2007-41
December 26, 2007

Poland (the Republic of)

Foreign LT: A-/Stable, Local LT: A/Stable

<Rating Perspective>

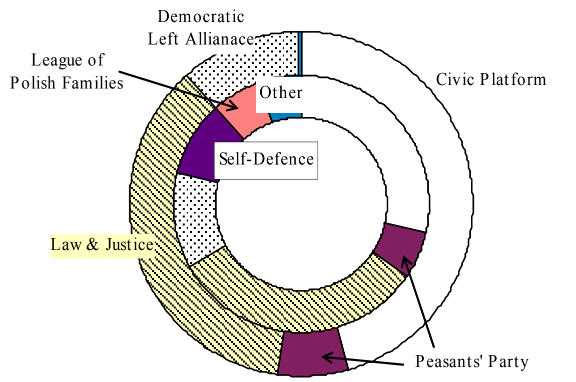
Positive Factors

- 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

The Results of Parliamentary Elections in October 2007



(Note) Inner pie chart indicates parliamentary seats before election

<Updated: from September 2007 to November 2007>

Positive Factors

- In the early general elections on October 21, the main opposition and liberal Civic Platform (PO), led by Donald Tusk, defeated the ruling conservative Law and Justice (PiS), under the leadership of Prime Minister Jaroslaw Kaczynski, by an unexpectedly wide margin. Mr. Tusk became new Prime Minister.
- The economy remained strong, bolstered by investment and consumer spending, although real GDP in the July-September quarter of 2007 decelerated slightly to 6.4% year-on-year from 6.8% in the first half of year.
- The central government fiscal deficit in the first ten months of 2007 was Zloty 4.42 billion (0.4% of GDP), merely 15 % of annual deficit under the 2007 fiscal plan. Ministry of Finance indicated that annual deficit for 2007 would be lower than Zloty 27 billion (2.6% of GDP) on November 19.
- New government cut its annual deficit target by Zloty 1.5 billion to Zloty 27 billion (2.2% of GDP) under the revised fiscal draft for 2008 on December 11.
- Unemployment rate stood at 9.1% (Eurostat) in October 2007, down a marked 3.8 pps from the year before.
- The consumer price inflation (Eurostat) remained stable at 3.0% year-on-year in October.

Negative Factors

- The current account deficit in the first ten months of 2007 grew by 49.5% year-on-year to EUR 9.75 billion (3.62% of GDP) on the increased trade deficit.

<Outlook and Points to Watch>

New government pursues more liberal economic policies

(1) A coalition government led by PO is expected to adopt liberal policies

In the early general elections on October 21, the main opposition PO, led by Donald Tusk, defeated the ruling conservative PiS, under the leadership of Prime Minister Jaroslaw Kaczynski, by an unexpectedly wide margin. The liberal PO won 209 out of 460 parliamentary seats, but fell short of securing a majority. This will prompt PO to form a coalition with the Peasant Party which took 31 seats. New coalition government was approved by the parliament on November 24. Mr. Tusk became new Prime Minister. Major policies of the PO unveiled so far are cutting the ratio of public debts to GDP by 4-7 pps by 2011, reduction of tax burden, promotion of investment on education and research, acceleration of privatization, simplifying the tax system and public administration reforms and preparation for the euro adoption.

These policies, if properly carried out, may prompt a sustained economic expansion and further improvement of the fiscal deficit, thereby cementing the path toward euro adoption for which a target date has yet to be specified. However, PO might be forced to revise its policies in the process of seeking legislation of its various reform plans partly due to coalition government, but due mainly to presidential veto. JCR will watch what policies new coalition government will come out with and how it will carry them out.

