

2008-21
August 28, 2008

Poland (the Republic of)

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

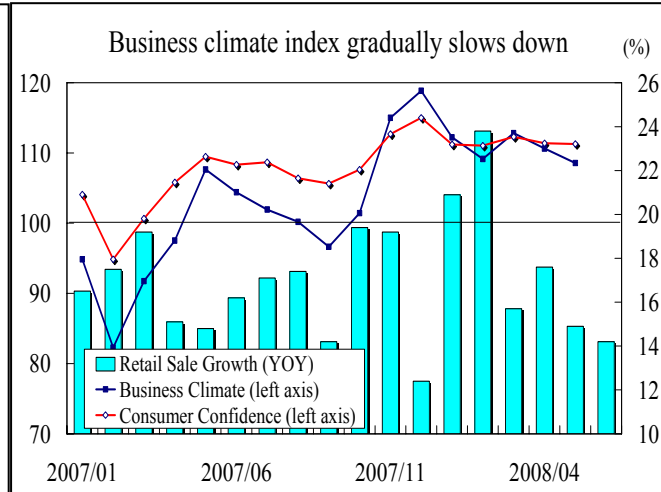
<Rating Perspective>

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

- High structural unemployment impeding economic flexibility
- Relatively heavy external burdens



<Updated: from June to August 2008>

Positive Factors

- The unemployment rate fell to 9.5% in June from 10.5% in April (7/28)
- Real GDP grew by 6.4% in the first quarter of 2008 (7/14)
- Retail sales grew a steady 10.1% in real terms year-on-year in the first quarter (7/28)

Negative Factors

- Amid continuing appreciation of the Polish zloty and overheating domestic demand, the current account deficit in the first quarter of 2008 widened to 4.9% of GDP (7/1)
- The inflation rate rose to 4.6% year-on-year in June, the highest since August 2004 (7/16)

<Outlook and Points to Watch>

Sound fiscal position sustained

(1) Economic growth remained robust until first quarter of 2008

Poland sustained its robust economic expansion in the first quarter of 2008 with a 6.1% real GDP growth rate. Much of the growth was paced by solid domestic demand amid a steady expansion of employment, income and gross fixed capital formation. However, there are some factors of concern for the future. First, while the consumer confidence index has been keeping its uptrend, the business sentiment index has been declining since the beginning of 2008. Second, retail sales increased more than 10% in the first quarter but the growth rate has been gradually slowing down as compared with the beginning of 2008. Another concern is the persistent inflation. The headline inflation rate accelerated to 4.8% year-on-year in July, the highest in seven years, rising for a third consecutive month. Mainly responsible for the rise were higher prices of foods, electricity, gas and fuels. Fuel prices, in particular, surged 8.2% year-on-year in July after a more moderate 6.0% gain in April. The core inflation rate stayed lower at 2.1% in May. But it has been on the constant rise since August 2007.

The National Bank of Poland (NBP) raised its policy interest rate by 25 bps in June. The rate has been raised by a total 100 bps since the start of 2008. The Polish zloty, which had long kept appreciating, has turned weakening, falling to a one-month low at the beginning of August. The turnaround apparently reflected the comment by NBP Governor Slawomir Skrzypek that he is "worried" about the zloty's appreciation. The surging inflation rate was also held responsible for the currency's depreciation.

(2) EC abrogates excessive deficit procedure against Poland

The cumulative fiscal deficit of the central government as of the end of June 2008 remained at the same level as that for the same period of 2007. However, the cumulative budget revenue growth was lower than that in 2007. Considering the continuing robust economic growth, revenue growth should prove higher in the latter half of 2008. On the other hand, the growth rate of expenditures was kept under control.

The government announced its budget guidelines for 2009 in late June. According to the guidelines, the fiscal deficit is planned to narrow to PLN18.2 bn or 1.3% of GDP. This forecast was based on a 5% real GDP growth rate and a 2.9% annual inflation rate. The government put the central government's budget revenues, including EU funds, at PLN310.5 bn, up 10.2 % from 2008, and expenditures at PLN328.7 bn, up 6.4%. As the government's economic forecast is almost the same as that of JCR, the revenue target will be reasonably attainable. On the other hand, JCR considers that the government may have difficulties curtailing its spending to meet the 6.4% expenditure growth target, which is far below the projected nominal GDP growth rate. Moreover, the planned cuts include expenditure items that will require politically difficult decisions.

On July 8, the European Commission decided to abrogate its excessive deficit procedure against Poland. According to a report by the commission, Poland's general government fiscal deficit was cut from 3.8% of GDP in 2006 to 2.0% in 2007, substantially below the 3.0% target set in the 2006 convergence program. The commission commented that the better-than-expected result was achieved not only by higher real GDP growth but also by the government's efforts to curtail spending. The commission affirmed that the deficit target can be trimmed to 2.5% as envisaged by the Polish government. As seen above, the government is aiming for a further reduction of the fiscal deficit in 2009. These were the main reasons for the decision to remove the excessive deficit procedure against Poland. This decision implies the commission's official endorsement of the Polish government's continued efforts for fiscal consolidation. It will have a positive impact on the country's creditworthiness.

Main Economic Indicators: The Republic of Poland

		2003	2004	2005	2006	2007	2008(f)	2009(f)
Convergence criteria for adopting the euro								
1. CPI (annual average)	2.4%	0.8	3.5	2.1	1.0	2.6	4.0	3.0
2. 10 year government bond yield	5.5%	5.8	6.9	5.2	6.2	6.5	7.5	5.5
3. General gov't fiscal balance/GDP(ESA95)	Below -3.0%	-6.3	-5.7	-4.3	-3.8	-2.0	-2.5	-2.0
4. General gov't debt/GDP(ESA95)	Below 60%	47.1	45.7	47.1	47.6	44.9	44.2	43.3
Real GDP growth rate	(%)	3.8	5.3	3.5	6.1	6.5	5.5	5.0
Unemployment rate (year-end)	(%)	19.6	19.0	16.7	11.9	8.2	7.0	6.0
Current account balance/GDP	(%)	▲2.1	▲4.3	▲1.7	▲2.3	▲3.4	▲4.3	▲4.8
Trade balance/GDP	(%)	▲2.7	▲2.2	▲0.9	▲1.4	▲2.9	▲3.5	▲4.0
Net FDI/GDP	(%)	2.0	4.8	2.3	3.0	3.8	3.9	2.6
Forex reserves (excl. gold)	(EUR mn)	25,310	25,313	32,797	34,242	37,800	41,580	45,783
Imports (G&S)/monthly imports	(months)	4.4	3.8	4.3	3.7	3.4	3.3	3.3
Forex reserves/short-tem external debt	(times)	1.6	1.4	1.4	1.3	1.1	1.0	1.0
Gross external debt/ exports (G&S)	(%)	133.2	124.1	123.8	116.8	115.3	121.5	123.2
Gross external debt/ GDP	(%)	44.3	46.7	46.0	47.0	48.0	49.2	49.6
Gross public external debt/exports (G&S)	(%)	56.3	55.4	56.7	47.8	44.7	42.9	42.2
Debt service ratio	(%)	24.9	34.6	28.7	19.5	18.2	17.5	17.5

(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

(Atsuko Kajiwara, Analyst)