

2007-27
September 27, 2007

Poland (the Republic of)

Foreign LT: A-/Stable, Local LT: A/Stable (Affirmed on January 9, 2007)

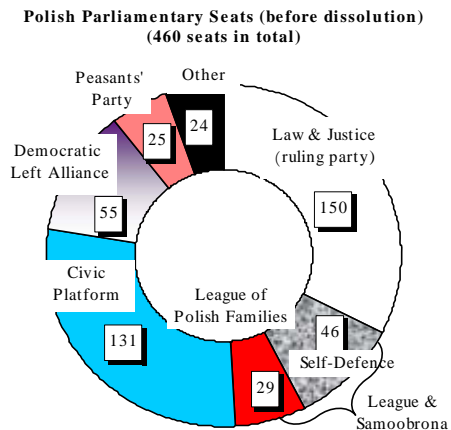
<Rating Perspective>

Positive Factors

- Continued convergence with the euro-zone economy in preparation for the adoption of the euro
- The expansion of production capacity through massive inflows of foreign direct investment and subsidy from the EU

Negative Factors

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



<Updated: from June 2007 to August 2007>

Positive Factors

- Real GDP in the April-June quarter of 2007 decelerated slightly to 6.7% year-on-year from 7.4% in the previous quarter. However, the economy remained strong, bolstered by investment and consumer spending.
- The central government fiscal balance in the first eight months of 2007 was in surplus by Zloty 275 million (equivalent to 0.02% of GDP) as against the Zloty 30 billion deficit targeted in the 2007 budget.
- The government retained its policy to contain the annual fiscal deficit below Zloty 30 billion (2.6% of GDP) under its 2008 budget plan announced on September 18.
- Unemployment rate stood at 9.7% (Eurostat) in July 2007, down a marked 3.9 p.p. from the year before.

Negative Factors

- Prime Minister Jaroslaw Kaczynski sacked Deputy Prime Minister and Agriculture Minister Andrzej Lepper, the leader of junior coalition partner Self-Defense, on July 9 over his alleged involvement in a corruption scandal.
- On September 7, the president set the date of a general election for October 21 following parliamentary dissolution.
- Prime Minister Kaczynski decided on September 12 to increase healthcare spending by Zloty 11 billion (1% of GDP) ahead of the general election.
- The current account deficit in the first seven months of 2007 doubled to EUR 6.35 billion (2% of GDP) from the year before.

<Outlook and Points to Watch>

Early elections to be held on October 21

(1) Next administration again to be a coalition government

The three-party coalition formed by the Law and Justice (PiS), the Self-Defense and the League of Polish Families (LPR) finally collapsed in August following dismissal of Andrzej Lepper, the leader of the Self-Defense, as Deputy Prime Minister and Agriculture Minister over his alleged involvement in a corruption scandal. On September 7, parliament was dissolved and President Lech Kaczynski set the date of a general election for October 21.

Most of the opinion polls suggest that no party will be able to win a majority in the election. The latest poll indicated the liberal opposition Civic Platform (PO) enjoyed the highest support rate of 31%. The ruling Law and Justice (PiS) came second with 29%, followed by the Left and Democrats (LiD) alliance mainly formed by the Democratic Left Alliance (SLD) with 8%. Other parties including the former coalition partners LPR and Self-Defence failed to get the 5% threshold required to secure parliamentary seats. Judging from the poll results, any party that will emerge dominant in the election may have to form a coalition with other parties. Chances of PiS forming a coalition with the Self-Defense and LPR look rather slim, given their deteriorated relationships. There is little possibility either of

PiS joining forces with PO or the leftist LiD as they are wide apart from each other over policy lines. JCR holds that a coalition led by PO would be the best choice from the standpoint of fiscal policy and will keep a close watch on election results from this viewpoint.

(2) Economy remains strong bolstered by investment

Real GDP in the April-June quarter of 2007 decelerated slightly to 6.7% year-on-year from 7.4% in the previous quarter. However, the economy remained strong, underpinned by investment and consumer spending. Investment, which surged 22.3% year-on-year for the fifth consecutive quarter of double-digit growth, was driven by corporate investment stemming from higher capacity utilization and solid corporate earnings and by infrastructure investment boosted by the inflow of massive subsidy from the EU. Consumer spending continued buoyant, growing 6.7% year-on-year on increased real wages and improved employment.

