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Economic and Political Challenges of Acceding to the Euro Zone Area: the Case of Poland

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Abstract

The paper examines economic and political challenges of joining the euro area in the case of Poland. After reviewing the economic developments since the pre-accession period and assessing economic convergence with the euro area the paper focuses on the political and institutional challenges of acceding to the euro zone. Special attention is given to the effect of the crisis triggered by the collapse of Lehman brothers in September 2008 on both political and economic dynamics of the process. The developments in parameters related to the economic and legal criteria for joining the euro area are scrutinized in detail during the entire period before and after the crisis. The paper is concluded with the review of the status quo in mid-2010 as well as summary and recommendations.

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1. EXECUTIVE SUMMARY

Poland's economic convergence to euro area (EA) levels has been uninterrupted since the reform *shock-therapy* in the early 1990s. The country grew on average much faster than the EA - with the growth differential reaching 4-5 percentage points - largely on the back of surging investment and exports. Polish GDP per capita rose from 15% of the EA average in 1996 to 32% in 2008 in current euro terms and from 36.6% to 49% in PPS in the same period. Real convergence led to price level convergence, and comparative price level of GDP grew from 41% of the EA average in 1996 to 47% in 2004 and up to 60% in 2007. The Polish currency, zloty, has been left free floating as the National Bank of Poland (NBP) switched to inflation targeting in 1999. Relatively high nominal fluctuations were complicating the job for Polish entrepreneurs, albeit with the help of a substantial foreign direct investment (FDI) inflow the industry did very well in terms of expanding its exports to the EU25 from 2.1% of total EU imports to 3.5% in 2007. Inflation has been largely brought under control and on average has not deviated from EA levels since 2001. This triggered a marked reduction in interest rates with both central bank and money-market rates gradually converging to levels exceeding those in the EA by a mere 1-2 percentage points after accession. Public finances have suffered from chronic deficits (up to 6.3% of GDP in 2003) leading the EU to impose excessive deficit procedure on Poland upon accession in 2004 and drop it in mid-2008 after the deficit was reduced to below 3%. Public debt has been under control fluctuating within 38%-48% of GDP in the last decade – well below the Maastricht-prescribed 60%. The current account of the balance of payments has been negative throughout the entire transition period (except for 1994-1995) but was largely financed by high FDI inflows and more recently by foreign loans. Unemployment rates – the highest in the EU25 in 2002-07 have been declining since the accession and now stand at 8-9% - slightly below the EA level.

The economic crisis was first felt in the stock exchange, which tumbled by 40% from September 2008 until March 2009, and in the foreign exchange market which saw a sharp 48% depreciation of the zloty between mid-September and mid-February. The dynamics of credit have gone down – although it is difficult to estimate the exact magnitude of this contraction due to the parallel depreciation which artificially inflated credit stock in zloty. This contraction was directly related to the global credit crunch and occurred despite the NBP's sharp drop in interest rates to the record-low level of 3.75% in end-March. The financial crisis is gradually showing in the real sector as well. The fourth-quarter GDP growth of 2.9% year on year was the lowest since 2005 and growth in industry has been contracting since mid-2008 to plunge into the negative in October. Balance of payments has seen a sharp contraction of both exports and imports coupled with lower inflows due to FDI and foreign loans. Inflation has come down from the commodity-price-shock-driven peak of 4.5% in mid-2008 down to 3.2% in January 2009.

No formal steps towards euro adoption were taken in Poland until September 2008. The four governments in place between May 2004 until late 2007 did little to initiate the formal EMU accession procedure either because it was too risky politically (left-wing governments in 2004 and 2005) or because they were ideologically opposed to the idea (right-wing governments in 2005-2007). Governments seemed preoccupied with the excessive budget procedure and the euro was effectively dropped from the agenda by late 2007. The real change came with the centrist government of Donald Tusk in November 2007 and its widely-known euro-supporter Minister of Finance Jacek Rostowski. The change was discernible from the considerable focus on the euro in annual convergence programme and from bringing the euro back to the political agenda. The first target for euro adoption in 2011 was announced in early September 2008. The crisis that hit the economy in late September only accelerated the government's activity. The road map was adopted by the government, setting the target rate of 2012 for euro adoption and the first half of 2009 for entering of the ERMII.

Fulfilling the deadlines implied by the roadmap is currently severely complicated by the lack of support of the main opposition party for introducing constitutional amendments – a necessary step for entering the EA. The opposition backed by the President conditions its support for these amendments on holding the referendum on the fast adoption of the euro – which was unacceptable for the coalition. The resulting gridlock has made the Polish currency particularly vulnerable to the turmoil in financial markets and has made prospective ERMII entry considerably more risky. Prompted by the lack of political consensus and the increasing instability of the zloty, the government postponed the ERMII entry and the euro adoption in April 2009. Somewhat earlier the Monetary Policy Council announced that it conditions its consent for ERMII entry on prior changes in the constitution to minimize potential tensions in the mechanism. This decision reinforced the importance of generating the political consensus around the euro and effectively lowered the likelihood of ERMII entry by June, as stipulated in the roadmap.

Around mid-2009 the debate shifted from the political problems to fiscal ones. The crisis-triggered widening of the budget deficit led to the imposition of the Excessive Deficit Procedure on Poland and the overall deterioration of economic and fiscal environment shifted the perspective of fulfilment of the fiscal Maastricht criterion beyond 2011. By the end of 2009 both inflation and interest rate criteria were breached with the public debt remaining the only criterion fulfilled.

Despite the deterioration of the macroeconomic indicators the euro process has not stopped with subsequent administrative steps taken by the Government's plenipotentiary amid a progressively maturing administrative and institutional environment. Viewed at mid-2010 the biggest obstacle to the process seems to be the gloomy fiscal outlook making the fulfillment of the Maastricht fiscal criterion more distant and more challenging as well as the lack of political support for the adequate constitutional amendments.

2. Country's Economic Convergence

Poland joined the EU together with seven other post-communist economies, Malta and Cyprus in May 2004. The period preceding accession was marked by intense efforts to harmonize the country's legal, institutional and economic system with that of the EU. In parallel with these processes, the Polish economy has been undergoing a gradual nominal and real convergence that in most aspects has not taken place until now and is far from finished.

2.1 Before and after the accession (1999-2008)

Poland's real convergence has been gradual and almost uninterrupted since the early 1990s. After the initial transition shock (1990-1992) the pace of economic growth has picked up quickly reaching 4-7% for most of the 1990 and after 2002. As figure 1 suggests, GDP in Poland grew faster than in the EA during the entire period under investigation (except for 2001) outpacing it by up to 5 percentage points (1996-7). Growth was mainly fuelled by investment in the 1990s, while after 2000 its sources have been changing. Following the slowdown related to a tightening of monetary policy in Poland 2000-2002/3 when investment decelerated into the negative, growth rebounded noticeably just before the accession in 2004 and has remained high since that time, averaging 10.7% during 2004-2008 (see table 1). Likewise, exports have been very important for Poland's growth from the early days of transition. Export of goods and services posted very high growth rates in the last decade averaging 8.5% in 1999-2003 and 10.3% during 2004-2008. Consequently exports saw its share in total GDP grow from 24.2% in 1999 up to 37.5% in 2004 and 40.8% and 39.4% in 2007 and 2008, respectively. This is roughly in line with the EA (41.5% in 2008) but still nearly half of the level in the Czech Republic and Hungary.

High economic growth in Poland facilitated gradual convergence to EU income levels. While the process is still far from complete, Poland's GDP per capita in EUR rose from 15% of the EA average in 1996 to 32% in 2008, respectively, while in PPS terms per capita income converged from 36.6% in 1996 to 48-49% in 2007/8. In parallel prices have been catching up as well (fig 2). The Comparative Price Level (CPL) for the overall GDP rose from 41% of the EA average in 1996 to 47% in 2004 and further to 60% in 2007. Convergence was faster for goods - in particular durables - which saw their CPL rise from 79.5% in 1999 to 89% in 2007 benefiting from trade-triggered arbitrage within the EU's single market. Convergence was slower in the case of prices of services which are largely sheltered from foreign competition and therefore tied stronger to local markets. The CPL for services rose from 34.8% in 1999 to 36.1% in 2004 and 44.7% in 2007. Accession to the EU single market in 2004 has certainly played a role in speeding up price convergence, however, the appreciation of the Polish currency after 2004 has been just as important as a factor (see figure 3).

The Polish currency, the *zloty* (PLN) has been left free-floating by the National Bank of Poland in the move accompanying switching to inflation targeting in 1999. Since then the currency has gone through four distinct periods of changing trends (in nominal and real terms alike): appreciation (1999-mid 2001), depreciation related to the economic slowdown (mid 2001-end 2003), appreciation following the EU accession (early 2004 – mid-2008) and lastly a sharp depreciation as a result of the global crisis (since August 2008). These diverging trends produced a difficult environment for entrepreneurs and exporters who had to cope with unpredictable cost of imports and the zloty-equivalent of their exports. Nevertheless, structural adjustments including labour shedding and intense cost cutting (particularly during the slow-down in 2000-02) have brought fast productivity growth over the last decade enabling the exports of Polish industry to expand in international markets.

A key role in this process was played by FDI which averaged €7.08bn a year during the pre-accession period of 1999-2003 and as much as €12.43bn after accession between 2004-08. Foreign investors, coming predominantly from EU countries, have helped modernise Polish industry, inject new technologies, and positioned their Polish plants within international supply chains. As a result, Polish exports to EU grew from 2.1% of the EU25's total imports in 1999 to 2.8% in 2004 and 3.5% in 2007. This reinforced the EU's key economic importance as Poland's main trading partner, accounting for 80-81% (1999-2003) and 77-79% (2004-2008) of total exports.

Following the decade of the 1990s when inflation persisted at double-digits (until 1999), Polish monetary authorities managed to keep it in the low range for most of the past decade while pursuing the Direct Inflation Targeting (DIT). As figure 4 indicates, the annual rate of change of the HICP has been reduced to less than 5% in mid 2001 and kept under 3.5% for most of the period afterwards. While hitting the official target bounds proved very difficult, especially in the beginning of the DIT experience (see fig 4), inflation has been brought down to low and stable levels, even including the two periods where one-off shocks temporarily raised inflation about the continuous target 1.5-3.5%. These shocks include the EU accession shock of 2004-05 when single market arbitrage and accession-triggered tax adjustments pushed prices up temporarily as well as the 2007-08 spikes in global commodity prices (including foodstuffs and energy). During most of the period since 2002 (with the exception of the two periods covering the above shocks), inflation has been within the Maastricht-prescribed bounds of up to 1.5 percentage points above the reference level, equal to the average inflation of the three lowest EU member inflation rates.

The dynamics of broad money supply (M3) and credit to the economy have been closely related to the rate of economic growth (see fig 1 and fig 5). Relatively low real interest rates combined with high economic growth in the late 1990s boosted money and credit which saw their dynamics rise to 30% and 40% year on year, respectively. A series of official NBP interest rate hikes aimed at cooling down the overheated economy in 1999 and 2000 led to a marked deceleration of the money dynamics which posted near-zero dynamics at the end of 2002. Credit slowed down less, to about 5-10% year on year during 2001-2004 and picked up quickly beginning with 2005 on the wave of post-accession optimism and record-low interest rates which were cut by 17.5 percentage points between March 2001 and March 2006. Credit to firms and households (fig 6) followed a similar pattern albeit household loans have consistently outpaced credit to firms. However, there was an important difference in the evolution of the credit stock structure. While households were taking an increasing share of credit in foreign currencies (mainly EUR and CHF) benefiting from lower interest and appreciating zloty, firms were more cautious and did not turn away from the credit in PLN. The portion of credit to households in foreign currency grew from a mere 7% in 1999 (on average) to 21.7% in 2002, 26.5% in 2004 and 32.5% in 2008. The analogous share for firms was around 30% until mid-2004 and began to decline afterwards averaging 24% in 2005 and 19.4% in 2008 (fig 6).

Polish 10-year government bond yields saw a great progress in convergence to the EA levels over the years (fig 7). Lower inflation differential vis-à-vis the EA (that turned negative in 2002/03), an accelerating economy and the accession perspective brought the reduction of spreads on government bonds from 6-7 p.p. in 2000-2001 down to 1-2 p.p. from 2003 on. Money market rates were even slower to converge with spreads persisting at 3-4 p.p. until

2003-2004 but then falling quickly below 1 p.p. in late 2006 to pick up in 2008 again as a result of the crisis.

Public finances have suffered from chronic deficits which have become a permanent feature of the general government fiscal balance (see table 2). Fiscal deficits grew in 2001-2002 above 5% of GDP – partly as a result of economic deceleration[1] and were very slow to come down again when high growth resumed in 2003. The high deficit exceeding the prescribed reference value of 3% prompted the European Commission to impose the excessive deficit procedure upon Poland's accession in May 2004. The deficit reduction efforts on the part of the Government aided by high economic growth proved successful and the EU dropped the procedure in July 2008 in reaction to the gradual decline of the deficit from 6.3% in 2003 down to 2% in 2007 and 2.8% in 2008.

Public debt has been under control in Poland - well below the Maastricht-prescribed 60% of GDP threshold and that of the EA (some 65-70% in recent years) – see table 2. It has been fluctuating within a range of 38% - 48% of GDP in the last decade, with recent years seeing a stabilization around 43% of GDP. Poland's share of foreign debt has been declining gradually (in particular since 2003) from near one-third in the late 1990s to 23% in 2008. The largest portion of the debt (some 95-96%) was due to the State Treasure debt – which has increasingly relied on treasury bonds issued for the Polish market. This debt instrument has become progressively more important for the government with its stock rising from 9.6% of GDP in 1999 up to 24.1% in 2008 crowding out other instruments such as T-bills or non-marketable securities. Within foreign debt one can point to the growing share of Brady bonds and other bonds issued for international market that have seen their stock in terms of GDP surge from roughly 3% in 1999-2002 to 7-9% in 2006-2008 despite the overall decline in the magnitude of foreign debt between these periods (see table 2).

The current account of the balance of payments (table 3) has been negative throughout the entire transition period (except for 1994-1995), albeit never exceeding alarming levels, and is moderate compared to some other transition economies (e.g. Baltic states, Bulgaria or Romania). Expanding domestic demand contributed to a marked widening of the current account in the second half of the 1990s (up to -7.4% of GDP in 1999) and motivated to a large degree the policy of monetary tightening that followed in 2000-01. A result of this process was the restrained demand and gradual contraction of the deficit to -1.2% in 2005. The period of 2006-08 again saw an expansion of the deficit (to -5.4% in 2008) on the back

[1] A very high share of rigid expenditures (pensions, social allowances, benefits) has been a permanent feature of public finances in Poland. Attempts to reform the system and reduce this burden on the budget have largely failed in recent years due to missing political support - leaving the budget outcome very dependent on the business cycle.

of worsening balance on merchandise trade and balance of income payments. FDI have been the major source of financing of the deficit on average - accounting for as much as 116% of the deficit (2006). Portfolio inflows surged in 2004 and 2005 (to levels of 3.7% and 4.0% of GDP, respectively) on the back of accession-related investors' positive outlook – but dropped quickly to negative levels subsequently as investors pulled out of the region. Portfolio flows have been replaced by loans (part of *other investment*) which grew rapidly in 2006-08 fuelling credit to economy (see fig 5) and pushing the dynamics of loans to households and firms to record high levels in late 2008 (fig 6).

The labour market has gone through radical changes in the past decade that often differed significantly from developments in the EA (fig 8). Starting with the same unemployment rate of about 10% in 1998, the Polish labour market diverged from the EA as restructuring-triggered labour shedding was pushing the unemployment rate up in Poland against the continuing gradual decline in the EA. The unemployment rate in Poland rose to 20% in 2002 – the highest among EU27 countries - and began its slow, but uninterrupted decline in 2003. As mentioned, for a number of years (2002-2007) the Polish unemployment rate was the highest in all the EU. It took several years of high economic growth generating new jobs for the rate to come down significantly and converge to EA levels (or even fell slightly below as was the case in 2008).

Total employment rates (among the population aged 15-64) in Poland were largely in line with those in the EA in the late 1990s (59% in EA and Poland in 1999) but diverged soon afterwards – with EA rates continuing its gradual rise and Polish rates declining by up to 10 p.p. between 1998 and 2003 (fig 9). EU accession and the ensuing acceleration of economic growth led to the resumption of the upward trend in Poland with EA and Polish total employment rates reaching 66% and 59%, respectively, in 2008. Employment rates for females have remained 10-14 p.p. lower than for males in Poland with the difference slightly up in recent years. This is on average considerably less than in the EA. However, while the disparity has been widening in Poland recently, it has a clear declining trend in the EA where it fell from 20 percentage points in 1999-2001 down to 15% in 2007-08.

