REPORT

MONETARY POLICY INSTRUMENTS OF THE NATIONAL BANK OF POLAND, 2005

BANKING SECTOR LIQUIDITY

Warsaw, 2006

Summary

Pursuant to Article 227 para. 1 of the Constitution of the Republic of Poland, the National Bank of Poland shall be responsible for the value of Polish currency. Article 3 of the Act on the National Bank of Poland of 29 August 1997 stipulates that the basic objective of NBP shall be to maintain price stability, and it shall at the same time act in support of the Government economic policies, insofar as this does not constrain the pursuit of the basic objective of the NBP. The basic responsibilities of the NBP are stipulated in the Act on the National Bank of Poland and in the Banking Law Act.

The following documents served as the basis for the NBP activity in 2005: *Monetary Policy Strategy beyond 2003, Monetary Policy Guidelines for the Year 2005* and *National Bank of Poland: Plan of Activity 2004–2006*.

The National Bank of Poland shaped the inflation level with short-term interest rates. By determining the basic NBP interest rates, the Monetary Policy Council determines the yields of monetary policy instruments. The basic NBP rate is the reference rate. This rate influenced the level of market rates with maturity comparable to that of basic open market operations. The NBP deposit and lombard rates determined the fluctuation band of overnight (O/N) interest rates in the interbank market. The band was symmetric against the reference rate and amounted to +/- 1.5 percentage points.

In 2005, the Monetary Policy Council reduced the basic interest rates on five occasions. Throughout the year, each basic interest rate was reduced by 2 percentage points. As at the end of December 2005, the reference rate stood at 4.5%, the lombard rate — at 6.0%, and the deposit rate — at 3.0%.

Open market operations were the basic instruments used by the NBP for the purposes of the banking sector liquidity management. Within the framework of open market operations, the NBP conducted regular, weekly issues of the NBP bills. The minimum yield on the NBP bills was determined by the NBP reference rate.

In order to facilitate liquidity management by commercial banks, and in relation to activities undertaken to adjust the operating system of the NBP monetary policy to the requirements of the Eurosystem, the NBP reduced the maturity of the NBP bills from 14 to 7 days in 2005. Basic open market operations were conducted with a group of 13 banks that performed the function of money market dealers, and with the Bank Guarantee Fund.

No fine-tuning or structural operations were conducted by the National Bank of Poland throughout 2005.

In the case of short-term deficit or surplus of the liquidity, commercial banks used standing facilities, i.e. the marginal lending facility and the deposit facility. Surplus of the liquidity at the end of the operating day was placed by commercial banks as overnight deposits. Short-term deficits in liquidity were compensated with marginal lending facility; the interest rate on the marginal lending facility constituted the maximum cost of raising overnight funds in the market.

The required reserve was used by the National Bank of Poland to smooth the short-term interest rates volatility. Banks maintained their required reserves with the NBP on the current accounts or on the

required reserve accounts. The interest rate on required reserves stood at 0% for the funds raised through sales of securities under repurchase agreements, and at 3.5% for other liabilities.

The NBP activities within the monetary policy operational framework in 2005 facilitated the maintenance of short-term money market interest rates at a level coherent with the inflation target set by the Monetary Policy Council. Fluctuations of the shortest-term market interest rates resulted from the unexpected changes in liquidity conditions and by the sustained expectations of interest rate reductions in the interbank market. The average absolute deviation of the market rate with a maturity of one week (WIBOR SW) from the NBP reference rate in 2005 amounted to 9 basis points. In the previous year the deviation equalled 16 basis points.

The average annual surplus of the liquidity of the banking sector, as measured with the scale of the NBP bills issues, was by 11,424 mln zloty higher (i.e. by 216%) as compared to the average surplus of the liquidity in 2004. The average annual absorption of funds from the banking sector in 2005 amounted to 21,707 mln zloty in total (16,699 mln zloty — the average level of the NBP bills, and 5,008 mln zloty — the average level of term deposits of the Ministry of Finance (MF) at the NBP) and was by 4,240 mln zloty higher, i.e. by 24.3%, as compared to 2004.

Liquidity conditions in the money market were shaped in particular months of 2005 by changes in autonomous factors (remaining beyond the direct control of the central bank). The increase in surplus of the liquidity of the banking sector resulted mainly from the net purchase of foreign currencies by the NBP. The purchase was primarily caused by using the EU funds in the Polish zloty, transferred from the auxiliary account of the European Commission (maintained in euro) held with the NBP to fund accounts, and further exchanged into zloty with the central bank. The amount of 3,942 mln euro was withdrawn from the European Commission account in 2005 out of which 3,341 mln euro was used in the Polish zloty, and increased the market liquidity. Other important factors that caused the surplus of the liquidity included a decrease in zloty deposits of the public sector maintained with the central bank by 6,609 mln zloty, and payment of the NBP profit to the central budget of 4,168 mln zloty.
This was offset by an increase in currency in circulation (by 3,864 mln zloty), a raised level of banks' reserve requirements (by 945 mln zloty), and repayment of the refinancing loan (of 343 mln zloty).

The monetary policy operational framework applied by the National Bank of Poland in 2005 was largely coherent with the framework of the Eurosystem. This was a consequence of the adjustment process conducted by the NBP for many years. The main difference between the two systems is the direction of the open market operations. The European Central Bank uses the open market operations to provide liquidity to the banking sector, whilst the NBP absorbs the surplus of the liquidity from the market. There are also some differences in the required reserve systems and in the collateral management framework of the monetary policy operations.

Upon Poland's accession to the Economic and Monetary Union, the NBP will be obliged to fully adjust its monetary policy operational framework to the Eurosystem requirements.

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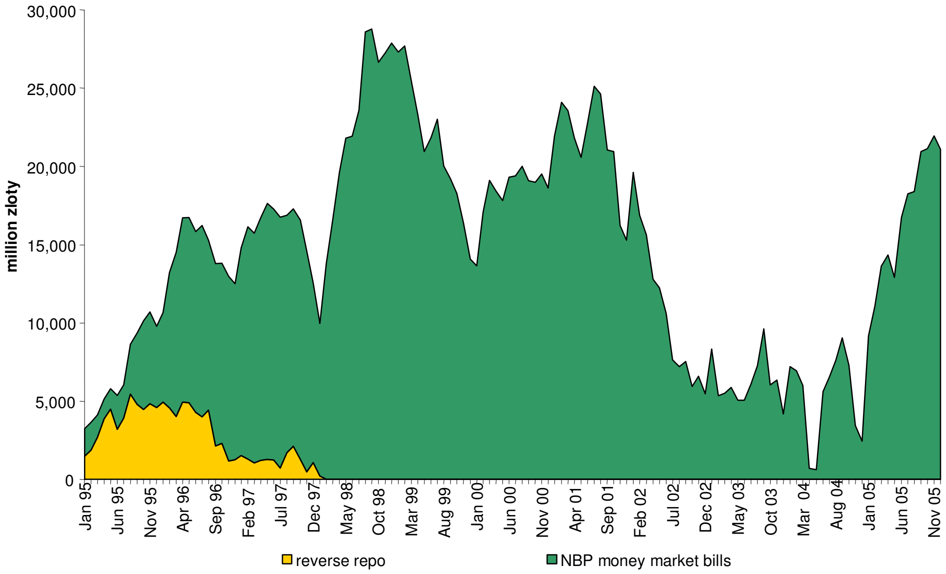
Sustained surplus of funds in the interbank market in the years 1995 – 2005 translated into the surplus of the liquidity the banking sector, as measured by the balance of the NBP bills issued and the reverse repo operations.

Figure 1. Average level of NBP bills and reverse repo operations, 1995-2005 in required reserves periods



Source: NBP

The years 1995-1998 brought a rapid increase in the surplus of the liquidity, caused by increased foreign exchange reserves (as a result of currency interventions of the central bank and purchase of foreign currencies by the NBP). The largest scale of the surplus of the liquidity was observed in 1998. In December 1998, the average level of the NBP bills stood at 27,886 mln zloty.

As of 1999, the surplus of the liquidity was reduced significantly by a gradual elimination of its sources. In the period between September 2000 and April 2003, the central bank was conducting an outright operation aimed at a sustained reduction of the surplus of the liquidity in the market. The operation consisted in the sale of the exchanged Treasury bonds to banks. The outright operation resulted in a sustained reduction in surplus of the liquidity of the banking sector by a total amount of over 14,000 mln zloty.

2004 brought a gradual increase in the level of the Ministry of Finance deposits with the NBP, which contributed to a decrease in the issue of the NBP bills. As a result, in the December 2004 reserve requirement period, the average level of the NBP bills amounted to 2,261 mln zloty, whilst the average level of deposits of the Ministry of Finance totalled 11,037 mln zloty.

I.1 Liquidity developments in 2005

Unlike in the preceding year, the surplus of the liquidity of the banking sector grew steadily in 2005. Its average annual level was 16,699 mln zloty, and was higher by 11,424 mln zloty (i.e. by 216%) as compared to 2004. It was influenced by the changes in autonomous factors that were independent of the central bank.

The first months of the year brought a dynamic growth in the scale of the banking sector liquidity: until April 2005 (i.e. in the reserve requirement period) the average level of the NBP bills in circulation increased by 12,077 mln zloty. It was related to a decrease in the average level of MF deposits with the central bank by 7,536 mln zloty within 4 months, and the purchase of foreign currencies by the NBP that was higher than their sales. In December 2004 a framework agreement was entered into by and between the Ministry of Finance and the National Bank of Poland, which specified limits for the MF term deposits with the NBP.

The NBP profit was paid to the central budget in mid-2005. These funds were gradually used to cover budget expenses, which further increased the balance of the NBP bills (the average level in July was 18,247 mln zloty).

The Surplus of the liquidity of the banking sector increased in the subsequent months, and was caused by the purchase of foreign currencies (coming from the pre-accession and post-accession EU funds) by the NBP. Throughout 2005 (December 2005 exclusive), the European Commission exchanged the Polish membership fee paid to EU budget outside the National Bank of Poland, which increased the liquidity of the banking sector. Only in December 2005, a part of the fee equivalent to 180 mln euro (694.88 mln zloty) was exchanged with the NBP.

The list below presents the factors that determined the banking sector liquidity in 2005. The flows pertain to changes in average balances in 2005 as compared to 2004 (annual average)

Factors increasing liquidity (in million zloty):

• *net purchase of foreign currencies by the NBP*	*7,479*
• *decrease of central budget deposits with the NBP*	*6,609*
• *other items, net*[1]	*1,862*
• *NBP withdrawals*[2]	*565*
• *deposit facility*	*154*
• *marginal lending facility usage*	*6*
Total:	***16,675***

[1] Other net items include changes in: the interest expense on term deposits and foreign currency current accounts of the public sector, the balance of funds on the Social Insurance Institution (*Zakład Ubezpieczeń Społecznych — ZUS*) accounts, the social insurance funds' accounts, and the balance of funds on the European Commission zloty account.

[2] NBP withdrawals consist of: the NBP bills discount, payment of the NBP profit to the central budget, the interest on the reserve requirements and the NBP bonds. In 2005 these amounted to 874 mln zloty, 4,168 mln zloty, 593 mln zloty and 479 mln zloty, respectively, which, in line with the method of presentation adopted in the above list, gives the average annual amount of 565 mln zloty.

Factors decreasing liquidity (in million zloty):

• *currency in circulation increase*	*3,864*
• *banks reserve requirements level increase*	*945*
• *refinancing loan repayment*	*343*
• *MF bonds denominated in USD redemption*	*99*
Total:	***5,251***

Surplus of the liquidity increased in 2005 primarily due to the NBP foreign exchange transactions stemming from the higher purchase of foreign currencies by the central bank in relation to the flow of the EU funds. In the period between January and December 2005 the balance of purchase and sales of foreign currencies by the NBP was 11,247 mln zloty on the purchase side, and its annual average was by 7,479 mln zloty higher as compared with 2004. Another important factor that contributed to the upward trend in liquidity in 2005 was a decrease (by 6,609 mln zloty) in zloty deposits of the public sector on the current accounts and term accounts with the NBP.

The main factor that mitigated liquidity in that period was the increase in currency in circulation (by 3,864 mln zloty).

The total absorption of funds from the banking sector, as measured with the scale of NBP bills issues and the level of the MF term deposits with the NBP, amounted to on the average basis, 21,707 mln zloty in 2005, and was by 4,240 mln zloty higher, i.e. by 24.3%, as compared with 2004. The average level of the NBP bills was 16,699 mln zloty, whereas the average level of the MF term deposits with the NBP amounted to 5,008 mln zloty.

I.2 Impact of autonomous factors on banking sector liquidity in 2005

I.2.1 Purchase and sale of foreign currencies by the NBP

The net balance of purchase/sale of foreign currencies by the NBP as on 31 December, 2005 amounted to 2,847 mln euro (11,581 mln zloty) on the purchase side, which increased the liquidity of the banking sector.

Sales of foreign currencies by the NBP resulted from:

- the repayment of the State Treasury foreign liabilities amounting to 841 mln euro (including the repayment of liabilities towards the Paris Club creditors of 209 mln euro and of interest on bonds issued to foreign markets of 468 mln euro),
- the return of funds used in 2004 from the structural fund accounts by the Ministry of Finance in order to improve the central budget liquidity, in the amount of 358 mln euro,
- the services to the central budget units which accounts are maintained with the NBP, in the amount of 323 mln euro,
- the currency exchange for a part of the membership fee paid to the EC account, in the amount of 180 mln euro.

Purchase of foreign currencies by the NBP was related to:

- the use of EU funds within the framework of pre- and post-accession assistance funds — 3,341 mln euro,
- the exchange for zloty of a part of funds from the issue of bonds to foreign markets — 830 mln euro,
- the exchange of funds from credits extended by the international financial institutions , and the repayment of loans granted to governments of other countries — 378 mln euro.

Foreign currency operations conducted by the central bank within the framework of purchase and sale of foreign currencies in 2005:

Transactions related to the membership in the European Union

Most foreign exchange transactions conducted by the central bank were related to servicing transactions of the purchase of foreign currencies, related to the use of pre- and post-accession EU funds in the Polish zloty, transferred by the European Commission in euro (amounting to 3,341 mln euro). The scale of sales of foreign currencies to the European Commission, related to the exchange for a part of the Polish membership fee paid to the EU in zloty in the central bank, amounted to 180 mln euro.

As a result of these operations, the NBP purchased foreign currencies amounting to a net value of 3,161 mln euro, which affected the increase in the banking sector liquidity by 12,576 mln zloty.

