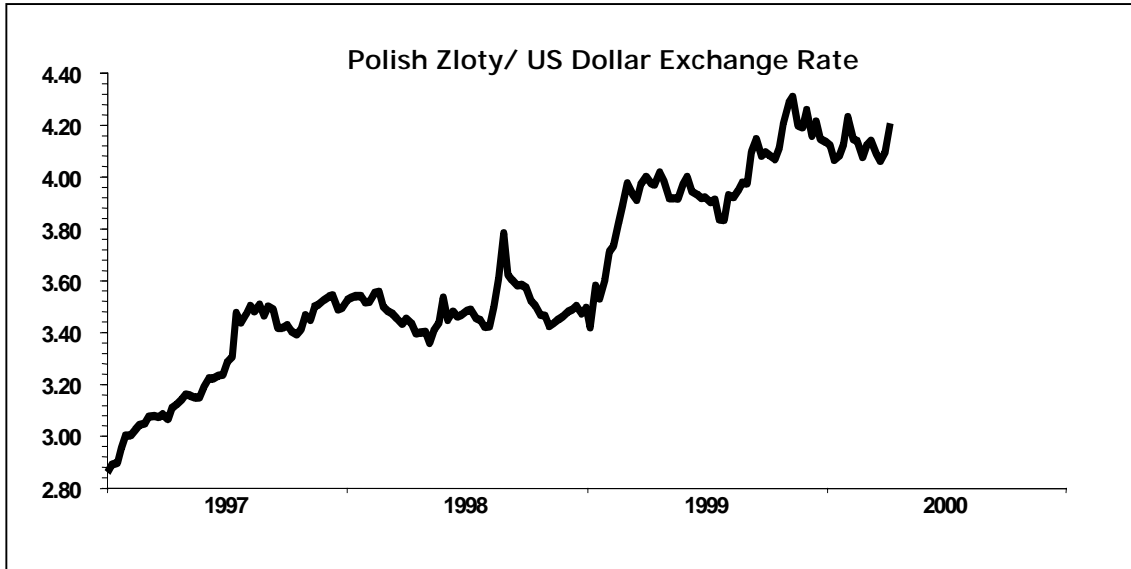


Poland Moves to Free Floating Currency



The National Bank of Poland announced on 11 April that it is removing the remaining restrictions on zloty trading, allowing it to float freely on foreign exchange markets. Under the previous system the currency was depreciated by 0.3% a month against a basket made up of the euro and the dollar. It then traded in a +/-15% band either side of a central parity rate set on a daily basis by the central bank. The free float will remain in place until Poland's planned entry to ERM2 (new trading range against the euro for prospective members) in preparation for joining EMU. However, this is sometime away. Poland hopes to become an EU member as soon as 2003, although some diplomats feel that 2005 is a more likely entry date. In the past, the NBA has said that it would like to switch to the euro some three years after Poland joins EMU. Two years membership of ERM2 is necessary before joining the euro.

The timing of the move came as a surprise particularly as the current account deficit remains high. However, given that the NBP's monetary policy council has been looking for approval from the government since the middle of last year a change in policy sometime this year had been discounted by the markets.

Initial market reaction to the announcement saw the zloty move higher against the dollar but then fall back as traders took profits. It is early days yet and trade is likely to be cautious. Overall however, the move, a necessary step in the plans to integrate with mainland Europe, should support inward investment and generally underpin demand for the zloty. The general strength in the currency should also help the central bank in its fight to bring inflation down to its end-year target of 5.6-6.8%. The current annual rate of inflation is 10.4%.

However, with no central parity rate as a reference volatility could increase as markets search for a suitable level. Currency risk will also intensify as traders start to observe more closely domestic fundamentals, in particular the current account deficit. Already at worrying levels, this poses the biggest threat to the zloty. Any further widening in the trade gap could undermine market confidence, resulting in some downward pressure on the currency.

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