The Warsaw Stock Exchange (WSE) has broadly followed European and global trends and magnified them somewhat in recent years (fig 10). After the vertical trend for most of 2002 and 2003, the WIG (the main WSE index) began to rise in late 2003 on the back of the accession-related optimism and the overall good global sentiment. Its growth was particularly rapid in most of 2004 and from mid-2005 until mid-2007 (with a slight correction in mid-2006) when 50-70% annual rates of return were not unusual. The worsening global economic situation in mid-2007 and the approaching crisis led to a reversal of this trend and stock exchanges around the world began their continued decline. The WSE was no exception as the WIG was tumbling rapidly in late 2007, 2008 and early 2009 to its lowest values since mid-2004.

Despite the undisputable success of economic reforms and the marked progress in real convergence to EA levels, Poland's institutional and legal environment is regarded as relatively unfriendly to businesses. The World Bank's *Doing Business 2009* ranking evaluates the overall ease of doing business in the country very low – at 76 (out of 106 evaluated countries). Furthermore, Poland got the lowest position (of all evaluated countries) in areas as important as dealing with construction permits and paying taxes. The other components of the ranking are as follows:

- Starting a business – 145 (out of 150)
- Dealing with construction permits - 158 (out of 158)
- Employing workers -82 (out of 167)
- Registering property – 84 (out of 168)
- Getting credit – 28 (out of 108)
- Protecting investors – 38 (out of 164)
- Paying taxes – 142 (out of 142)
- Trading across borders – 41 (out of 116)
- Enforcing contracts – 68 (out of 156)
- Closing a business – 82 (out of 113)

2.2 DEVELOPMENTS SINCE SEPTEMBER 2008

Although the economic slowdown triggered by the US sub-prime meltdown has infected European financial and real sectors since mid 2007, it wasn't until the fourth quarter of 2008 that the crisis hit with full force. The bankruptcy of Lehman Brothers in September sent shockwaves across global financial markets – in rich economies and emerging markets alike. The immediate impact in Poland was first felt in the stock and foreign exchange rate markets. The WSE, much like most stock exchanges in Europe, exhibited signs of panic in mid-September and October when the extent of the financial system crisis gradually emerged (fig 11 and fig 12). The main WSE index – WIG which has already been in a falling trend for over a year (see fig 10 and 12) lost 10% in the first half of September and a further 30% during the first 28 days of October amid extreme day to day volatility. The average daily change of the index reached a massive 2.3% in absolute terms during September and October and fluctuations exceeding 5% day on day were not uncommon in October. The index rebounded towards the end of October and gained 14.4% between October 28 and November 4 but afterwards quickly resumed the declining trend. December saw a predominantly vertical trend but January and first half of February 2009 again featured sharp declines as the WIG tumbled by a further 26% between January 1 and February 17. An extended upward trend set in afterwards leading to a near doubling of the index between the mid-February 2009 low and late January 2010 high. The index continued to rise (with the exception of a temporary 10%-correction in late January and early February 2010) with the local peak in mid-April 2010, up by 107% on its February 2009 low and somewhat above the September 2008 level, but still 35% short of its all-time high in July 2007.

Like the stock exchange, the forex market has been bearing the full brunt of the crisis since its beginning. The Polish zloty (much like the Hungarian forint and the Czech koruna) began its month-long decline directly following the fall of Lehman Brothers in September (fig 11). With several short periods of stability or mild appreciation (late October, early November, early January) the currency has been losing its value from mid September 2008 until mid-February 2009 in the steepest stretch of depreciation in a decade. The zloty lost nearly 48% of its value against the euro between September 22nd and February 17th – the dates that mark a local maximum and minimum, respectively, to reach the level of 4.88PLN/1EUR on February 17 – a little short of its historical weakest of 4.93PLN/1EUR (registered in February 2004). This was considerably more than losses incurred by the Czech koruna (22.5%) or even the troubled Hungarian forint (31.9%) in the same period[2].

The crisis-triggered credit crunch has affected the entire EU area, spilling over boundaries via multinational financial institutions and external branches of affected American and European parent banks. The Polish financial system was no exception and has been struck by the liquidity and confidence crisis. At first sight this is hard to reconcile with the rise in the annual dynamics of monetary and credit aggregates in the fourth quarter of 2008 and the first two months of 2009 (fig 5 and 6). However, a careful look at the structure of credits suggests that it was the foreign currency denominated credit and assets that were the major source of inflated money and credit aggregates. The massive depreciation of the zloty since September has artificially magnified the value of foreign currency loans expressed in zloty, increasing their share in total loans and pushing credit and money aggregates up. The

[2] For the forint the end of the period was moped to March 6th – the date forint reached its lowest-ever exchange rate to the euro.

precise impact of the depreciation is impossible to calculate without data on the detailed disaggregation of credit into individual currencies (as most loans were taken in CHF and EUR) so far unavailable from the central bank. However, the vast majority of the 71% increase in the foreign currency credit to households[3] between February 2009 and August 2008 may be due to the massive depreciation of zloty during this period rather than the increase of the credit volume. More insight is gained by looking at the dynamics of household credit in zloty, which grew by a mere 1.1% month on month on average in the same six-month period compared to a 2.0% average in the first half of 2008 and 3.1% in 2007. While such volume growth rates are impossible to calculate for the foreign currency denominated credit there are reasons to expect a much sharper deceleration. The media have long signalled a substantial slowdown of the foreign currency credit action to households and firms on the part of most commercial banks – the move largely inspired by their liquidity-strapped parent banks.

Credit to firms (accounting for roughly 35% of the total credit to non-government) behaved similarly. The rise in year-on-year dynamics in the crisis period was smaller than in the case of household credit – and likewise was due to the depreciation of zloty rather than increased credit volumes. The volume of PLN credit to firms rose at an average rate of only 0.2% month on month from September 2008 to February 2009 compared to 2.2% on average in the first eight months of 2008. By contrast, credit in foreign currencies (converted into PLN) soared at 8.5% on average in the crisis period vs. 1.9% in Jan-Aug 2008.

To ease the credit crunch the NBP has been lowering its interest rates in line with the general trend across central banks worldwide. The key central bank interest rates were lowered seven times between November 2008 and June 2009 by the total of 2.5 percentage points to 5.00% (Lombard/lending rate) and 3.50% (reference rate) – the lowest level ever in Poland but still as much as 2.5-3.25 percentage points above the EA level (as of end-June 2010). Money market rates followed suit (fig 7) but - as previous paragraphs indicate - they failed to produce increased credit action due to the extremely cautious approach of commercial banks coupled with the gradual worsening of the situation in the real sector.

The real sector slowdown was most visible in industry, which posted a sharp contraction in the fourth quarter of 2008 and the first quarter of 2009. After growing by a robust 7.7% year on year on average in the first half of 2008, industrial production (adjusted by working days) began to decelerate quickly in the third quarter, plunging into the negative in October. Industrial output contracted by 6.1% year on year in the fourth quarter (vs. contraction of

[3] Credit for households makes up roughly 60% of the total credit to the non-governmental sector.

9.5% in the EA) and by 11.9% year on year in the first quarter of 2009 (vs. a much sharper contraction by 18.6% in the EA). Declines in manufacturing were larger in the fourth quarter of 2008 (-7.9%) but slightly less in the first quarter of 2009 (-11.4%) – but still moderate compared to EA slumps by 9.5% and 20.4% in 2008Q4 and 2009Q1, respectively.

Fourth quarter GDP data pointed to a marked slowdown in the entire economy. Real GDP expanded by 2.8% year on year in the fourth quarter – down from 5.6%, 6.0% and 6.5% in the third, second and first quarter, respectively. The GDP growth bottomed out in the first quarter of 2009 (0.8%) and began accelerating gradually afterwards posting expansion by 1.2% in the second and third quarter of 2009, 3.5% and 2.9% in the 4Q09 and 1Q10. However, the crisis has been putting increased pressure on the labour market as reflected in growing unemployment rates. The harmonized and seasonally adjusted unemployment rate has been growing progressively from the all-time low of 6.8% in September 2008 (0.8 p.p. below the EA) to 9.9% in April 2010 (vs. 10% in the EA) (figure 13).

The state treasury debt increased markedly faster in the second half of 2008 compared to the first half of 2008 and the entire 2007 (see fig 14). The end-quarter year on year growth in the zloty value of the debt accelerated gradually throughout 2008 from 1.2% in Q1, to 4.3% in Q2, 5.4% in Q3 up to 13.6% in Q4 and above 20% in the first three quarters. Consequently the debt grew as a share of GDP as well – from 27% of GDP in 2008Q3 to 29.3% in 2008Q4 and 30% for the first three quarters of 2009– the highest level in 20 years.

The crisis has strongly affected flows related to the balance of payments. Merchandise trade decelerated sharply. The annual dynamics of Polish exports in EUR fell in the fourth quarter of 2008 and January 2008 owing to contracting demand in Poland's major trading markets, including the EU (fig. 15). This coupled with the overall worsening of economic outlook in Poland markedly reduced the demand for imports as well. Consequently both flows decelerated from around 20% year on year in the first nine months of 2008 to 1 - 6% in October, around -10% in November, -14% in December and further down to -28 and -33% respectively for exports and imports in April 2009. The trade dynamics rebounded in May and gradually reached positive rates in late 2009. The fact that both imports and exports have slowed down comparably (and other CA components are relatively stable) led to significant improvements in the current account deficit which shrank to 1.6% of GDP in 2009 – considerably less than in previous years (see table 3).

The developments in the financial account were more worrying. The net FDI inflows shrank considerably in 2008 compared to 2007 and decelerated in the second half of 2008 compared with the first half (fig 16). The inflow of FDI fell from EUR5.1mn in 2008H1 to EUR

3.4mn in 2008H2, with June and December 2008 posting net outflows. Likewise, portfolio investments were sharply cut reflecting the deterioration of global investment prospects and the market's sentiment towards Poland and the region. Some EUR 3.4 bn of net portfolio capital flew out in October (the largest monthly inflow in many years), following September's outflow of EUR 0.32bn and further outflows continued in December (EUR-0.58bn) and the first quarter of 2009 (EUR-0.81bn). The net portfolio investment fell by EUR 3.8bn in the fourth quarter and by a massive EUR 4.24bn during a 7-month period from September 2008 to March 2009. Both FDI and portfolio investment remained subdued throughout 2009 and early 2010.

Considerable slowdown was also registered for the *other investment*, mainly flows related to MFI (monetary financial institutions) and the banking and financial sector. These flows (net) have come down from EUR 15.8bn in 2008H1 to EUR 5.8bn in 2008H2 and EUR4.2bn in 2009Q1. The result of the marked contraction of financial flows into Poland was the negative overall balance of payments and the ensuing reduction of official reserve assets (fig 16). Reserve assets have seen their trend change abruptly in the course of 2008 with a moderate upward growth until July 2008 and persistent contraction since August 2008. These developments contributed to reducing the NBP official reserves by as much as EUR 13.4bn between August 2008 and March 2009.

Inflation has come down from commodity price shock induced high levels, prevailing in both Poland and EA in the last quarter of 2007 and first three quarters of 2008 (fig 17). There are two key factors behind this decline: 1) a sharp reversal of commodity prices (including food and fuel) to levels registered in 2005-06 as well as 2) spreading deflationary pressures coming from the weakening economy. The combination of these trends forced inflation in the EA down by nearly 3 percentage points in just six months: from 4% in July 2008 to 1.1% in January 2009. These forces have been counteracted in Poland by the depreciating zloty (pushing imported prices up) and large administrative price adjustments (electricity, heating and hot water), leaving inflation considerably higher than in most EU countries. As Figure 17 suggests, the Polish inflation ceased to fulfil the Maastricht criterion reference level in October 2008 after being equal or below the reference since late 2005.

The interest rate on 10-year government bonds have been rising gradually from 5% in mid-2006 to over 6% in late 2008 with the crisis period slightly accelerating the trend. As fig 18 suggests, the rate shoot up above the Maastricht-criterion reference level in September 2009 (with a short period in late 2009 when it was below the reference level).

3. National Goals and Strategies for the Euro Adoption

3.1 Before the Global Crisis

The adoption of the euro was not considered a priority in Poland until the global crisis struck the economy. In fact, during the three-and-a-half years following the accession (mid-2004 till end-2007) the political consensus was not to touch the theme of euro adoption due to its inherent political risk. Politicians seem to have given up to the strength of stereotypes underpinning the reluctance towards the euro (e.g. that euro means higher prices or that we are too poor for the euro) rather than make an effort to change them. The safer option was not to mention the euro at all and leave the public unaware of the staple information regarding the European currency. This attitude was taken also during the EU-accession referendum campaign in spring 2003 by most policymakers and even EU protagonist. The prospective euro adoption was considered as too risky to put on campaign banners and the campaign period was deemed as inappropriate to explain why the future euro adoption can be one of the key pro-accession arguments. The result was the complete unawareness of the public of the fact that the decision to replace the zloty with the euro was effectively made in the accession referendum. Not much has changed over the years - as many opinion polls show. The regular *Eurobarometer* surveys paint a disastrous picture of Polish respondents' levels of knowledge regarding their country's status vis-à-vis the adoption of the euro. Responding to the question whether new member states can choose whether or not to adopt the euro, Poland has consistently ranked the worst out of all new member states giving the lowest percentage of correct answers (NO). In the survey carried out in September 2004, 28% said NO but in subsequent surveys the situation only got worse with the share of correct answers dropping to 23%, 20%, 16%, 19%, 19%, and 15% in surveys from 09/2005, 04/2006, 09/2006, 04/2007, 09/2007, 05/2008, respectively. The persistent and ever-broadening lack of fundamental knowledge about the obligation to join the EA provides the best evidence for the complete inexistence of the euro adoption process in the public debate during the four years following accession.

Indeed, the four governments in place since EU accession until late-2007 did very little to change this unawareness and inform the public about the euro. The left-wing governments of Leszek Miller (October 2001-May 2004) and Marek Belka (May 2004 - October 2005), the right wing government of Kazimierz Marcinkiewicz (October 2005 – July 2006) and Jaroslaw Kaczynski (July 2006 – November 2007) did not take any formal steps to initiate the process of joining the EA. In particular, they have not announced the national strategy for euro adoption nor set the planned date for adopting the euro.

While no formal euro-oriented steps were taken, one can talk of a considerable degree of subordination of domestic fiscal policies to this goal indirectly via the convergence report/programme process. The institutional framework of the European Commission and ECB convergence reports and the responses of new member states to them - convergence programmes will be reviewed in more detail in the following chapter. It effectively reminds the governments of their convergence states in the area of all Maastricht criteria – regardless of whether countries are formally pursuing concrete roadmaps or not. In Poland the framework was significantly reinforced by the *excessive deficit procedure* automatically initiated on the first day of EU membership and lifted only in July 2008. The bulk of Polish convergence programmes submitted annually to the European Commission have therefore been devoted to elaborating upon Poland's fiscal outlook, which was the most tangible obstacle to joining ERMII and subsequently the EA. However, being in the excessive deficit procedure does not justify the lack of concrete steps towards adopting a national euro strategy. Such a strategy could be elaborated and a specific plan drawn up taking into account the most likely date of fulfilment of the fiscal Maastricht criterion (e.g. Slovakia in 2004-2007).

The Polish convergence programmes clearly reflect the absence of a clear road map to the euro (Ministry of Finance 2004a, 2005a, 2006a, 2007a and 2008a). The first programme was prepared by the left-wing government of Leszek Miller and submitted to the EC upon accession on April 30th 2004. It does not mention the euro adoption among key objectives of economic policy in the opening section. It does, however, contain the pledge that becoming a member of the euro area is "*the objective of the Government and the NBP*" in the Monetary and exchange rate policy section of the document[4] - a rather objective statement directly following from the accession treaty. The document specifies that the strategy for the euro adoption should aim for the "*shortest possible participation in the ERM II and for setting the central exchange rate at the level that would provide conditions for a sustainable economic growth, allow to avoid tensions on the exchange rate market and take into consideration the market exchange rate of the zloty against the euro in the selected reference period"(p. 8)".* These general declarations have neither triggered any concrete action plan nor have been given a clear priority in national policymaking in subsequent four years.

Subsequent convergence programmes have not even included general intentions such as the ones above. The adoption of the euro is not explicitly mentioned in the 2005 Convergence Programme Update published in early 2006 (Ministry of Finance, 2006a) and 2006 Convergence Programme Update published in November 2006 (Ministry of Finance, 2006b). Both convergence report updates were prepared by right-wing governments with the

[4] Ministry of Finance (2004a)

party Law and Justice (PiS) as the majority coalition partner, which has openly expressed its lack of interest to initiate the formal procedure leading to entering the EA and to put the process off indefinitely in future.

The euro as a strategic plan comes back in convergence programmes published in 2008 (Ministry of Finance, 2008a, 2008b) by the new centrist government of Donald Tusk (in power since November 2007). The first one published in March 2008 (Ministry of Finance 2008a) states that efforts to meet all convergence criteria have one ultimate goal – i.e. to take *"the decision with regard to the date for joining the ERM II mechanism and adopting the euro"* (p. 4). Preparing the Polish economy for adoption of the euro was also named one of the priority objectives of macroeconomic policy in Poland (albeit, judging by the ranking number, it is the lowest level priority) in the opening section of the document. It is therefore the political change in Poland rather than the crisis marked symbolically by the fall of Lehman Brothers that introduces a new approach to the euro.

