2006-26
September 26, 2006

Poland (the Republic of)

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

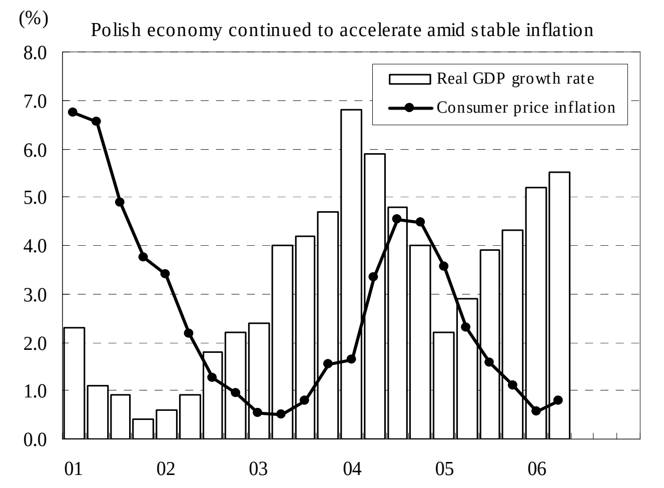
Main Factors for the Ratings

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

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



Updated: from June 2006 to August 2006

Positive Factors

- The former Finance Minister Zyta Gilowska was appointed as new Finance Minister and Deputy Prime Minister on September 22 following the resignation in June over her alleged collaboration with Communist-era secret police (The accusation was cleared by a special court held in September).
- Real GDP growth in the April-June quarter of 2006 accelerated to 5.5% year-on-year from 5.2% the previous quarter on solid domestic demand in the private sector.
- State budget deficit in the first seven months of 2006 stood at Zloty 15.6 billion, accounting for 51% of the annual target under the 2006 budget plan.
- 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).
- Car production in the first half of 2006 rose by 18.9% year-on-year to 363,000 units.
- Consumer price inflation in July 2006 remained stable at 1.1% year-on-year.
- Unemployment rate in July 2006 registered 15.3%, the lowest since the end of 2000.

Negative Factors

- Prime Minster Kazimierz Marcinkiewicz was forced to resign on July 10 following his private meeting with Donald Tusk, the leader of Civic Platform. Jaroslaw Kaczynski, the leader of the ruling Law and Justice (Pis), was elected to replace Marcinkiewicz as prime minister on July 14.
- Andrzej Lepper, the Self-Defence leader, Deputy Prime Minister and Agriculture Minister was dismissed on September 22

<Prospects and Noticeable Points>

No substantial shift of fiscal policies

(1) Polish economy continued to grow led by domestic demand in the private sector as inflation stayed stable

Real GDP growth in the April-June quarter of 2006 accelerated to 5.5% year-on-year from 5.2% in the previous quarter on solid domestic demand in the private sector. The growth was paced by fixed capital formation which rose a strong 14.4% year-on-year on solid corporate profit performances and low interest rates. Consumer spending also remained solid, rising 4.9% year-on-year on improved labor market conditions including increased real wages. Net external demand continued to contribute to the economic expansion, with exports growing faster than imports. Exports, though moderately slower than the year before, posted a solid 13.0% gain on improved productivity and a gradual recovery of demand for Polish products in European countries. The economy is projected to grow more than 5% annually in 2006 and 2007 on robust domestic demand spurred by an improving labor market and lower interest rates.

Consumer price inflation remained stable, although it slightly accelerated to 1.1% year-on-year in July 2006 on higher food prices caused by the drought this summer. The improving labor market and the high fuel prices have had only a limited impact on the

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inflation so far. After cutting its policy rate 25 basis points in both January and February, the central bank has kept the rate unchanged at 4%. Food prices may rise in the coming months, but the inflation rate is expected to continue stable at 1-2% in 2006 and 2007.

(2) Fiscal target for 2006 likely to be achieved if current fiscal policies are maintained

State budget deficit in the first seven months of 2006 came to Zloty 15.6 billion, accounting for 51% of the annual target set under the 2006 budget plan. The implementation of the 2006 state budget has been rather slow. Much of the improvement on the fiscal deficit stemmed primary from curbed expenditures. While revenues in the first seven months of 2006 came to 56.2% of the budgeted total, the equivalent ratio for expenditures was 55.6%. The fiscal target in the 2006 budget plan is highly likely to be achieved should the current fiscal policies be maintained. On June 13, the former administration approved a budget plan for 2007. The plan is in line with the government's policy to keep the annual fiscal deficit lower than Zloty 30 billon for four years from 2006.

(3) Substantial shift of economic and fiscal policies is highly unlikely under Kaczynski administration

Following the resignation of Finance Minister Gilowska on June 24, Prime Minster Marcinkiewicz was forced to resign on July 10. Jaroslaw Kaczynski, the leader of the Pis and twin bother of President Lech Kaczynski, took over the position on July 14. Stanislaw Kluza, a former chief economist with a private bank in Poland, was appointed as new finance minister on July 10. In its economic policies, the Kaczynski administration attaches particular importance to the need to foster national champions in key industrial sectors and improve the quality of social welfare services. On the fiscal front, the administration advocates the policy to keep the annual fiscal deficit lower than Zloty 30 billon for four years from 2006 as pursued by its predecessor. The administration also supports the adoption of the euro, though it has not set any specific target date. Other measures the administration is expected to push include eradication of corruption and elimination of the influence of former Communists. JCR holds that while the Kaczynski administration may pursue more conservative economic policies, there will be no substantial policy shift for the present. In fact, in the formation of his cabinet, the prime minister replaced only two ministers including the finance minister in the former Marcinkiewicz administration.

(4) Another political uncertainty emerges

On September 22, Prime Minister Kaczynski dismissed Lepper, Deputy Prime Minister and Agriculture Minister. This dismissal indicates that three-party coalition government collapsed practically. Accordingly, another political uncertainty emerges. Prime Minister Kaczynski was trying to form a new coalition, starting talks with the Peasants party and trying to entice Self-Defence member of parliaments to abandon their party. If those attempts fail, Prime Minister Kaczynski showed intension to hold early elections at the end of November. The appointment of the former Finance Minister Gilowska to new Finance Minister and deputy Prime Minister is positive factor for stabilization of fiscal deficits... JCR will keep an eye on the political development.

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	1.3	2.0
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	-3.0	-3.0
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	5.3	5.0
Unemployment rate (year-end)	(%)	18.0	19.7	20.0	19.6	18.2	16.4	15.0
Current account balance/GDP	(%)	-2.8	-2.6	-2.1	-4.2	-1.4	-1.8	-2.3
Trade balance/GDP	(%)	-4.0	-3.7	-2.7	-2.2	-0.9	-0.9	-1.6
Net FDI/GDP	(%)	3.0	2.0	2.0	4.7	2.2	2.4	1.7
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	43.6	44.0
Gross public external debt/exports (G&S)	(%)	58.5	57.2	56.3	55.4	57.0	54.2	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

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