2010-045
April 28, 2010

Poland (the Republic of)

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

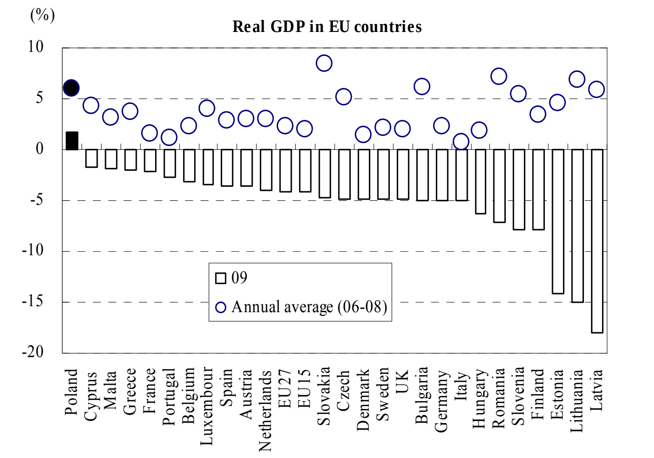
<Rating Perspective>

Positive Factors

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

Negative Factors

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



<Updated: from January to April 2010>

Positive Factors

- Despite the disastrous loss of president Lech Kaczyński as a victim to the airplane crash on April 10, Mr. Bronisław Komorowski, the speaker of the lower house of parliament, duly took over as interim president. The presidential election was moved up to June 20 from October 2010.
- The current account deficit in 2009 improved noticeably to 1.7% of GDP from 5.1% in 2008
- Net capital inflows into Poland (foreign direct investment, portfolio investment and other investments) increased to 8.1% of GDP in 2009 from 7.5% in 2008
- Foreign exchange reserves at the end of February 2010 renewed its record to EUR 54.6 billion
- Poland was the only of the EU 27 countries to register a positive economic growth rate of 1.8% in 2009. Real GDP in the October-December quarter of 2009 revised upwardly from 3.1% year-on-year to 3.3%
- Year-on-year growth rate of the industrial output continued grow for five months running from November 2009

Negative Factors

- The general government fiscal deficit (ESA95) in 2009 deteriorated to 7.1% of GDP from 3.7% in 2008. The government debt in 2009 also worsened to 51.0% of GDP from 47.2% in 2008. The state budget deficit in the first two months of 2010 widened to 1.2% of GDP from 0.4% a year earlier
- The European Commission made negative evaluation on the Poland's Convergence Programme submitted in February 2010

<Outlook and Points to Watch>

Monitoring fiscal policy ahead of the elections

(1) On March 30, JCR has affirmed the ratings on Poland

The ratings are primarily supported by the country's diversified industrial structure that supports the largest economy in Central and Eastern Europe, and its expanded production capacity on the back of a massive EU subsidies and foreign direct investments. On the other hand, the ratings remain constrained by the widening fiscal deficit and a relatively larger foreign debt owed primarily by the private sector.

The outlook of the ratings is kept stable. In the midst of the continued economic recovery, the county's external position has improved markedly thanks to a narrowing current account deficit, its increasing foreign exchange reserves, and the IMF's Flexible Credit Line (FCL). Despite implementation of any drastic fiscal consolidation measures can hardly be anticipated ahead of the two major elections scheduled for 2010 and 2011, the coalition government is expected to take gradual consolidation measures to curb the large fiscal deficit in preparation for the country's euro adoption.

(1) After averting a recession, the economy will keep growing moderately

Poland was the only of the EU 27 to register a positive economic growth rate of 1.8% in 2009 without going through a notable recession even after the global financial turmoil. Unlike other Central and Eastern European countries, the Polish economy showed resilience to the global economic downturn due mainly to a relatively low dependence on exports and built-in stabilizers functioning well, aside from appropriate fiscal measures. The economy is projected to grow moderately by around 3% in 2010 and 2011, slightly lower than the country's potential growth rate. The inflation rate (HICP) accelerated to an estimated 4% in 2009 on higher food and energy prices and currency depreciation, but is likely to stabilize amid an expected moderate economic recovery in the coming years. The central bank has kept its policy rate at 3.50% after cutting it by a total 250bps between November 2008 and June 2009. Poland's financial system remains sound with adequate capitalization to absorb any deterioration in the quality of assets held by banks. A further increase of nonperforming loans looks inevitable as the nonperforming loans ratio rose to 7.2% at the end of 2009 from 4.5% a year before. However, the country's financial system retains sufficient capacity to absorb increased credit costs, with the capital adequacy ratio improving to 13.3% at the end of 2009.