3.2 THE IMPACT OF THE GLOBAL CRISIS

The crisis had a tremendous impact on the perception of the euro in Poland. However, the real change in how the euro is perceived in Poland came from the different attitude of policymakers - with the crisis only reinforcing their pro-euro stance. The government led by Donald Tusk was formed in November 2007 as a coalition government of the liberal, pro-European centre-right Civic Platform (PO) and the agrarian Polish Peasants' Party (PSL). Professor Jacek Rostowski, the finance minister in the government, is known as a strong supporter of the euro and initiated a debate on the unilateral adoption of the euro in the late 1990s - long before Poland's accession to the EU. Professor Rostowski - then a respected academic - has been stirring the economic debate in Poland and abroad by publishing books and articles (together with Andrzej S. Bratkowski) and speaking at many conferences on the rationale of the unilateral *euroization,* not only for Poland but also for other prospective new member states[5]. The idea – back then criticised by the European Commission on legal and institutional grounds – was advocated for by Professor Rostowski for so many years that his choice as a new finance minister was viewed by the business and financial community as a symbolic commitment to the euro. Since being nominated the finance minister, Professor Rostowski abandoned the idea of unilateral Euroization and adopted the legalistic and politically feasible approach to the euro adoption process in Poland. He motivated this transition by the radical change in the macroeconomic environment in Poland in the late 1990s when his idea was first publicised and in 2007 when he became the finance minister.

[5] A representative selection of Rostowski's articles devoted to those topice in available here: http://www.case.com.pl/strona--ID-jednostronna_euroizacja_opracowania,nlang-710.html

Advocating for unilateral euro adoption was then motivated by the fear of pre-accession turbulence, fast expansion of the public debt and persistent inflation. In 2007 and 2008, Rostowski did not see the need for unilateral steps thanks for the enormous progress in macro stability that made it possible to fulfil most if not all of the Maastricht criteria.

Following the first Rostowski-prepared Convergence Programme Update published in early 2008 in which adoption of the euro was set as one of the key priorities, the government welcomed the formal dropping of the excessive deficit procedure in July 2008. One of the key formal obstacles to initiating the ERMII process was gone and the government was accelerating its efforts on the road to the euro. During the annual Economic Forum in the resort town of Krynica in southern Poland in September (9-12), Prime Minister Tusk declared that the goal of his government is to adopt the euro in 2011, adding that the task is *difficult but not unrealistic*. The pledge made a few days before the crisis hit with new strength amid the Lehman Brothers bankruptcy seemed somewhat surprising and not fully coordinated within the Government, let alone the central bank or the Monetary Policy Council. Particularly unexpected was the target date of 2011 that was immediately judged as overly ambitious and formally impossible to meet, taking into account the multi-step procedure of acceding to the EA. In spite of these doubts directly following Tusk's pledge, the joint meeting was organized on September 16th during which the representatives of the Ministry of Finance, the NBP and the Monetary Policy Council agreed on the goal of entering the EA in 2011 and committed to close institutional cooperation in order to make meeting this goal possible. The joint announcement was acknowledged in Brussels and prompted satisfied comments from Commission officials.

Several weeks directly following the Lehman Brothers bankruptcy saw an unprecedented intensification of the euro-related debate in the media accompanied by the acceleration of euro-oriented steps on the part of the government. The direct trigger was the sharp depreciation of the zloty (see fig 11) and tumbling stock exchange indices (fig 12). Thousands of Polish households who took mortgages in foreign currencies (which accounted for 60% of all mortgage credit in August 2008) have closely watched everyday currency developments and politicians – both coalition and opposition alike - have turned to euro adoption with renewed interest. This period was also a busy one at the Ministry of Finance where work was underway on the specific roadmap to the euro. As works progressed it became clear that the challenges ahead and the mere institutional length of the process of entering and staying in ERMII made it impossible to adopt the euro in 2011. Gradually, the year 2012 became dominant in the government's announcements and by mid-October it fully replaced the initial suggestion of 2011.

On October 28, the government adopted the official *Roadmap to the Euro* (Ministry of Finance, 2008c). The document (which was *preliminarily consulted* with the central bank – as remarked in the introduction) lists necessary intermediate steps and actions along with the dates which will lead Poland to become the fully-fledged member of the EMU on January 1, 2012. The roadmap specifies that Poland will adopt the so-called 'big-bang scenario' and that the process is divided into four stages:

- The first stage (beginning in the current period and ending in the first half of 2009) will be a period of intense work on introducing the zloty into the ERMII mechanism.
- The second stage – from entering the ERMII to formal ECFIN decision of lifting the derogation was planned to finish in mid-2011
- The third stage involving largely practical issues related to the currency changeover was planned for the second half of 2011.
- The fourth stage will begin on January 1, 2012 with euro banknotes replacing zloty and intense efforts for smooth and cost-less transition from zloty to the euro.

The first concrete step in the roadmap was the nomination of the government's plenipotentiary for the coordination of preparations for the euro adoption in November 2008[6]. The roadmap also specifies that one of the key documents, the National Changeover Plan, will be adopted in the first quarter of 2009. However, until now (April 8th) the government has not delivered it thwarted by the lack of broader political consensus on the many aspects of the plan (for details see section 4.2).

One of the subsequent steps was the publication of the new Convergence Programme Update – the first one after the Commission formally dropped the excessive budget procedure in July 2008 (Ministry of Finance 2008b). As mentioned at the end of the previous section, the first Convergence Programme Update published in early 2008 included a firm commitment to the euro. The second one published in December 2008 included a very clear euro-adoption goal and makes frequent reference to the 2012 date. The document includes macroeconomic and fiscal forecast until 2011, which suggests that Poland should be able to fulfil all convergence criteria by the end of that year. The document makes clear that the biggest challenges in the area of Maastricht criteria will be those concerning the stability of the exchange rate in the ERMII and the structural reform of public finances that will lead to

[6] Ludwik Kotecki, the undersecretary of state in the Ministry of Finance was nominated for this position

the reduction of the tax burden, tax wedge and will increase Poland's rate of economic activity – one of the lowest in EU.

While the general consensus has been that economic conditions will not present a real obstacle to entering the EMU (except maybe the exchange rate, which fluctuated in a very wide range in the fourth quarter of 2008), it was the necessary legal changes that the public debate focused on in late 2008 and early 2009. There are a number of changes following from the Treaty and other European Commission legal acts that are necessary before Poland can adopt the euro. The May 2008 ECB Convergence Report (European Central Bank, 2008) mentions introducing changes in several laws (the Law on Narodowy Bank Polski, the Law on the Bank Guarantee Fund, the Law on banking the Law on settlement finality in the payment and settlement systems) as well as a modification of the Constitution that would make it possible to hand over the power to issue money in Poland to the ECB. While there seems to be a consensus over modifying the aforementioned laws among all involved institutions, changing the Constitution remains the key challenge. According to the Polish law, such a change requires a two-thirds majority in Parliament that the currently ruling coalition does not have. It is necessary to convince the largest opposition party – PiS to vote for such changes. The interplay between main political forces over changing the constitutions will be briefly summarized in the next chapter.

While the Tusk government has been the main driving force of the euro adoption process, the MPC of the NBP has also made steps towards euro adoption. Immediately following the first announcement of the intended date of euro adoption (September), a formal meeting between the MPC and the government took place with concluding comments expressing the broad agreement over speeding the EMU-accession process. Formally the MPC acknowledged taking the government's euro-related plans into account while preparing the annual document Monetary Policy Guidelines for 2009. The document specifies that in case of the binding and formally confirmed euro adoption date "*the Council will make all necessary adjustments of the monetary policy strategy and – in consultation with the Council of Ministers – of the exchange rate policy to conditions ensuing from the necessity of meeting the convergence criteria indispensable for the euro adoption."* The MPC stressed that in its opinion *"the accession of Poland to the euro area should take place at the earliest possible date"* and that *"in the coming years economic policy in Poland should be conducted in such a way as to – by implementing structural reforms – enable the sustainable fulfilment of the Maastricht criteria and, at the same time, the maximisation of benefits related to the euro area accession".* The document concludes by committing to presenting *a document describing the monetary policy strategy subordinated to the necessity of sustainable* *fulfilment of the convergence criteria in the period preceding the euro adoption* after the binding decision on the scheduled date of Poland joining the euro area (National Bank of Poland, 2008). However, due to the still missing formal accession target date no such document has been published until now.

In February 2009 the NBP published the long-awaited Report on the Euro[7] which summarized the year-and-a-half-long research work on the various aspects of integration with the EA. The general conclusion of the several hundred pages of analyses and research papers has been very supportive of the prompt adoption of the euro – not withstanding some challenges and costs involved in this process. This was the second such report created at the NBP – the first one was published in March 2004 (National Bank of Poland 2004) when the bank was headed by Leszek Balcerowicz. This report, while being much more modest in scope and contents, was strongly (more so than the current one) advocating the speedy adoption of the euro.

In terms of the impact of the crisis on the financial regulation the NBP started to react as early as September acknowledging the need to send a proper signal to destabilized markets. In mid-October the NBP's governor, Slawomir Skrzypek presented the *Confidence Package* aimed at reviving confidence among participants of the banking sector by acting in four areas: *animation* of the markets, boosting liquidity in zloty and the foreign currencies as well as working to tighten links between banks. The package contains several new measures which were designed to increase confidence between banks, provide indirect forms of supporting intra-bank transactions (giving explicit guarantees is prohibited by the Law of NBP) and boosting liquidity through a range of new types of open market operations.

The government's determination to adopt the euro as early as possible had a strong influence on its efforts to carry out decisive budget expenditures cuts in response to the sharp deceleration of economic activity in January and February 2009. Worsening macroeconomic indicators forced the Minister of Finance to lower the 2009 economic growth projection from 3.7% as stated in the Convergence Programme 2008 Update (published in December 2008) down to (a still very optimistic) 1.7% in February. In order not to increase the deficit the prime minister and the finance minister requested strong cuts in budgets from all ministries in the amount of 10% of expenditures planned for the first half of 2009. This decision was widely criticised by the opposition but also by several prominent economists on the grounds that it represents fiscal tightening in times when Poland – much like the rest of EU – should adopt fiscal expansion as a way to counter the effects of the crisis. As a result of

[7] Formally entitled The Report on the Full Membership of the Republic of Poland in the Third Stage of the Economic and Monetary Union (National Bank of Poland 2009).

the decisive action the government managed to find savings in the amount of PLN19.7bn (PLN2.7bn more than initially planned), which allowed it to avoid adjusting the budget deficit upwards (from PLN18.2bn). The key rationale for the government and the main argument used to defend this plan in the media was related to the process of integration with the EMU, the fiscal and public debt criteria and the positive message such disciplining of public finances would send to financial markets.

4. Institutional and Policy Environment regarding the Euro adoption

4.1 *Before the Global Crisis*

Poland is one of the ten new member states that participate in the third stage of the EMU with the derogation status. According to the treaty signed upon accession, Poland is thus obliged to fulfil all convergence criteria and adopt the euro at some point. The Council of the European Union requested that the ECB and the European Commission deliver reports "*on the progress made in the fulfilment by the Member States of their obligations regarding the achievement of economic and monetary union*" at least once every two years or as requested by the member state. Through these regular reports all countries are screened with respect to the four economic criteria (Maastricht criteria) as well as the state of harmonization of relevant domestic legal acts enabling the adoption of the euro. Thus, Poland - as all other member states with derogation - has been systematically forced to think about and subordinate its economic policies to the future adoption of the euro.

So far there were four ECB and four EC convergence reports submitted to the Council that included evaluation of Poland's progress on the way to adopting the euro. These reports were dated October 2004, December 2006, May 2008 and May 2010. Additionally the EC issues annual or bi-annual *Reports on the practical preparations for the future enlargement of the euro area* – a communication to the Council, The European Parliament, The European Economic And Social Committee, the Committee of the Regions and the ECB. There were nine such reports published so far: seven published between November 2004 and November 2007 one on December 2008 and the latest in March 2010. The reports used standard format for evaluation of countries' preparedness for joining the EA and provided in-depth analysis of the legal and institutional requirements.

All reports dated before September 2008 correctly indicate that Poland has not made any formal steps towards the introduction of the euro. In particular, it has not set the target date, nor issued the National Changeover Plan. It also has not decided on a changeover strategy.

A lot remains to be done in the area of legislation. The fulfilment of the standard Maastricht criteria has varied over the years. While the public debt to GDP ratio has been below the Maastricht threshold, the budget deficit criterion has been persisting above the prescribed 3% of GDP since accession until July 2008 (see table 2). The fulfilment of other criteria: low inflation, low interest rates and stable exchange rate have varied across time (see figures 16 and 17).

Because no steps were taken on the Polish side, comments by the European Commission and ECB on the euro adoption process have been scarce and concentrated on the fiscal situation - which directly followed from the excessive deficit procedure. Likewise, in Poland the debate was mostly related to the fiscal situation and the optimal path to leaving the procedure. The very fact that Poland was under this procedure was used by politicians (e.g. Finance Minister Zyta Gilowska in Marcinkiewicz's and Kaczynski's Government) as the rationale for not initiating the debate on the adoption of the euro. The reasoning given was that the procedure effectively prevents the government from thinking of the euro in practical terms and the debate could be launched only after the procedure was dropped. Slovakia's example, which was preparing its path to the euro while being affected by the procedure (May 2005 – June 2008), was unconvincing.

The reasons were rooted more deeply. None of the four governments in power during 2004-07 decided to take up adoption of the euro as a fully-fledged political project – although the first and the latter two had differing reasons. In the case of the left wing government of Marek Belka (May 2004 - October 2005), the lack of concrete action reflected the perceived feasibility problem and political risks involved rather than ideological opposition to the issue. Both finance ministers in this government (Andrzej Raczko until July 2004 and Miroslaw Gronicki afterwards) are considered liberal economists who favoured fast accession to the EMU. Raczko gave many interviews in which he strongly supported entering the EA at the earliest possible date which he then estimated to be no earlier than 2008, owing to problems related to the deficit. Both Raczko and Gronicki intensified the frequency of meetings of the inter-institutional working group for EMU accession comprised of representatives of the Ministry of Finance and the NBP that was charged with coordinating EMU-integration-related activities since mid-2002. Under Gronicki in August 2005 the Ministry of Finance published a very important document: *Integration of Poland with the Euro Area - Conditions for membership and the strategy for managing of the process* (Ministry of Finance, 2005c) that clearly outlines what remains to be done on the path to euro adoption and approximates the length of each stage of the accession process.

Positive signals were also sent from the NBP governed by Professor Leszek Balcerowicz from January 2001 till January 2007. Balcerowicz, the father of Polish reforms from the early 1990s and the long-time Minister of Finance (1989-1991 and 1997-2000) was one of the strongest and most outspoken supporters of the euro. He initiated research on the first report on the consequences of adoption of the euro in Poland (National Bank of Poland, 2004) whose conclusions were very much in favour of fast integration with the EMU. Nevertheless, the close ties and common view on the process between Raczko, Gronicki and Balcerowicz amid the largely favourable political environment during 2004-05 failed to produce formal euro-related steps for a variety of reasons.

The first year of EU membership featured a number of new problems, of which EU-entry inflation shock was probably the most visible to the common public. As figures 4 and 17 show, inflation in Poland rose from well below 2% in 2002-03 to 5% in mid-2004, owing largely to arbitrage in the food market in the wake of accession and upward adjustment of various taxes and dues required by membership. The mid-2004 inflation shock in Poland was the largest among the 10 new member states chiefly because of the size of the agricultural sector in Poland and the fact that the country has one of the highest shares of food in the consumer basket among EU countries. Insufficient information about the true nature and the temporary character of this shock (which was underpinned by the sudden success of Polish exports!) resulted in the strong negative association of accession with economic hardship and high prices. The public was convinced that adopting the euro was going to produce another inflation shock – especially since price increases remained the strongly associated with EA creation in 2002.

This interpretation is confirmed by the results of the Eurobarometer. In its seven surveys carried out between accession and late 2008, Poland emerges as one of the most sceptical countries when it comes to the euro. In the first survey carried out in mid-2004, Polish respondents came out as the most afraid of abuses and cheating on prices during the changeover – 83% (compared with 71% average for new member states) and ranked third among the countries associating the changeover with higher inflation (54% vs. 48% new member states average). In the same survey Poles declared themselves as being uninterested in the euro (the highest proportion of respondents for not interested and not at all interested) and considering euro negative for their country (44% - the highest among new member states), and for themselves personally (50% - the highest among new member states). These results seem to reflect fairly well the general attitude towards the euro during the initial months following accession - an attitude that has not changed much over the years. Apparently in spite of the favourable political support of the two key state institutions the government did not take any steps towards the introduction of the euro. The government was preoccupied with other issues and uninterested in risking voters' support by forcing the adoption of an *unpopular* new currency. Instead of informing the public and making the effort to explain the entirety of potential consequences of euro adoption, the government gave in to stereotypes and decided not too tackle the issue at all. Resulting was the lack of formal progress on the road to the euro despite the favourable attitude of the key institutions involved in the process. The next chance for such consensus would come no earlier than early 2008.