Foreign operations of the State Treasury

Foreign operations of the State Treasury, consisting in the purchase and sale of foreign currencies by the NBP, influenced the banking sector liquidity. Foreign exchange transactions in 2005 were conducted pursuant to Annex to the agreement entered into by and between the Ministry of Finance and the NBP in December 2004.

Box 1. Agreement on purchase and sale of foreign currencies

On 22 December 2004, the Ministry of Finance and the NBP signed Annex to the agreement on purchase and sale of foreign currencies for servicing foreign liabilities and receivables of the State Treasury and on the servicing principles of 12 January 2004. The Annex introduced limits on the value of foreign exchange transactions in 2005: the purchase of foreign currencies by the NBP up to 3,600 mln euro and the sales up to 3,750 mln euro, with the accumulated absolute difference between the sales amount and the purchase amount as at the end of the year not exceeding an equivalent of 1,000 mln euro.

In 2005, the agreement was executed in 22.42% as regards the sale of foreign currencies by the NBP and in 33.22% as regards their purchase. The difference between the purchase and the sale amount stood at 367.3 mln euro.

Other funds for servicing the foreign debt came from the issue of bonds in foreign markets. The bonds issued by the Ministry of Finance in foreign markets in 2005 amounted to 9,142 mln euro. The majority of funds from the issue of bonds (6,909.94 mln euro, i.e. 75.59%) was transferred to the Ministry of Finance foreign currency account with the NBP. These funds were partially used for the advance repayment of the foreign debt of the State Treasury towards the Paris Club creditors. Moreover, they were used for the regular foreign debt repayments.

Other operations

Apart from the foreign exchange operations related to the foreign liabilities and receivables of the State Treasury and the transactions involving the EU funds, the central bank conducted foreign exchange operations with entities that were authorised under the bank account agreement to purchase-and sell foreign currencies by the central bank.

I.2.2 Central budget deposits held with the central bank.

The Central budget deposits held with the central bank include: the funds of the central budget units, the MF term deposits with the NBP, and the special fund resources.

The average level of the central budget deposits in 2005 amounted to 8,235 mln zloty, whilst in the previous year it stood at 14,844 mln zloty.

The Changes in the level of the central budget deposits resulted from the flows of funds between the banking sector and the central budget. They resulted primarily from:

- the agreement between the Ministry of Finance and the NBP, put into force, that introduced limits on the MF term deposits with the central bank,
- the volume of the central budget incomes and expenditures,
- the settlements for the Treasury Securities issues and repurchase,
- the payment date related to meeting the borrowings of the public sector,
- the funds flows of between Poland and the European Union,
- the use of the EU funds.

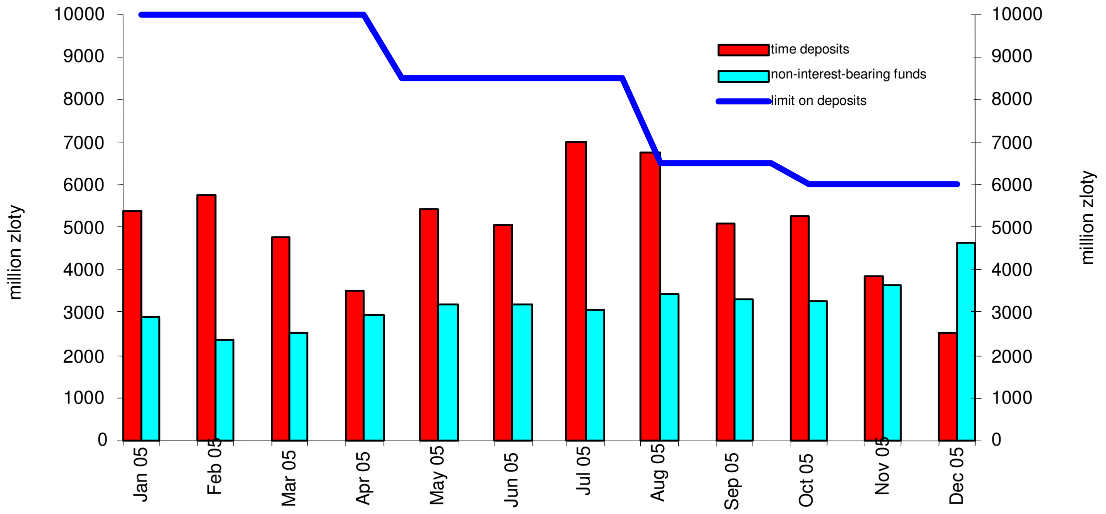
In 2005, the share of the MF zloty term deposits in the central budget deposits held with the NBP amounted to 61.1%, as compared to 82.1% in 2004.

Box 2. MF term deposits held with the NBP in 2005

Pursuant to Article 108 of the Public Finance Act, in 2005 the Minister of Finance was entitled to place the interest-bearing deposits of the Polish zloty surplus funds with the NBP.

Moreover, in justified cases, the Minister of Finance held the right to deposit funds with any bank. The detailed principles for depositing such funds with the NBP are specified in the framework agreement entered into by and between the Ministry of Finance and the NBP in 2003, as amended on 15 December 2004 to introduce daily limits on the balances of deposits with the NBP as of 1 January 2005.

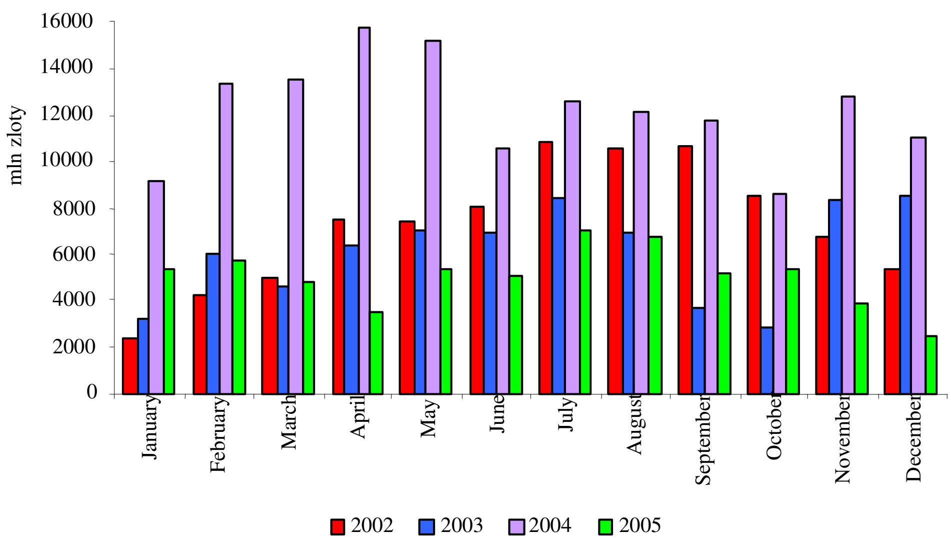
Figure 2. Average monthly level of zloty funds of the central budget held with the NBP and limits on MF term deposits



In 2005, the limit on MF term deposits with the NBP, as measured by daily balances, amounted to: 10 bn zloty in the period from 1 January to 11 April; 8.5 bn zloty in the period from 12 April to 11 August; 6.5 bn zloty in the period from 12 August to 11 October, and 6 bn zloty in the period from 12 October to 31 December.
Source: NBP.

In 2005, the Ministry of Finance held funds on the term deposit accounts with the NBP amounting to the monthly average of 5,008 mln zloty, i.e. less by over a half than in the previous year (12,192 mln zloty). Having reached a record level in 2004, the average level of term deposits in 2005 was similar to the values recorded in 2002-2003.

Figure 3. Average level of MF term deposits with the NBP in particular months of 2005

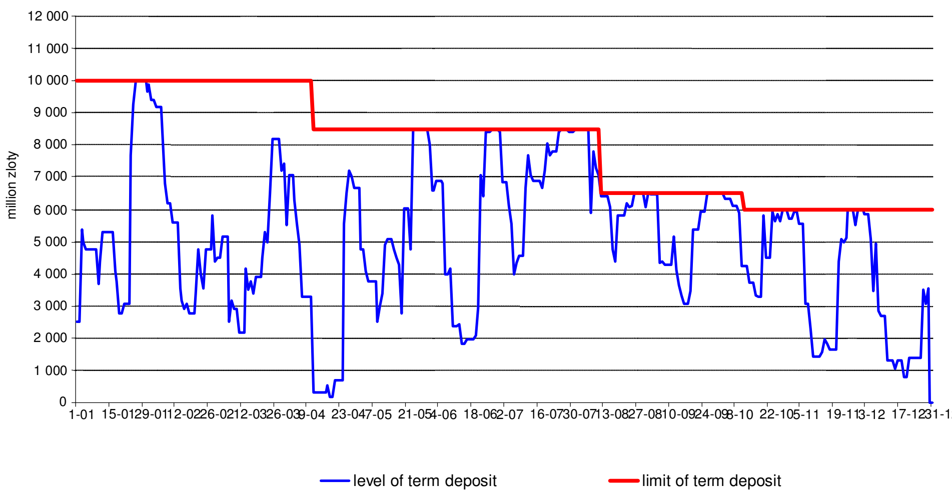


Source: NBP.

The lower level of the MF term deposits with the NBP in 2005 resulted primarily from the limits introduced under the framework agreement entered into by and between the Ministry of Finance and

the NBP in December 2004. The limit established in the agreement was gradually decreased from 10 billion Polish zloty at the beginning of 2005 to 6 billion Polish zloty at the end of the year. The introduction of limits on deposits decreased the share of the term deposits in the total central budget deposits, and reduced the fluctuations of the central budget deposits held with the NBP, what in turn was conductive to the stability of interest rates in the money market. In 2005, the maximum daily change in the level of the MF term deposits with the NBP amounted to 4,900 mln zloty, whereas it stood at 7,200 mln Polish zloty a year earlier.
Throughout 2005, the Ministry of Finance used the average of 64% of the established limit on the term deposits held with the NBP.

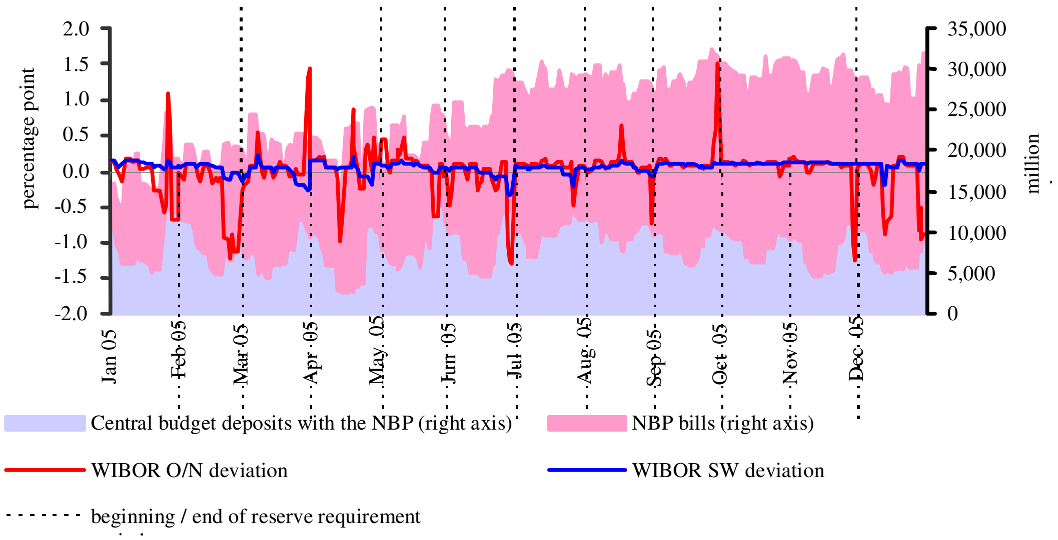
Figure 4. MF deposits limit with the NBP in 2005used



Source: NBP

In 2005, a part of the central budget surplus funds was deposited in the interbank market through Bank Gospodarstwa Krajowego. Conditional liquidity transactions of the buy-sell-back transactions were concluded with banks that performed the function of the Treasury securities dealers. Before 21 January 2005, transactions of this type were collateralised with the Treasury bills. As of 22 January, the Treasury bonds were also used for this purpose. Since July 2005 the Ministry of Finance deposited funds in the interbank market of the unsecured term deposits. The scale of the Polish zloty operations between the Ministry of Finance and commercial banks increased in the second half of 2005, which was additionally induced by the market sale of foreign currency by the Ministry of Finance.
The NBP prepares forecasts of the MF deposits on the basis of information provided by the Ministry of Finance during meetings of the Public Debt Management Committee (once a month), and within the framework of ongoing cooperation. In 2005, the actual balances of deposits were typically lower than the average levels planned for a given month.
The change in the strategy of the central budget liquid funds improved the predictability of the market liquidity fluctuations, which had a moderating effect on the short-term market rates.
The transfer of the central budget funds from the term deposits with the NBP into the interbank market increased the scale of the open market operations by the same amount. The decrease in the level of the central budget deposits with the NBP was the second most important factor, after the purchase of foreign currencies, affecting the increase in the surplus of the liquidity in 2005.

Figure 5. Balance of NBP bills and central budget funds held with the central bank vs. deviation of WIBOR rates from the NBP reference rate (cumulated values)



Source: NBP, Reuters.

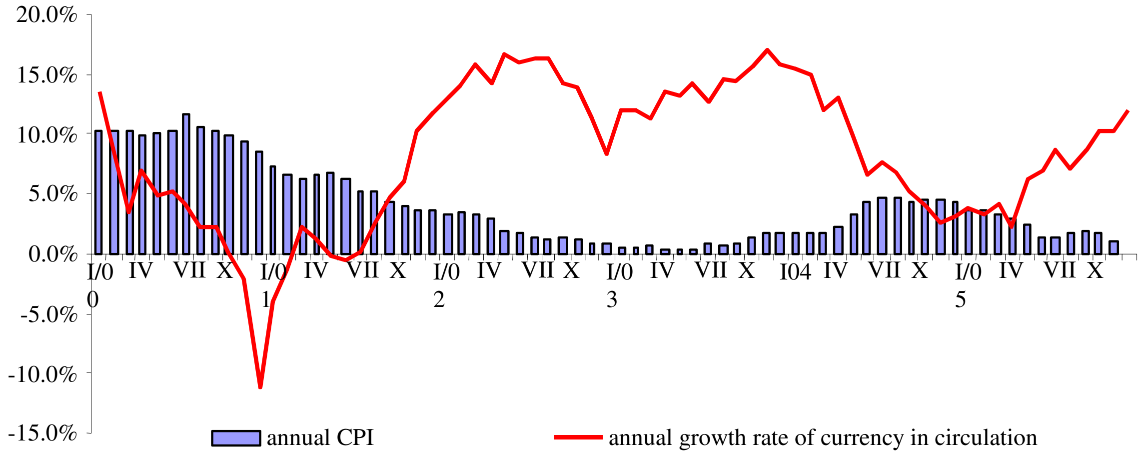
I.2.3 Currency in circulation

The volume of currency in circulation (including bank vaults) stood at 62,597 mln zloty as at the end of December 2005. The annual increase in 2005 amounted to 6,672 mln zloty, i.e. 11.9% (December 2005 on December 2004). For a comparison, in 2004 the level of currency in circulation increased by 1,748 mln zloty, i.e. by 3.2% in relation to 2003.

