

2003-60
March 22, 2004

Poland (the Republic of)

Rating on Foreign Currency Long-term Senior Debts: A-/Stable

Rating on Local Currency Long-term Senior Debts: A/Stable

(Affirmed on May 8, 2003)

Main Factors for the Ratings

Positive Factors

- More stable economic structure is to be built through progress in reforms inspired by a strong political will to adopt the euro.
- Increasing exports to the EU countries resulting from the expansion of production capacity through inflows of foreign direct investment.

Negative Factors

- Increasing government debt due to persistent budget deficits.
- Rise in structural unemployment impeding economic flexibility.
- Heavy external debt consisting mainly of private sector debt.

The medium-term fiscal reform plan

	(zł million)
Total	Total
	(04-07)
Social security cuts (need legislative approval)	34,075
Current expenditure cuts and additional revenues	20,490
items that need legislative approval	18,182
items that do not need legislative approval	2,308
Total	54,565
Ratio to nominal GDP in 2003	6.7%
The value of cuts to be made under approved bills, etc. (as of March 4, 2004)	15,868
Ratio to nominal GDP in 2003	2.0%

Updated: from December 2003 to February 2004

Positive Factors

- Three bills related to a medium-term fiscal reform program proposed by Deputy Prime Minister Jerzy Hausner were approved in parliament.
- Economic recovery turned firmer as real GDP grew by 4.7% year-on-year in the October-December quarter of 2003.
- The current account deficit in 2003 shrank by nearly half from the previous year, with its ratio to GDP falling to 1.8%.

Negative Factors

- 2004 budget plan was approved in parliament. The consolidated fiscal deficit will remain as high as 6.3% of GDP on the assumption of a 5% economic growth rate.
- Prime Minister Leszek Miller resigned as head of the Democratic Left Alliance (SLD) and expressed an intention to call an early election should parliament fail to approve the medium-term fiscal reform program.
- The popularity rate of the ruling SLD slipped to 12%, the lowest on record.

<Prospects and Noticeable Points>

Economic recovery is on track

Real GDP grew by 4.7% year-on-year in the October-December quarter of 2003, indicating that the Polish economy is right on a recovery track. Fixed capital formation has turned upward since the July-September quarter, while steady expansion of consumer spending. Exports have been strengthening due in part to the depreciation of the zloty. Real GDP grew by 3.7% in 2003 as a whole, far exceeding the 1.4% registered the previous year. In 2004, the recovery will be firmer and the economy will expand more than 4%. Price levels, though rising moderately at the moment amid the economic recovery, will remain generally stable in 2004 as the supply-demand gap is unlikely to tighten. The current account deficit improved to 1.8% of GDP in 2003, helped by a strong gain in exports. However, the current account

deficit is likely to increase moderately in 2004 as imports will accelerate amid stronger business pickup. The central bank has kept its monetary policy neutral but may change it to a restrictive one by mid-2004 in view of stronger economic recovery and continuing large fiscal deficit.

Three reform-related bills enacted by parliament

In order to curb the fiscal deficit, the most crucial issue for Poland, the adoption of a medium-term fiscal reform program ^(note) proposed by Deputy Prime Minister Hausner is extremely important. The minority coalition government needs to get support from opposition parties, in particular the No.1 opposition Citizen's Platform (PO), to have the reform program approved in parliament. Three bills including a bill revising the price indexation of pensions were approved with the backing of PO and another opposition party, which had recently joined the coalition government. To date, the total amount of spending cuts between 2004 and 2007 resulting from the approved bills and other measures that do not require legislative action is estimated at zloty 15.9billion or 2.0% of GDP. These measures will contribute toward reducing the fiscal deficit albeit insufficient in amount.

Note: The program envisages cuts in social security and administrative expenses amounting to zloty 54.6 billion or 6.7% of GDP between 2004 and 2007. The program was approved by the cabinet in January and related bills were put before parliament on March. In order to fully implement the fiscal reform program, more than twenty bills need to be approved in parliament.

Revision of rating outlook possible depending on future policies

Following its EU accession in May 2004, one of decisive factors for the rating on Poland will be how soon it can decide to adopt the euro. Before a country can switch to the euro, it must comply with four economic criteria. The most difficult criterion for Poland will be to cut and keep the budget deficit below 3 % of GDP. JCR believes that the remaining bills related to the fiscal reform program will probably clear parliament, as the three of them have already been approved with the support from opposition parties. If the program can be fully implemented, it is highly likely that the fiscal deficit will be cut below 4 % of GDP in 2005 and trimmed further to fall below 3 % within several years. The government seeks to contain the deficit below 3% of GDP by 2006. Now that some of the reform-related bills have been enacted, the possibility of an early election earlier suggested by Prime Minister Miller has apparently receded. Focus of attention now shifts to how swiftly parliament will act on the remaining bills and how far the government will be able to carry out the reform program ahead of the next general election due to be held in September 2005. JCR has retained its current ratings, but may consider revising its rating outlook should the government fail to carry out the fiscal reforms.

Main Economic Indicators: The Republic of Poland

		2000	2001	2002	2003(f)	2004(f)
Real GDP growth rate	(%)	4.0	1.0	1.4	3.7	4.5
CPI (annual average)	(%)	10.1	5.5	1.9	0.8	1.8
Unemployment rate	(%)	14.0	16.2	17.8	18.0	17.5
General gov't budget deficit/GDP	(%)	-2.9	-5.1	-6.0	-6.3	-6.6
General gov't debt/GDP	(%)	44.4	39.3	47.2	52.0	55.0
Current account balance	(US\$mn)	-9,946	-7,166	-6,700	-3,767	-6,238
Current account balance/GDP	(%)	-6.1	-3.9	-3.5	-1.8	-2.7
Trade balance/GDP	(%)	-8.0	-6.4	-5.5	-4.6	-5.4
Net Foreign Direct Investment	(US\$mn)	8,169	6,928	3,789	3,675	8,150
Net Foreign Direct Investment/GDP	(%)	5.0	3.8	2.0	1.8	3.5
Forex reserves (excl. gold)	(US\$mn)	26,562	25,648	28,650	31,853	33,465
Imports (G&S) coverage	(months)	6.8	6.6	7.1	6.5	6.0
Forex reserves/short-tem external debt	(times)	2.8	2.3	2.1	1.8	1.7
External debt/ exports (G&S)	(%)	218.7	209.4	228.2	197.6	195.3
External debt/ GDP	(%)	42.3	39.2	44.6	45.5	44.9
Public external debt/exports (G&S)	(%)	105.2	86.9	97.0	83.5	84.5

Note: figures for 2003 and 2004 are JCR forecast.

Sources: The central bank, Ministry of Finance

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