

2007-57
March 27, 2008

Poland (the Republic of)

Foreign LT: A-/Positive, Local LT: A/Positive

<Rating Perspective>

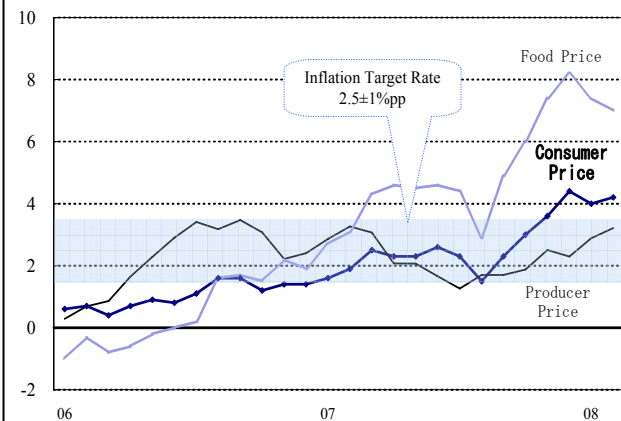
Positive Factors

- Continued convergence with the euro-zone economy in preparation for the adoption of the euro.
- The expansion of production capacity through massive inflows of foreign direct investment and subsidy from the EU

Negative Factors

- Persistent budget deficit
- High structural unemployment impeding economic flexibility
- Relatively heavy external burdens

Inflation rate exceeds the target



<Updated: from January to March 2008>

Positive Factors

- The Energy Regulation Office announced a plan to liberalize electricity prices for households as from January 1, 2009. (2/27) This follows the liberalization of electricity prices for corporate users this year.
- Support rating for the ruling Civic Platform (PO) party remains high at 46%. (3/5)
- The government announced plans to start privatizing the power, coal and pharmaceutical sectors during 2008. (3/4)
- The finance minister suggested that Poland may start linking the zloty to the euro possibly next year with the aim of euro adoption by 2012. (3/12)

Negative Factors

- The president of the National Bank of Poland (NBP) has announced a projection that the inflation rate, staying above 4% since December 2007, will contract to the 2.5% target by 2010.
- President Lech Kaczynski proposed a selective secession from the Treaty of Lisbon, posing confrontation with the ruling PO, which advocates a full ratification of the treaty. (3/18).

<Outlook and Points to Watch>

Outlook revised to Positive on improvement of fiscal deficit and political stability

(1) JCR has affirmed the ratings and revised the outlook to positive

JCR changed the rating outlook of Poland's both foreign-currency and domestic-currency long-term senior debts to positive on February 26, 2008. The revision reflects the country's continuing improvement on the fiscal deficit amid economic expansion and the former government's policy commitments to hold down the annual central government deficit. It is also based on the fact that the new government has launched a set of reform initiatives geared for a further reduction of the fiscal deficit and that the country's political stability has been maintained, with the approval rating for the new Cabinet remaining high. A further reduction of the fiscal deficit is likely to be attained, with the economy seen to continue growing by around 5% annually in the medium term.

(2) Fiscal deficit improving amid revenue increase

The general government fiscal deficit (ESA95) in 2007 is seen to have narrowed to around 2.5% of GDP, lower than the 3.0% convergence criterion, on revenue expansion led by increased tax income. The central government fiscal deficit narrowed to PLN19.7 billion (about 1.7% of GDP), far below the government's PLN30 billion target. The major deficit reduction stemmed mainly from increased tax income brought by the economic expansion and in part from reduced expenditures due to government failure to execute part of the EU subsidies. Counting the reduced social security burdens announced by the outgoing government, the 2008 budget plan has projected the central government fiscal deficit at PLN27.1 billion (about 2.2% of GDP), which is slightly less than that estimated in the

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former government's budget plan. According to the revised Convergence Program approved by the government on March 25, 2008, the general government plans the fiscal deficit target to 1% of GDP in 2011. It is also expected that the government will give top priority to the reduction of the structural fiscal deficit and public debt in the program. In 2006, the former government introduced steps to reduce income tax and social insurance contributions targeted at wage earners in a move to ease their heavy burdens. In February 2008, the present government announced a policy to promote broader-based tax reforms, including a review of the value added tax system and a reduction of corporate income tax rates. The government is also planning to ease the public debt burden through promotion of privatization as part of efforts to cut the structural fiscal deficit. Although privatization-related revenues had reached only 5.19% of the annual target as of the end of February, privatization is expected to make further headway, as the government has announced plans to privatize the electricity, coal and pharmaceutical sectors.