Currency in circulation, as calculated excluding bank vaults, stood at 57,154 mln zloty as on 31 December 2005. Its level increased by 6,379.1 mln zloty, i.e. by 12.6%, as compared to 2004.

At the same time, the share of currency in circulation in the total supply of currency was rather stable, and amounted to 13.9% in December 2005 (in 2004 — 13.7%).

Figure 6. Growth rate of currency in circulation against inflation in 2000-2005

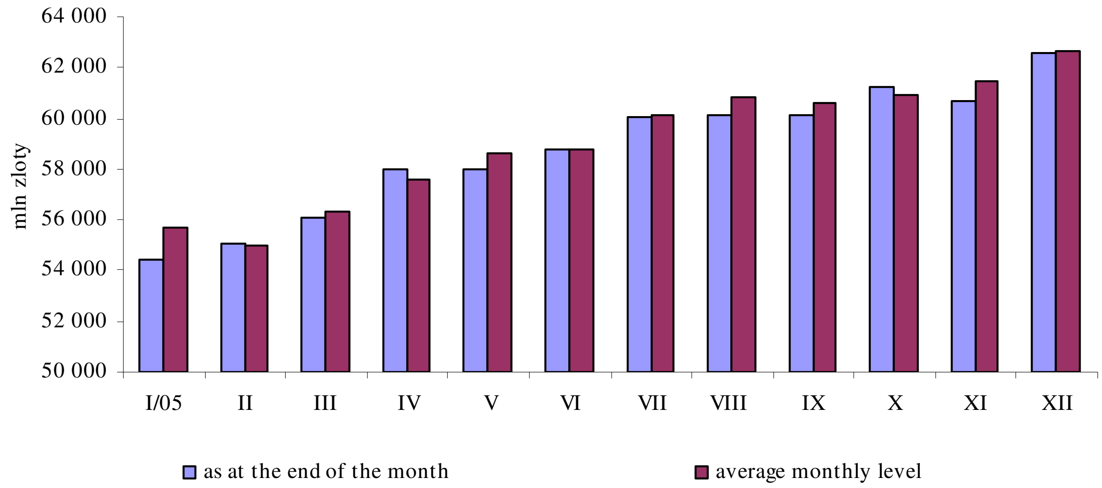


Source: NBP

In the consecutive months there was a steadily rise in the growth rate of currency in circulation . It was especially noticeable in the second half of the year. Insofar as in April 2005 the annual growth rate of currency in circulation stood at 2.4%, in December 2005 it amounted to 11.6%. The fluctuations in the growth of currency in circulation in 2005 resulted from a shift in the structure in the narrow money M1.[3] The fact that the increased growth in currency in circulation was accompanied by a relatively steady ratio of currency in circulation to broad money (M3) in the consecutive months of 2005 indicated that changes in this money aggregate did not stem directly from a decrease in the central bank interest rates. It also resulted from the increased income of households. Additionally, the transfer of wages earned by the Poles working in the EU Member States and the flow of the EU funds should be taken into account. In 2005, in line with a long-term seasonal trend, an increased growth rate of currency in circulation was observed before Christmas and Easter, and during holiday seasons.

[3] Source: NBP, Inflation Report — January 2006

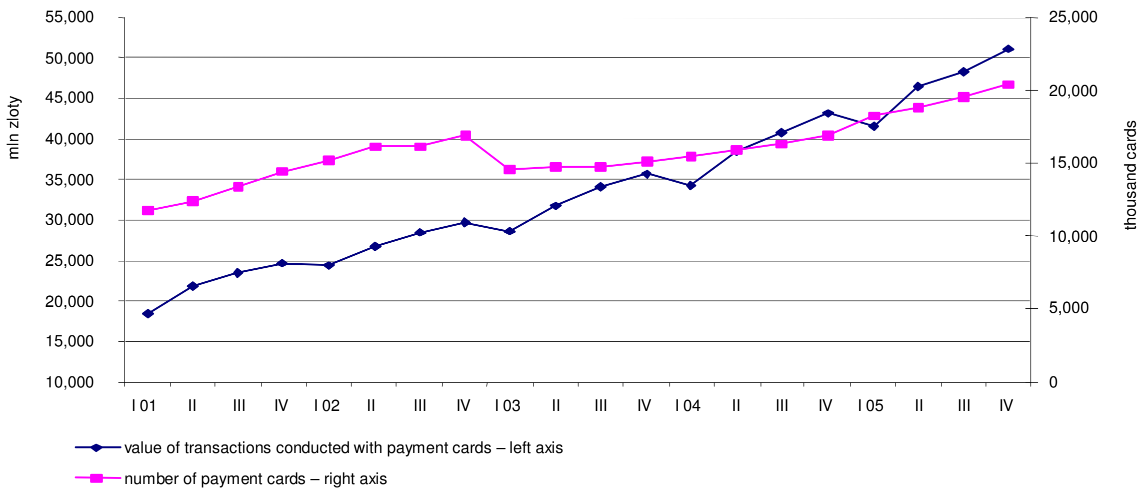
Figure7. Level of currency in circulation in 2005



Source: NBP

At the same time, the increased level of currency in circulation throughout 2005 was accompanied by the increased level of transactions with payment cards. The value of such transactions in 2005 grew by 7,901.6 m zloty as compared to the previous year.

Figure 8. Development of payment cards in 2000 – 2005



Source: NBP

Chapter II
Impact of monetary policy operating system on banking sector liquidity in 2005

II.1 Monetary policy instruments in 2005

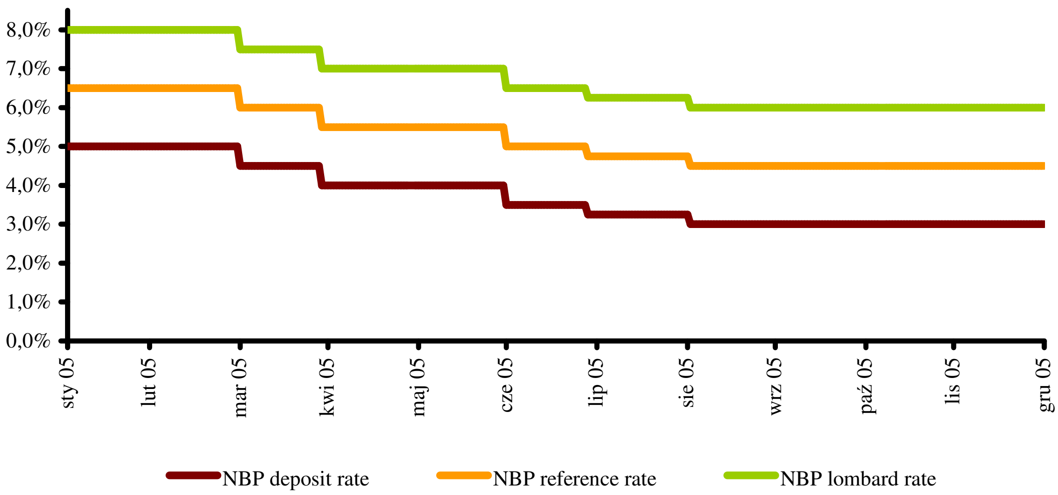
II.1.1 Interest rates

The primary instruments for *Monetary Policy Guidelines* implementation are interest rates. In 2005, the Monetary Policy Council reduced the NBP basic interest rates five times. The reference rate was reduced in total from 6.50% to 4.50%, the lombard rate — from 8.00% to 6.00%, and the deposit rate — from 5.00% to 3.00%. The fluctuation band for the short-term market rates remained unchanged at +/- 1.5 percentage points.

Box 3. NBP interest rates

The NBP reference rate specifies the minimum yield of the basic open market operations and simultaneously affects the interest rate on deposits in the interbank market with maturity similar to that of open market operations.
The NBP lombard rate specifies the ceiling for an increase in the overnight market rates and indicates the cost of funds offered by the central bank.
The NBP deposit rate specifies the lower limit for a decrease in the overnight market rates and indicates profitability of the overnight deposits with the NBP.
The NBP deposit and lombard rates establish the fluctuation band for the overnight rate, which is symmetric against the central bank reference rate.

Figure 9. NBP interest rates in 2005



Source: NBP.

II.1.2 Open market operations

Open market operations serve as an instrument facilitating the maintenance of the short-term interest rates at a level specified by the Monetary Policy Council.
Open market operations were conducted pursuant to Resolution 14/2004 of the Monetary Policy Council of 14 December 2004 on the principles of conducting open market operations, and pursuant to Resolution of the Monetary Policy Council of 29 September 2004 on adopting the *Monetary Policy Guidelines for 2005*.

Basic operations

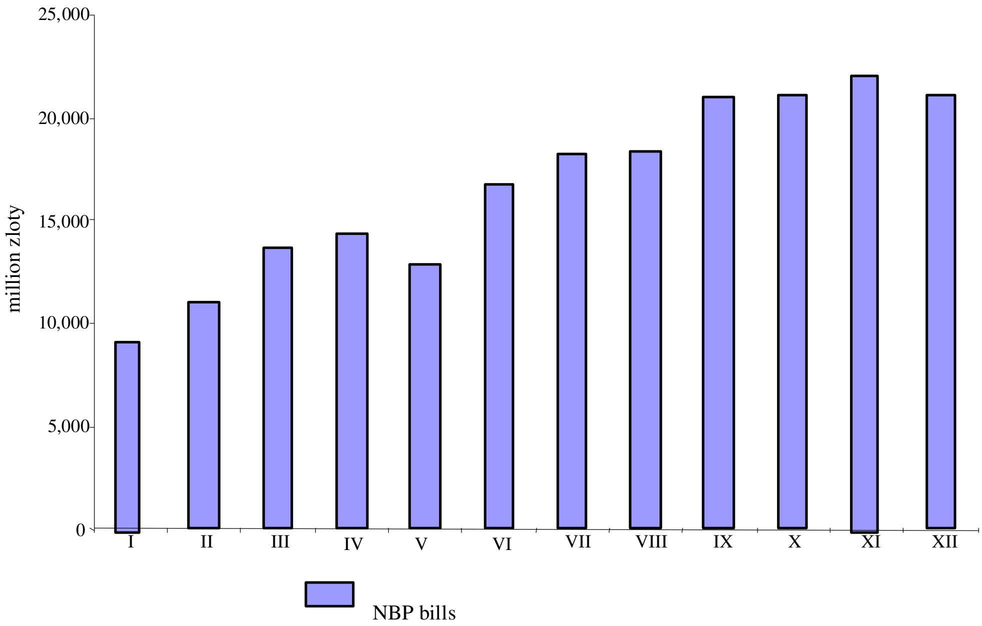
In 2005, the NBP shortened the maturity of the NBP bills from 14 to 7 days. It contributed to the improved management of the banking sector liquidity and brought the NBP operating system closer to the ECB standards.

As in the previous year, the basic open market operations were conducted regularly on a weekly basis, on Fridays. Where Friday was not a working day, the NBP conducted the basic open market operations on a different day.[4]. The yield on the NBP bills was established in the course of tenders, and its bottom limit was determined by the NBP reference rate.

In 2005, the central bank supplied the NBP bills of the nominal value of 865.1 billion zloty whereas the market demand amounted to 1,530.2 billion zloty.[5] The central bank accepted offers of the nominal value of 857.1 billion zloty. The demand for the NBP bills exceeded their supply by 77%. Overbidding[6] was much lower in 2005 as compared to the previous year, when the demand exceeded the supply of NBP bills by as much as 230%.
The balance of open market operations stood at 23,000 mln zloty as at the end of 2005, and was by 17,260 mln zloty higher than in the previous year. In annual terms, the average growth in the balance of open market operations was smaller — the average balance of NBP bills in 2005 stood at 16,699 mln zloty, and was by 11,424 mln zloty higher as compared to the previous year.

[4] In 2005, the NBP conducted the basic open market operations on an irregular date on two occasions, i.e. on 7 April 2005 and on 10 November 2005.
[5] See: Annex 2.
[6] The phenomenon of the demand exceeding the supply of the NBP bills could be observed in the first three months of 2005 in particular, as it was reported by the commercial banks. The average money market liquidity in that period, in monthly terms, ranged between 9.2 and 13.6 billion zloty. At the end of 2005 the demand for open market operations was similar to their supply offered by the central bank.

Figure 10. Average monthly issue of NBP bills in 2005



Source: NBP.

Fine-tuning operations

The National Bank of Poland could conduct fine-tuning operations in 2005. Such operations may have been initiated in the case of unexpected, short-term changes in the banking sector liquidity that could have led to undesirable, from the point of view of the monetary policy, fluctuations of the short-term interest rates. These could have included both absorbing and providing operations, i.e. the issue of the NBP bills, the repo operations, and early repurchase of NBP bills. There was no need to conduct such operations in 2005.

Structural operations

Structural operations are aimed at a long-term change in the banking sector liquidity.
If such a need had to be met, the central bank could conduct operations consisting in the repurchase of its own bonds (held in the portfolios of commercial banks), the purchase of securities in the market, or the issue of the long-term debt securities.
No structural operations were conducted by the NBP throughout 2005.

II.1.3 Required reserves

For the purpose of stabilisation of the short-term interest rates, the National Bank of Poland used the averaged system of required reserves.

