

2005-13  
June 24, 2005

## Poland (the Republic of)

**Foreign LT: A-/Stable, Local LT: A/Stable** (Affirmed on May 12, 2005)

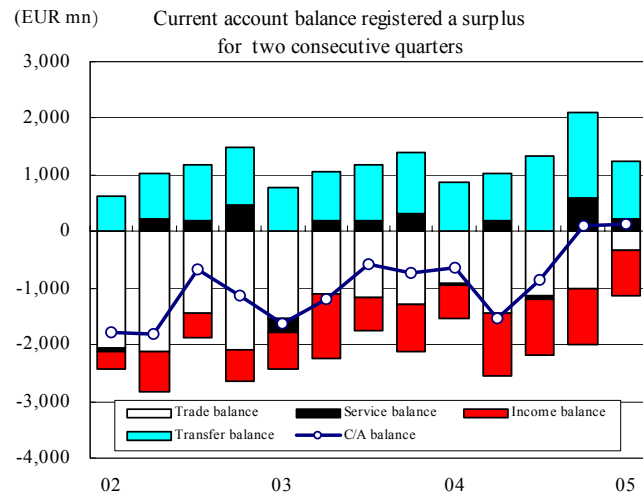
### Main Factors for the Ratings

#### Positive Factors

- A more stable economic structure is likely to be built on progress made in various reforms geared for adoption of the euro.
- Increasing exports brought by the expansion of production capacity through inflows of foreign direct investment.

#### Negative Factors

- Persistent budget deficits.
- High structural unemployment impeding economic flexibility.
- Relatively heavy external burdens



### Updated: from December 2004 to February 2005

#### Positive Factors

- Following rejection of an early election by parliament on May 5, Prime Minister Marek Belka tendered his resignation to President Aleksander Kwaśniewski on May 6. As the president rejected his resignation, the Belka administration will stay in office until the next parliamentary election in September 2005. As a result, political uncertainty has been averted.
- By the end of May, Poland had repaid around 30% of its Paris club debt.
- Current account balance posted a surplus of EUR118 million in the January-March quarter, registering a surplus for two consecutive quarters.
- The central bank cut its policy rate by 100 bps in March and April, and changed its easy monetary policy bias to neutral on April 28.
- Consumer price inflation in May slowed down to 2.5% year-on-year.

#### Negative Factors

- Real GDP in the January-March quarter of 2005 decelerated further to 2.1% year-on-year.

## <Prospects and Noticeable Points>

### The ratings on foreign and local currency were affirmed

#### (1) Following its affirmation of the ratings on foreign and local currency debts on May 12, JCR assigned the rating to the third Samurai bonds on June 8

The rating stems from the expectation that Poland will make further progress on economic and fiscal reforms in pursuit of an early participation in the Exchange Rate Mechanism II and adoption of the euro in 2009, that the country's exports will continue growing, buoyed by the expansion of production capacity brought by inflows of foreign direct investment and that the country will make further headway in its privatization schemes.

On the other hand, the rating is constrained by the fact that the fiscal deficit, though slightly better than the government estimate for 2004 due to increased tax revenues and restrained expenditures, still remains at high levels. Furthermore, Poland has relatively heavy external burdens and a high structural unemployment, with 18% (Poland Central Statistical Office) of its total workforce engaged in the agricultural sector, whose productivity is extremely low. These factors impede the country's further economic growth.

## (2) The economy slowed due to weak domestic demand

JCR estimates that the Polish economy will grow by more than 4% in 2005, led by both domestic and external demand centering on gross fixed capital formation. However, its expansion was slow in the January-March quarter of 2005, with the real GDP growth rate decelerating to 2.1% year-on-year from 4.0% in the previous quarter. While personal consumption dipped marginally to 1.7% from 1.9% in the previous quarter, gross fixed capital formation plunged sharply to 1.0% from 7.4%. In contrast, growth of exports continued outpacing that of imports despite the appreciation of the zloty. The sharp economic slowdown in the first quarter was due in part to base period effects. The Polish economy surged in the January-March quarter of 2004, buoyed by strong consumer spending ahead of the EU accession. Furthermore, there were fewer working days in the first quarter of this year. JCR forecasts that the economy will bounce back in the latter half of the year as gross fixed capital formation will pick up again and exports will continue growing. Consumer price inflation rate rose to 4.5% year-on-year in the latter half of 2004 due primarily to temporary factors such as higher food prices caused by strong external demand for Polish food products. It slowed down to 2.5% year-on-year in May 2005. The central bank cut its policy rate by 100 bps in March and April, and shifted its easy monetary policy bias to neutral on April 28.

