise due to tax cuts. As a result of these changes, over PLN35 billion more will be left in taxpayers' pockets in 2009 compared with 2007. The government also plans to increase investment demand by removing barriers to investment projects partially funded with EU money. (www.kprm.gov.pl)

Anti-crisis measures in the "Stability and Development Plan"

The first element of the [anti-crisis – ed.] plan is to increase the availability of loans for businesses. To this end, the government is going to increase the limit earmarked for Treasury guarantees under the 2009 budget bill to PLN40 billion. The Treasury will be able to guarantee the repayment of refinancing loans taken by banks from the National

Bank of Poland in order to prevent the loss of liquidity. The Treasury will also be able to guarantee the repayment of individual liquidity loans on the interbank market.

The second element is to support financial institutions. The government is preparing another draft law to secure the solvency of financial institutions. Under the draft, the institutions could receive capital injections from the Treasury in exchange for their stock. In less than two weeks, the draft law will be submitted to ministries for consultation and will be consulted with banking officials.

The third element of the plan is to strengthen the system of guarantees for small and medium enterprises. The government estimates that the average value of guarantees from the EU Guarantee Fund, National Credit Guarantee Fund and National Guarantee Group will amount to 50% of the loan value. The government's action is to enable to secure lending activity to the tune of PLN20 billion in 2009. To this end, the government is going to inject PLN2 billion to Bank Gospodarstwa Krajowego. The money injection will be coupled with legislative changes. The Council of Ministers wants to adopt a programme in the form of an ordinance defining the rules and direction for the development of guarantee activity, an amendment to the law on guarantees granted by the Treasury and some legal persons and an amendment to the law on province and county government.

The fourth element is to speed up investment partially funded from EU sources (structural funds and the Cohesion Fund) in 2009. After consultation with individual departments and province governments, the spending of EU money is to increase from PLN10 billion to PLN16.8 billion.

In order to increase propensity to invest, especially on the part of small Polish companies, the government will present a draft amendment to the law on corporate income tax. Small companies and start-ups will be allowed to deduct from taxable income any kind of investment expenditure up to EUR100,000 in 2009 and 2010. Companies which started operations in 2008 would also be eligible for this assistance.

The remaining elements of the government plan include measures aimed to remove barriers to investment in ICT infrastructure, the right to deduct additional spending on research from taxable income and support for investment in renewable energy sources.
(www.kprm.gov.pl)

Zofia Bolkowska, Marek Misiak