(2) External position improved on IMF's FCL and increased capital inflows

The country's external position has improved, bolstered by the IMF assurances in May 2009 of a credit line totaling US$20.6 billion under its FCL program and increasing capital inflows following the recovery of international investors' confidence in Poland. The current account deficit narrowed to 1.7% of GDP in 2009 from 5.1% in 2008. The deficit was sufficiently covered by net capital inflows which grew to around 8.1% of GDP during the year. As a result, the foreign exchange reserves swelled to EUR 54.6 billion at the end of February 2010, exceeding the short-term foreign debts outstanding as of the end of 2009 and five times as great as the average monthly imports in 2009. Nonetheless, the county's debt burden remains heavy with the balance of foreign debt totaling EUR193.9 billion or 61.9% of GDP at the end 2009. The ratio of the foreign debt to exports exceeded around 160% at the end of 2009 from 119% a year earlier.

(3) Government poised to promote fiscal reforms in preparation for euro adoption

The general government fiscal deficit (ESA95) in 2009 widened to 7.1% of GDP, up from 3.6% in 2008, due to a revenue shortfall resulted from the economic slowdown and other fiscal measures taken prior to the crisis. The government debt at the end of 2009 also worsened to 51.0% of GDP from 47.2% in 2008. The government's *Convergence Program* (published in February 2010) envisaged cutting the deficit to 2.9% of GDP in 2012 from 6.9% in 2010 through implementation of reforms on the social security system, adoption of a stricter spending rule and an expansion of the tax base. The country's *Public Finance Law* requires the government to take rigid corrective measures when the cash-based government debt exceeds 55% of GDP. Such measures would have a negative impact on the economy. The government's *Public Debt Management Strategy* published in late September 2009 estimated that the debt will stay below 55% of GDP in 2010-2012. In order to stem any further expansion of the debt, the government plans to repay its debt by raising 25.0 billion zloty (1.9% of GDP) in 2010 through the sale of state-owned assets.

The center-right coalition government has so far implemented measures to expedite an early adoption of the euro and economic growth on its parliamentary majority and high public support to the PO. JCR holds that the government will take necessary measures to curb the large fiscal deficit in preparation for euro adoption, although it may find it harder to take any drastic measures ahead of the elections in 2010 and 2011.

Main Economic Indicators: The Republic of Poland

		2006	2007	2008	2009	2010(f)	2011(f)
Convergence criteria for adopting the euro							
1. CPI (annual average)	-0.7%	1.3	2.6	4.2	4.0	2.5	3.0
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%	-3.6	-1.9	-3.7	-7.1	-6.6	-5.3
4. General gov't debt/GDP(ESA95)	Below 60%	47.7	45.0	47.2	51.0	56.5	60.3
Real GDP growth rate	(%)	6.0	6.7	5.0	1.8	2.0	2.5
Unemployment rate (year-end)	(%)	16.2	12.7	9.8	10.9	12.1	11.3
Current account balance/GDP	(%)	-2.7	-4.7	-5.1	-1.7	-2.5	-4.2
Trade balance/GDP	(%)	-2.0	-4.0	-5.0	-1.0	-2.0	-3.7
Net FDI/GDP	(%)	3.2	4.2	2.2	1.9	3.4	2.7
Forex reserves (excl. gold)	(EUR mn)	34,242	37,141	40,637	48,387	58,500	64,500
Imports /monthly imports	(months)	3.6	3.3	3.1	4.8	5.2	4.9
Forex reserves/short-tem external debt	(times)	1.3	0.9	0.9	1.0	1.2	1.2
Gross external debt/ exports	(%)	116.5	124.8	119.1	160.5	158.3	151.7
Gross external debt/ GDP	(%)	47.0	50.9	48.5	61.9	62.1	63.0
Gross public external debt/exports	(%)	47.8	46.8	34.3	53.5	57.7	55.7
Debt service ratio	(%)	23.5	24.6	22.5	28.0	22.1	22.7

(Note) Figures for criteria 1 and 2 are annual average between February 2010 and January 2010. Figures for 2010 - 2011 are projection made by JCR
(Source) The European Commission, National Bank of Poland and Ministry of Finance

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