The political atmosphere towards the euro changed radically with new elections in October 2005 when the right-wing socially conservative Law and Justice (PiS) formed a coalition government with the radical-populist agrarian Self-Defence and the Catholic-nationalist League of Polish Families (LPR). The government was very outspoken about its lack of interest in the euro. The reasons for this attitude were manifold and ranged from ideological aversion to the idea of giving up monetary power to the supranational body such as the ECB to conservative attachment to national symbols (e.g. Polish currency, Polish monetary policy) to the purely political motive of economizing on public aversion to the euro. Consequently, under the two finance ministers (Teresa Lubinska and Zyta Gilowska[8]), euro adoption was effectively dropped from the agenda and the impression prevailed that initiating any concrete euro-related steps had to wait until the derogation of the excessive budget procedure. The most frequent date mentioned by government officials was 2012; however, no formal procedure was initiated.

The period of PiS governments was also a very difficult time from the point of view of the collaboration with the NBP. Different political sympathies coupled with serious disputes related to the parliamentary commission initiated by PiS to investigate abuses in the banking system during the Balcerowicz's term as central bank's governor have contributed to freezing the relationship between the central bank and the government – resulting in halting the euro issue as well. Balcerowicz's successor, Slawomir Skrzypek, nominated by president Lech Kaczynski[9] in January 2007, was much closer ideologically to the government when it came to adoption of the euro. The tension between the central bank and the government was gone as was the enthusiasm for the euro in the NBP. This two-year period (October 2005 – November 2007) was entirely lost to the euro adoption process.

A big change came by way of parliamentary elections and the formation of new government in November 2007. In order not to split the period in two parts by reviewing events before

[8] After Zyta Gilowska there were two other finance ministers serving together for less than 3 months
[9] A twin brother of Jaroslaw - the head of PiS - and a strong, albeit not explicit, supporter of PiS.

and after the crisis, the institutional and policy environment related to the entire period of Tusk government will be taken up in the next section.

4.2 THE IMPACT OF THE GLOBAL CRISIS

As mentioned in 3.2 the process of euro adoption got accelerated under the Tusk government but it wasn't until the third quarter that the Government decided to make firmer commitments and pledges to initiating the formal procedures. The reaction of other institutions and political parties to the acceleration of the euro adoption process has evolved in line with the subsequent waves of the crisis. The main opposition party, PiS, has largely remained hostile, however, the strength of this hostility may have declined somewhat into early 2009 when the disadvantages of staying outside of the EA became very clear.

The key to understanding the political economy of the process is the complex set of relations among the main institutional actors. The Tusk government with its finance minister Rostowski have been pushing the idea for fast-tracking the process since September with tentative dates moving from 2011 (September-October) to 2012 (from November). The president, Lech Kaczynski has shown his aversion to the euro and - in spite of being much more moderate than the leaders of PiS- can be classified as opposing the speedy adoption. Slawomir Skrzypek, Kaczynski-nominated central bank governor has evolved from being indifferent to the process (2007 and early 2008) to getting more active and cooperative with the government, albeit with no actual steps taken – under apparent influence of the president. As mentioned many times before the largest opposition party PiS has been consistent in opposing the acceleration of the euro adoption process – but varied this opposition from strong to moderate at times. The other opposition party – social democrat Democratic Left Alliance (SLD) – has evolved from being cautions and indifferent to the process to supporting the government policies towards to euro.

The dynamics of the EMU accession debate in late 2008 and in 2009 was predominantly driven by the political complexity of amending the Polish Constitution to allow subsequent transferring of monetary power to the ECB. Since the coalition did not have the two-thirds share of votes in parliament required for modifying the constitution, convincing the opposition (PiS) to support the amendment became unavoidable. However, PiS decided in October 2008 to condition its support on holding a referendum on the euro. The likely motive of this decision was to economize on the unpopularity of the euro in Poland and to win the support of euro opponents who say that Poland should join the EMU only after reaching the average level of EA economic development – the fallacy commonly shared among euro-sceptics. For a long time PiS leaders did not specify what kind of referendum question they meant. It could not be a referendum on the adoption of the euro per se – as Poland does not have the opt-out option. The leaders hinted that the referendum should ask the population whether they favour adoption soon or later. The suggestion was made to specify what was meant by soon and later, however no coherent proposition for a referendum has ever been clearly and officially articulated by the opposition. The leader of PiS suggested that the referendum should take place together with the June European Parliament elections.

The coalition, supported here by the minor opposition party SLD was strongly opposed to the idea of the referendum pointing to the impossibility of formulating a sensible referendum question and its sending a wrong signal to international community in the midst of the crisis. The President, not surprisingly, quickly adopted the idea of a referendum, expressing his support less decisively than the opposition, but nevertheless sticking to this idea since its inception in late 2008. His support was somewhat softened after the *social summit* meetings organized by his office in late February 2009. However, his opinion has been rather unclear since then, with more signals still sent in favour of the referendum rather than against it.

Meanwhile, the lack of political consensus over the future of the euro has seriously weakened Poland's reputation in the financial markets. February's turmoil in the foreign exchange market hit the Polish currency the hardest of all new member states and led to unprecedented daily fluctuations. The continued support of the referendum on the part of PiS, the backing of the President for this idea coupled with strong opposition from the coalition resulted in a gridlock and put the government's roadmap under severe pressure. Government officials and many respected economists have recently voiced their serious doubts about whether it is still possible to meet the 2012 target date. According to them, without a consensus on changing the Constitution it would be simply too risky to enter the ERMII as the Polish currency would be too exposed to speculative attacks. Furthermore, the increased fluctuation of the exchange rate in the first months of 2009 (viewed by many as a *consequence* of missing consensus over the euro) has reached alarming levels, making entry to the ERMII n the first half of 2009 (as stipulated in the roadmap) doubtful and potentially unsafe. Not entering ERMII in the first half of 2009 clearly implies pushing the EMU accession past 2012.

Unsurprisingly the political problems and unstable financial markets have forced the finance minister to soften the commitments towards the roadmap. Rostowski remarked recently that the government's approach to the ERMII and EMU entry is pragmatic rather than dogmatic and added that the recent instability of the financial markets may impede efforts to enter the ERMII in the first half of the year. This hints at a later EMU accession than January 2012. The problems and risks associated with entering ERMII during this period of turmoil have recently taken center stage with many renowned economists (including the former NBP governor Leszek Balcerowicz, members of the Monetary Policy Council, banking economists, etc.) indicating that entering the ERMII under current circumstances would be unwise. The government's plenipotentiary Mr. Kotecki stressed in early April 2009 that the recent instability of the zloty exchange rate created very unfavourable conditions for ERMII entry – hinting that the official entry will be put off in time.

Responding to those concerns was the latest proposition of the IMF to allow the troubled new member states to undergo unilateral Euroization without formally accessing the EA. This met with firm opposition of the EC and ECB officials who insisted on the necessity of adhering to standard multi-step procedure of entering the EMU including meeting all the criteria – particularly in the turbulent crisis time. Earlier in March 2009 the Financial Times suggested facilitating EMU entry for new member states with sound fiscal policies by preparing a fast-track procedure bypassing the ERMII two-year rule. The newspaper argued that this could help stabilizing the currencies and in the end would benefit the countries and the new member states alike. Both ideas have echoed in Poland and met with great interest in media and economist circles. However, the government and central bank officials have generally abstained from making comments about these propositions most probably because of their largely unofficial character and also to emphasize their commitment to the official euro adoption strategy. In particular the finance minister, Jacek Rostowski chose not to speak about the fast-track euro options put forth in the media although they resembled very much Professor Rostowski's late 1990s idea of *unilateral Euroization*. His decision not to issue any statements about these ideas was certainly a meaningful and symbolic pledge to the official roadmap used by the government as a way to build and enhance the much needed credibility for its pro-euro stance.

The MPC joined the debate by making an important declaration on the conditions for its support for ERMII entry. The MPC, being a very heterogeneous body[10], is dominated by supporters of the euro. In the meeting with the Prime Minister the MPC members stressed that their consent for the entry of the zloty into the ERMII depends on prior constitutional amendments. In view of the MPC entering the mechanism without securing the constitutional changes would be too risky and could expose the zloty to speculative attacks. In the minutes from its late March meeting, the MPC made it clear that *Poland should join the ERM II and the euro area at the earliest possible date, after achieving the necessary political support for amendments in the Constitution of the Republic of Poland and other legal acts necessary for*

[10] Composed of 10 members – three nominated by the President, the House of Representatives and the Senate + the Governor.

the euro adoption in Poland (Monetary Policy Council 2009). In this way, the MPC stressed the importance of securing the constitutional changes **before** ERMII entry occurs, thus closing the debate on the feasibility of entering the mechanism without the amendments (and securing them afterwards) and channelling the euro-related debate entirely on the constitutional change. Given the general pro-euro stance of the MPC this decision should not be considered as thwarting the euro plans in Poland but rather as one securing the smoothest possible path to the euro - without exposing the currency locked into the mechanism to risks inherent in political debates that inevitably accompany constitutional amendments.

On April 27th, 2009, the government adopted "*The conditions for accomplishing subsequent steps of the euro adoption process in Poland"*. The document was an imperfect substitute for the updated roadmap and the national changeover plans which were supposed to be published in the initial months of 2009. It reiterates the commitment to the 2012 euro adoption date and indicates that the date is still feasible even if zloty does not enter ERMII in the first half of 2009 as planned. If the entry to ERMII is delayed but the period of currency stabilization begins in the second quarter – then the 2012 data remains on the table. If, however, that does not happen the government acknowledges the need to move the euro adoption data past 2012.

The document also argues that inflation in Poland may soon return below the Maastricht reference level as a result of the NBP's policy targeting an inflation rate of 2.5% - the level likely to allow fulfillment of the criterion. If the reference inflation falls below this level the NBP may have to lower its target accordingly. However, most of the document is devoted to the exchange rate volatility, which rose in late 2008 and 2009 to record high levels as measured by the official European Commission exchange rate volatility indicator (ERV). This volatility makes is very hard to set an exchange rate parity for the ERMII that would be compatible with equilibrium exchange rate theories, both behavioral and fundamental. The document also points to the lack of political consensus over constitutional amendments, adding that such a consensus is necessary along with increased exchange rate stability to initiate the procedure of entering the ERMII. While not giving a precise answer as to how this stability should be defined, it states that to enable setting the ERMII parity the exchange rate fluctuations should not significantly exceed the levels prevailing in other countries that recently joined the EA.

To ease tensions in the currency market, the government requested the so-called Flexible Credit Line (FCL) from the IMF, which was granted in late April 2009. This move was conceived to contribute to stabilizing the currency and sending the positive signals to financial markets. While being mentioned in the government's official document related to euro adoption as one of the factors boosting the country's credibility, the FCL was not officially integrated into the government's euro strategy.

The publication of "The conditions…" did little to change the impression of the easing the government's determination to stick to the 2012 euro adoption date– the process best captured by recent Rostowski's comment about 2012 being a *pragmatic goal* rather than a *dogma* for the government. In late April 2009 it was gradually becoming clear that the economic slowdown was taking a more serious toll on the roadmap to the euro than previously expected. The government had to drastically revise the 2008 fiscal deficit data upwards by a massive 2 percentage points to 3.9% of GDP thus breaching the Maastricht fiscal criterion. The current fiscal developments have been rather gloomy as well with the budget deficit after four months of 2009 reaching 85% of the deficit envisaged for the entire year. In contrast to the commitment shown by government circles in late 2008 and early 2009 and reassured by the good record related to the Maastricht criteria (see figures 17 and 18 and table 2), the recent economic deterioration has shaken the government's relentless stance regarding a speedy adoption of the euro. Although formally not required at the time of EMU entry - fulfilling the criteria at the time of accession to the mechanism has been viewed as an important and implicit condition, sending a positive signal to financial markets and a robust credibility indicator lowering the likelihood of speculative attacks. However, due to the very fast deterioration of the economic situation in early 2009, Poland found itself in mid-May meeting only two criteria – those related to the interest rate and to the debt/GDP ratio (with the latter considered to be endangered by the combination of slowing economic growth and rising financing needs).

The ultimate blow to Poland's speedy euro adoption plan came from the European Commission's Spring 2009 forecasts. The updated forecast saw Poland's deficit rise to a massive 6.6% in 2009 and 7.3% in 2010 and the GDP plunging by 1.4% in 2009 – figures markedly worse than official the ministry of finance projection. While these forecasts were evaluated as unrealistic and far too gloomy by Polish authorities, the media has begun to speculate about their potential consequences for the roadmap to the euro. In mid-May Minister Rostowski continued to stand by the expectation of a lowered but positive economic growth (+1.7%) and a budget deficit of 4.6% of GDP in 2009 in the worst-case scenario. As expected the European Commission imposed soon afterwards the excessive budget procedure after lifting it only in the summer of 2008. This irrevocably ruined the plans to adopt the euro in 2012 as given the gloomy prospects for the years to come it is close to impossible to reduce the budget deficit to less than 3% by 2011.

The potential problems related to Maastricht criteria, so far downplayed by the – perhaps too complacent - government, came to the fore of the euro-related debate in Poland in May 2009. The prospective excessive budget procedure, along with the recent breaching of the inflation criteria and the highly fluctuating zloty, has effectively shifted public interest away from issues related to the constitutional amendments or the lack of political agreement over euro towards the more objective concerns related to Poland's deteriorating macroeconomic situation.

4.3 RECENT DEVELOPMENTS

Late 2009 and the first half of 2010 brought many new developments in the euro adoption process in Poland. Towards the end of 2009 Poland ceased to fulfill all Maastricht criteria with the exception of the public debt. With Poland's general government deficit markedly above 3% (see table 19) the European Commission formally imposed the Excessive Deficit Procedure (EDF) on Poland in mid-2009. Inflation has been exceeding the Maastricht level since November 2008 and remained above it for all 2009 and the first half of 2010 (fig. 17). In November 2009 long-term interest started to exceed the reference level and have been predominantly above that level since then (see fig. 18). Exchange rate volatility has been very high while the public debt was the only macroeconomic parameter than remained below the Maastricht benchmark of 60% (see table 2).

In February 2010 the Ministry of Finance published the annual Convergence Programme (2009 Update) which reiterated the authorities' commitment to the euro and focused on the measures needed to bring the economy back in line with the Maastricht criteria. The biggest emphasis was put on healing public finances and the elaboration of the new Plan for Development and Consolidation of Finances. According to the Programme adhering to this plan would lead to the reduction of the deficit to 2.9% in 2012 (see fig. 19) paving the way for the adoption of the euro in 2015.

On the administrative level recent months have been very active. The government's Plenipotentiary for Euro Adoption, Ludwik Kotecki has been coordinating various euro-related tasks that gained speed visibly in late 2009 and the first half of 2010 despite unfavourable change in Poland's fulfillment of the Masstricht criteria. In numerous statements in aftermath of the Greek crisis Mr Kotecki stressed that joining the euro area -in a speedy and secure way- remains the key priority for the authorities. He recalled that "*The conditions for accomplishing subsequent steps of the euro adoption process in Poland"* adopted in April 2009 stipulated that the entry into ERMII will be safe under a number of conditions. Currently due to the high risks related to the still ongoing financial turbulence, current problems with the fulfillment of the fiscal criterion as well as the lack of consensus on the necessary constitutional amendments, the Government chose to abstain from giving a precise date of the ERMII entry and the subsequent euro day. Failing to adhere to such a commitment would tarnish Poland's reputation and lower the credibility of its euro adoption efforts. However, while no concrete dates will be given at the moment, subsequent formal and institutional steps stipulated in the 2008 Roadmap are implemented gradually.

In December 2009 the inter-institutional organisational structure was established, comprising the National Coordination Committee, the Coordination Council and 8 Working Committees. The work of the structure is chaired by the Plenipotentiary and co-chaired by the Plenipotentiary for Euro Adoption of the National Bank of Poland's Management Board. More than 30 institutions are involved in its work, in particular the Ministry of Finance and the National Bank of Poland. Until mid-2010 this committee had two fruitful meetings.

One of the most important decisions by the committee was taken in May 2010 with regard to the detailed timetable of activities for working groups which constitutes another milestone in the process of euro adoption. The timetable spans the entire period from the first quarter of 2010 until the euro-adoption date (which is parametrised by the letter € in place of the concrete date). The plenipotentiary also finalised work on the Strategic Framework of the National Changeover Plan and postponed the publishing of the fully-fledged National Changeover Plan until 2011.