The continued strong economic expansion has helped to lower the unemployment rate, which used to be the highest among the EU27. In July 2007, the unemployment rate fell 3.9 percentage points year-on-year to 9.7%, lower than that of Slovakia. The consumer price inflation in August dropped to 1.5% year-on-year due to falls in prices of food and non-alcoholic beverages. However, the tightening labor market and strong economic expansion exceeding the potential economic growth rate has begun to put added pressure on inflation. Alerted by the development, the central bank raised its policy rate by 25 basis points in June and again in August to 4.75%, following the first hike in April since September 2004.

The current account deficit in the first seven months of 2007 doubled to EUR 6.35 billion (2% of GDP) from the year before. Weaker exports and stronger imports resulted in significant deterioration of the trade deficit. More than 70% of the current account deficit continued to be covered by FDI inflows.

With additional interest rate hikes expected, the Polish economy may somewhat slow down toward the end of 2007 and in 2008. But the growth rate is expected to stay at around 6%, bolstered by solid investment and consumer spending. While the current account deficit is likely to widen on increased imports amid strong domestic demand, refinancing risks will continue to be eased by strong FDI inflows.

(3) Fiscal deficit for 2007 seen to be lower than that envisaged in budget plan

Budget deficit continued to improve thanks mainly to the strong economic expansion and the government's commitments to its policy to keep the annual budget deficit lower than Zloty 30 billion (equivalent to 2.6% of GDP in 2006) for four years from 2006. The central government fiscal balance in the first eight months of 2007 was in surplus by Zloty 275 million (0.02% of GDP), compared with the Zloty 30 billion deficit as envisaged in the 2007 budget. A full-year deficit is highly likely to prove lower than the budget estimate. However, the planned increase of healthcare spending by Zloty 11 billion (1% of GDP) may reduce any substantial improvement of the fiscal balance. The government retained its policy to contain the annual fiscal deficit to less than Zloty 30 billion (2.6% of GDP) under its 2008 budget plan unveiled on September 18 after allowing for the personal income tax cut that had been approved in parliament.

Main Economic Indicators: The Republic of Poland

		2002	2003	2004	2005	2006	2007(f)	2008(f)
Convergence criteria for adopting the euro (2006)								
1. CPI (annual average)	2.4%	1.9	0.8	3.5	2.1	1.0	2.2	2.8
2. 10 year government bond yield	5.5%	7.3	5.8	6.9	5.2	5.2	5.4	5.6
3. General gov't fiscal balance/GDP(ESA95)	Below -3.0%	-5.0	-6.3	-5.7	-4.3	-3.9	-3.3	-3.0
4. General gov't debt/GDP(ESA95)	Below 60%	42.2	47.1	45.7	47.1	47.8	48.2	49.5
Real GDP growth rate	(%)	1.4	3.8	5.3	3.5	6.1	6.5	6.0
Unemployment rate (year-end)	(%)	19.9	19.6	19.0	17.7	14.0	10.2	8.4
Current account balance/GDP	(%)	-2.6	-2.1	-4.3	-1.7	-2.3	-3.0	-3.9
Trade balance/GDP	(%)	-3.7	-2.7	-2.2	-0.9	-1.4	-2.4	-3.3
Net FDI/GDP	(%)	2.0	2.0	4.7	2.1	2.9	2.8	3.2
Forex reserves (excl. gold)	(EUR mn)	25,504	25,310	25,313	32,797	34,242	36,200	38,600
Imports (G&S)/monthly imports	(months)	4.6	4.4	3.8	4.3	3.7	3.3	3.1
Forex reserves/short-term external debt	(times)	1.9	1.6	1.4	1.4	1.3	1.3	1.3
Gross external debt/ exports (G&S)	(%)	135.4	133.2	123.8	123.4	115.7	117.2	119.8
Gross external debt/ GDP	(%)	38.7	44.3	46.6	45.8	46.7	47.2	47.7
Gross public external debt/exports (G&S)	(%)	57.2	56.3	55.4	56.7	48.0	42.0	38.3
Debt service ratio	(%)	22.5	24.9	18.0	19.2	19.5	18.2	17.5

(Note) Figures for criteria 1 and 2 are annual average between September 2006 and August 2007. Figures for 2007 and 2008 are based on projection made by JCR
 (Source) The European Commission, National Bank of Poland and Ministry of Finance

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