Box 5. Required reserves

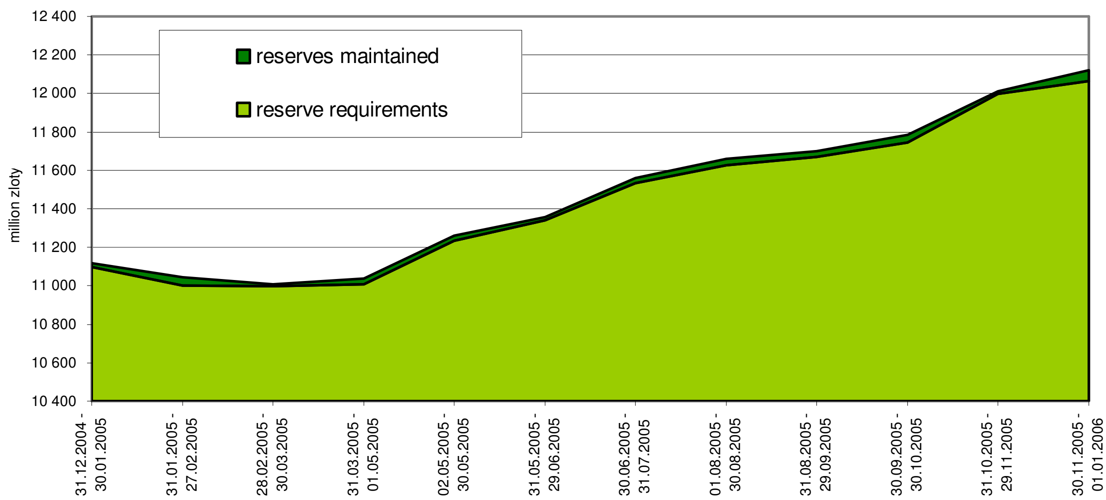
The banks maintain the required reserves on the current accounts or the required reserve accounts with the NBP.
Required reserves are calculated on the basis of repayable funds accumulated on bank accounts and the funds obtained from the sales of securities, with the exception of funds accepted from a different domestic bank and/or obtained from abroad for a period of at least 2 years.
The reserves are calculated and maintained in zloty. The required reserve rate was not changed in 2005 and stood at:

- 0% for funds obtained from the sale of securities under the repurchase agreements (repo transactions)
- 3.5% for other liabilities

All banks reduce the amount of the calculated required reserves by an equivalent of 500,000 euro.
The principles for calculating and maintaining the required reserves are specified in Resolution 15/2004 of the Management Board of the NBP of 13 April 2004, with later amendments, and Resolution 1/2004 of the Monetary Policy Council of 30 March 2004 on the rates of banks' required reserves and on the interest rate on the required reserves.

The level of the required reserves stood at 12,065 mln zloty as on 31 December 2005. It increased by 968 mln zloty (8.7%) as compared with the level as on 31 December 2004.

Figure 11. Changes in the level of required and maintained reserves in 2005



Source: NBP

The increase in required reserves in 2005 was determined by a growth in deposits (by 8.3%) that constitute the basis for calculating their level.
The average level of funds on the current accounts of banks slightly exceeded the level of the required reserves in all the reserve requirement periods, by 28 mln zloty, i.e. by 0.24%, on average. In individual periods, the excess ranged from 0.09% in March 2005 to 0.46% in December 2005.
The marginal differences between the maintained and required reserves in the individual maintenance periods result from proper asset management in commercial banks and from using the instruments that facilitate the management of funds on the NBP accounts by banks. An additional factor that streamlines the decision-making process regarding the current liquidity management by commercial banks is daily publishing of balances on their accounts held with the NBP (Reuters website: NBPM).
In 2005, the required reserves were not maintained on the required level on five occasions. It resulted from the unexpected orders performed by banks on the last day of a given reserve requirement period. The deficiencies ranged from 112 thousand zloty to 5,300 thousand zloty in commercial banks. In cooperative banks, deficiencies did not exceed 7 thousand zloty.
Pursuant to Article 41 of the Act on the NBP, the penalty interest, in the amount of double interest on the marginal lending facility, was calculated on the amount of the required reserve deficiencies ranged. The total amount of calculated interest was 83 thousand zloty.
In 2005, one of the banks subject to the rehabilitation programme was party exempt from the requirement to maintain the required reserves, pursuant to the decision taken by the NBP Management Board in 1999. The exemption amount was 421.7 mln zloty.

II.1.4 Standing facilities

Standing facilities are aimed at stabilising liquidity conditions in the interbank market, and limiting fluctuations of the overnight market rates. Unlike open market operations, they are executed on the initiative of commercial banks. Thanks to such operations banks can supplement shortage fund or deposit fund surpluses with the central bank. Standing facilities include the marginal lending and deposits facility.

Marginal lending facility is a source of overnight liquidity for commercial banks. It is collateralised with the Treasury securities, and its interest rate determines the cost of raising funds at the central bank. In 2005, banks used the marginal lending facility to shortage of supplement fund mainly on the last days of the required reserve maintenance periods. The average daily use of the marginal lending facility stood at 28.4 mln zloty, as compared to 22 mln zloty in 2004.

Deposit facility enables commercial banks to place their surplus of the liquid funds on the term deposit accounts with the central bank, to be returned on the following operating day. The average daily level of the overnight deposits in 2005 stood at 155.9 mln zloty, whereas in 2004 it amounted to 310 mln zloty.

A lower level of standing facilities used by commercial banks at the end of operating day indicates the improved liquidity management by the central bank.

II.1.5 Other components of NBP monetary policy operational framework

Intraday credit facility in zloty

The intraday credit facility is one of the most important components of the settlement system. It serves to support both the liquidity management by commercial banks during the operating day, and the interbank settlements with the NBP. It takes the form of a loan from the central bank, collateralised with the Treasury securities (mainly bonds — 72%). It is non-interest bearing and is subject to repayment at the end of the same operating day. In 2005, banks used the intraday credit facility on a daily basis, and its average balance stood at 7.4 billion zloty — higher by 32% than in 2004.

Intraday credit facility in euro

On 7 March 2005 the NBP, through the intermediary of the central bank of Italy, joined the TARGET euro settlement system. One of the conditions set out in the TARGET Agreement to be met by the NBP was the requirement to ensure liquidity of settlement in SORBNET-EURO. This function is performed by the intraday credit facility in euro, granted to the national RTGS participants. As an intraday type of credit, it is subject to repayment by the end of the operating day on which it is taken out, and is non-interest bearing.

The intraday credit may be collateralised with the Treasury bonds subject to MTS-CeTO fixing[7], and the principles of securities valuation — against the amounts of credit granted — are fully compliant with the Eurosystem standards. The average daily debt of commercial banks with the NBP in 2005 stood at 0.3 mln euro.

POLONIA rate

At the beginning of 2005, the NBP introduced the POLONIA (Polish Overnight Index Average) rate. It is the average overnight rate weighted with the volume of transactions in the interbank deposit market. Its level reflects real interest rates on the short-term interbank deposits. Due to its structure (similar to that of the EONIA rate functioning in the Eurosystem), it is a better indicator of the actual cost of overnight money than WIBOR O/N. The POLONIA rate is published by the NBP on the Reuters website (NBPS) on a daily basis at 5 p.m.[8]Its average deviation from the NBP reference rate amounted to 26 basis points in 2005. It was close to the deviation of WIBOR O/N, which stood at 22 basis points. The deviation of WIBOR O/N was significantly lower than that recorded in 2004, when it amounted to 38 basis points).

[7] MTS-CeTO is an electronic platform for trading in securities and financial instruments in a market that is subject to supervision of the Polish Securities and Exchange Commission.

[8] POLONIA fixing is conducted by the NBP on each operating day at 4:45 p.m. Each participant of the fixing is required to submit to the central bank a list of O/N transactions completed with other participants and routed for settlement on a particular day by 4.30 p.m. The list includes the amount of zloty deposit, the rate at which the transaction is concluded, and the name of the bank — counterparty to the overnight transaction.

Publishing information on Reuters website

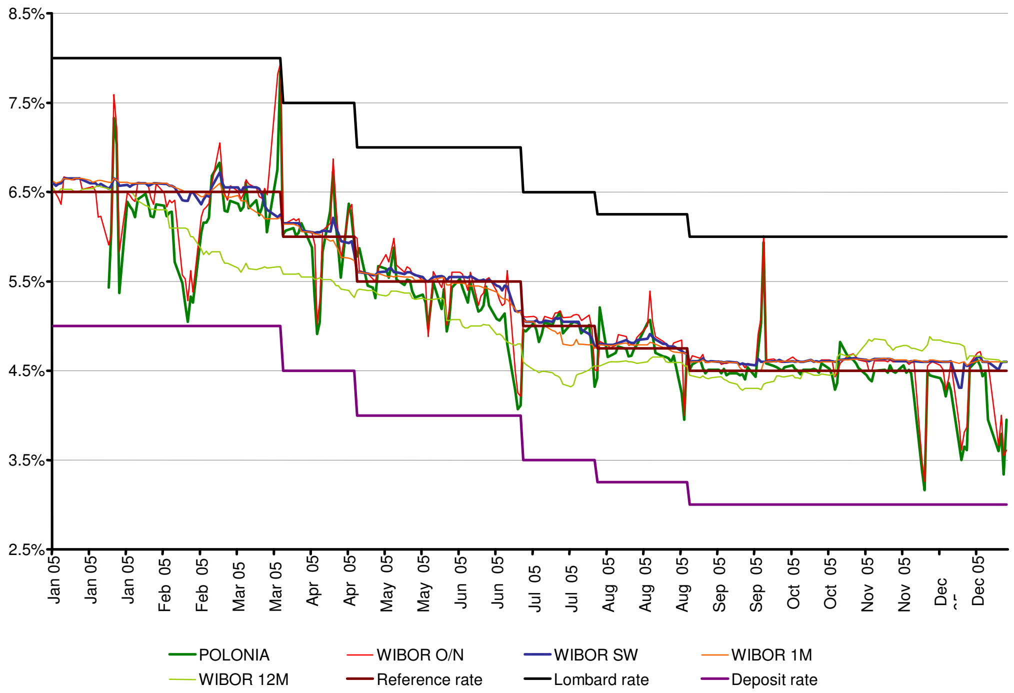
In 2005, the NBP provided banks with the ex post information about the current liquidity scenario in the market. The following data were presented on each operating day on NBPM page at Reuters website:

- the reserve requirement maintenance period,
- the level of reserves required in a given maintenance period,
- the daily balances, from the beginning of a particular maintenance period to the preceding operating day calculated:
- the current account balances of commercial banks,
- the deposit facility used by commercial banks,
- the marginal lending facility granted by the NBP to commercial banks.

II.2 Developments in the interbank money market

By conducting the basic open market operations in 2005, the central bank had an influence on the level of the market rate with a maturity of one week (WIBOR SW). Shortening of open market operations to 7 days had a stabilising effect on the money market rates. The WIBOR SW rate remained within the fluctuation band determined by the NBP lombard and deposit rates. The average deviation of WIBOR SW from the NBP reference rate in 2005 amounted to 9 basis points, against 16 basis points in the previous year. In 2004, WIBOR 2W was a market rate with a maturity equal to that of the basic open market operations. Its average deviation amounted to 18 basis points. POLONIA and WIBOR O/N fluctuated within a wider band. Due to their shorter maturity, they were more sensitive to changes in the current liquidity developments in the banking sector.

Figure 12. WIBOR and POLONIA fluctuations against NBP interest rates in 2005



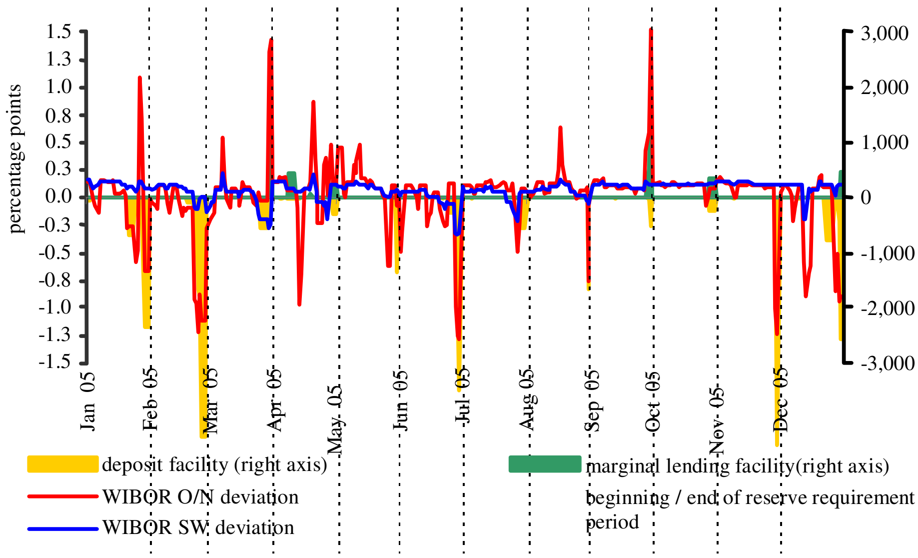
Source: NBP, Reuters.

The reserve requirement periods include days of more pronounced debits and credits on the banks' accounts, which occur repeatedly on a monthly basis. Most payments (related primarily to the central budget flows) are effected in the second half of the month, and the ensuing movements in the current account balance influence the changes in the market interest rates.

In the averaged reserve system, commercial banks can flexibly adjust the current account balance on a particular day to their liquidity requirements. As a result, there are no major fluctuations of the short-term rates throughout most of the reserve requirement period. Only in the last days of a reserve requirement period banks are forced to dispose of the surplus of the liquidity or supplement the shortage of the liquidity, due to the obligation to maintain the required reserves. It contributes to higher volatility of the shortest-term market rates. If the settlement is not possible, banks use standing facilities with the central bank. These operations are relatively costly (the marginal lending facility determines the ceiling[9] on the cost of the overnight money in the market) or entail lost profits (the deposit facility determines the lowest return on overnight deposits).

[9] The market overnight rate may be higher than the lombard rate in the case when a bank lacks the required collaterals to use the marginal lending facility offered by the NBP.

Figure 13. Standing facilities offered by the NBP against the deviation of WIBOR rates from the NBP reference rate in 2005



Negative values on the right axis indicate reduced liquidity of the banking sector (deposits placed with the NBP), whereas positive values indicate provided liquidity (marginal lending facility offered by the NBP).

Source: NBP, Reuters.

Fluctuations of the short-term interest rates also reflected the interbank market expectations regarding the changes in the central bank basic interest rates. In 2005, expectations of the interbank market participants as regards the reductions of interest rates were particularly visible in March and June.

On 25-30 March, WIBOR SW deviated significantly from the reference rate (20-28 basis points below the reference rate), whilst the level of the deposit facility used by banks in that period was low. On the last day of March 2005, the Monetary Policy Council decided to cut the central bank basic interest rates by 50 basis points.

A similar situation occurred on 27-29 June. In that period, the WIBOR SW rate fell by 33-34 basis points below the reference rate. The level of the overnight deposits placed was not high, either. On the following day, i.e. on 30 June, the MPC reduced the NBP basic interest rates by 50 basis points.