The European Commission published its regular Spring Forecasts in March while new convergence reports were published in by the EC and the ECB in May 2010. In regard to the euro adoption process in Poland the Commission showed a more pessimistic assessment of the perspectives of fiscal consolidation. While the forecasts do not cover 2012 (for which the Ministry of Finance forecasts the deficit of 2.9%) the Commissions' expectations of the deficit at -7.3% and -7.0% in 2010 and 2011, respectively, is considerably worse than those of the Ministry, -6.9% and -5.9%, respectively. Some of the difference comes from the Commission's lower GDP growth forecasts, at 2.7% and 3% in 2010 and 2011 vs. Ministry of Finance's 3%, 4.5% and 4.2% in 2010, 2011 and 2012, respectively. These forecasts suggests that the Commission assessed the likelihood of slashing the deficit below 3% in 2012 as relatively low.

The April 10th plane crash near Smolensk in which both President Lech Kaczynski and the NBP governor Sławomir Skrzypek died triggered a series of political changes that are likely to have an impact on the euro process in Poland. As noted earlier the opposition of the president to constitutional amendments allowing the transfer of powers to the ECB was viewed as one of the key obstacle to accelerating the euro process in early 2009. The new president Bronisław Komorowski elected on July 4th 2010 is likely to present a more pro-euro stance and is expected to facilitate progress in this area. Furthermore, the new governor of the NBP, prof. Marek Belka (former prime minister between May 2004 - October 2005) has already announced that the euro adoption will be one of its priorities and declared willingness to contribute to speeding up respective preparations. This may signal a change from a more cautious and hesitant approach presented by Sławomir Skrzypek.

On the other hand, the composition of the Parliamentary remained unchanged which means that there still exists no appropriate majority for amending the constitution. The situation is likely to change – either way – with the new Parliament due to be elected in the autumn of 2011. Until then a lack of constitutional amendments continues to be the most important legislative shortcoming on the way to the euro adoption – as pointed out by the EC and ECB in the May convergence reports.

Meanwhile amid a more conducive political atmosphere and a fully active and functional administrative environment, the perspective of euro adoption remains unclear largely due to the challenges with reducing the fiscal deficit. As the year progresses it becomes clearer that it will be extremely difficult to implement appropriate fiscal measures that will produce a massive fiscal adjustment over the next few years and subsequently bring the deficit to 2.9% in 2012. The latest Reuters poll on the expected euro adoption date among market analysts indicates early 2015 as the most likely date (median) with dates ranging from 2014 to 2019 (Nominal Convergence Monitor, July 2010, MF). The analysis based on the term-structure of interest rates points to a markedly further period in the range of 2019-2020 as the date that financial markets embed in their decisions and contracts.

5. Conclusion: Progress, Perspectives, Recommendations

Examined in mid-2010, the process for euro adoption in Poland lost most of the momentum it had in late 2008. In early 2009 the major culprit was the lack of political consensus over constitutional amendments as well as exceptional instability of the zloty exchange rate. These factors have severely complicated the process and prevented the government from taking subsequent steps. It has quickly become clear that entering the ERMII in the first half of 2009 as stipulated in the November roadmap would be very difficult. The new blow to the adoption process came with the sharp worsening of fiscal indicators that prompted the European Commission to initiate the excessive budget procedure in mid-2009. The two European Commission forecast rounds in 2009 and the Spring 2010 round made it clear that the initial plan to adopt the euro in 2012 is entirely unrealistic.

Viewed in mid-2010 the euro adoption process continues well on the administrative level with the government's plenipotentiary very active and the institutional environment around the euro process gradually maturing, becoming richer and more functional. While there is still no adequate parliamentary majority to amend the Constitution, the political environment has become somewhat more conducive to the euro with the new President, central bank governor and the Monetary Policy Council likely to be more supportive for the process. However, the crisis-induced widening of the budget deficit, the ensuing excessive deficit procedure and shifting of the perspective of fulfilment of the fiscal criterion became the most immediate problem for the euro adoption in Poland.

While the current crisis has undoubtedly increased the appeal of the EMU by sharply raising costs of staying outside, it has also complicated the accession process tremendously. The extent of these complications crucially depends on the length and depth of the crisis. If it continues beyond 2009-10, most non-EA member states may find themselves unable to fulfill the fiscal deficit criterion and possibly also the debt criterion. If it is accompanied by persistent depreciation of local currencies then the inflation criterion will be too ambitious and entering the ERMII and holding the exchange rate within narrow bands for 2 years– simply unrealistic. This may mean that EMU members with derogation will diverge from the Maastricht benchmark further than they have ever been – to the obvious detriment of the countries themselves but also of the EA and the whole EU, which will have to cope with a ticking bomb in the east.

It may therefore be wise to carefully combine last year's propositions of the Financial Times and the IMF and devise a fast-track accession process for those countries that have shown commitment to sound fiscal policies and the institutional maturity to take on the euro. The flexibilization of the Maastricht criteria may be most welcome in the case of the exchange rate stability criterion. It seems completely unrealistic to expect exchange rate stability in the current period of turbulence – even from the countries that "behave." The financial markets have shown on many occasions that they treat the entire group of non-EA new member states as a homogenous block with all countries being punished or rewarded as a consequence of an individual country's failure or success.

The concrete forms of modifying the stability criterion would have to be discussed taking into account all pros and cons of all solutions. However, at this point it seems that sticking to the two year requirement acts as an efficient deterrent for all countries pondering euro adoption in the near future and provides easy ammunition for euro skeptics.

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7. APPENDIX

7.1 TABLES

Table 1. Annual rates of growth of real GDP aggregates in Poland and EA (in %)

	Gross domestic product at market prices		Final consumption expenditure		Domestic demand		Gross capital formation		Exports of goods and services		Imports of goods and services	
	EA	*PL*	*EA*	*PL*	*EA*	*PL*	*EA*	*PL*	*EA*	*PL*	*EA*	*PL*
1996	1.5	6.2	1.6	7.2	1.1	9.4	-0.8	19.5	4.8	12	3.6	28
1997	2.5	7.1	1.6	6.3	1.9	9.1	3.4	21	10.7	12.2	9.2	21.4
1998	2.8	5	2.6	4.3	3.6	6.3	7.2	13.6	7.5	14.4	10.4	18.6
1999	2.9	4.5	3	5	3.5	5.2	5.3	6	5.7	-2.5	7.8	1
2000	3.9	4.3	2.9	2.9	3.3	3.1	5	3.9	12.7	23.2	11.6	15.5
2001	1.9	1.2	2	2.3	1.3	-1.3	-1.5	-13.4	3.9	3.1	2.2	-5.3
2002	0.9	1.4	1.3	3	0.4	0.9	-3	-7.2	1.8	4.8	0.4	2.8
2003	0.8	3.9	1.3	2.7	1.4	2.8	1.8	3.3	1.2	14.2	3.1	9.6
2004	2.1	5.3	1.6	4.3	1.9	6.3	3.1	14.7	7.3	14	6.9	15.8
2005	1.7	3.6	1.7	2.7	1.9	2.5	2.5	1.4	4.9	8	5.6	4.7
2006	2.9	6.2	1.9	5.2	2.8	7.4	5.9	16.1	8.3	14.6	8.2	17.3
2007	2.6	6.6	1.7	4.7	2.4	8.8	4.6	23.7	5.9	9.1	5.3	13.6
2008	0.8	4.8	0.9	4.1	0.8	5	0.4	7.7	1.3	5.8	1.2	6.2
2009	-4.1	1.7	-0.2	2.0	-3.4	-1.1	-14.5	-10.8	-12.9	-9.1	-11.5	-14.3

Source: Eurostat

Table 2. General government fiscal balance, public debt and state treasure debt as % of GDP

	General Gov't Fiscal Balance	Public Debt			State Treasury Debt						
		Total			Total						
			Domestic debt	Foreign debt		Domestic debt (towards residents)			Foreign debt (towards non-residents)		
						Total	Treasury bills	Treasury bonds issued for domestic market	Total	Treasury bonds issued for domestic market	Brady Bonds and treasur
1999q04	-2.3	41.8	-	-	39.7	19.7	4.0	9.6	20.0	1.0	3.2
2000q04	-3.0	38.7	-	-	35.8	17.5	3.1	10.3	18.3	2.3	2.7
2001q04	-5.1	38.8	26.0	12.7	36.4	21.4	4.4	13.3	15.0	2.5	2.6
2002q04	-5.0	43.6	30.1	13.5	40.6	23.5	5.1	15.3	17.0	3.8	3.3
2003q04	-6.3	48.4	33.2	15.2	44.9	25.4	5.6	17.1	19.6	4.8	4.8
2004q04	-5.7	46.7	34.5	12.2	43.6	25.1	5.0	17.8	18.4	6.7	4.9
2005q04	-4.3	47.5	34.5	12.9	44.8	25.6	2.5	21.3	19.2	7.0	8.0
2006q04	-3.8	47.8	35.6	12.2	45.1	26.8	2.4	22.9	18.3	7.0	7.9
2007q04	-1.9	44.8	34.3	10.5	42.6	26.5	1.9	23.5	16.1	6.3	7.3
2008q01	-	43.2	33.2	10.0	41.3	26.3	1.1	24.1	14.9	5.7	7.0
2008q02	-	42.9	33.0	9.9	41.1	26.7	2.3	23.3	14.4	5.1	7.1
2008q03	-	42.8	33.0	9.8	41.1	27.0	2.8	23.1	14.1	5.0	7.1
2008q04	-3.7	46.9	34.8	12.1	44.7	29.3	3.9	24.0	15.4	4.3	8.8
2009q01	-	48.7	35.4	13.3	46.6	29.9	4.0	24.4	16.7	4.4	9.5
2009q02	-	48.7	36.1	12.6	46.6	29.9	4.2	24.2	16.6	4.8	9.0
2009q03	-	49.9	36.7	13.2	47.6	29.9	4.4	24.1	17.7	5.5	9.3
2009q04	-7.1	49.8	36.7	13.1	47.0	28.9	3.3	24.3	18.0	5.8	9.4
2010q01		50.7	37.2	13.5	48.3	29.1	3.3	24.3	19.1	6.7	9.8

Source: Ministry of Finance of Poland and Eurostat

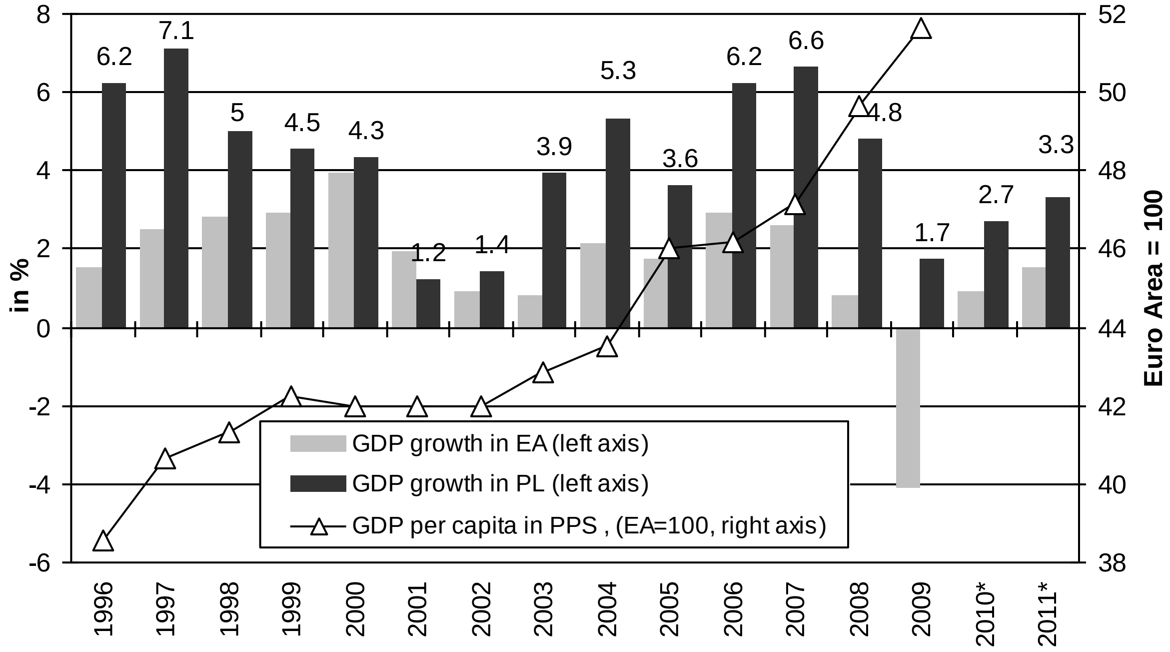
Table 3. Annual Balance of Payments (as % of GDP)

		1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
A.	Current Account	-2.1	-3.7	-4.0	-7.4	-6.0	-3.1	-2.8	-2.5	-4.0	-1.2	-2.7	-4.7	-5.1	-1.6
	Balance on Goods	-4.7	-6.3	-7.5	-9.0	-7.2	-4.0	-3.7	-2.6	-2.2	-0.9	-2.0	-4.0	-4.9	-1.0
	Balance on Services	2.2	2.0	2.4	0.8	0.8	0.4	0.4	0.1	0.0	0.2	0.2	1.1	1.0	1.1
	Balance on Income	-0.7	-0.7	-0.7	-0.6	-0.4	-0.3	-0.5	-1.1	-3.2	-2.2	-2.8	-3.8	-2.6	-3.2
	Balance on Current Transfers	1.1	1.3	1.7	1.3	0.8	0.8	1.0	1.1	1.5	1.6	1.9	2.0	1.5	1.5
B.	Capital Account	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.5	0.3	0.6	1.1	1.1	1.6
C.	Financial Account	4.3	4.7	7.7	6.2	6.0	1.6	3.6	4.0	3.3	5.0	3.8	6.1	8.1	4.9
	Direct investment	2.9	3.1	3.5	4.3	5.6	3.0	2.0	2.0	4.6	2.3	3.2	4.3	2.2	2.0
	abroad	0.0	0.0	-0.2	0.0	0.0	0.0	-0.1	-0.1	-0.4	-1.1	-2.6	-1.3	-0.6	-0.7
	in Poland	2.9	3.1	3.7	4.3	5.6	3.0	2.1	2.1	5.0	3.4	5.8	5.5	2.8	2.7
	Portfolio investments	0.2	1.3	1.0	0.1	1.8	0.5	1.0	1.2	3.7	4.0	-0.9	-1.3	-0.5	3.6
	Other investment	1.2	0.3	3.2	1.5	-1.5	-1.8	1.1	1.3	-5.1	-1.4	1.7	6.6	5.8	3.0
	Financial derivatives	0.0	0.0	0.0	0.3	0.2	-0.2	-0.5	-0.4	0.1	0.1	-0.2	-0.5	-0.2	-0.3
D.	Net errors and omissions	0.2	0.8	-0.3	1.3	0.4	1.2	-0.5	-0.9	0.6	-1.4	-1.0	-2.4	-4.1	-4.9
	Overall Balance	2.5	1.9	3.4	0.1	0.4	-0.3	0.3	0.6	0.3	2.6	0.7	3.0	-0.7	3.4
E.	Official Reserve Assets	-2.5	-1.9	-3.4	-0.1	-0.4	0.3	-0.3	-0.6	-0.3	-2.6	-0.7	-3.0	0.7	-3.4

Source: Eurostat

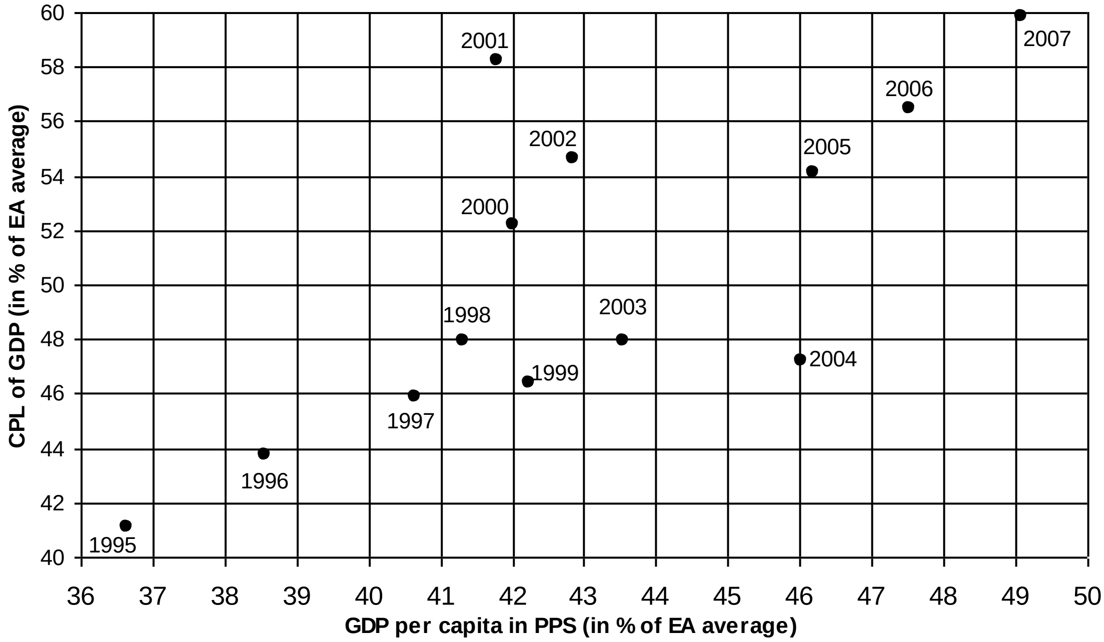
7.2 FIGURES

Figure 1. Real GDP growth in Poland and EA and the level of GDP per capita in PPS in Poland 1996 – 2009 and forecasts* for 2010-2011