## (3) Current account surplus and progress on repayment of Paris club debts

In January 2005, the government expressed its intention to move up the repayment of its Paris club debt that totaled EUR 12.3 billion and accounted for 50% of its total external public debts (falling due between 2005 and 2009). By the end of May, Poland had repaid around 30% of its Paris club debts. Because the repayment was financed with the issuance of sovereign bonds, it did not contribute to any appreciable reduction of government external debts. But it contributed toward reducing refinancing risks and debt servicing costs. The current account balance registered a surplus in the January-March quarter of 2005 on increased exports of both goods and services. The financial account balance also posted a surplus in the January-March quarter as inflows of net portfolio investment (issues of sovereign bonds) and FDI more than offset outflows of other investment (repayment of the Paris club debts).

## (4) Focal point is fiscal policy to be taken by post-election government

The current center-left coalition government led by the Democratic Left Alliance has not enough power to push further fiscal tightening because of its dwindling popularity and minority status in parliament. Following rejection by parliament on May 5 of an early election, Prime Minister Belka submitted his resignation to President Kwasniewski on May 6. The president refused to accept the resignation, forcing the Belka administration to stay in office until the next parliamentary election in September 2005. Thus, a new political crisis has been averted. However, the crucial task of reducing the fiscal deficit in pursuit of the euro adoption has been left to be resolved by the next administration. The liberal Civic Platform and the rightist Law and Justice, which enjoy growing popularity in the latest opinion polls, are likely to emerge victorious in the next election and form a coalition government with a parliamentary majority. Should this happen, the new government might be able to implement more proactive fiscal reforms.

### Main Economic Indicators: The Republic of Poland

		2000	2001	2002	2003	2004	2005(f)	2006(f)
<b>(Convergence criteria)</b>	<b>Criteria (2004)</b>							
1.CPI (annual average)	2.6%	10.1	5.5	1.9	0.7	3.5	3.2	3.0
2.10 year government bond yield	5.6%	11.8	10.7	7.4	5.8	6.9	6.5	6.0
3.General gov't budget deficit/GDP(ESA95)	Below -3%	-2.8	-3.9	-3.6	-4.5	-4.8	-4.0	-3.3
4.General gov't debt/GDP(ESA95)	Below 60%	51.3	36.7	41.2	45.4	43.6	45.0	47.5
Real GDP growth rate	(%)	4.0	1.0	1.4	3.8	5.4	4.5	4.7
Unemployment rate (year-end)	(%)	14.0	18.0	19.7	20.0	19.6	18.8	18.0
Current account balance/GDP	(%)	-6.1	-2.9	-2.7	-2.2	-1.6	-2.3	-3.0
Trade balance/GDP	(%)	-7.5	-4.2	-3.9	-2.8	-2.6	-3.2	-3.8
Net Foreign Direct Investment/GDP	(%)	5.8	3.2	2.1	1.9	2.2	2.7	1.9
Forex reserves (excl. gold)	(EURmn)	27,215	26,747	25,504	25,310	25,313	26,500	27,500
Imports (G&S) coverage	(months)	5.3	4.9	4.6	4.4	3.8	3.5	3.1
Forex reserves/short-tem external debt	(times)	2.7	2.1	1.9	1.6	1.5	1.6	1.6
Gross external debt/ exports (G&S)	(%)	148.3	141.8	135.3	131.8	122.4	119.5	115.6
Gross external debt/ GDP	(%)	42.0	39.8	40.5	45.6	49.0	50.5	52.2
Gross public external debt/exports (G&S)	(%)	71.3	58.5	57.1	55.0	55.8	56.9	58.8
Debt service ratio	(%)	20.7	27.9	22.4	18.4	15.0	15.5	16.5

(Note) Figure for 2005 and 2006 are based on JCR forecast.

(Sources) The European Commission, Central Bank, and Ministry of Finance.

(Toshihiko Naito, Senior Analyst)