

Poland (the Republic of)

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

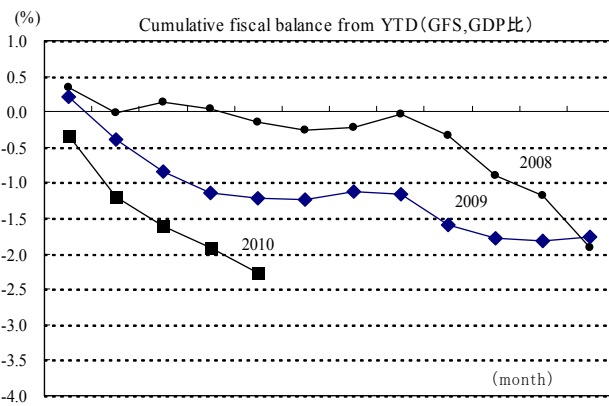
<Rating Perspective>

Positive Factors

- Diversified economic structure
- Expansion of production capacity on increased investment underpinned by massive inflow of FDI and EU subsidies

Negative Factors

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



(Source) Poland Central Statistical

<Updated: from April to July 2010>

Positive Factors

- Mr. Bronislaw Komorowski, the former speaker of the lower house of parliament and the candidate of the ruling Civic Platform (PO), was elected president in the run-off election held on July 24.
- The IMF approved to renew its Flexible Credit Line (FCL) for Poland on July 2
- The government has so far sold 11.7 billion zloty (0.8% of GDP) worth of state assets or roughly half its 25 billion zloty target set for 2010.
- The industrial output in the April-May period grew 11.9% year-on-year after a 10.1% gain in the January-March quarter of 2010.
- Foreign direct investment inflows in the first five months of 2010 surged to reach 2.9% of GDP from 0.7% a year earlier. The current account deficit in the same period remained subdued at 0.5% of GDP.
- Foreign exchange reserves at the end of June 2010 swelled to a record EUR60.4 billion.

Negative Factors

- The state budget deficit in the first five months of 2010 widened to 2.1% of GDP from 1.2% a year earlier. The government debt at the end of June 2010 also increased to 51% of GDP from 49% at the end of March.
- The external debt at the end of March 2010 grew 21% year-on-year to EUR205.5 billion (62.6 % of GDP), due mainly to an increased debt owned by the public sector.
- Real GDP growth rate in the January-March quarter of 2010 slowed slightly to 3.0% year-on-year from 3.3% the previous quarter, due mainly to a sharp fall in investments. Seasonally adjusted, the growth rate was 0.5% quarter-on-quarter, the lowest in the past year.

<Outlook and Points to Watch>

PO strengthens its political base

(1) PO candidate Komorowski elected new Polish president

The presidential election was originally scheduled to take place in October 2010. However, it was brought forward following the death of then President Lech Kaczynski in a plane crash in April 2010. In the first round of voting held on June 20, no candidates won a majority. In the run-off election held on July 4, Mr. Komorowski, the former lower house speaker and candidate of the ruling Civic Platform (PO), was elected new president. His election has resulted in strengthening the political base of the ruling coalition formed by PO and the Polish Peasant's Party (PSL).

(2) The coalition government made progress so far on the economic and fiscal reforms

The center-right PO, which is more in favor of a market-oriented policy than previous government, has so far made some progress on the economic and fiscal reforms. Privatization, which should provide much of the funds needed to finance the growing government deficit, has been making progress according to its original plan. The government has so far sold its part of stakes in major insurer PZU SA, copper producer KGHM, oil refiner Grupa Lotos SA and energy producer Tauron Polska Energia SA. Proceeds from the sales have so far totaled 11.7 billion zloty (0.8% of GDP) or

about half the government's 25 billion zloty target set for 2010. The fiscal reform also made some progress as the proposed budget for 2011 was tabled according to the expenditure rule for the first time, which limits the year-on-year growth of flexible expenses and new fixed expenses to the rate of inflation plus 1%, with the aim of cutting the state fiscal deficit to 40 billion zloty (2.7% of GDP) from 52 billion zloty (3.4% of GDP) in 2010. The 2011 budget plan estimated the real GDP growth rate at 3.5% and the inflation rate at 2.3%. Nonetheless, the future progress on the fiscal reform should be slow in view of the general election in 2011.