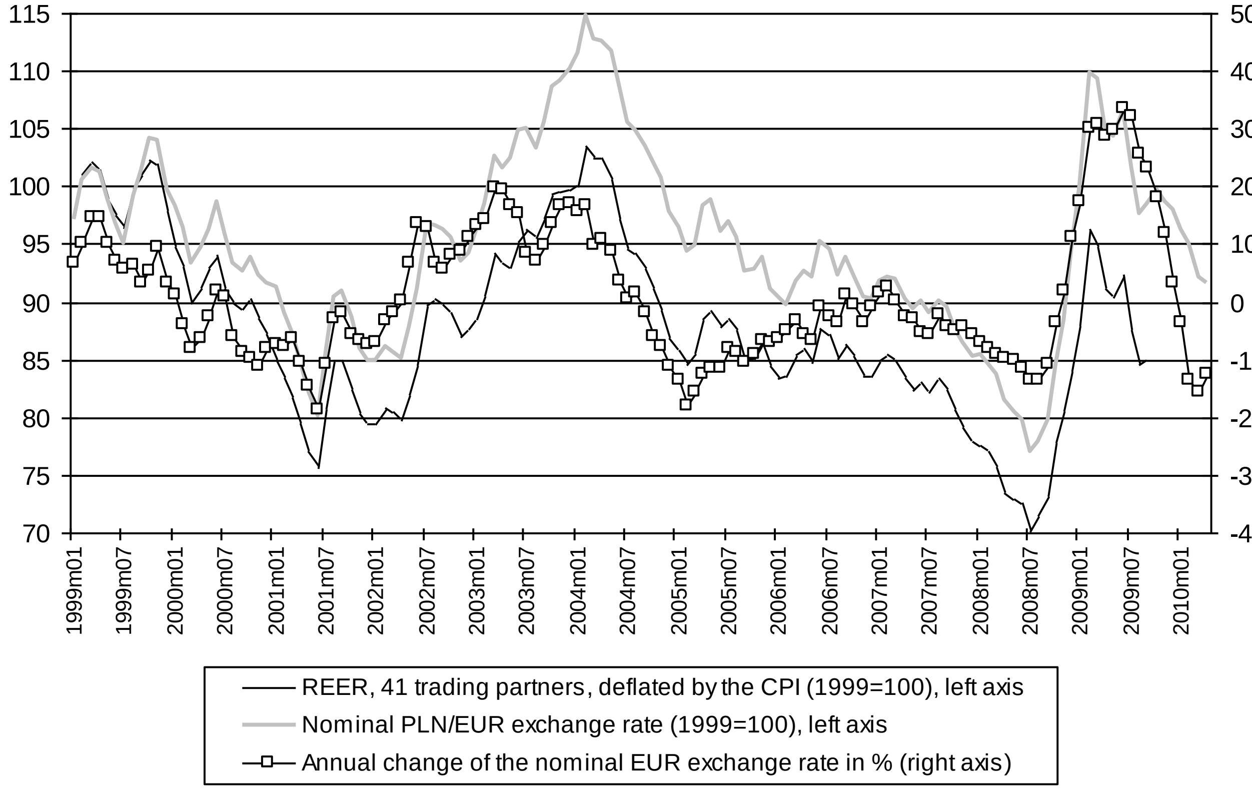
Source: Eurostat, * European Commission Spring 2010 Forecasts

Figure 2. GDP per capita vs. Comparative Price Level (CPL) as % of the EA average



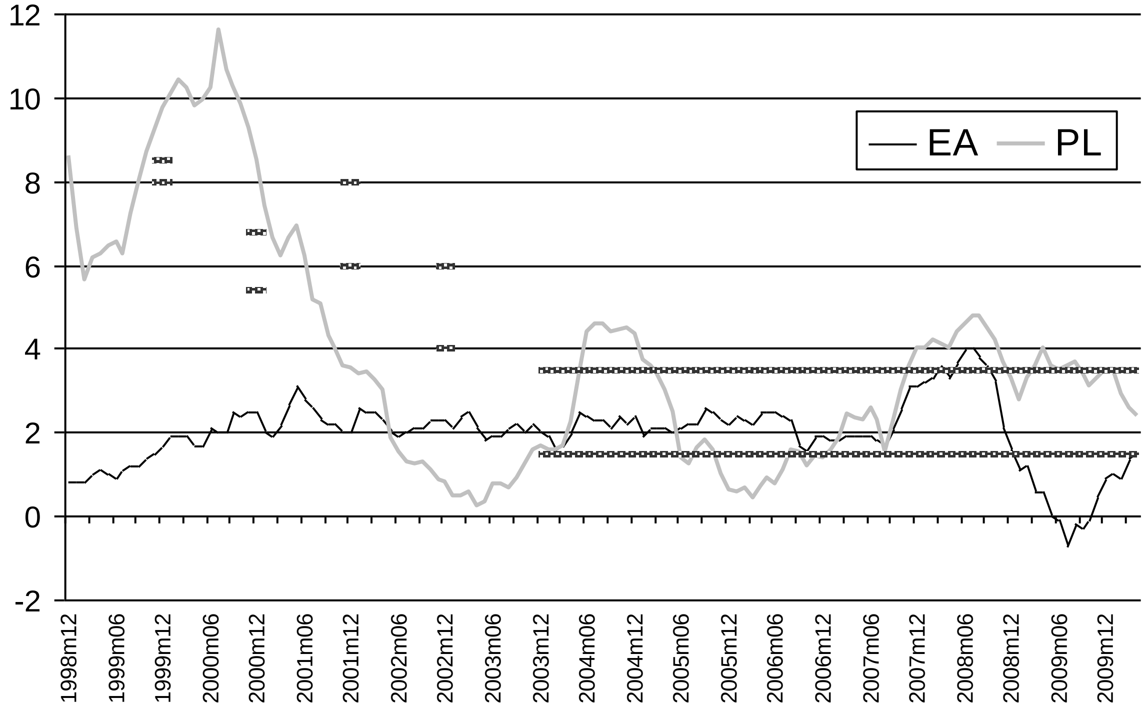
Source: Eurostat

Figure 3. Nominal EUR and real effective exchange rate of the Polish zloty (1999=100) and the annual change of the PLN/EUR exchange rate



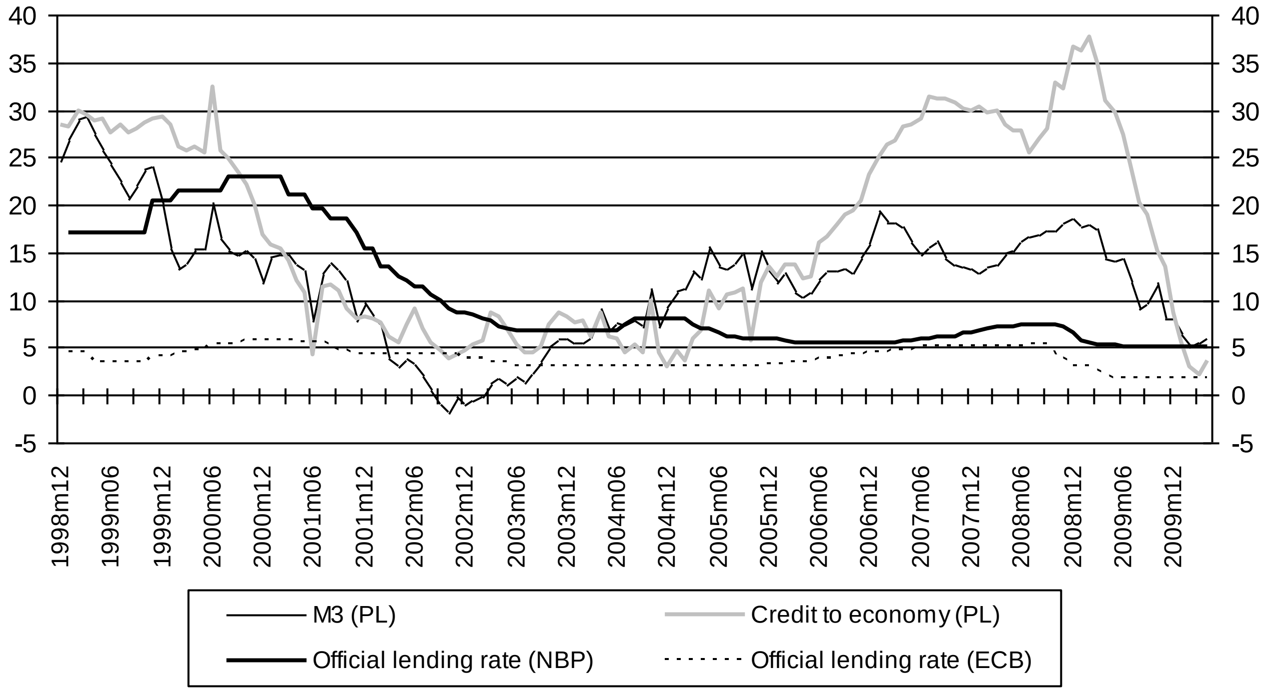
Source: Eurostat

Figure 4. Inflation (year on year, in %) in Poland (domestic CPI) and EA (HICP) as well as inflation target bounds in Poland.



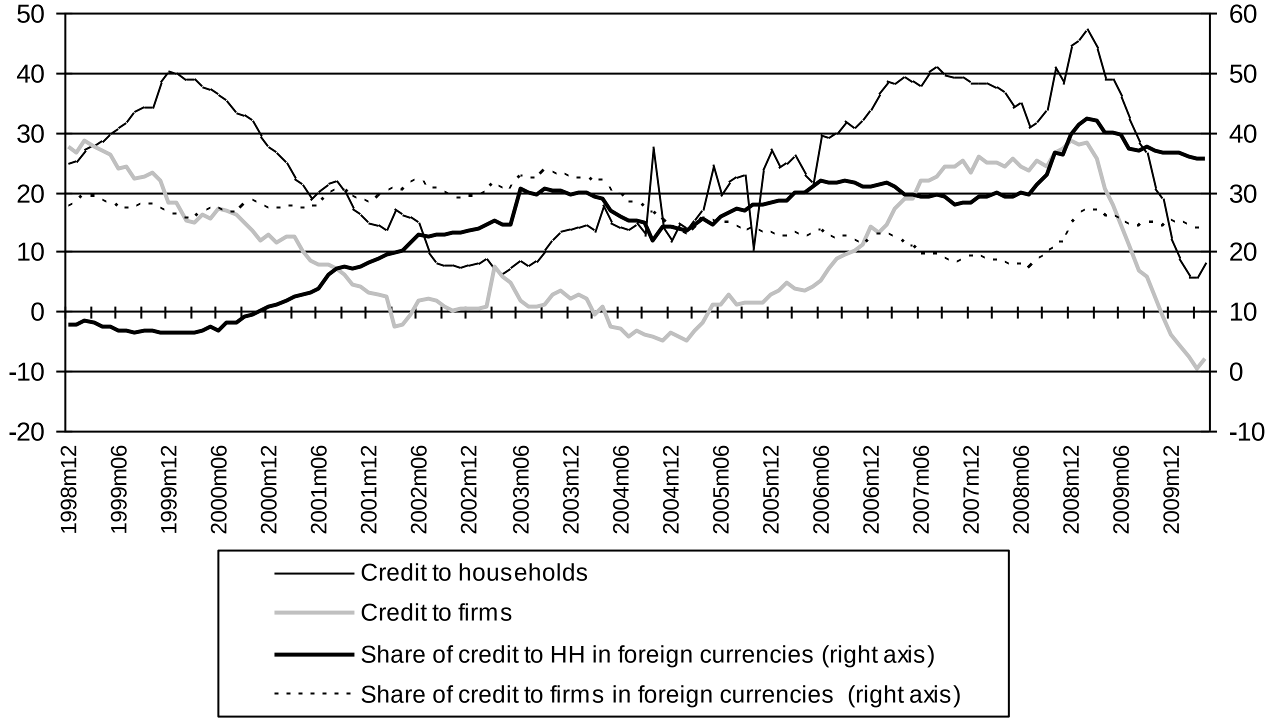
Source: Eurostat and the National Bank of Poland

Figure 5. Annual growth of M3 and credit to economy in Poland as well as official lending rate of the National Bank of Poland and the European Central Bank (in % per annum)



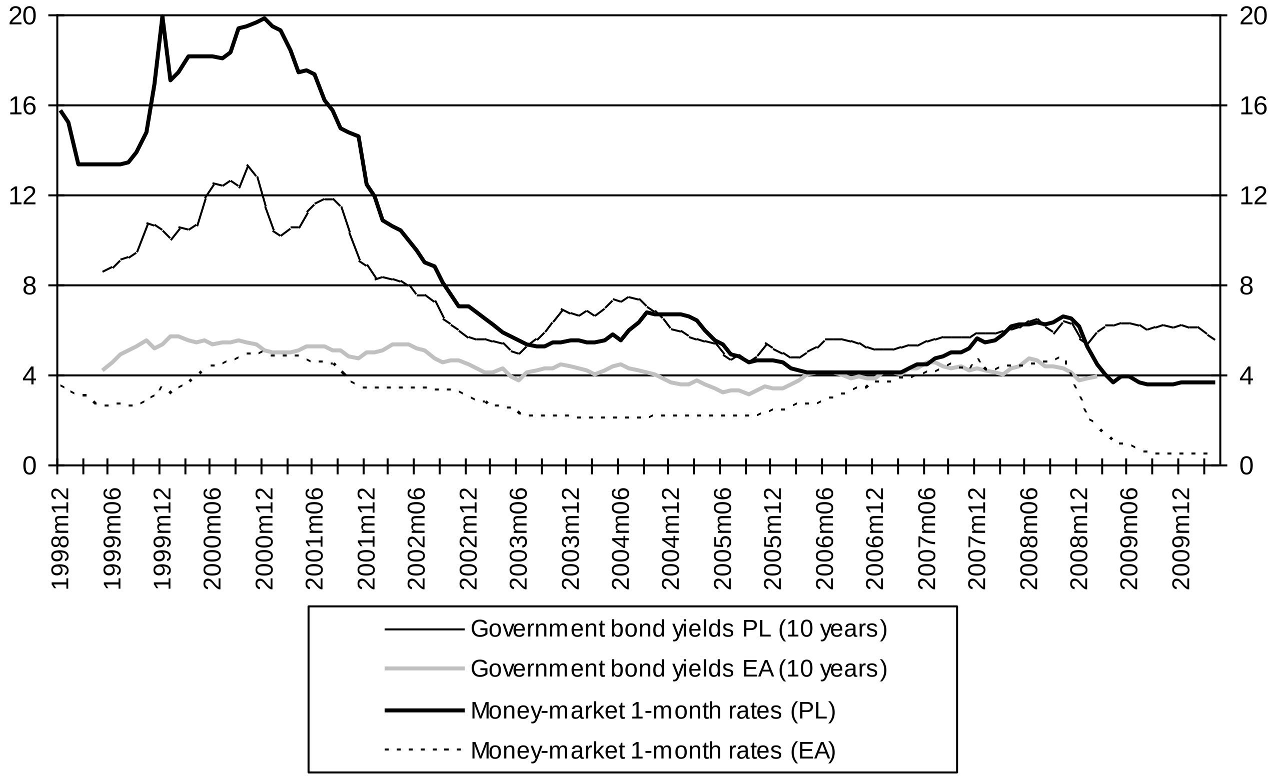
Source: Eurostat

Figure 6. Annual growth of credit to households and firms (in %, left axis) as well as shares of credit in foreign currency in total credit (in %, right axis)