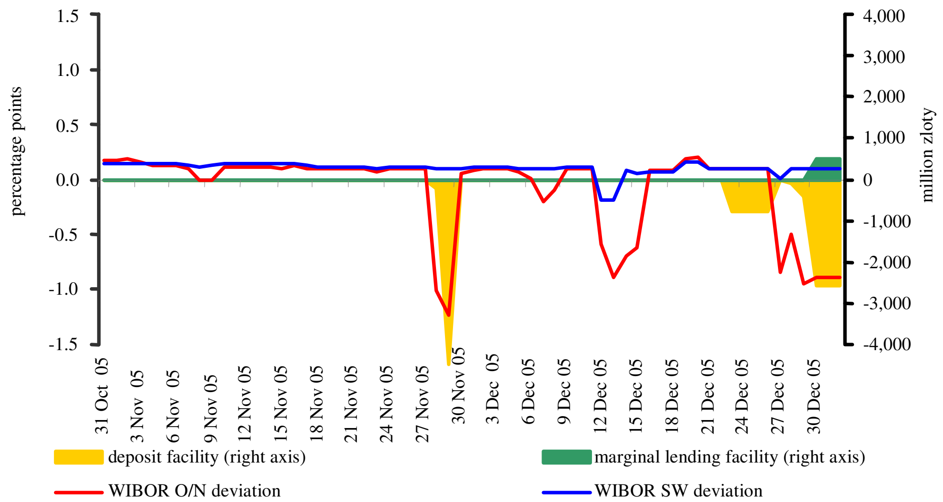
The fluctuations of the short-term interest rates in 2005 were also determined by differences in the assessment of the liquidity conditions between the central bank and the banking sector. The central bank has a wider access to information about factors affecting the liquidity conditions in the market. That is why the liquidity forecasts prepared by the NBP are more precise than those developed by particular commercial banks. Deviations in the forecasts of the central bank are usually marginal. However, it sometimes happens that these deviations are larger due to the influence of unpredicted factors.

Throughout 2005, some significant differences in the assessment of the liquidity conditions by commercial banks and the liquidity forecasts prepared by the central bank were observed in the last two months of the year. The banks expected the shortage of the liquidity, having not fully considered liquidity injections from the central budget and the Social Insurance Institution (ZUS), and expecting market sales of foreign currencies by the Ministry of Finance. Thus, the demand for the NBP bills they reported was lower than the supply.

In the last tender in the November reserve requirement period, banks reported a demand for the NBP bills amounting to 18,713 mln zloty, whilst the offer stood at 20,400 mln zloty. As a result, the surplus of the liquid funds was reported in the market at the end of the month and resulted in a decrease in WIBOR O/N. Since there was no possibility to dispose of the surplus of the liquid funds in the market, the total value of the overnight deposits placed by commercial banks on 28-29 November amounted to 4,700 mln zloty.

December was a month when commercial banks were closing their annual settlements and thus reported a demand for the NBP bills that was lower than the NBP forecasts and the actual demand. This led to more pronounced fluctuations in the short-term rates in the interbank market.

Figure 14. Liquidity conditions and use of standing facilities of the central bank in November and December 2005



Negative values on the right axis indicate reduced liquidity of the banking sector (deposits placed with the NBP) whereas positive values indicate provided liquidity (marginal lending facility offered by the NBP).

Source: NBP, Reuters

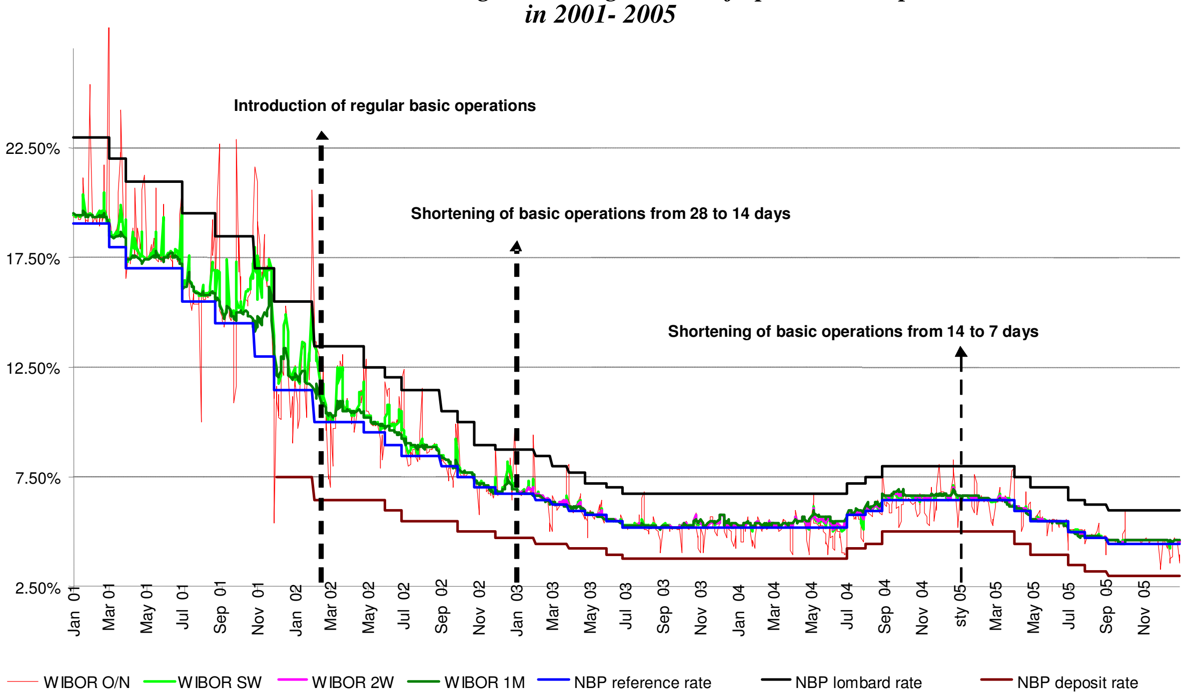
Conclusions

The NBP monetary policy activities in 2005 facilitated the maintenance of the short-term interest rates in the interbank market on a level complying with the inflation target set by the Monetary Policy Council.

The changes in the monetary policy operating system and the introduced limits on the MF zloty deposits held with the NBP contributed to the stabilisation of the short-term rates in the interbank market.

Shortened maturity of open market operations in the subsequent years indicated that the central bank focused on a direct stabilisation of the market rate with the increasingly shorter maturity.

Figure 15. Changes in fluctuations of the shortest term interest rates in the interbank market against changed dates of open market operations in 2001- 2005



Source: NBP

The average annual level of the banking sector surplus of the liquidity, as measured with the scale of the NBP bills issues, was higher by 11,424 mln zloty (i.e. by 216%). The total absorption of funds from the banking sector was higher by 4,240 mln zloty (i.e. by 24.3%) than in 2004.

Table 1. Liquidity of the banking sector in 2002 – 2005

Period	Surplus of the liquidity of the banking sector (annual average) in million zloty			
	NBP bills	MF term deposits with NBP	Share of NBP bills in total absorption (%)	Total NBP bills and MF term deposits
2005	16,699	5,008	77	21,707
2004	5,275	12,192	30	17,467
2003	6,251	6,067	51	12,318
2002	10,565	7,275	59	17,840

The surplus of the banking sector liquidity increased primarily due to the NBP foreign exchange transactions stemming from a higher purchase of foreign currencies by the central bank, related to the flow of EU funds. Diminishing the factor which had affected the liquidity level in previous years , namely the MF term deposits with the NBP, as a result of gradual introduction of limits on the term deposits, mitigated fluctuations of the level of the central budget deposits held with the NBP, which in turn, contributed to the interest rate stability in the money market.

Table 2. Standing facilities and market rates levels in 2002 – 2005

Period	Standing facilities			Average reference rate %	Deviation of rates from reference rate in basis points (%)				Average deviation of banks' current accounts from reserve requirements (ths. zloty)
	Deposit facility	Marginal lending facility	Balance (standing facilities)		O/N	1W	2W	1M	
2005	162	29	-133	5,34	22	9			28
2004	310	22	-288	5,79	38		18		24
2003	167	34	-133	5,67	27		11		25
2002	80	170	89	8,82	99			43	43

Annex 1. Absorption of short-term liquidity in operations conducted by the NBP with the banking sector and MF (mln zloty).

	Average level of NBP bills	Average level of central budget deposits with the NBP	Average level of overnight deposits	Average level of marginal lending facility	**Total**
2005	1	2	3	4	**1+2+3+4**
I	9 151	8 255	301	0	**17 707**
II	11 089	8 133	626	0	**19 849**
III	13 629	7 310	75	-99	**20 915**
IV	14 338	6 425	33	-71	**20 725**
V	12 903	8 571	54	0	**21 528**
VI	16 750	8 208	218	0	**25 176**
VII	18 247	10 074	58	0	**28 379**
VIII	18 387	10 186	66	0	**28 638**
IX	20 977	8 438	39	-102	**29 352**
X	21 145	8 557	119	-34	**29 788**
XI	21 971	7 481	208	0	**29 660**
XII	21 116	7 180	397	-42	**28 651**

	Share of the average level of NBP bills in liquidity absorption	Share of the average level of central budget deposits with the NBP in liquidity absorption	Share of the average level of overnight deposits in liquidity absorption	Share of the average level of marginal lending in liquidity absorption	**Total**
2005					
I	51,68%	46,62%	1,70%	0,00%	**100,00%**
II	55,87%	40,98%	3,16%	0,00%	**100,00%**
III	65,16%	34,95%	0,36%	-0,47%	**100,00%**
IV	69,18%	31,00%	0,16%	-0,34%	**100,00%**
V	59,94%	39,81%	0,25%	0,00%	**100,00%**
VI	66,53%	32,60%	0,87%	0,00%	**100,00%**
VII	64,30%	35,50%	0,21%	0,00%	**100,00%**
VIII	64,20%	35,57%	0,23%	0,00%	**100,00%**
IX	71,47%	28,75%	0,13%	-0,35%	**100,00%**
X	70,99%	28,73%	0,40%	-0,11%	**100,00%**
XI	74,08%	25,22%	0,70%	0,00%	**100,00%**
XII	73,70%	25,06%	1,39%	-0,15%	**100,00%**

Annex 2. Tenders for NBP bills

	Tender date	Payment date	Nominal value of sales offers (m zloty)	Nominal value of offers to buy (m zloty)	Nominal value of accepted offers (m zloty)	Average accepted price (for 10,000 zloty)	Value in sales price (m zloty)	Average yield on bills (annual) (365/360)
1	05-01-07	05-01-07	7 500	17 800	7 500	9987.37	7 491	6.50%
2	05-01-14	05-01-14	9 500	19 788	9 500	9987.37	9 488	6.50%
3	05-01-21	05-01-21	10 000	26 762	10 000	9987.37	9 987	6.50%
4	05-01-28	05-01-28	6 500	28 751	6 500	9987.37	6 492	6.50%
5	05-02-04	05-02-04	9 500	31 670	9 500	9987.37	9 488	6.50%
6	05-02-11	05-02-11	12 500	48 050	12 500	9987.37	12 484	6.50%
7	05-02-18	05-02-18	13 500	55 260	13 500	9987.37	13 483	6.50%
8	05-02-25	05-02-25	12 000	112 650	12 000	9987.37	11 985	6.50%
9	05-03-04	05-03-04	17 000	23 604	17 000	9987.37	16 979	6.50%
10	05-03-11	05-03-11	15 000	30 056	15 000	9987.37	14 981	6.50%
11	05-03-18	05-03-18	12 500	28 603	12 500	9987.37	12 484	6.50%
12	05-03-25	05-03-25	10 500	38 443	10 500	9987.37	10 487	6.50%
13	05-04-01	05-04-01	12 000	30 700	12 000	9988.34	11 986	6.00%
14	05-04-07	05-04-08	13 000	13 640	13 000	9988.34	12 985	6.00%
15	05-04-15	05-04-15	20 000	28 050	20 000	9988.34	19 977	6.00%
16	05-04-22	05-04-22	14 500	26 050	14 500	9988.34	14 483	6.00%
17	05-04-29	05-04-29	10 600	14 190	10 600	9989.31	10 589	5.50%
18	05-05-06	05-05-06	17 000	17 505	17 000	9989.31	16 982	5.50%
19	05-05-13	05-05-13	12 000	17 721	12 000	9989.31	11 987	5.50%
20	05-05-20	05-05-20	12 000	22 652	12 000	9989.31	11 987	5.50%
21	05-05-27	05-05-27	11 200	19 122	11 200	9989.31	11 188	5,50%
22	05-06-03	05-06-03	16 000	26 295	16 000	9989.31	15 983	5.50%
23	05-06-10	05-06-10	18 000	29 989	18 000	9989.31	17 981	5.50%
24	05-06-17	05-06-17	18 500	35 866	18 500	9989.31	18 480	5.50%
25	05-06-24	05-06-24	16 900	39 979	16 900	9989.31	16 882	5.50%
26	05-07-01	05-07-01	18 500	37 461	18 500	9990.28	18 482	5.00%
27	05-07-08	05-07-08	20 500	31 176	20 500	9990.28	20 480	5.00%
28	05-07-15	05-07-15	18 000	34 050	18 000	9990.28	17 983	5.00%
29	05-07-22	05-07-22	16 500	30 464	16 500	9990.28	16 484	5.00%
30	05-07-29	05-07-29	17 500	28 319	17 500	9990.77	17 484	4.75%
31	05-08-05	05-08-05	18 800	25 467	18 800	9990.77	18 783	4.75%
32	05-08-12	05-08-12	20 500	30 798	20 500	9990.77	20 481	4.75%
33	05-08-19	05-08-19	17 000	31 210	17 000	9990.77	16 984	4.75%
34	05-08-26	05-08-26	17 500	33 213	17 500	9990.77	17 484	4.75%
35	05-09-02	05-09-02	20 000	30 176	20 000	9991.25	19 983	4.50%
36	05-09-09	05-09-09	21 000	34 106	21 000	9991.25	20 982	4.50%
37	05-09-16	05-09-16	22 500	35 557	22 500	9991.25	22 480	4.50%
38	05-09-23	05-09-23	21 400	29 982	21 400	9991.25	21 381	4.50%
39	05-09-30	05-09-30	20 500	33 813	20 500	9991.25	20 482	4.50%
40	05-10-07	05-10-07	20 200	31 960	20 200	9991.25	20 182	4.50%
41	05-10-14	05-10-14	22 400	32 463	22 400	9991.25	22 380	4.50%
42	05-10-21	05-10-21	21 200	26 010	21 200	9991.25	21 181	4.50%
43	05-10-28	05-10-28	21 800	26 591	21 800	9991.25	21 781	4.50%
44	05-11-04	05-11-04	21 000	20 820	20 820	9982.53	20 783	4.50%
45	05-11-10	05-11-10	4 000	4 098	4 000	9991.25	3 997	4.50%
46	05-11-18	05-11-18	22 700	25 253	22 700	9991.25	22 680	4.50%
47	05-11-25	05-11-25	20 400	18 713	18 713	9991.25	18 697	4.50%
48	05-12-02	05-12-02	21 500	19 311	18 811	9991.25	18 795	4.50%
49	05-12-09	05-12-09	24 000	21 133	20 533	9991.25	20 515	4.50%
50	05-12-16	05-12-16	24 000	25 210	24 000	9991.25	23 979	4.50%
51	05-12-23	05-12-23	21 000	25 082	21 000	9991.25	20 982	4.50%
52	05-12-30	05-12-30	23 000	24 556	23 000	9991.25	22 980	4.50%
	Total 2005:		865 100	1 530 180	857 076		856 201	

Annex 3. Banks — Money Market Dealers in 2005

Money Market Dealers:

- BRE BANK S.A.

