

Poland (the Republic of)

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

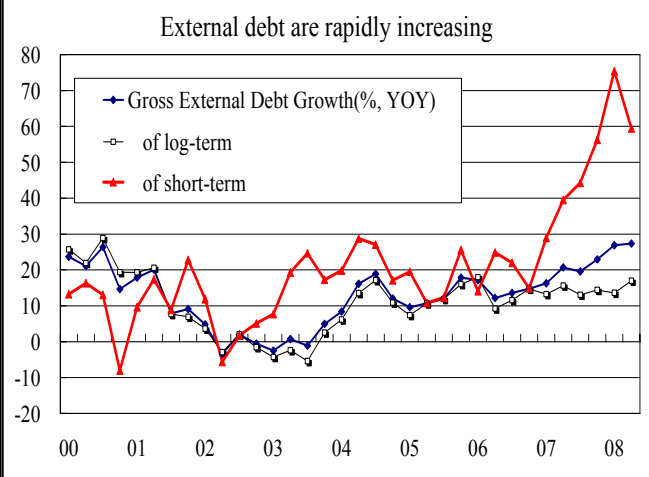
<Rating Perspective>

Positive Factors

- Continued convergence with the eurozone 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

- National Bank of Poland (NBP) announced a new instrument for use in providing Polish banks with PLN and FX liquidity (10/15, 11/7, 11/24)
- The government began revising budget and GDP growth estimates but planned to keep fiscal deficit estimate unchanged (11/20)

Negative Factors

- Real GDP growth in the third quarter slowed down to an estimated 4-4.5% from 5.8% in the previous quarter.
- Growth of retail sales decelerated to 8.0% in the third quarter from 11.1% in the previous quarter. (11/20)
- Industrial output growth slowed down from 8.5% in the second quarter to 3.4% in the third quarter. (11/21)
- Inflation rate fell to 4.5% in September from 4.8% in August. (11/20)
- Current account deficit widened to US\$7.6 billion in the second quarter. (10/28)
- Short-term external debt/gross external debt ratio increased to 44% in the second quarter from 32% the year before. (9/26)

<Outlook and Points to Watch>

Concerns growing over dependence on foreign finances

(1) Polish economy starts slowing down

Poland, which has sustained a robust economic growth until now, has begun to show clear signs of slowdown as advanced and some emerging economies head for economic deceleration. The country's industrial output registered minus growth in August from the year before. While its growth rate recovered to 7.6% in September, it declined again to 0.2% in October. The growth of the construction sector skidded down to 10% year-on-year in August after growing around 20% from 2007 to the first half of 2008. Retail sales have been slowing down uninterruptedly since the turn of 2008. The business climate and consumer confidence index has also stayed weak since the second quarter of 2008 and is likely to further weaken in the fourth quarter. The real GDP growth is projected to decline to 3-4 % in the latter half of 2008. The inflation rate began to decline in September, reflecting the economic slowdown and falls in primary commodity prices. Poland has kept a tighter monetary policy since inflationary pressures surged in 2007. However, the Monetary Policy Committee (MPC) has been keeping the official interest rate intact since June amid the weakening economic performance. Comments in MPC statements have been changing to imply its concerns over the future of the economy. There might be a cut in the interest rate depending on future economic trends.

(2) Concerns growing over dependence on foreign funds

The Polish zloty (PLN) steeply depreciated (falling by 30% against the US dollar) as foreign investors began pulling

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out their funds from Central and Eastern European countries (CEECs) including Poland. The stock market also took a battering, with the key WIG index losing by an average 30% in October alone. Both the currency and stock markets in the CEECs began to calm down after the IMF and EU announced a massive financial support for Hungary in early November. However, future trends need to be closely watched as foreign investors are still cautious about investment in emerging markets. Many Polish banks are the subsidiaries of major foreign banks. They depend on foreign funds borrowed through interbank deals with their parent banks. However, it is becoming uncertain whether they can continue their liquidity supply to their subsidiaries amid the credit crunch spreading across Europe. In a bid to ease the impact of the financial crisis, NBP announced on November 15 a new instrument to provide banks with PLN-denominated liquidity. One future concern for the banks is whether they can secure foreign currency-denominated liquidity. The outstanding balance of household loans has rapidly swelled in recent years. Such loans now account for 70% of the total bank credit balance. In particular, mortgage loans have been on the steady rise. Now they account for 90% of the total household loans. Although foreign currency-denominated loans had only a modest 26% share in the outstanding balance of bank loans, the corresponding ratio of mortgage loans was high at 58.2% in the January-September period of 2008. The share of Swiss franc-denominated mortgage loans is said to be particularly high. Considering such situations, NBP started to operate aggressive measures to secure providing foreign currency liquidity to the market. First, NBP announced the liquidity provision by utilizing swap facilities in cooperation with Swiss National Bank on Nov. 7. On Nov. 21, NBP also announced that it secure a facility to borrow up to EUR 10 billion from ECB. As data related to inter-bank transactions and so on has not been publicized yet, JCR will closely watch the future development of the financial market.

(3) The government starts revising the 2009 budget

The cumulative fiscal deficit of the central government as of the end of October 2008 proved to be substantially bigger than the year before. As usual, expenditures tended to grow faster in the latter half of the fiscal year. However, the growth of cumulative budget expenditures, which had been well controlled in the first half of 2008, began gradually picking up later while that of cumulative budget revenues slowed down in the third quarter. The government announced its budget guidelines for 2009 in late June. The guidelines projected the fiscal deficit to narrow to PLN18.2 bn or 1.3% of GDP. This forecast was based on a 4.8% real GDP growth rate and a 2.9% annual inflation rate. However, NBP later downgraded its economic forecast amid the rapid global economic slowdown and deterioration of Poland's core economic indicators. The IMF also revised downward its economic growth forecast for Poland twice in October and November. In view of these developments, the government has started revising its 2009 budget guidelines and GDP growth estimate. According to comments made so far by the government, the GDP growth forecast will be lowered to 3.5-4.0% but the estimated budget deficit will be kept unchanged.

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	6.1	5.7
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	5.2	3.6
Unemployment rate (year-end)	(%)	19.6	19.0	16.7	11.9	8.2	8.0	7.5
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	43,930	48,323
Imports (G&S)/monthly imports	(months)	4.4	3.8	4.3	3.7	3.4	3.5	3.5
Forex reserves/short-tem external debt	(times)	1.6	1.4	1.4	1.3	1.1	0.6	0.6
Gross external debt/ exports (G&S)	(%)	133.2	124.1	123.8	116.8	125.7	150.6	143.8
Gross external debt/ GDP	(%)	39.1	37.6	36.9	37.5	38.7	43.3	41.0
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	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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