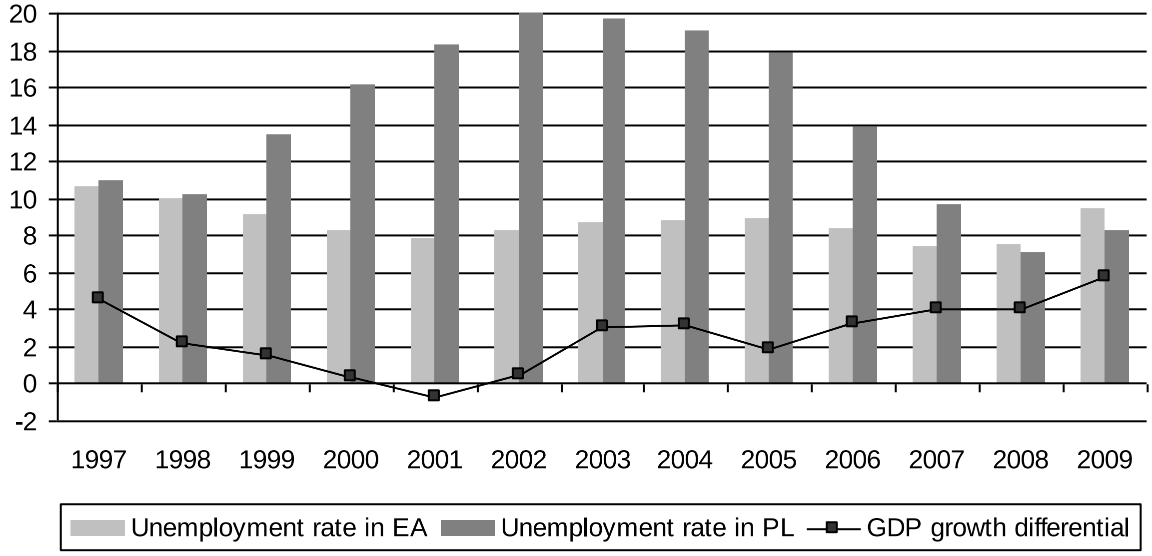
Source: Eurostat, National Bank of Poland

Figure 7. Government 10-year bond yields and money-market 1-months rate in Poland and EA



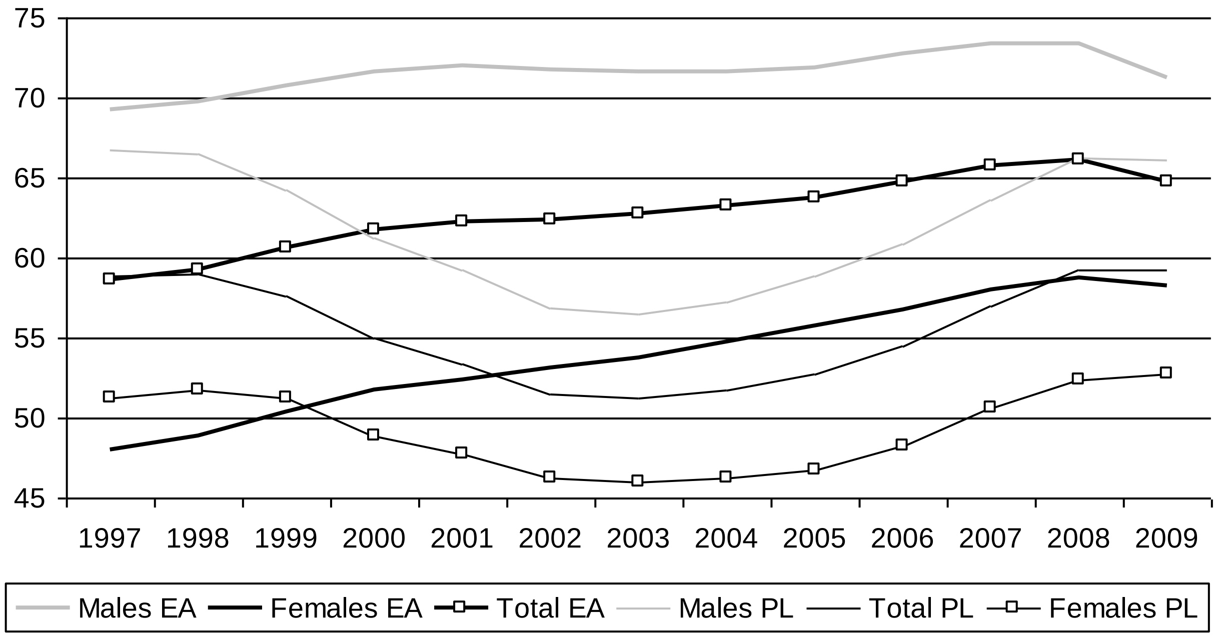
Source: Eurostat

Figure 8. Unemployment rates in Poland and EA and real GDP growth differential between Poland and EA (in %)



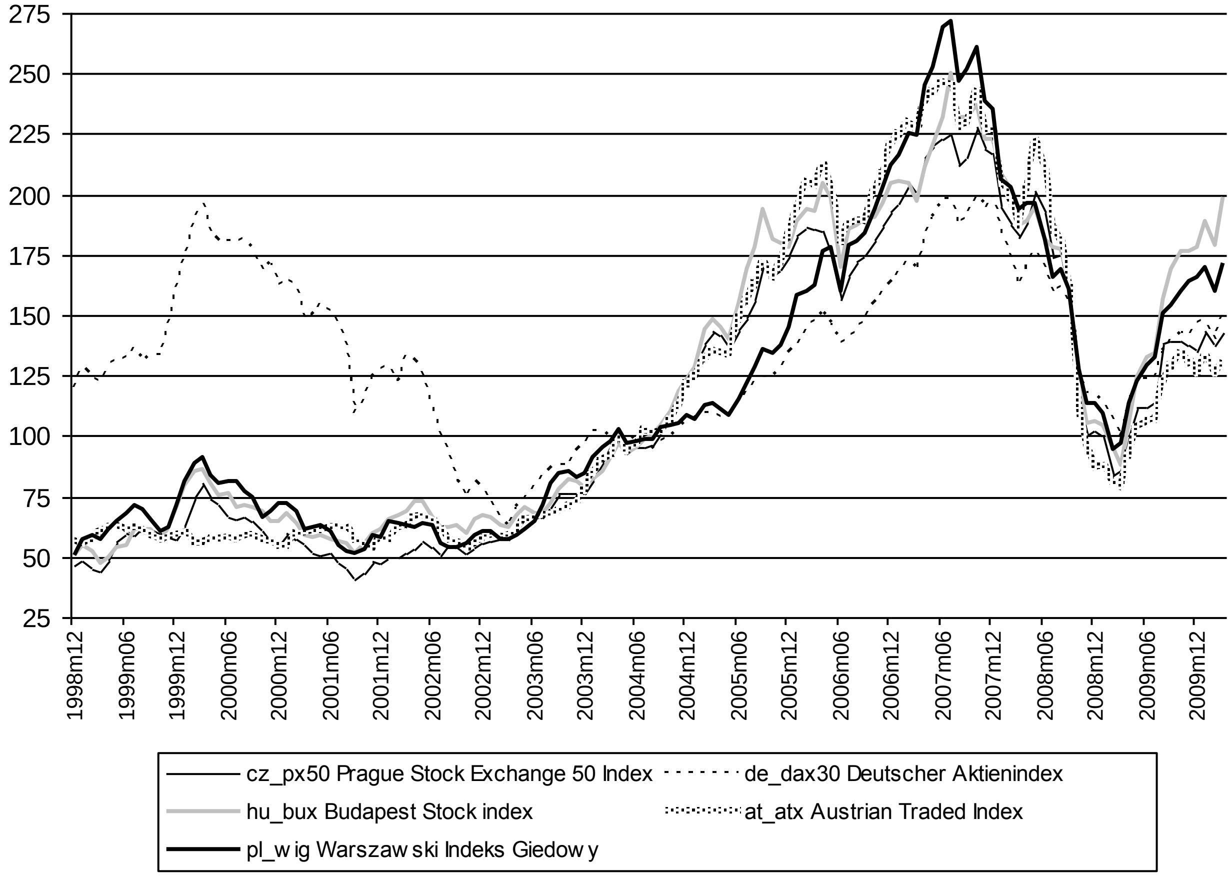
Source: Eurostat

Figure 9. Employment rate (15-64 years) in Poland and EA



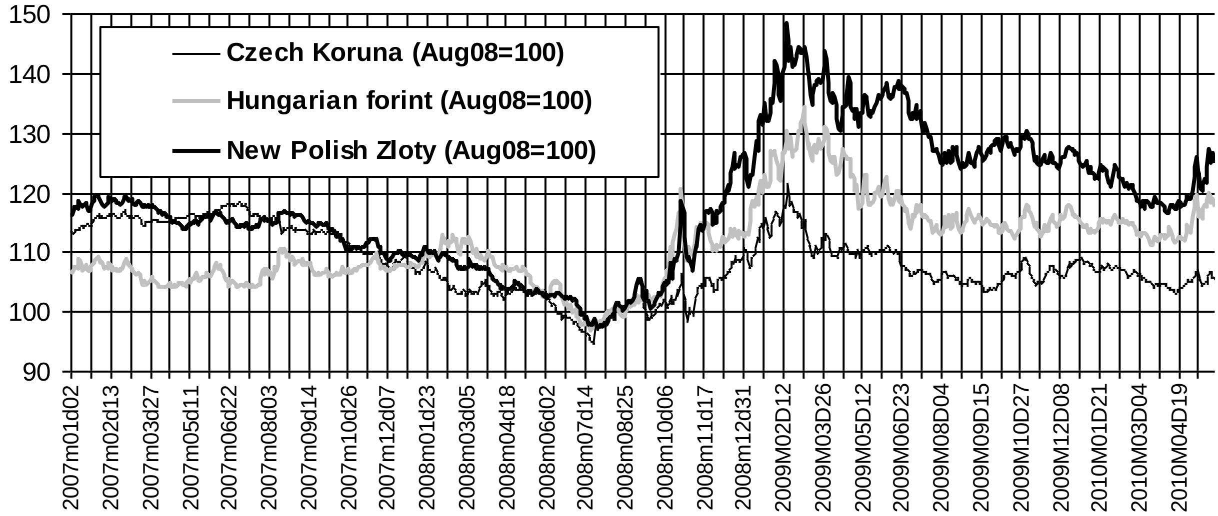
Source: Eurostat

Figure 10. Main stock exchange indices in Poland, Germany, Austria, Czech Republic and Hungary (December 1998 – March 2010, 2004=100)



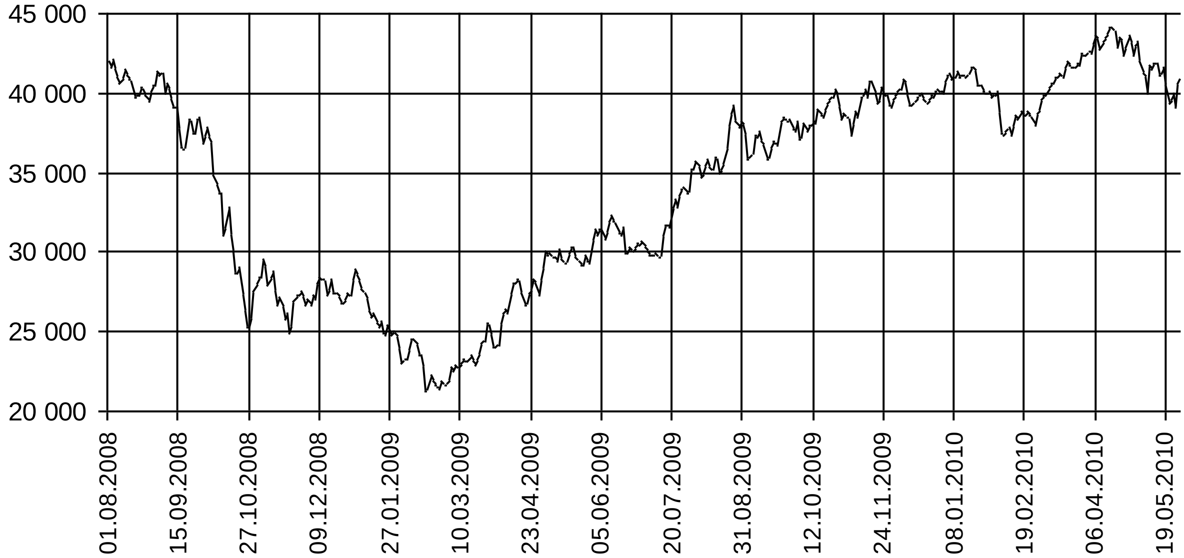
Source: Eurostat

Figure 11. Indices of daily nominal exchange rates vis-à-vis EUR (1.09.2008-31.03.2009)



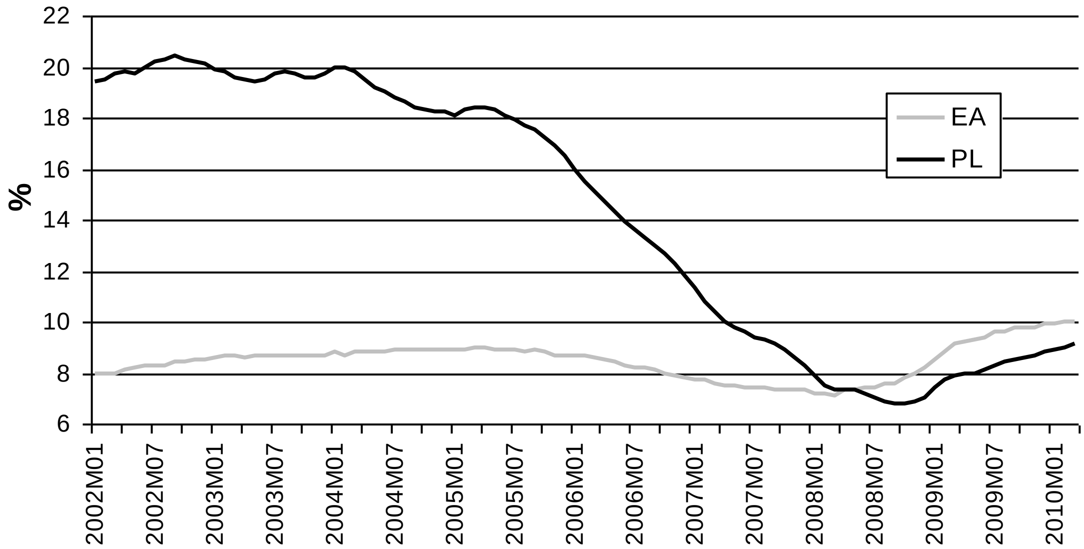
Source: Eurostat
Note: rise=depreciation

Figure 12. Daily value of the Warsaw Stock Exchange Index – WIG (1.09.2008-27.05.2010)



