

2009-05  
April 28, 2009

## Poland (the Republic of)

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

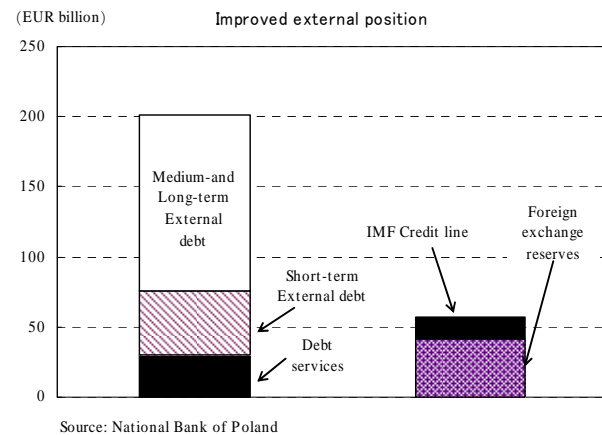
### <Rating Perspective>

#### Positive Factors

- Diversified industrial structure and the largest economy in Central and Eastern Europe
- The expansion of production capacity through massive inflows of foreign direct investment and subsidies from the EU

#### Negative Factors

- The chronic fiscal deficit
- Relatively heavy external burdens
- Rigid labor market



### <Updated: from February 2009 to April 2009>

#### Positive Factors

- On April 14, the IMF approved EUR 16 billion credit line to Poland under the Flexible Credit Line (FCL)
- The central bank cut its policy rate on February 26 and March 26 by a total 50bps to 3.75%
- From September 2008 to December 2008, external debt decreased by EUR 13.2 billion to EUR 171.8 billion
- The Zloty in February fell sharply to the lowest level around 4.9 against EUR since 2004, but recovered to around 4.2 in the middle of April, reflecting improved market sentiment against the Central and East European region
- The European Investment Bank doubled its lending to Poland to EUR 6 billion in 2009 from EUR 2.8 billion in 2008

#### Negative Factors

- Real GDP in the October-December quarter of 2008 slowed down to a 2.9% year-on-year from 4.8% in the previous quarter on slumped exports and stagnant investment demand
- The industrial production fell sharply to 14.3% year-on-year in February 2009 and ended in five consecutive contraction since October 2008
- Exports in February 2009 also decelerate further to 28.2% year-on-year

## <Outlook and Points to Watch>

### Provision of the IMF Flexible Credit Line

#### (1) JCR has affirmed the foreign and local currency ratings on Poland

On April 9, JCR has affirmed the A- rating on the foreign currency long-term senior debts and the A rating on the local currency long-term senior debts. The outlook of the ratings is stable.

The ratings are primarily based on the country's diversified industrial structure that supports the largest economy in Central and Eastern Europe, an expanded production capacity rendered by a heavy foreign direct investment (FDI) inflow and growing infrastructure investment backed by a massive inflow of EU subsidies.

On the other hand, the ratings remain constrained by the chronic fiscal deficit despite its improvement, a relatively large external debt owed primarily by the private sector and a rigid labor market that impedes further economic growth.

The Polish economy, though slowing down amid slumped exports, is highly likely to stay clear of a deep recession, underpinned by a stable domestic demand. With an increased general government fiscal deficit inevitable in 2009 on revenue shortfalls resulting from the economic downturn, the center-right coalition government with a stable political base will continue to pursue a stringent spending control to keep the deficit low after 2010 in a bid to prepare for the adoption of the euro. The government plans to enter the EU's exchange rate mechanism (ERM2) in mid-2009 and adopt the euro in 2012. However, JCR sees the timetable as premature not only because of the persistent currency volatility in the unsettled financial market but also because of a constitutional amendment needed for euro adoption.

**(2) Deep economic recession unlikely despite economic slowdown**

The Polish economy, which had annually expanded faster than 5% since 2006, slowed down to a 2.9% year-on-year growth rate in the October-December quarter of 2008 on slumped exports amid the economic downturn in its major European trading partners and stagnant investment demand. While the growth rate may further decelerate to around 1% in 2009 from 4.8% in 2008, a deep recession is likely to be averted as consumer spending will stay stable on tax cuts and rising real wages, and infrastructure investment will keep growing on the back of increased EU subsidies. Moreover, any further deterioration of exports will be avoided thanks to their improved competitiveness brought by the Polish zloty's steep depreciation. Amid the subsiding inflationary pressure and deteriorating economic outlook, the central bank started to ease its monetary policy since November 2008 and has cut its policy rate by a total 225bps to 3.75%.