- BANK BPH S.A.

- ING BANK ŚLĄSKI S.A.

- BANK HANDLOWY W WARSZAWIE S.A.

- BANK POLSKA KASA OPIEKI S.A.

- BANK MILLENNIUM S.A.

- PKO BANK POLSKI S.A.

- SOCIETE GENERALE S.A. BRANCH IN POLAND

- DEUTSCHE BANK POLSKA S.A.

- KREDYT BANK S.A.

- ABN AMRO BANK POLSKA S.A.

- BANK ZACHODNI WBK S.A.

- BANK GOSPODARKI ŻYWNOŚCIOWEJ S.A.

Annex 4. Daily information (as at month-end)

Item	XII 2004	I 2005	II 2005	III 2005	IV 2005	V 2005	VI 2005	VII 2005	VIII 2005	IX 2005	X 2005	XI 2005	XII 2005
(m zloty)													
CENTRAL BUDGET													
revenues	160 153.46	18 332.95	29 998.06	42 696.45	57 519.29	70 706.50	87 449.03	103 026.37	118 815.41	134 691.68	150 566.06	166 266.86	183 033.11
expenses	197 903.12	18 496.97	37 664.10	54 075.20	69 816.16	87 827.10	105 104.91	119 339.78	135 955.47	151 016.31	169 713.09	186 865.07	208 481.67
deficit(-)/surplus(+)	-37 749.66	-164.01	-7 666.04	-11 378.75	-12 296.86	-17 120.60	-17 655.88	-16 313.41	-17 140.06	-16 324,62	-19 147.03	-20 598.21	-25 448.56
central budget funds	1 394.77	1 673.30	1 063.19	2 452.48	1 879.85	1 658.69	1 637.84	1 910.35	1 887.69	2 431.72	2 154.11	2 805.88	3 757.38
MF foreign currency account	131.94	12 234.33	14 204.10	389.27	5 948.46	5 327.57	7 275.16	5 535.67	5 396.05	1 889.19	1 916.97	2 874.24	3 392.37
MF zloty deposits	2 500.00	9 691.37	5 801.37	5 500.00	6 700.91	8 000.91	8 399.91	8 399.91	6 090.91	6 490.91	5 740.91	5 995.91	0.00
CURRENCY IN CIRCULATION	55 924.95	54 401.39	55 058.79	56 103.49	57 981.97	58 002.35	58 762.46	60 025.52	60 095.95	60 118.45	61 244.89	60 649.00	62 596.88
CURRENT ACCOUNT	13 230.41	12 084.32	12 139.86	12 278.32	11 722.03	13 954.64	12 396.80	11 530.75	14 906.20	12 100.45	11 412.36	14 486.98	7 880.96
balance deviation from required reserves	2 172.29	1 099.83	1 164.76	1 294.81	-17.51	2 643.45	885.48	23.81	3 261.32	381.08	-573.51	2 448.39	327.12
REFINANCING LOAN	2 950.73	2 965.77	2 979.35	2 862.19	3 169.31	2 890.89	2 773.66	2 787.79	2 801.92	2 685.12	2 698.80	2 707.10	3 055.68
marginal lending	0.00	0.00	0.00	0.00	293.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	464.00
rediscount	0.00	0.00	0.00	0.00	0,00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
INTRADAY CREDIT	4 435.42	6 646.14	7 466.62	6 561.34	8 697.48	9 523.10	7 727.71	12 680.48	5 485.47	12 791.16	5 033.31	5 777.87	15 267.90
DEPOSIT FACILITY	52.37	6.97	0.37	2.24	282.84	2.33	3.97	559.64	1.10	0.00	0.50	3.40	2 581.81
OPEN MARKET OPERATIONS.*/	5 740.00	6 500.00	12 000.00	10 500.00	10 600.00	11 200.00	16 900.00	17 500.00	17 500.00	20 500.00	21 800.00	18 713.00	23 000.00
repo	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
NBP money market bills<7 days	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
NBP money market bills 7 and 14 days	5 740.00	6 500.00	12 000.00	10 500.00	10 600.00	11 200.00	16 900.00	17 500.00	17 500.00	20 500.00	21 800.00	18 713.00	23 000.00
POLONIA**/		6.39%	6.04%	6.02%	5.87%	5.41%	4.96%	5.21%	4.75%	4.58%	4.66%	4.49%	3.95%
WIBOR													
O/N	6.64%	6.49%	6.22%	6.15%	5.62%	5.54%	5.11%	4.83%	4.67%	4.62%	4.67%	4.55%	3.61%
T/N	6.67%	6.53%	6.26%	6.17%	5.63%	5.58%	5.12%	4.82%	4.70%	4.61%	4.66%	4.58%	4.60%
SW	6.66%	6.58%	6.36%	6.15%	5.60%	5.55%	5.09%	4.80%	4.69%	4.60%	4.63%	4.60%	4,60%
2W	6.67%	6.60%	6.44%	6.15%	5.60%	5.55%	5.09%	4.80%	4.69%	4.60%	4.62%	4.60%	4.60%
1M	6.66%	6.61%	6.45%	6.14%	5.60%	5.54%	5.08%	4.79%	4.68%	4.60%	4.62%	4.60%	4.60%
3M	6.64%	6.61%	6.31%	5.91%	5,59%	5.44%	4.90%	4.67%	4.61%	4.50%	4.62%	4.63%	4.60%
12M	6.57%	6.51%	5.86%	5.58%	5.41%	5.30%	4.60%	4.55%	4.55%	4.36%	4.66%	4.79%	4.60%
WIBID													
O/N	6.37%	6.27%	5.92%	5.90%	5.34%	5.28%	4.89%	4.56%	4.49%	4.43%	4.45%	4.36%	3.32%
T/N	6.41%	6.29%	5.96%	5.91%	5.34%	5.31%	4.89%	4.57%	4.49%	4.42%	4.46%	4.40%	4.35%
1W	6.46%	6.38%	6.16%	5.95%	5.40%	5.35%	4.89%	4.61%	4.50%	4.41%	4.44%	4.40%	4.40%
2W	6.47%	6.40%	6.24%	5.95%	5.40%	5.35%	4.89%	4.61%	4.50%	4.40%	4.44%	4.41%	4.40%
1M	6.46%	6.41%	6.25%	5.95%	5.40%	5.34%	4.89%	4.61%	4.48%	4.40%	4.43%	4.41%	4.40%
3M	6.44%	6.41%	6.11%	5.71%	5.40%	5.24%	4.70%	4.48%	4.41%	4.30%	4.43%	4.44%	4.40%
12M	6.37%	6.31%	5.66%	5.38%	5.22%	5.10%	4.40%	4.35%	4.35%	4.16%	4.46%	4.59%	4.40%
USD/PLN (fix)	2.9904	3.1200	2.9501	3.1518	3.2988	3.3265	3.3461	3.3689	3.3140	3.2575	3.3067	3.3165	3.2613
EUR/PLN (fix)	4.0790	4.0503	3.9119	4.0837	4.2756	4.1212	4.0401	4.0758	4.0495	3.9166	3.9893	3.9053	3.8598
EUR/USD	1.3640	1.2982	1.3260	1.2957	1.2961	1.2389	1.2074	1.2098	1.2219	1.2023	1.2064	1.1775	1.1835
official reserve assets (as at month-end)													
m zloty	109 996.26	127 821.20	125 484.80	120 464.20	134 503.80	135 182.48	137 983.85	137 455.77	136 995.37	133 735.66	137 821.49	137 437.67	138 837.60
m euro	26 966.00	31 558.50	32 078.00	29 498.80	31 458.50	31 802.00	34 154.00	33 725.00	33 830.00	34 146.00	34 548.00	35 193.00	35 970.20
(purchase) sale of foreign currency	-292.56	-466.21	-432.46	-458.87	-1 846.91	-3 852.69	-800.57	-1 671.90	-437.65	-690.43	-473.07	-37.88	-426.07

**/ - Open market operations are reported as at nominal value.*

***/ - As of 24 Jan 2005, the NBP calculates POLONIA (Polish Overnight Index Avarage) which is the reference rate for O/N deposits accepted or granted among participants of the POLONIA fixing.*

Annex 5. NBP monetary policy instruments in 1990 - 2005

Item	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Required reserves																
Issue of NBP bills																
Issue/repurchase of NBP bonds																
Repo / reverse repo																
Outright																
Loans for central investments																
Rediscount loan																
Marginal lending																
Deposit facility																
Loan limits																
Deposits for households																
Intraday credit																

Annex 6. Foreign currency flows within the framework of using of EU funds

On the first business day of each month, the Ministry of Finance is required to pay approx. 94% of the Polish monthly membership fee to the European Union. The remaining 6% is paid on the 20th day of each month. The fee is paid in zloty to the EC account with the NBP, maintained in zloty as well. The Council Regulation No 2028/2004 of 16 December 2004 authorizes the European Commission to require payment of 5/12 of the annual membership fee from each Member State in the first quarter of each year.

Funds on the account can be exchanged for euro with the NBP or transferred in zloty to the loro account of another central bank which maintains an EC account with the NBP regional branch, operated in zloty. Up to now, central banks of Germany, France and Hungary have opened such accounts. In the period between November 2004 and November 2005, the European Commission used only Deutsche Bundesbank (DBB) as an intermediary in the exchange of zloty for euro in the foreign exchange market. These funds are then transferred from DBB to foreign banks accounts held in the Polish commercial banks, and are subsequently exchanged for euro in the market. The foreign currency thus obtained goes back to the EC account with the DBB. These funds are transferred to the EC auxiliary account with the NBP, and further on particular fund accounts held and disposed of by the Ministry of Finance.

The EC auxiliary account can also be credited with funds unused in other EU Member States.
The funds from the auxiliary account are transferred to the pre- and post-accession funds accounts operated in euro.
Pre-accession funds include:

- PHARE fund,
- SAPARD fund
- ISPA fund.

Funds on these accounts can be used both in zloty and in euro, depending on the needs of their beneficiaries.
Post-accession funds include:

- structural funds,
- Cohesion Fund,
- Common Agricultural Policy,
- Cash Flow Facility Instrument
- Schengen facility.

The structural funds include:

- European Regional Development Fund,
- European Social Fund,
- Guidance Section of the European Agricultural Guidance and Guarantee Fund,
- Financial Instrument for Fisheries Guidance.

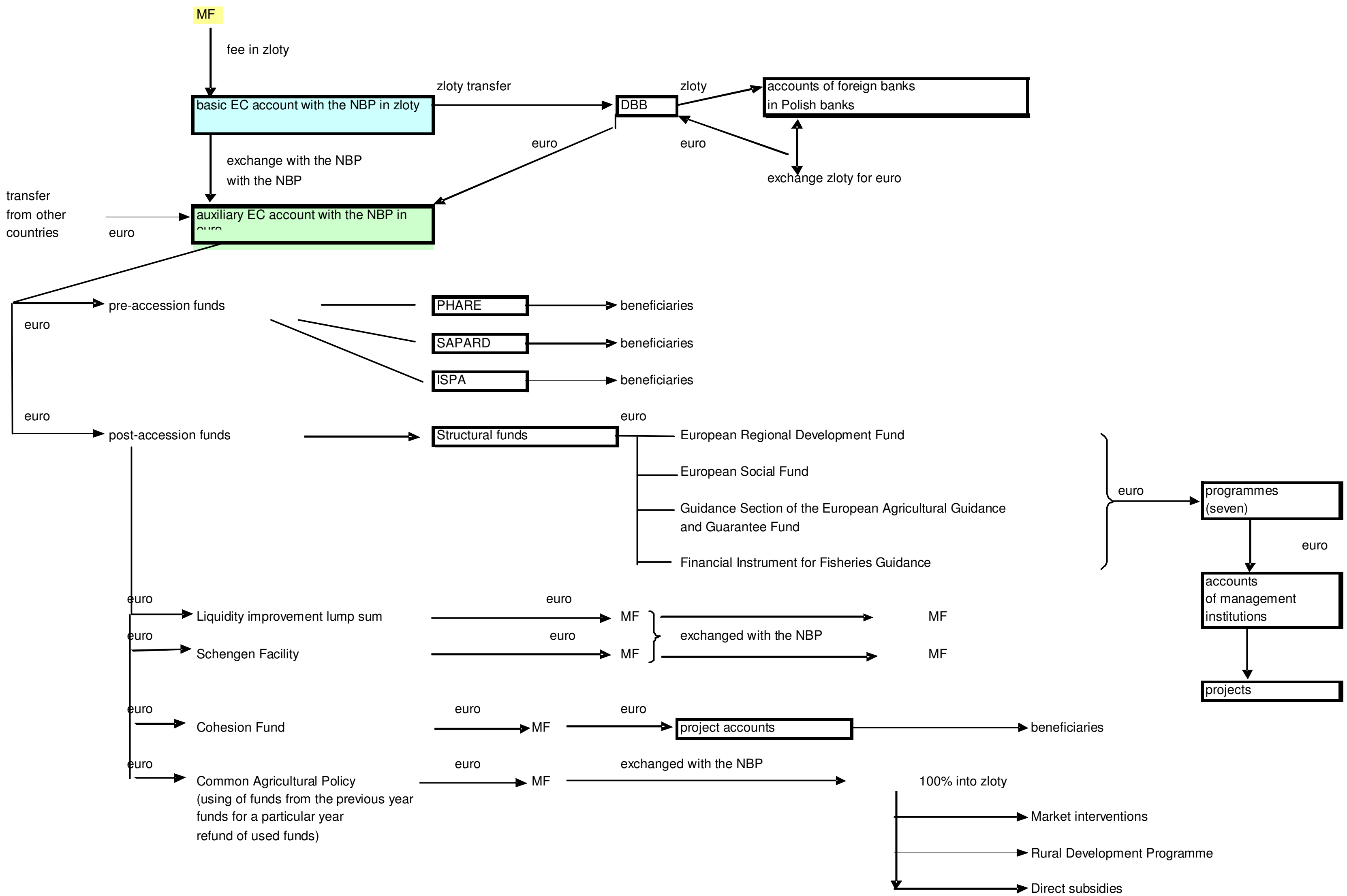
Funds on these accounts are transferred to the programme accounts (there are 7 of them), and further on the accounts of managing institutions. These accounts are at the disposal of : the Ministry of Transport and Construction, the Ministry of Agriculture and Rural Development, the Ministry of

Regional Development, and Voivodship Offices. The institutions managing these funds allocate them to the projects previously approved by the European Union. Funds allocated to particular projects may be used both in zloty and in euro.
71 accounts were opened in December 2004 to use the funds coming from the Cohesion Fund. They are credited in euro by the EC, and the funds are allocated to individual projects approved by the European Union. These funds are further on transferred to end-beneficiaries. They are used in euro in 95%.