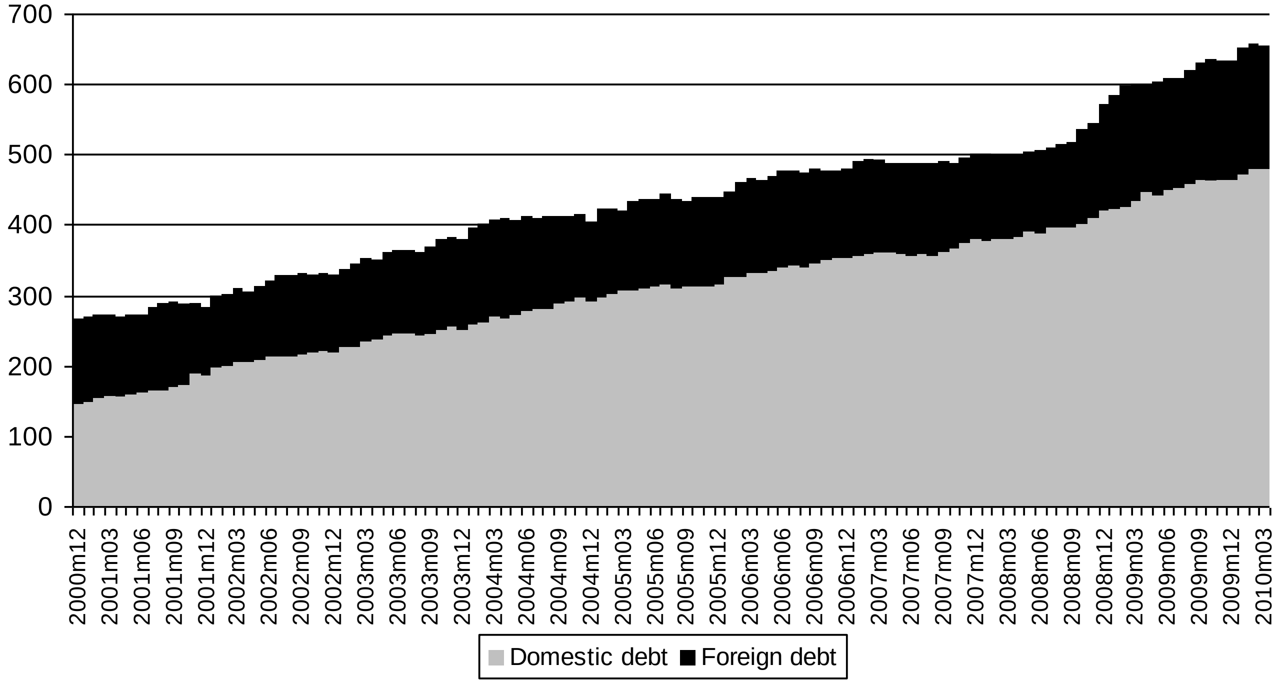
Source: Warsaw Stock Exchange

Figure 13. Seasonally adjusted monthly unemployment rates in Poland and EA



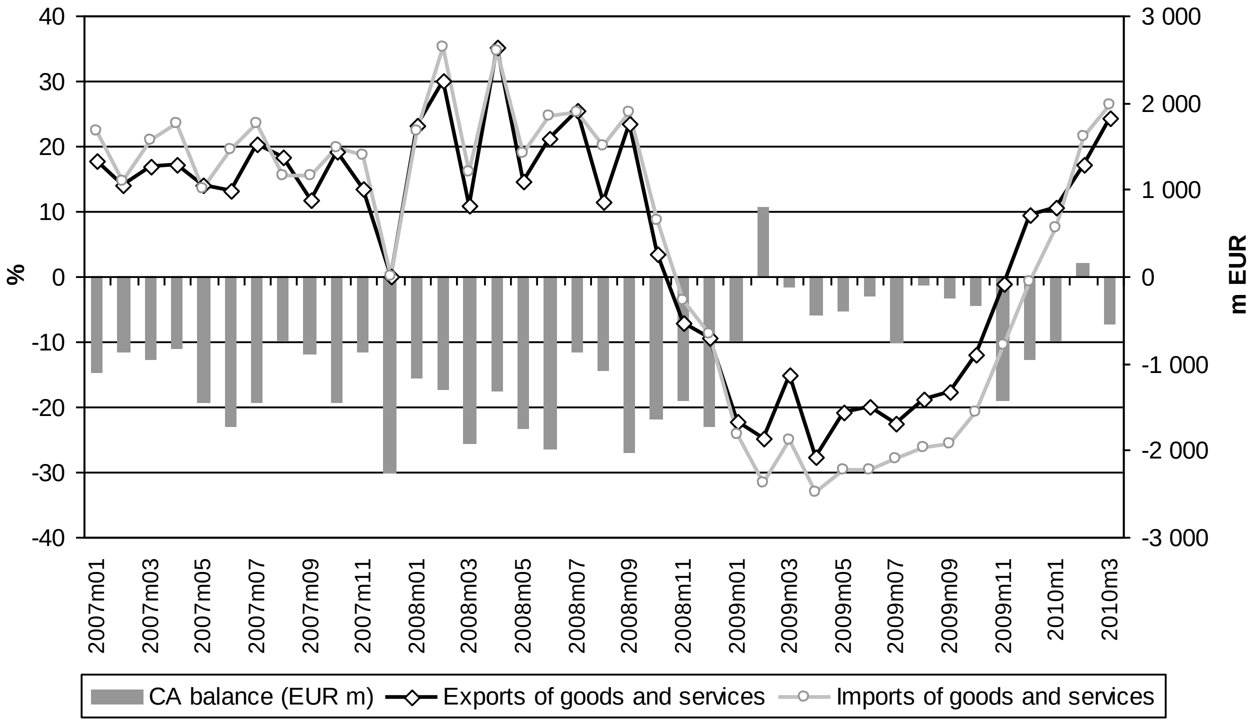
Source: Eurostat

Figure 14. Monthly levels of state treasure debt (PLN bn)



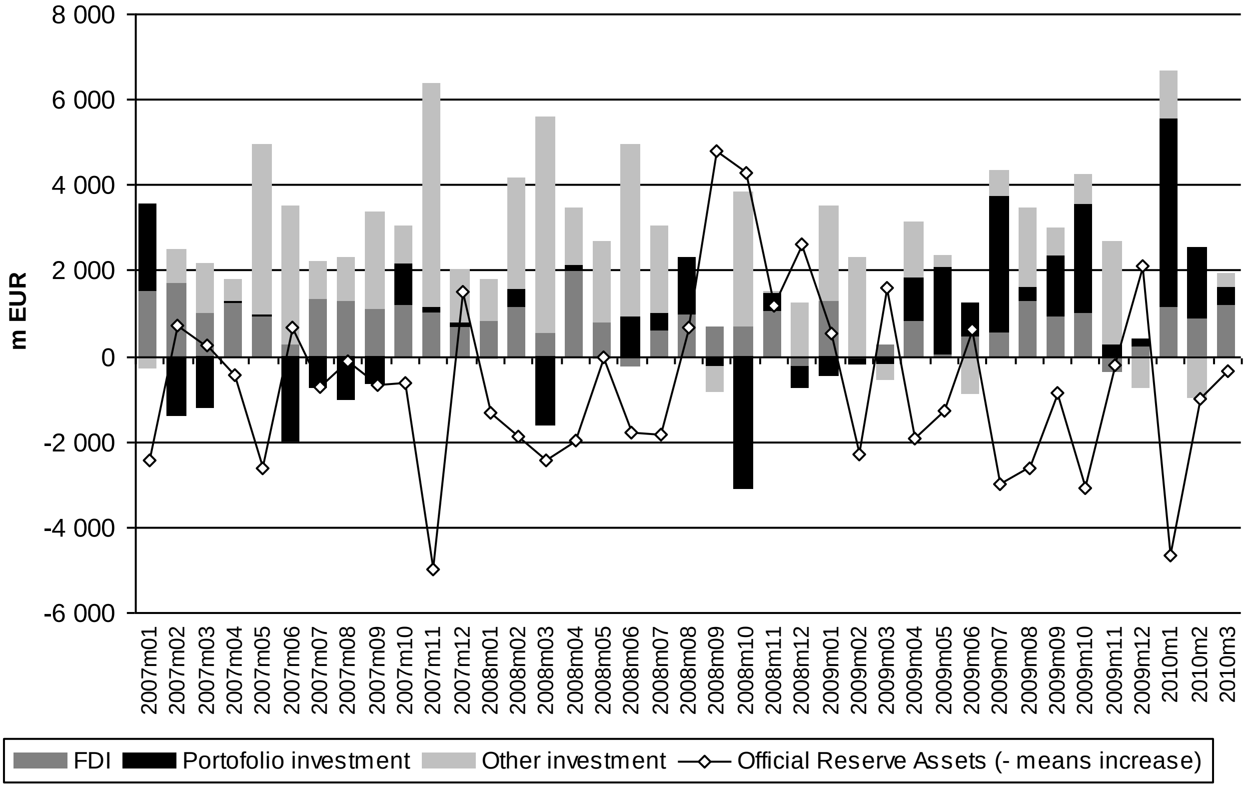
Source: Ministry of Finance of Poland

Figure 15. Monthly current account flows: CA deficit in mn EUR (right axis) and year on year growth rates of exports and imports of goods and services



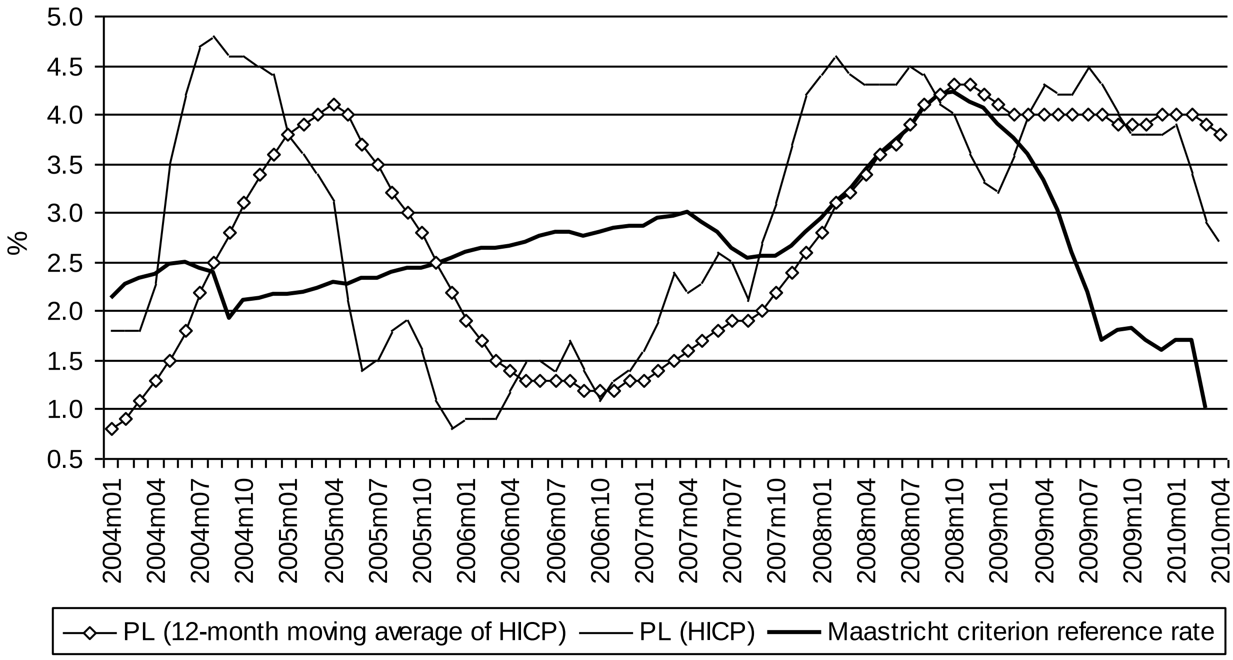
Source: National Bank of Poland

Figure 16. Monthly Balance of Payments flows (in mn EUR)



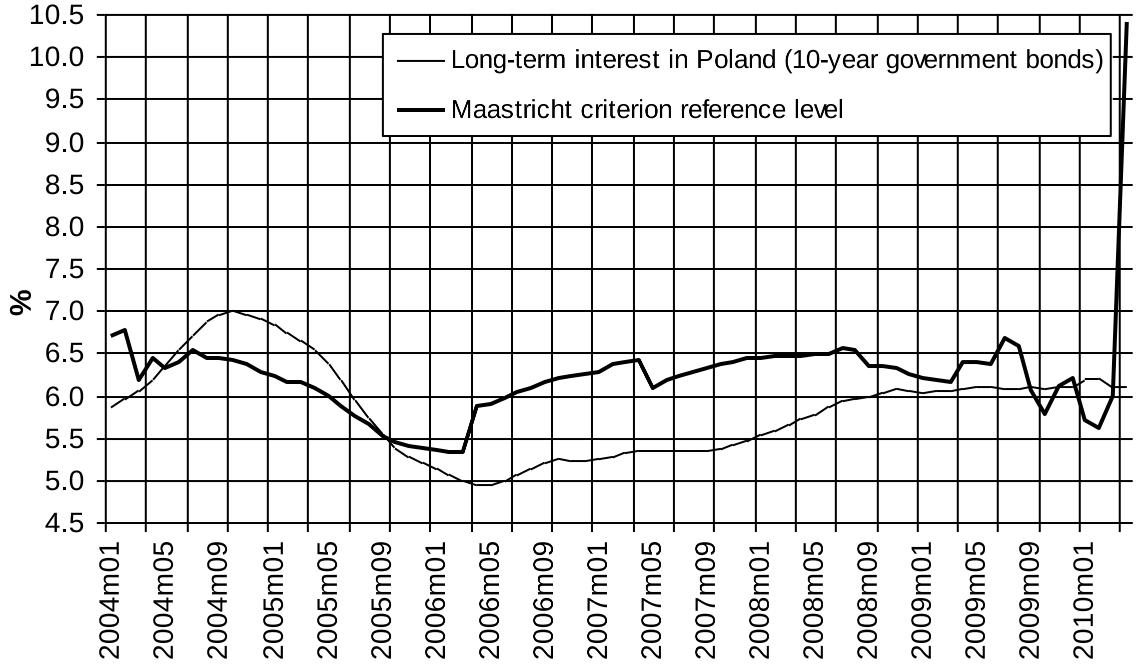
Source: National Bank of Poland

Figure 17. Annual inflation in Poland – actual monthly and 12-month moving average as well as the reference value of the Maastricht criterion



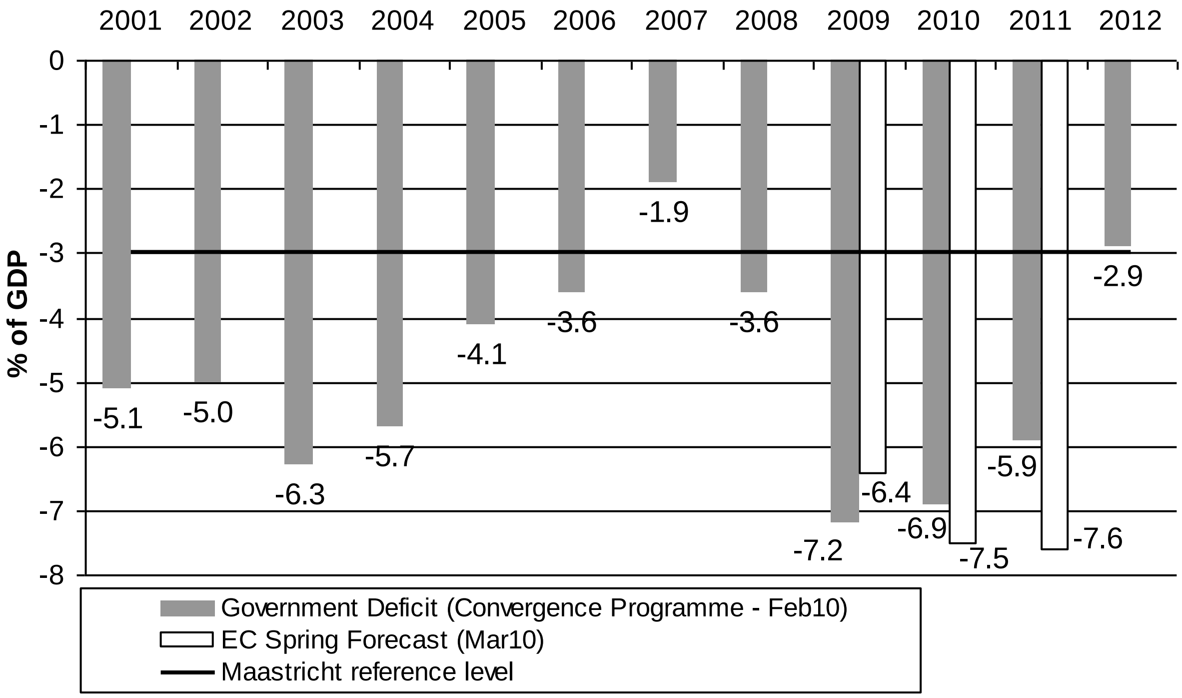
Source: Eurostat and own calculations

Figure 18. Monthly interest rates of the 10-year Polish Government bonds and the reference level of the Maastricht criterion



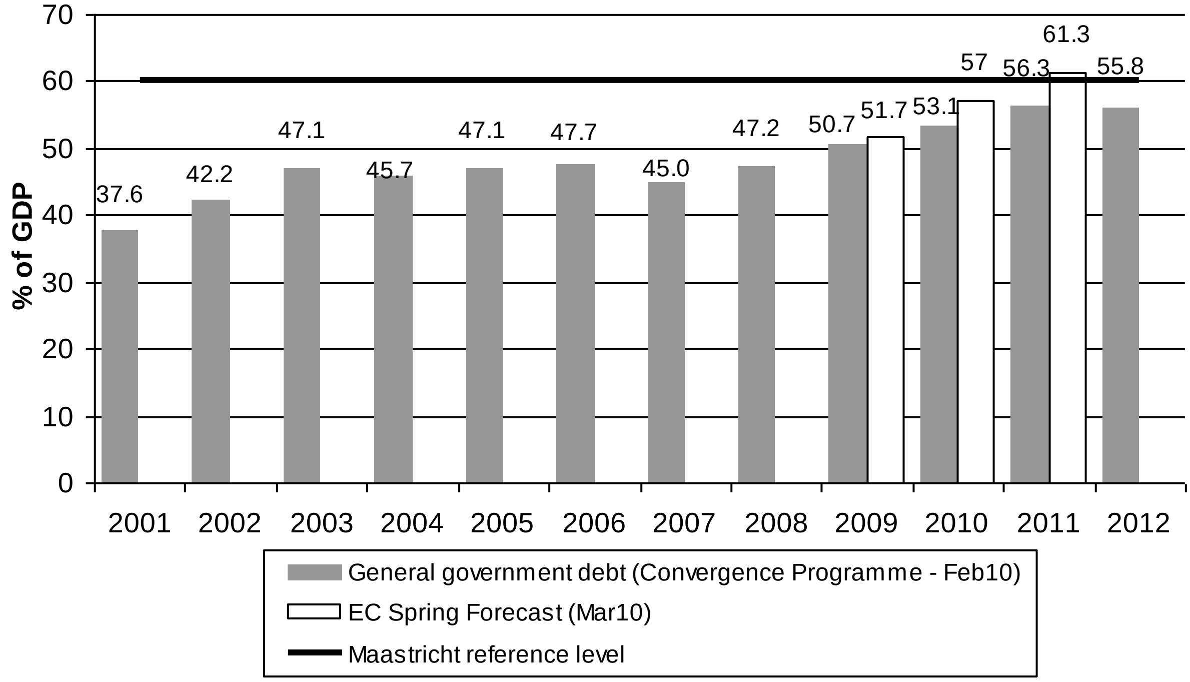
Source: Eurostat and own calculations

Figure 19. Fiscal deficit as % of GDP



Source: Eurostat and the Ministry of Finance

Figure 20. Public debt as % of GDP



Source: Eurostat and the Ministry of Finance