(3) Will 2008 be the year to start preparations for euro adoption in 2012?

Since the beginning of 2008, several comments have been made on the timing of the planned euro adoption. Announcing a mid-term projection of the inflation rate, NBP President Sławomir Skrzypek said that adoption of the euro will be realized by 2010, when the inflation rate may slow down to the 2.5% target. Finance Minister Jacek Rostowski has said that Poland is considering linking the zloty to the euro (the ERM2 mechanism) as early as in 2009 with the aim of adopting the common European currency by 2012. Prime Minister Donald Tusk also suggested on March 21 the adoption of the EURO in 2012. In any event, however, the government has not changed its cautious approach that a date for euro adoption will be determined only after confirming that Poland can keep its economic and fiscal indicators within the convergence criteria and that euro adoption does not pose a factor threatening the stability of the Polish economy.

(4) Higher economic growth to continue in 1Q of 2008 amid robust investment growth

The Polish economy registered a high 6.5% real GDP growth in 2007, much faster than the 2.9% average growth for the EU27. The growth was primarily driven by investment in the manufacturing and construction sectors and increased private consumption spurred by higher real wages. In 2008, corporate investment has been faring well and private consumption growing steadily, with the consumer confidence index on the rise. Meanwhile, there remains strong inflationary pressure spearheaded by higher real wages and food prices. The harmonized index of consumer prices rose 4.2% year-on-year in February, staying above the inflation target rate since December 2007. This has prompted the central bank to raise its policy rate twice by a total 50 basis points to 5.50% since the beginning of 2008. NBP President Skrzypek implied on Feb. 29 that the inflation pressure may continue throughout 2008 and that the inflation rate will slow down to the 2.5% target only after 2009. This indicates that the monetary tightening is highly likely to continue for the moment. The current account deficit almost doubled to PLN12 billion in 2007 from PLN6.3 billion in 2006 on a faster growth of imports amid strong domestic demand. FDI inflows grew a strong 42% in 2007 from the year before. Both exports and imports stayed brisk, expanding more than 20% year-on-year in January 2008.

Main Economic Indicators: The Republic of Poland

		2003	2004	2005	2006	2007(f)	2008(f)	2009(f)
Convergence criteria for adopting the euro								
1. CPI (annual average)		2.4%	0.8	3.5	2.1	1.0	2.5	3.0
2. 10 year government bond yield		5.5%	5.8	6.9	5.2	5.2	5.1	5.5
3. General gov't fiscal balance/GDP(ESA95)	Below -3.0%	▲6.3	▲5.7	▲4.3	▲3.8	▲3.0	▲2.8	▲2.5
4. General gov't debt/GDP(ESA95)	Below 60%	47.1	45.7	47.1	47.6	47.0	46.2	45.4
Real GDP growth rate	(%)	3.8	5.3	3.5	6.1	6.5	5.2	4.8
Unemployment rate (year-end)	(%)	19.6	19.0	17.7	14.0	10.0	7.8	6.0
Current account balance/GDP	(%)	▲2.1	▲4.3	▲1.7	▲2.3	▲3.6	▲4.0	▲4.5
Trade balance/GDP	(%)	▲2.7	▲2.2	▲0.9	▲1.4	▲2.6	▲3.2	▲3.7
Net FDI/GDP	(%)	2.0	4.8	2.3	3.0	4.0	3.9	2.6
Forex reserves (excl. gold)	(EUR mn)	25,310	25,313	32,797	34,242	37,800	40,000	41,500
Imports (G&S)/monthly imports	(months)	4.4	3.8	4.3	3.7	3.5	3.3	3.1
Forex reserves/short-term external debt	(times)	1.6	1.4	1.4	1.3	1.3	1.1	0.9
Gross external debt/ exports (G&S)	(%)	133.2	124.1	123.8	116.8	116.5	122.3	124.0
Gross external debt/ GDP	(%)	44.3	46.7	46.0	47.1	48.3	49.7	50.2
Gross public external debt/exports (G&S)	(%)	56.3	55.4	56.7	47.8	44.7	43.2	42.4
Debt service ratio	(%)	24.9	18.0	19.2	19.5	18.2	17.5	18.5

(Note) Figures for criteria 1 and 2 are annual average of 2007. Figures for 2007, 2008 and 2009 are projection made by JCR

(Source) The European Commission, National Bank of Poland and Ministry of Finance

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