The EC funds allocated to the Common Agricultural Policy are used in zloty only. They are transferred to the Ministry of Finance for the sake of market interventions, the Rural Development Programme, and for direct subsidies. Market interventions are at the discretion of the Agency for Restructuring and Modernisation of Agriculture. The Rural Development Programme is managed by the Agricultural Market Agency, and direct subsidies are transferred to self-employed farmers. The CAP funds are shifted in time, therefore both the funds unused in the previous year and the funds transferred by the EC for the subsequent year are held in the CAP account in a particular year. Direct subsidies are covered with the central budget funds, and are reimbursed to the central budget by the European Union 2 months later.

The funds allocated to the Schengen Facility and Cash Flow Facility Instrument are fully used in zloty, hence the Ministry of Finance exchanges the euro for zloty with the NBP on the day the funds are received from the EC account. These funds are further on used by the central budget.

Structure of currency flows related to EU funds



Annex 7. Monetary policy operational frameworks of the Eurosystem and the NBP

1. Eurosystem monetary policy operational framework

1.1. Monetary policy instruments

Monetary policy instruments constitute a basic component of the Eurosystem[10] operational framework. They include open market operations, the required reserve system, and standing facilities. Yield of monetary policy instruments depends on the ECB interest rates.

Open market operations perform the most important function in the set of the instruments used. They are used by the Eurosystem for the management of the banking sector liquidity and to steer the short-term market interest rates. Other instruments are used primarily to reduce the volatility of liquidity conditions in the market.

Within the framework of open market operations, the Eurosystem conducts or may conduct the basic refinancing operations, the longer-term refinancing operations, the fine-tuning operations and the structural operations. By using basic (7-day) operations, the Eurosystem satisfies approx. 70% of the demand for liquidity of the euro area banking sector. Longer-term operations are used to satisfy the needs reported for a period of 3 months (approx. 30% of refinancing funds). The refinancing operations, repo operations and collateralised loans are mainly used[11]. For sterilising operations, the term deposits are applied most frequently.

Open market operations may be conducted via tenders or through bilateral operations with selected counterparties. There are standard and quick tenders. In the case of standard tenders, used for the basic and longer-term operations, the period between the announcement to a tender and its settlement is 2 days. Quick tenders are used by the ECB to conduct the fine-tuning operations the Eurosystem aimed at smoothing the effect on the short-term interest rates caused by the unexpected liquidity fluctuations in the market. Thus, the duration of a quick tender usually does not exceed 90 minutes. The fine-tuning operations are settled on the day of their execution.

[10] ECB Governing Council decided that the term Eurosystem shall be construed as the ECB and national central banks of the Member States that have adopted a single currency pursuant to the Maastricht Treaty.

[11] The national central banks may perform reverse transactions either in the form of the repurchase agreements (i.e. the ownership of the asset is transferred to the creditor, while the parties agree to reverse the transaction through a re-transfer of the asset to the debtor at a fixed future point in time) or as the collateralised loans (i.e. an enforceable security interest is provided over the assets but, assuming fulfilment of the debt obligation, the ownership of the asset is retained by the debtor). Further provisions for the reverse transactions based on the repurchase agreements are specified in the contractual arrangements applied by the respective national central bank (or the ECB). Arrangements for the reverse transactions based on the collateralised loans take account of the different procedures and formalities required to enable the establishment and subsequent implementation of a relevant interest in the collateral (e.g. a pledge) which apply in different jurisdictions.

Open market operations conducted and available in the Eurosystem

Open market operations	**Type of operation**		**Maturity**	**Frequency**
	Liquidity-providing	**Liquidity-absorbing**		
Basic refinancing operations	Repo transactions / collateralised loans	-	One week	Weekly
Longer-term refinancing operations	Repo transactions / collateralised loans	-	Three months	Monthly
Fine-tuning operations	Repo transactions / collateralised loans	Repo transactions / collateralised loans	Non-standardised	Non-regular
	Foreign exchange swaps	Foreign exchange swaps		
	Outright purchases	Outright sales		
		Collection of fixed-term deposits with the NCB[12]		
Structural operations	Repo transactions / collateralised loans	Issue of debt certificates	Non-standardised	Non-regular
	Outright purchases	Outright sales		

Source: ECB.

[12] These are the only sterilising operations, currently used by the ECB in its monetary policy in the euro area (fine-tuning operations). Other sterilising operations have not been used so far.

Box 1. Counterparties of monetary policy operations in the Eurosystem

In order to participate in the Eurosystem monetary policy operations, credit institutions have to meet specific criteria. The criteria are broken down into the general and detailed ones, depending on the type of operation. Meeting the general criteria entitles to participate in the basic and longer-term open market operations and easy use of the standing facilities. The detailed criteria specify the conditions of using of other open market operations (used in quick tenders and bilateral operations).

General eligibility criteria:

- Participation in the Eurosystem required reserve system,
- Sound financial standing,
- Meeting any operational criteria specified in the relevant contractual or regulatory arrangements, applied by NCB or ECB respectively.

Institutions meeting the general eligibility criteria may access the Eurosystem's standing facilities and participate in the Eurosystem open market operations based on the standard tenders.

Detailed eligibility criteria:

- *Repo transactions, collateralised loans, and fixed-term deposits with the NCB* — each NCB selects a group of counterparties from among the institutions established in its Member State which meet the general counterparty eligibility criteria. In this respect, the activity in the money market is the prime selection criterion. Other criteria which might be taken into account are, for instance, the efficiency of the trading desk and the bidding potential,
- *Foreign exchange swaps* — counterparties must be able to conduct large-volume foreign exchange operations efficiently under all market conditions. The range of counterparties to the foreign exchange swaps corresponds to the counterparties located in the euro area which are selected for the Eurosystem foreign exchange intervention operations,
- *Outright transactions* – no restrictions as such are placed on the range of counterparties.

Source: .ECB

The basic function of the **required reserve**[13] that credit institutions are required to maintain at national central banks, is the stabilisation of liquidity conditions in the market. The maintenance of reserves on the average basis reduces the volatility of short-term interest rates. Moreover, required reserves strengthen sustained deficit of liquidity in the banking sector of the euro area.

The ECB applies uniform "non-zero" reserve requirements (currently at 2.0%) against most of the items included in the reserve base. The "zero" reserve requirements apply solely to the following categories of liabilities: deposits with an agreed maturity of over two years, deposits repayable at notice of over two years, repurchase agreements, and debt securities with an agreed maturity of over two years.

Required reserves are interest-bearing. Interest paid to credit institutions is calculated on the basis of the average (weighted with the number of calendar days) maximum yield obtained through tenders of basic refinancing operations in a particular maintenance period.

[13] The ECB requires that credit institutions maintain required reserves on the accounts at national central banks within the framework of the Eurosystem required reserve system. The legal framework for the system is specified in Article 19 of the ESCB Statute, Resolution of the Council (EC) on the application of required reserves by the ECB and the ECB Resolution concerning the application of required reserves.

Standing facilities perform the function of instruments mitigating volatility of liquidity conditions in the market. Their yield reduces fluctuations of the shortest-term market rates.

Credit institutions may use the marginal lending facility to obtain overnight liquidity from national central banks at a pre-set interest rate. The interest rate on marginal lending facility constitutes the ceiling for fluctuations of the shortest market rates. The facility may be granted through repo operations or as a collateralized loan. The principles and conditions for using of marginal lending facility are the same throughout the euro area.

Deposit facility enables credit institutions to make overnight deposit with the national central bank. The interest rate on overnight deposits constitutes the lower limit for fluctuations of the shortest-term market rates. As in the case of the marginal lending facility, the principles and conditions for usage of the deposit facility are the same throughout the euro area.

1.2.Market conditions

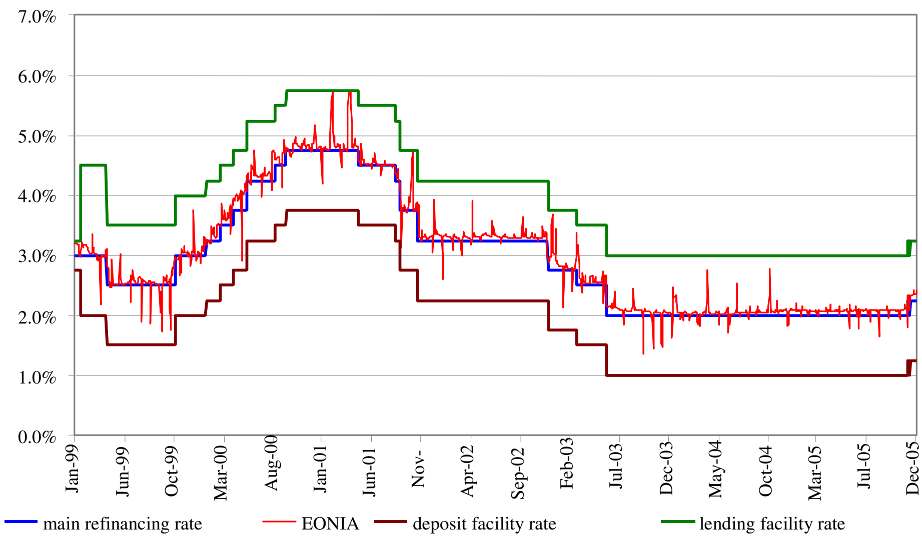
The banking sector of the euro area is characterised by a sustained liquidity deficit. It means that monetary policy operations in net terms provide liquidity. Their level is determined by current liquidity requirements of the banking sector, which stem from:

- maintenance of required reserves by credit institutions,
- effects of the so-called autonomous liquidity factors i.e., *inter alia*, changes in the level of currency in circulation, central budget funds held with the NCB, and official foreign exchange reserves of the Eurosystem (reserves of the ECB and national central banks).

1.3. ECB strategy of banking sector liquidity management

The strategy of the banking sector liquidity management implemented by the ECB is based on the so-called benchmark allotment, conducted with the use of the basic refinancing operations.

Figure 1. EONIA fluctuations against the ECB interest rates in 1999-2005



Source: ECB

Box 2. Banking sector liquidity management in the Eurosystem

The ECB is responsible for the management of the banking sector liquidity in the Eurosystem. A daily analysis of the liquidity conditions is based on the following data provided by the national central banks (NCBs):

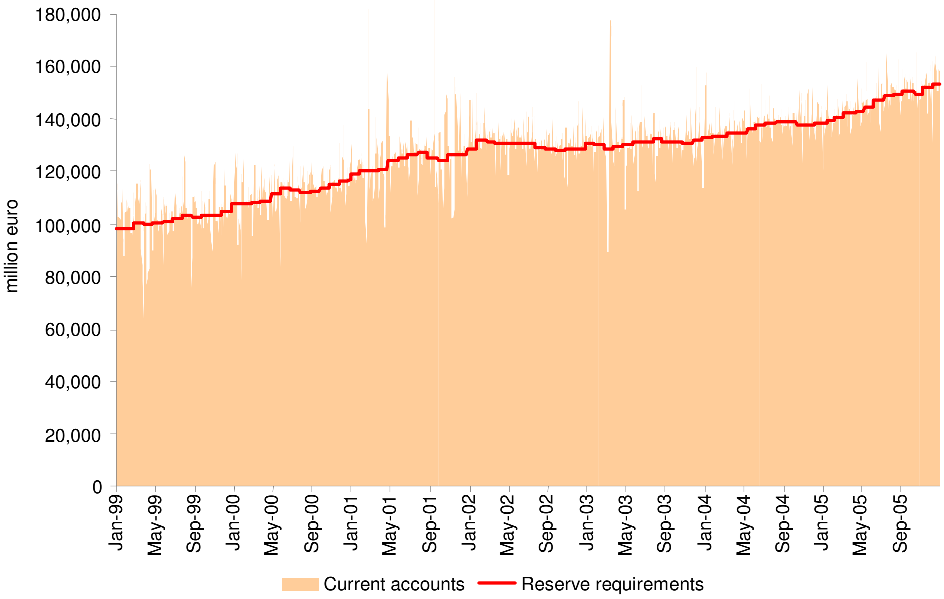
- NCB balance-sheet items as on the previous operating day,
- short-term forecasts for the shaping of balance-sheet items of a particular NCB.

The ECB aggregates the obtained data and prepares the liquidity forecasts for the whole banking sector in the euro area. On the forecasts grounds, decisions are taken on the level of the regular open market operations and the possible necessity to apply the fine-tuning or structural operations.
Once a week, the ECB publishes the banking sector liquidity forecast, which includes the maturity period of basic refinancing operations (to be more precise: estimated liquidity requirements of the banking sector for a particular period are announced to the market participants). The liquidity requirements are defined as the level of liquid funds absorbed from the market through the required reserves and autonomous factors. The level of the required reserves remains constant throughout a particular reserve requirement period. It means that the scale of the liquidity requirements changes under the influence of the autonomous factors exclusively. The market evaluates such requirements and the scale of liquidity-providing operations in the Eurosystem on the basis of the forecasted average level of the autonomous factors and benchmark allotment, published by the ECB.

Source: ECB

While calculating the benchmark allotment, the ECB acts under the assumption that the scale of the basic refinancing operation within its maturity period should enable credit institutions to maintain funds on the current account at a level similar to the required reserve. When calculating this amount, the ECB takes into consideration the market liquidity mismatch occurring in a particular maintenance period, which is reflected in the scale of deviation of the average current account balance from the required level.

