

2009-44
January 29, 2010

Poland (the Republic of)

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

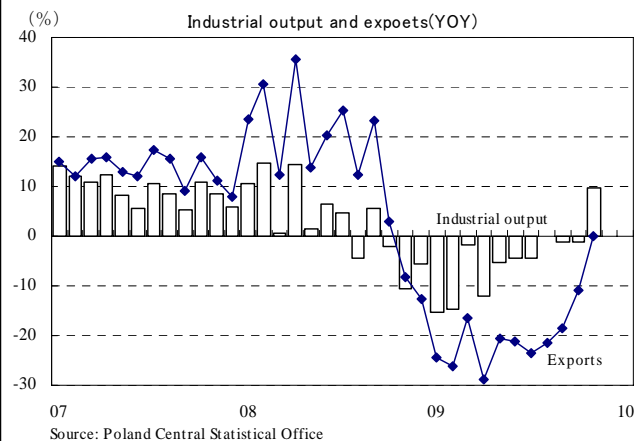
<Rating Perspective>

Positive Factors

- Diversified economic structure with lower dependence on exports
- Expansion of production capacity on the back of growing investment underpinned by massive inflows of FDI and EU subsidies

Negative Factors

- Chronic fiscal deficit
- Relatively heavy external burdens
- Rigid labor market



<Updated: from October 2009 to January 2010>

Positive Factors

- The state budget deficit in the first eleven months of 2009 was Zloty 24.4 billion (1.8% of GDP), in line with the government 2009 fiscal plan (Zloty 27 billion)
- The current account deficit in the January-November period of 2009 improved noticeably to 1.3% of GDP from 4.7% a year earlier
- Year-on-year growth of industrial output in November 2009 surged to 9.8%, the strongest growth rate since April 2008
- Net capital inflows into Poland (foreign direct investment, portfolio investment and other investments) increased to 8.0% of GDP in the January-November period of 2009 from 7.5% a year earlier
- Real GDP in the July-September quarter of 2009 continued to grow positively to 1.7% year-on-year from 1.1% in the previous quarter (on qoq basis, real GDP grew positively for three consecutive quarters from the beginning of 2009)
- Foreign exchange reserves at the end of 2009 increased by 19% year-on-year to EUR 48.4 billion
- Polish banking sector recorded a net income of Zloty 7,007 million in the July-September quarter of 2009, up from Zloty 4,333 million in the previous quarter

Negative Factors

- Under the approved budget plan for 2010, the state budget deficit in 2010 expected to widen to 3.7% of GDP from 2.0% in 2009
- Finance Minister announced to delay the country's euro adoption from 2014 to 2015

<Outlook and Points to Watch>

Continued economic recovery

(1) The country will keep positive economic growth after avoiding a recession

Poland is probably the only EU member country that has averted a recession in the wake of the global economic and financial turmoil. The economy grew 6.0% per year on average in the past three years to 2008 and kept a positive growth rate from the beginning of 2009 on yoy basis. Real GDP in the July-September quarter of 2009 continued to grow 1.7% yoy from 1.1% in the previous quarter. Unlike other Central and Eastern European countries, steady domestic demand has been supporting the whole economy, which is relatively less dependent on exports. As industrial output surged to 9.8% yoy in November 2009, real GDP in the October-December quarter of 2009 is likely to grow further.

Despite the rising unemployment and credit tightening by the banks, the economy is highly likely to achieve a moderate growth in 2010, due mainly to the steady personal consumption supported by tax reduction and an expansion of infrastructure investment underpinned by EU subsidies. Amid the subsiding inflationary pressure and weak economic outlook, the central bank started easing its monetary policy in November 2008, cutting its policy rate by a total 250bps

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so far to 3.50%.

(2) Stable financial system has enough capacity to absorb increased credit cost

The financial system has restored its stability after experiencing deterioration amid the global financial turmoil. Banks suffered profit setbacks on increased loan-loss provisions, with the ratio of nonperforming loans rising to 7.0% at the end of September 2009 from 4.5% at the end of 2008. Given the slower economic growth, a further increase of nonperforming loans looks inevitable. However, the country's financial system retains sufficient capacity to absorb the increased credit cost, with the capital adequacy ratio improving to 13.0% at the end of September 2009 from 11.2% at the end of 2008. Most of the major Polish banks are subsidiaries of big European banks and dependent on their parents for much of their liquidity. JCR holds that the possibility of those parent banks withdrawing their funds is rather slim as their exposure in Poland is reportedly based on their long-term investment strategy.