The government debt increased to 51% of GDP at the end of June 2010 from 49% at the end of March. The country's *Public Finance Law* requires the government to take rigid corrective measures when the government debt exceeds 55% of GDP. Such measures would have a negative impact on the economy. The government estimated that the debt will stay below 55% of GDP in 2010-2012.

(3) The economy will keep growing moderately but slower than potential growth rate

Poland was the only country among the EU 27 to register a positive 1.8% economic growth rate in 2009 without going through a recession in the aftermath of the global financial woes. Real GDP growth rate in the January-March quarter of 2010 slowed slightly to 3.0% year-on-year from 3.3% in the previous quarter, due mainly to a sharp fall in investments. Seasonally adjusted, the growth rate was 0.5% quarter-on-quarter, the lowest in the past year. By contrast, the industrial output in the April-May period grew 11.9% year-on-year, exceeding the 10.1% gain in the January-March quarter. The economy is projected to grow in and around 3% in 2010 and 2011, slightly lower than the country's potential growth rate, as exports and investment will pick up amid economic recovery in its major European trading partners and increased EU subsidies. The inflation rate is likely to stay subdued in keeping with the country's moderate economic recovery.

The central bank has kept its policy rate at 3.5% after cutting it by a total 250bps between November 2008 and June 2009. Poland's financial system remains sound as banks have enough capital to absorb any deterioration in the quality of their assets. A further increase of nonperforming loans looks inevitable, but banks keep their credit cost at fully manageable levels thanks to their solid profitability and capital adequacy ratio, which stood at 13.3% at the end of 2009.

(4) External position improves on increased capital inflows and IMF's FCL

Poland's external position has improved, bolstered by increased capital inflows and the IMF assurances in May 2009 of a credit line totaling US\$20.6 billion under its FCL program. The foreign exchange reserves swelled to a record EUR60.4 billion at the end of June 2010, or more than enough to cover the short-term foreign debts outstanding at the end of March and over five times as much as the average monthly imports in the first five months of 2010. The IMF approved to renew its FCL Line for Poland on July 2.

The current account deficit in the first five months of 2010 remained subdued at 0.5% of GDP. The deficit was sufficiently covered by FDI inflows which surged to 2.9% of GDP in the period from 0.7% a year earlier. Nonetheless, the country's debt burden remains heavy, with the balance of foreign debt standing at EUR205.5 billion or 62.6% of GDP at the end of March 2010.

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)	-0.5%	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	-7.5	-7.0
4. General gov't debt/GDP(ESA95)	Below 60%	47.7	45.0	47.2	51.0	53.5	56.8
Real GDP growth rate	(%)	6.0	6.7	5.0	1.8	2.5	3.0
Unemployment rate (year-end)	(%)	16.2	12.7	9.8	10.9	12.5	11.8
Current account balance/GDP	(%)	-2.7	-4.7	-5.1	-1.6	-2.8	-5.2
Trade balance/GDP	(%)	-2.0	-4.0	-5.0	-1.0	-2.3	-4.7
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	62,500	68,500
Forex reserves /monthly imports	(months)	3.6	3.3	3.1	4.8	5.5	5.1
Forex reserves/short-tem external debt	(times)	1.3	0.9	0.9	1.0	1.1	1.1
Gross external debt/ exports	(%)	116.5	124.8	119.1	160.5	162.3	158.1
Gross external debt/ GDP	(%)	47.0	50.9	48.5	61.9	63.6	65.7
Gross public external debt/exports	(%)	47.8	46.8	34.3	53.5	60.2	62.1
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 of 2009. Figures for 2010 and 2011 are based on the projection made by JCR

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

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