Figure 2. Banking sector liquidity management by the ECB — daily fluctuations of the aggregated level of the commercial banks current accounts held with the NCB against the level of reserve requirements in 1999-2005



Source: ECB

Box3 Eurosystem fine-tuning operations in 2005. The last week of a reserve requirement period.

As a result of changes in the monetary policy operational framework in the Eurosystem in 2004, an open market operation (OMO) conducted as the last one in the particular reserve requirement period determines the liquidity conditions in the banking sector for the last 7 days of the period. During the maturity period of the last OMO, banks must fulfil the obligation of maintenance of the required reserve on a required level, whereas the ECB cannot influence market conditions with standard operations. Before the changes in the operational framework were introduced in 2004, the ECB could frequently adjust an operation conducted at an inappropriate scale with another regular operation that matured in the following reserve requirement period.

In 2005, the ECB did not develop a final stance on the necessity to apply the fine-tuning operations on the last days of a reserve requirement period. This instrument was used on several occasions to provide a desired liquidity to the banking sector. Works related to this issue are underway in the Eurosystem.

Fine-tuning operations in 2005 (data in m euro)

Date	Level of operations	Type of instrument	Maturity (in days)
18-01-2005	8,000	Repo / collateralised loan	1
07-02-2005	2,500	Repo / collateralised loan	1
08-03-2005	3,500	Fixed-term deposit at the NCB	1
07-06-2005	3,708	Fixed-term deposit at the NCB	1
12-07-2005	9,605	Fixed-term deposit at the NCB	1
09-08-2005	500	Fixed-term deposit at the NCB	1
06-09-2005	9,500	Repo / collateralised loan	1
11-10-2005	8,500	Fixed-term deposit at the NCB	1
05-12-2005	7,500	Fixed-term deposit at the NCB	1

Source: ECB

1.4. ECB monetary policy operations collateralized framework

Pursuant to Article 18.1 of the ESCB Statute, the Eurosystem liquidity-providing operations must have an adequate collateral established. Within the framework of the eligible collateral, a distinction is made between the two categories: the tier one assets and the tier two assets. The former include marketable debt instruments fulfilling the uniform euro area-wide eligibility criteria specified by the ECB. The tier two consists of additional assets, marketable and non-marketable, which are of particular importance to the national financial markets and banking sectors, and for which the eligibility criteria are established by the national central banks.

Eligible assets for Eurosystem monetary policy operations

Criteria	Tier one	Tier two
Type of assets	ECB debt certificates Other marketable debt instruments	Marketable debt instruments Non-marketable debt instruments
Settlement procedures	Instruments must be centrally deposited in a book-entry form with national central banks or an SSS meeting the ECB's minimum standards	Assets must be easily accessible to the national central bank that has included them in its tier two list
Type of issuer	Central banks Public sector Private sector International and supernational institutions	Public sector Private sector
Credit standards	The asset must be deemed of high credit quality by the ECB (which could include an eligible guarantee of an EEA[14]guarantor which is deemed financially sound by the ECB).	The asset must be deemed of high credit quality by the national central bank which has included them in its tier two list (which may include an eligible guarantee of a euro area guarantor which is deemed financially sound by the national central bank which has included the assets in its tier two list)
Location of establishment of the issuer	EEA countries non-EEA G10 countries (for issuers only)	Euro area
Location of establishment of the guarantor	EEA	Euro area
Placement of asset	Location of issue: EEA Location of settlement: euro area	Euro area
Currency	Euro	Euro
Cross-border transaction	Yes	Yes

Source: ECB

[14] The European Economic Area (EEA) includes: EU countries, Norway, Iceland, and Lichtenstein.

Eligible assets may be used on a cross-border basis by credit institutions in the Eurosystem monetary policy operations. The correspondent central banking model[15] or eligible links between SSSs for transferring securities in the EU are used for that purpose.

Works are underway in the Eurosystem and are aimed at introducing a uniform list of eligible assets. This single list will be introduced gradually and will eventually replace the current collateral management framework. The majority of tier two eligible assets will remain on the single list. Scarce tier two assets that do not meet the eligibility criteria for drawing them onto the single list will be gradually phased out".

2. NBP monetary policy operational framework

In the *Medium-Term Strategy of Monetary Policy (1998-2003)*, the MPC indicated the necessity to initiate works aimed to prepare Poland, including its monetary policy, to the integration with the European Union, and further on with the European Economic and Monetary Union. Since then, the NBP has been gradually adjusting its monetary policy operating system to the Eurosystem requirements.

The NBP joined the European System of Central Banks (ESCB) in May 2004. The obligation to join the euro area in the future does not entail any current obligations of the NBP as regards shaping of its monetary policy, which is still implemented independently.

Upon Poland's accession to the euro area, the domestic monetary policy operational framework will have to be fully adjusted to the Eurosystem requirements. The monetary policy operations will be coordinated by the ECB, and the NBP will be responsible for conducting them in the Polish banking system. It means that the NBP will be forced to implement appropriate changes beforehand or to prepare for their implementation as of the day of adoption of the euro.

Changes in the monetary policy operational framework introduced in 2005 and prepared for the implementation in the early 2006 have brought the system closer to the Eurosystem solutions. Further changes will be introduced gradually, or with the NBP's joining the Eurosystem.

2.1. Changes prepared for implementation as of the beginning of 2006

2.1.1. Expansion of the scope of data published by the NBP

The scope of information about the liquidity conditions in the banking sector, announced by the NBP, should be best adjusted to the characteristics of the local market. The basic indicator taken into consideration by banks in the assessment of the liquidity conditions is the balance on the banks' current accounts with the NBP. Hence, as of the beginning of 2006, the NBP expanded the scope of information published in the Reuters information service, to include:

❖ Forecast of the average current account balance

[15] The correspondent central banking model (CCBM) is a mechanism developed by the European System of Central Banks to facilitate utilisation of security assets in cross-border settlements. Within the CCBM, national central banks serve as fiduciary agents to one another (they operate deposit accounts for each national central bank and for the ECB).

A forecast projection of this item is announced once a week (on the day of conducting the basic open market operation), simultaneously with the publication of information about tender terms and conditions (at approx. 10.45 a.m.). The scope of data published includes the average daily forecast of the banks' current account balance with the NBP (the impact of the open market operations on the account balance is taken into consideration) within the horizon of the maturity period of the operation conducted. If the reserve requirement period finishes within the duration of the basic open market operation, the NBP announces two forecasts of the average account balance and of reserve requirements — for the current and subsequent reserve requirement periods. One of the forecasts pertains to the account balance in the period from conducting the operation to the end of the maintenance period. The other pertains to the period from the beginning of the new reserve requirement period up to the maturity date of the open market operation.

The central bank has a wider access to information about the factors affecting the liquidity conditions of the banking sector as compared with the data available to the market participants. Therefore the liquidity forecasts prepared by the NBP are usually more precise than those developed by the commercial banks. The NBP forecasts frequently include transactions effected by the central budget or institutions that hold accounts with the central bank (e.g. the European Commission, the Social Insurance Institution), as well as operations conducted by the central bank, of which the market has no information. Therefore, publication of the proposed scope of information by the NBP should improve the accuracy of assessment of the liquidity conditions by the market participants. As a result, it should contribute to the stability of the short-term rates in the interbank market.

❖ The average balance on the current account

The data on the average balance of the current account are published daily and cover the period from the beginning of the reserve requirement period to the preceding operating day.

It follows from the experience of the NBP and other central banks that where the so-called averaged required reserve system is used, some entities in the market may have problems with determining the liquidity position of the whole banking sector (since they only have information about the current account level and the reserve requirements). Instead of calculating the average deviation of the account balance from the required reserve, the market participants often constrain themselves to aggregating daily deviations. Such a method of calculating deviations may lead to erroneous assessment of the market liquidity position, which makes it more difficult to take a decision on participation in the open market operations. Publication of the average balance on the banks' current accounts should help banks in the assessment of the liquidity conditions.

Thanks to the changes introduced as of 2006, the banking sector is provided with the following scope of information about the liquidity conditions in the banking sector:

a) the reserve requirements in the current maintenance period (and in the subsequent period, if it starts during the maturity period of the basic operation),
b) the forecasted average daily balance on the current account during the maturity period of the basic open market operation, published upon the announcement of tender terms and conditions,

c) the average balance on the current account in the period since the beginning of the reserve requirement period up to the preceding operating day,
d) the daily balances on the banks' current accounts in the current reserve requirement period (data series for the period to the preceding operating day),
e) the use of the central bank's standing facilities, i.e. the deposit facility and the marginal lending facility, by banks, in the current reserve requirement period (data series for the period to the preceding operating day),
f) the level of the last basic open market operation.

2.1.2. Changes in the selection of the counterparties eligible to participate in NBP open market operations

As of 2006, the NBP introduced the following changes in the criteria for the selection of participants in the open market operations:

a) the expanded access to basic open market operations for all banks which:
    - participate directly in SORBNET,
    - hold an account in the Securities Register,
    - have the ELBON application in place, which facilitates electronic transfer of orders to the NBP,
b) fine-tuning operations are conducted only with the banks that conduct activity in the money and foreign exchange markets, and act efficiently in the case of the necessity for quick interventions in the money market on the part of the NBP,
c) flexible selection of the counterparties for structural operations by the NBP.

This change enables each bank that meets the criteria specified to participate directly in the NBP basic open market operations. In previous years, only the banks that performed the function of the Money Market Dealers could participate in such operations. Other banks could purchase the NBP bills only through their intermediaries. The increased number of entities participating in the basic open market operations should contribute to boosted competition among banks in the primary market of the NBP bills.

The method of identification of participants to fine-tuning and structural operations should enable the central bank to conduct quick fine-tuning operations in the case of the liquidity disorders in the money market, and provide more freedom in the selection of counterparties to structural operations that are aimed at the long-term changes in the structure of the banking sector liquidity.

2.2. Other adjustments

2.2.1. Open market operations

The NBP conducts basic open market operations in the direction reverse to that in the Eurosystem, due to the sustained surplus of the liquidity in the domestic banking sector. If the surplus remains in place in the future, the adjustment of the direction and type of the basic operations will take place upon Poland's accession to the EMU. Since then on, the monetary policy operations conducted by the NBP with the domestic banking sector will be coordinated by the ECB. Banks will be given the possibility to deposit the likely surplus of the liquidity within the single currency area (transactions with other commercial banks).

As regards the basic refinancing operations, the differences between the NBP and the ECB pertain to the following: the type of the instrument applied (issue of the NBP bills in the case of the NBP and repo operations or collateralized loans in the case of the ECB), and dates of their execution (on Fridays — the NBP, on Tuesdays — the ECB). Full harmonisation of basic operations will depend on the liquidity conditions in the Polish banking sector.

Currently, the NBP does not conduct longer (3-month) refinancing operations, as is the case with the ECB, since there is no need for them. If these operations remain in the operational framework of the Eurosystem[16], they will be introduced either when a sustained liquidity shortfall is attained or when the Polish zloty is replaced with the euro. The NBP is technically prepared for executing such operations.

Although the fine-tuning operations are among the available monetary policy instruments, they are not used by the NBP. Harmonisation of the available types of the fine-tuning operations will take place upon Poland's accession to the euro area.

Structural operations are identical with those likely to be conducted in the euro area. The issue of the ECB debt certificates will become one of the NBP instruments upon the bank's accession to the Eurosystem.

The NBP open market operations may be conducted, as is the case in the Eurosystem, through tenders or bilateral transactions. The only difference is the timeframe of basic operations. In Poland, the period between the announcement of tender terms and conditions and the liquidity forecast (at about 10.45 a.m. on Fridays) and the tender settlement is approx. 2-3 hours. In the euro area, it takes one day (in the case of the NBP, the settlement date for the operations is T+0, which means that they can also be conducted within a T+1 date, as is the case in the Eurosystem).

Open market operations conducted by and available to the NBP

Open market operations	**Types of operations**		**Maturity**	**Frequency**
	Liquidity- providing	**Liquidity-absorbing**		
Basic operations		Issue of NBP bills with maturity of 7 days	One week	Weekly
Fine-tuning operations	Repo transactions	Repo transactions	Non-standardised	Non-regular
		Issue of NBP bills		
	Pre-maturity buy-out of NBP bills			
Structural operations	Outright operations	Outright operations	Non-standardised	Non-regular

Source: NBP

[16] In 2003, the ECB conducted public consultations on the possible discontinuation of such operations. The majority of the credit institutions voiced opinions against such a proposal.

2.2.2. NBP required reserve system

The required reserve system is largely harmonised with the one in the Eurosystem. The following adjustments are only necessary to be made:

- introduction of the uniform reserve requirements (reduction of the "non-zero" requirement from 3.5% to 2% and introduction of 0% reserve requirements against deposits with an agreed maturity of over two years, deposits repayable at notice of over two years, and debt securities with an agreed maturity of over two years),
- introduction of a uniform maintenance period (it is approx. one month in Poland),[17]
- introduction of a uniform **lump-sum allowance** (it amounts to 100 thousand euro in the Eurosystem and to 500 thousand euro in Poland),
- change in the reserve interest rate from 0.9 of the rediscount rate to the average of maximum profitability obtained through tenders for main operations.

2.2.3. Standing facilities[18]

The standing facilities are largely adjusted to the Eurosystem requirements. The only difference pertains to eligible assets that can collateral the marginal lending facility (see below) and the timeframes of availability of both instruments. Banks can use the marginal lending facility offered by the NBP before 5.30 p.m., and place overnight deposits with the NBP before 6 p.m. In the Eurosystem, both operations may be completed before 6.30 p.m. (i.e. at least 30 minutes following the closing of TARGET).

2.2.4. Monetary policy collateral framework

The list of eligible assets from a particular EU Member State depends largely on the level of development of the local financial market. Thus, such a list may include a wide range of financial instruments (e.g. in Germany and France), or be limited to a single type of assets (e.g. Treasury securities in Greece).

Assets deemed eligible by the NBP to collateralize refinancing operations may currently include only the Treasury bills and Treasury bonds, quoted in the market and deposited with the National Depository for Securities or the NBP Securities Register. The possible future extension of the list of eligible assets by the NBP will depend on current market conditions, and particularly on the level of development of the financial market.

[17] As of March 2004, the new maintenance period in the Eurosystem begins on the day of settlement of the basic refinancing operation (Wednesday) maturing directly after the meeting of the ECB Governing Council. The number of days in individual maintenance periods may vary. A calendar of maintenance periods is published in advance (at least three months prior to the beginning of a particular year).

[18] The term "standing facilities" is used by the NBP as an equivalent of "overnight operations" used by the Eurosystem.