

2004-14
June 21, 2004

Poland (the Republic of)

Foreign LT: A-/Stable, Local LT: A/Stable (Affirmed on May 8, 2003)

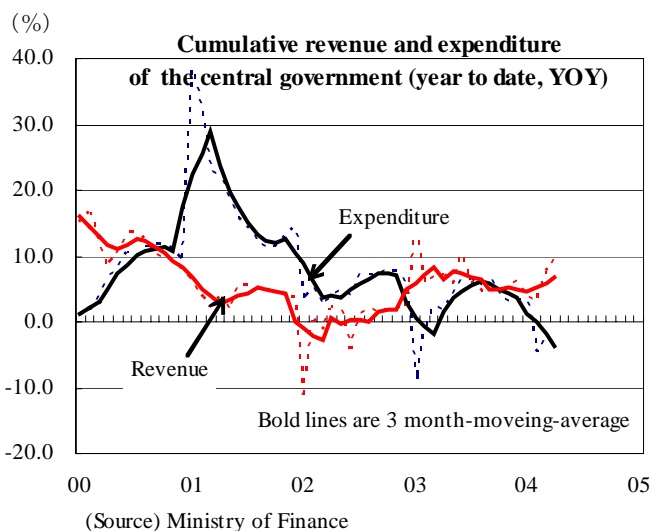
Main Factors for the Ratings

Positive Factors

- A 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.



Updated: from March 2004 to May 2004

Positive Factors

- On May 1, 10 countries including Poland joined the EU.
- In coping with rising inflation expectation, the central bank changed its monetary policy stance from neutral to restrictive in April.
- The current account deficit between January and March was EUR 429 million, a quarter of the level in the previous year.
- The government estimates that 5-6 billion zloty will be raised in revenue from the IPO (30% of total share to be sold) of PKO BP, the country's largest state owned bank.
- Due to restrained expenditure and increased tax revenue, the central government's fiscal deficits in the January - April period was held at 24.3% of target set by the government for 2004, lower than the original government projection.

Negative Factors

- While the approval rate of the ruling Democratic Left Alliance continues to slide as low as 6%, that of Citizens' Platform (PO) has risen to 29%.
- Following the resignation of Prime Minister Leszek Miller, the former finance minister Marek Belka, who has been named next prime minister, failed to win the first confidence vote in parliament.

<Prospects and Noticeable Points>

Economic expansion has favorable effect on containing fiscal deficit

Poland's real GDP grew by 4.7% year-on-year in the October-December quarter of 2003, indicating that the economy is right on a recovery track. The growth of gross fixed capital formation turned positive in the July-September quarter amid the steadily expanding consumer spending. Exports have been strengthening due in part to the depreciation of the zloty. The Polish economy has been growing faster than JCR had projected. The real GDP in the January-March quarter grew by 6.9% mainly driven by robust exports and investment. It is highly likely that the economy will grow by more than 5% in 2004 as a whole (the government revised its projection from 5.0% to 5.7%). The rate of inflation continued to accelerate, registering a rise of 2.2% year-on-year in April amid the economic expansion and a surge in energy prices. The central bank changed its monetary policy stance from neutral to restrictive in April to cope with rising inflation expectation. It is highly likely that the central bank will increase its interest rate in near future. The current account deficit improved considerably due primarily to rising exports. In fact, the deficit in the January-March quarter shrank to a quarter of the level in the previous year. Growing inflows of foreign direct investment exceeded the current account

<1/2>

deficit, resulting in an increase in the foreign exchange reserves. The central government's fiscal deficit, which has been a source of concern for years, in the January - April period was held at 24.3% of the level targeted for 2004, or lower than earlier projected by the government, due primarily to restrained expenditure and increased tax revenue.

Uncertainty remains over politics following resignation of Prime Minister Miller

After Prime Minister Miller announced his resignation on March 26 (and resigned on May 2), President Kwasniewski expressed his intension to nominate the former Finance Minister Marek Belka as caretaker prime minister. Polish law requires a caretaker prime minister to win confidence vote in parliament in order to become prime minister. If he or she is rejected by parliament, an election has to be called. The first confidence vote (in which absolute majority is required) was held on May 14, following the official appointment of Mr. Belka as caretaker prime minister. Mr. Belka failed to win the motion (the vote was 188 in favor and 226 against). Then, none of the parliamentary parties could field a candidate for next prime minister by the deadline of May 28. In this situation, the second or final confidence vote (in which simple majority is required) is scheduled to be held at the end of June. Mr. Belka is seen certain to be nominated again by the president, but he needs the support from opposition parties to secure a simple majority in parliament. Mr. Belka is now making an effort to enlist support from opposition parties.

Revision of rating outlook possible should fiscal reform program fail to be implemented

A crucial issue for Poland which seeks to adopt the euro following its EU accession is to contain the fiscal deficit below 3% of GDP, one of the convergence criteria. Extremely important in this respect is whether the country can carry out a medium-term fiscal reform program proposed by Deputy Prime Minister Hausner. Mr. Belka has already expressed his intention to support the reform program. His confidence in parliament will surely add to the probability of the program being implemented.

However, there remains the possibility that his government is forced to revise the program to ensure cooperation from the opposition camp. Furthermore, there is the possibility that the country's next general election scheduled for September 2005, is moved up as demanded by some opposition parties. In the next general election, it is highly likely that PO, which is gaining popularity, will emerge victorious and form a coalition government with other right-wing parties. Should this happen, the government would be able to implement more proactive fiscal reforms. 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	2004(f)
(4 Convergence criteria)						
1.CPI (annual average)	(%)	10.1	5.5	1.9	0.8	2.3
2.10 year government bond yield	(%)	11.2	9.0	5.6	6.6	7.7
3.General gov't budget deficit/GDP(ESA95)	(%)	-1.8	-3.5	-3.6	-4.1	-6.0
4.General gov't debt/GDP(ESA95)	(%)	36.6	36.7	41.2	45.4	50.8
Real GDP growth rate	(%)	4.0	1.0	1.4	3.8	5.2
Unemployment rate (year-end)	(%)	14.0	16.2	17.8	18.0	17.3
Current account balance/GDP	(%)	-6.0	-2.9	-2.7	-2.0	-1.6
Trade balance/GDP	(%)	-7.4	-4.1	-3.8	-2.7	-2.6
Net Foreign Direct Investment/GDP	(%)	5.7	3.1	2.0	1.8	3.9
Forex reserves (excl. gold)	(EURmn)	26,562	25,648	28,650	31,853	33,465
Imports (G&S) coverage	(months)	5.7	5.5	5.1	4.7	5.0
Forex reserves/short-tem external debt	(times)	2.9	2.4	2.1	1.8	1.9
External debt/ exports (G&S)	(%)	148.4	125.2	141.5	163.0	166.8
External debt/ GDP	(%)	41.4	34.7	41.9	56.0	61.5
Public external debt/exports (G&S)	(%)	71.4	58.5	57.2	54.8	57.1
Debt service ratio	(%)	21.3	29.3	23.4	19.4	18.5

Note: figures for 2004 are based on JCR estimation.

Sources: The central bank, Ministry of Finance, The European Commission

(Toshihiko Naito, Senior Analyst)