The country's financial system remains solid so far, but banks' profit has begun to be eroded by increased loan-loss provisions. Their financial base somewhat weakened as the capital adequacy ratio fell to 10.8% in 2008 from 12.1% in 2007. The country's banking sector is relatively small, with its private-sector credits accounting for less than 50% of GDP in 2008. Polish banks make less foreign-currency loans than peers in Central and Eastern Europe. Most of the major Polish banks are the subsidiaries of big European banks and depend on loans from their parents for fund procurement. The parent banks have kept their exposure in Poland largely intact so far. However, if they face difficulties amid the deepening financial market crisis, they may tighten their lending to their Polish subsidiaries.

**(3) Government to keep stringent fiscal policy to prepare for euro adoption**

The general government fiscal deficit in 2008 is estimated to have widened slightly to 2.7% of GDP as compared with 2.0% of GDP in 2007 due mainly to revenue shortfalls resulting from the economic slowdown. Under its 2009 budget plan unveiled in December, the government estimated the annual deficit at 2.5% of GDP on the assumption that the economy will grow 3.7%. However, faced with the deteriorating economic outlook, the government lowered its economic growth estimate to 1.7% in February. At the same time, it announced an additional spending cut equivalent to over 1% of GDP to keep the deficit below 3% of GDP. Considering the worsening economic situation, the deficit in 2009 is highly likely to widen on reduced revenues unless a further spending cut is implemented. But the deficit is expected to improve as the government will keep its stringent fiscal policy after 2010 to pave the way for future euro adoption. Meanwhile, the general government fiscal debt was estimated at around 46% of GDP at the end of 2008, a slight increase from the previous year. But it stayed well below the 60% threshold of the Maastricht Convergence criteria.

**(4) External position improved by the new lending provided by the IMF**

The current account deficit widened to around 5% of GDP in 2008 from 4.7% in 2007. A steeper economic slowdown may allow Poland to trim the deficit on reduced imports. The deficit had been mainly financed with FDI inflows until 2007. In 2008, however, about half of the deficit was covered with bank loans and foreign exchange reserves. Poland's external debt at the end of 2008 narrowed to 48% of GDP from the year earlier. While the foreign exchange reserves stood at EUR41.4 billion at the end of March 2009, the short-term foreign debt primarily owed by private sector remained as high as EUR 46.1 billion at the end of 2008. On April 14, the IMF approved EUR 16 billion credit line to Poland under FCL. This lending facility will contribute to stabilizing the country's external position because the government could utilize the lending to strengthen the country's foreign exchange reserves if necessary.

**Main Economic Indicators: The Republic of Poland**

		2005	2006	2007	2008	2009(f)	2010(f)
<b>Convergence criteria for adopting the euro</b>							
<b>1. CPI (annual average)</b>	<b>4.0%</b>	2.2	1.3	2.6	4.0	3.3	2.0
<b>2. 10 year government bond yield</b>	<b>5.9%</b>	5.2	5.2	5.5	6.0	n.a.	n.a.
<b>3. General gov't fiscal balance/GDP(ESA95)</b>	<b>Below-3.0%</b>	-4.3	-3.8	-2.0	-2.7	-3.5	-3.0
<b>4. General gov't debt/GDP(ESA95)</b>	<b>Below 60%</b>	47.1	47.7	44.9	45.9	46.0	47.0
<b>Real GDP growth rate</b>	(%)	3.6	6.1	6.7	4.8	1.0	2.0
<b>Unemployment rate (year-end)</b>	(%)	17.7	13.8	8.5	9.1	9.5	9.8
<b>Current account balance/GDP</b>	(%)	-1.6	-3.2	-4.7	-5.5	-4.5	-3.9
<b>Trade balance/GDP</b>	(%)	-0.9	-2.0	-4.0	-4.6	-4.4	-4.6
<b>Net FDI/GDP</b>	(%)	2.3	3.0	4.2	3.1	1.7	2.3
<b>Forex reserves (excl. gold)</b>	<b>(EUR mn)</b>	32,797	34,242	37,141	40,637	49,400	57,500
<b>Imports /monthly imports</b>	<b>(months)</b>	4.3	3.6	3.3	3.1	3.8	4.2
<b>Forex reserves/short-tem external debt</b>	<b>(times)</b>	1.4	1.3	0.9	0.9	1.2	1.3
<b>Gross external debt/ exports</b>	(%)	123.7	116.6	125.0	120.8	115.4	113.7
<b>Gross external debt/ GDP</b>	(%)	45.9	47.0	51.0	48.5	47.2	46.1
<b>Gross public external debt/exports</b>	(%)	56.6	47.8	46.9	35.0	32.4	31.9
<b>Debt service ratio</b>	(%)	28.6	17.4	16.4	17.6	20.7	19.3

(Note) Figures for criteria 1 and 2 are annual average between March 2008 and February 2009. Figures for 2008 and 2009 are projection made by JCR

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

(Toshihiko Naito, Chief Analyst)