2006-13
June 30, 2006

Poland (the Republic of)

Foreign LT: A-/Stable, Local LT: A/Stable (Affirmed on April 12, 2006)

Main Factors for the Ratings

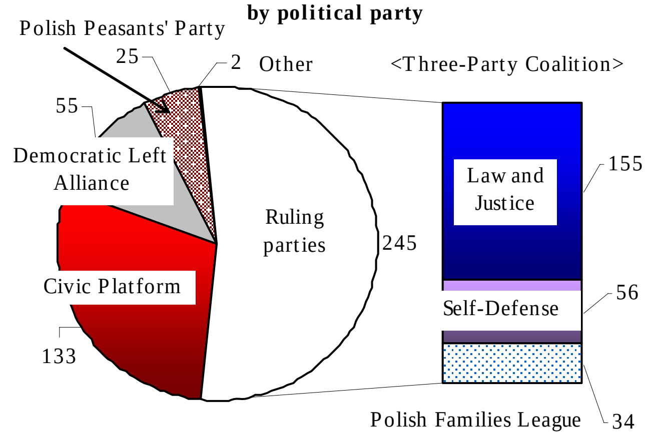
Positive Factors

- Continued harmonization with the euro-zone economy in preparation for the adoption of the euro
- Strong exports brought by the expansion of production capacity through inflows of foreign direct investment.

Negative Factors

- Heavy fiscal deficit
- High structural unemployment impeding economic flexibility
- Relatively heavy external burdens

Composition of Lower House members by political party



Updated: from March 2006 to June 2006

Positive Factors

- On May 8, Law and Justice party (PiS), Self-Defense and the Polish Families League (LPR) agreed to form a coalition government, securing a majority of 245 seats in the 460-member parliament.
- Real GDP growth in the January-March quarter of 2006 accelerated to 5.2% year-on-year from 4.3% in the previous quarter.
- On June 13, the government approved a budget plan for 2007, pledging to keep the fiscal deficit at zloty 30 billon (2.7% of GDP).
- The budget plan also called for cutting the number of government employees by 10,700 or 10% from 107,000 at the end of 2005.
- Prime Minister Kazimierz Marcinkiewicz announced that his government plans to introduce in 2007 new measures aimed at reducing the fiscal deficit to less than 3% of GDP.

Negative Factors

- State budget deficit in the first four months of 2006 widened 37% year-on-year to zloty 19 billion (equivalent to 62% of the 2006 budget). Finance Minister Zyta Gilowska was dismissed following allegations that she had cooperated with Communist-era secret police.
- The European Commission called on the Polish government to take necessary measures to slash the fiscal deficit to less than 3% of GDP by the end of 2007.
- The current account deficit in the first four months of 2006 widened 28% year-on-year to EUR1,331 million or 0.5% of GDP.

<Prospects and Noticeable Points>

Political uncertainty will recede temporarily

(1) JCR has affirmed the ratings in annual review

On April 12, 2006, JCR has retained the ratings on foreign currency and local currency long-term senior debts and outstanding bonds in consideration of the government's retention of a policy to keep the annual fiscal deficit around zloty 30 billion and the country's continued favorable economic prospects. The ratings outlooks were stable. JCR will closely follow how the PiS will make progress on fiscal reforms in cooperation with coalition partners, Self-Defense and LPR led government.

(2) Consumer spending and exports boost economic growth in the January-March quarter of 2006

The real GDP growth in the January-March quarter of 2006 accelerated to 5.2% year-on-year from 4.3% in the previous quarter. Much of the growth came from consumer spending which rose 5.1% year-on-year on improved labor market including an increase in real wages. Gross fixed capital formation, though slightly weaker than the previous quarter, posted a strong 7.4% year-on-year gain on solid corporate profit performances and low interest rates. Export rose 20.8% year-on-year, sharply up from an 11.8% growth in the previous quarter. The negative effect on exports of a strong zloty was canceled out by the improved productivity and a gradual recovery in demand for Polish products in European countries. Imports rose 18.9% year-on-year after a 14.7% increase the previous quarter on increased capital goods imports induced by strong investment. The economy is projected to grow more than 4% annually in 2006 and 2007 on robust domestic demand spurred by an improving labor market and lower interest rates.

Inflation remained significantly slow with CPI rising 0.7% year-on-yea in April 2006. The improving labor market has had a limited impact on the inflation so far and falling food prices and temporarily weak fuel prices have been contributing to the stability of overall prices. After cutting its policy rate 25 basis points in both January and February, the central bank is keeping the rate unchanged at 4%. Although the inflation may remain subdued, the bank will find a further rate cut harder to implement for the present given the rises in international interest rates and nominal wages in Poland.