(3) Improved external position on the back of IMF's FCL and increased inflow of foreign capital

The country's external position has improved after it secured a line of credit totaling US\$ 20.6 billion in April 2009 under the IMF's Flexible Credit Line (FCL) program. The current account deficit narrowed to 1.3% of GDP in the January-November period from 4.7% a year earlier. The deficit was sufficiently covered by net capital inflows (foreign direct investment, portfolio investment and other investments) which increased during the period to 8.0% of GDP. As a result, the foreign exchange reserves rose by 19% to EUR 48.4 billion at the end of November 2009 and amply covered the short-term external debt at the end of September 2009. The IMF support has helped a great deal to improve the international investors' confidence in Poland. JCR estimates that the total sum of the foreign exchange reserves and the FCL credit line is enough to cover the need of country's external finance for 2010 with narrowing current account deficit.

(4) Government to keep stringent fiscal policy in preparation for euro adoption

Faced with a bleak economic outlook in June 2009, the government revised its general government fiscal deficit estimate to 4.6% of GDP from 3.0%. In the following month, the Ecofin Council of EU put Poland under the *excessive deficit procedures* and called on the country to cut its fiscal deficit to less than 3.0% of GDP by 2012. JCR forecasts the deficit in 2009 to widen to around 6% of GDP on reduced revenues and the general government debt, which increased to 47.1% of GDP at the end of 2008, is highly likely to increase rapidly in the coming years. However, the latest *Public Debt Management Strategy* published in late September 2009, foresaw that the debt will remain below 55% of GDP in 2010-2012. In order to curb swollen debts, the government plans to raise 25.0 billion zloty (1.9% of GDP) in 2010 through the sale of state-owned assets. If the debt-to-GDP ratio may exceed 55% in 2010, the government would be required to take measures under *the Public Finance Laws* to compile a balanced budget in the following year. A balanced budget would negatively affect the economy.

The center-right coalition government which enjoys a strong political base had to postpone its euro adoption from 2014 to 2015. However, it will resume implementing fiscal reforms in 2010 in a bid to prepare for euro adoption. JCR will keep monitoring how the fiscal reforms will be substantiated.

Main Economic Indicators: The Republic of Poland

		2006	2007	2008	2009(f)	2010(f)	2011(f)
Convergence criteria for adopting the euro							
1. CPI (annual average)	-0.7%	1.3	2.6	4.0	3.0	2.5	2.8
2. 10 year government bond yield	4.8%	5.2	5.5	6.0	6.1	n.a.	n.a.
3. General gov't fiscal balance/GDP(ESA95)	Below -3.0%	-3.9	-1.9	-3.9	-6.0	-6.8	-6.5
4. General gov't debt/GDP(ESA95)	Below 60%	47.7	44.9	47.1	51.3	55.5	60.3
Real GDP growth rate	(%)	6.2	6.8	5.0	1.5	2.0	2.5
Unemployment rate (year-end)	(%)	13.8	8.5	9.1	12.0	11.6	11.0
Current account balance/GDP	(%)	-2.7	-4.7	-5.2	-0.7	-2.2	-3.5
Trade balance/GDP	(%)	-2.0	-4.0	-5.0	-0.4	-2.5	-3.8
Net FDI/GDP	(%)	3.2	4.3	2.3	2.1	2.3	1.7
Forex reserves (excl. gold)	(EUR mn)	34,242	37,141	40,637	48,387	53,600	56,300
Imports /monthly imports	(months)	3.6	3.3	3.1	4.7	4.5	4.0
Forex reserves/short-tem external debt	(times)	1.3	0.9	0.9	1.0	1.1	1.2
Gross external debt/ exports	(%)	116.6	125.0	119.8	149.7	153.1	145.9
Gross external debt/ GDP	(%)	47.0	51.0	48.8	60.7	61.1	63.2
Gross public external debt/exports	(%)	47.8	46.9	34.3	48.9	48.2	44.4
Debt service ratio	(%)	17.4	16.4	17.6	20.7	19.3	19.3

(Note) Figures for criteria 1 and 2 are annual average between December 2008 and November 2009. Figures for 2009 - 2011 are projection made by JCR

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

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