The current account deficit in the first four months of 2006 widened 28% year-on-year to EUR1,331 million or 0.5% of GDP due to a smaller transfer account surplus despite a reduced trade deficit. Much of the reduced transfer account surplus stemmed from one-time factors such as contribution to the EU budget. Thus, the current account balance is likely to end up with a smaller deficit in 2006 and 2007 as a reduced trade deficit will prove substantive enough to offset the income balance deficit.

(3) The formation of a coalition with a parliamentary majority will reduce political uncertainty for now

Immediately after a motion for parliamentary dissolution was rejected, PiS, Self-Defense and LPR agreed to form a coalition government, securing a 245 majority in the 460-member legislature. While Kazimierz Marcinkiewicz (PiS), known to pursue a rather liberal policy, was retained as prime minister, three ministers (agriculture, education and, labor and social policy) joined his Cabinet from the two coalition partners. The coalition pact may help reduce political uncertainty for the time being.

(4) Replacement of finance minister may add to spending pressure

State budget deficit in the first four months of 2006 widened 37% year-on-year to zloty 19 billion (equivalent to 62% of the 2006 budget). Revenues were in line with what had been projected in the budget for the year, but expenditures swelled due mainly to interest payments that proved bigger than those earmarked in the budget. Without the interest payments, expenditures would have been just as planned in the budget. On June 13, the Cabinet approved a 2007 budget plan. This seeks to hold the fiscal deficit for the year to zloty 30 billion (2.7% of GDP) in a continuation of the previous government's policy to keep the annual fiscal deficit lower than zloty 30 billon for four years from 2006.

On June 23, Finance Minister and Deputy Prime Minister Zyta Gilowska was dismissed following allegations that she had worked in collaboration with the Communist-era secret police. The former finance minister was an ex-PO member and an advocate of a flat tax rate and spending cuts. Mr. Pawel Wojciechowski, one of the prime minister's economic advisers and former head of Allianz Polska, the subsidiary of a German insurance company, was appointed new finance minister.

With future economic and fiscal policies, fiscal policies of new Finance Minister Wojciechowski are unclear yet. However, the alliance with the populist Self-Defense and LPR may inevitably lead to a shift in the economic and fiscal policies. Both parties favor bold policies such as increasing the social welfare spending by making use of the foreign reserves held by the central banks. They have backpedaled on such policies as the price for forming a coalition with PiS. However, there remains the possibility that they may argue for an amendment of the 2007 budget plan in the process of parliamentary debate. In addition, local government elections are scheduled this fall. All these factors suggest that political uncertainty may again come to the surface. JCR closely watch the developments.

Main Economic Indicators: The Republic of Poland

		2001	2002	2003	2004	2005	2006(f)	2007(f)
Convergence criteria for adopting the euro	**(2005)**							
1. CPI (annual average)	2.9%	5.5	1.9	0.7	3.5	2.1	1.8	2.5
2. 10 year government bond yield	5.4%	10.7	7.4	5.8	6.9	5.2	5.3	5.5
3. General gov't budget deficit/GDP(ESA95)	Below-3.0%	-3.7	-3.2	-4.7	-3.9	-2.5	-3.5	-4.0
4. General gov't debt/GDP(ESA95)	Below 60%	35.9	39.8	43.9	41.9	42.5	44.0	46.5
Real GDP growth rate	(%)	1.0	1.4	3.8	5.3	3.2	4.3	4.5
Unemployment rate (year-end)	(%)	18.0	19.7	20.0	19.6	18.2	16.8	15.9
Current account balance/GDP	(%)	-2.8	-2.6	-2.1	-4.2	-1.4	-1.6	-2.6
Trade balance/GDP	(%)	-4.0	-3.7	-2.7	-2.2	-0.9	-0.7	-2.0
Net FDI/GDP	(%)	3.0	2.0	2.0	4.7	2.0	1.9	2.3
Forex reserves (excl. gold)	(EUR mn)	26,747	25,504	25,310	25,314	32,797	35,000	38,000
Imports (G&S)/monthly imports	(Months)	4.9	4.6	4.4	3.8	4.3	3.9	3.6
Forex reserves/short-tem external debt	(times)	2.1	1.9	1.6	1.4	1.5	1.5	1.5
Gross external debt/ exports (G&S)	(%)	141.9	135.4	133.2	123.0	121.8	112.4	107.4
Gross external debt/ GDP	(%)	38.4	38.7	44.3	46.4	45.1	43.9	44.3
Gross public external debt/exports (G&S)	(%)	58.5	57.2	56.3	55.4	57.0	54.3	52.5
Debt service ratio	(%)	27.9	22.5	24.9	17.7	11.5	12.3	13.3

(Note) Figures for 2006 and 2007 are based on JCR forecast

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

(Toshihiko Naito, Senior Analyst)