(2) New government may pursue more prudent fiscal policy amid improving fiscal deficit

Poland's fiscal deficit continued improving thanks primarily to the strong economic expansion and the former Kaczynski government's policy commitments to keep the annual fiscal deficit lower than Zloty 30 billion (equivalent to 2.8% of GDP in 2006) for four years from 2006. The central government fiscal deficit in the first ten months of 2007 was Zloty 4.42 billion (0.4% of GDP), merely 15 % of annual deficit under the revised 2007 fiscal plan. A full-year deficit is highly likely to prove lower than that of the previous year, even considering the lowered social security contributions. In fact, Ministry of Finance indicated that annual deficit for 2007 would be lower than Zloty 27 billion (2.6% of GDP)

New government cut its annual deficit target by Zloty 1.5 billion to Zloty 27 billion (2.2% of GDP) under the revised fiscal plan for 2008 on December 11. Zloty 3.5-4 billion generated by expenditures cut will be utilized for increase in wages of public employee and reduction of fiscal deficit.

The new Convergence Program, prepared and submitted to the European Commission in October by the former government, envisaged lowering the general government fiscal deficit (ESA95) in stages to 3.0% of GDP in 2008, 2.8% in 2009 and 2.5% in 2010. New coalition government is expected to move up the implementation of more active deficit reduction program.

(3) The economy remains strong bolstered by consumer spending and investment as well as the sustained expansion of exports

The economy remained strong, bolstered by investment and consumer spending as well as strong exports, although real GDP in the July-September quarter of 2007 decelerated slightly to 6.4% year-on-year from 6.8% in the first half of year.

The strong economic expansion has helped to lower the unemployment rate, which used to be the highest among the EU27. Since the beginning of 2007, the unemployment rate (Eurostat) has been lower than that of Slovakia, falling further to 9.1% in October. By contrast, the tightening labor market and a surge in food and fuel pries have begun to put added pressure on inflation, although the consumer price inflation (Eurostat) remained stable at 3.0% year-on-year in October. Alerted by the development, the central bank raised its policy rate by a total 100 basis points to 5.00% since the beginning of the year. The current account deficit in the first ten months of 2007 widened to an estimated 3.62% of GDP reflecting the robust imports buoyed by strong domestic demand.

With additional interest rate hikes and an unfavorable export environment in sight, the Polish economy may somewhat slow down toward 2008. But the annual growth rate is expected to stay at around 6%, bolstered by solid investment spurred by massive inflows of FDI and EU subsidy.

Main Economic Indicators: The Republic of Poland

		2003	2004	2005	2006	2007(f)	2008(f)	2009(f)
Convergence criteria for adopting the euro								
1. CPI (annual average)	2.4%	0.8	3.5	2.1	1.0	2.5	3.0	2.8
2. 10 year government bond yield	5.5%	5.8	6.9	5.2	5.2	5.1	5.5	5.2
3. General gov't fiscal balance/GDP(ESA95)	Below-3.0%	▲6.3	▲5.7	▲4.3	▲3.8	▲3.0	▲2.8	▲2.5
4. General gov't debt/GDP(ESA95)	Below 60%	47.1	45.7	47.1	47.6	47.0	46.2	45.4
Real GDP growth rate	(%)	3.8	5.3	3.5	6.1	6.5	5.2	4.8
Unemployment rate (year-end)	(%)	19.6	19.0	17.7	14.0	10.0	7.8	6.0
Current account balance/GDP	(%)	▲2.1	▲4.3	▲1.7	▲2.3	▲3.6	▲4.0	▲4.5
Trade balance/GDP	(%)	▲2.7	▲2.2	▲0.9	▲1.4	▲2.6	▲3.2	▲3.7
Net FDI/GDP	(%)	2.0	4.8	2.3	3.0	4.0	3.9	2.6
Forex reserves (excl. gold)	(EUR mn)	25,310	25,313	32,797	34,242	37,800	40,000	41,500
Imports (G&S)/monthly imports	(months)	4.4	3.8	4.3	3.7	3.5	3.3	3.1
Forex reserves/short-tem external debt	(times)	1.6	1.4	1.4	1.3	1.3	1.1	0.9
Gross external debt/ exports (G&S)	(%)	133.2	124.1	123.8	116.8	116.5	122.3	124.0
Gross external debt/ GDP	(%)	44.3	46.7	46.0	47.1	48.3	49.7	50.2
Gross public external debt/exports (G&S)	(%)	56.3	55.4	56.7	47.8	44.7	43.2	42.4
Debt service ratio	(%)	24.9	18.0	19.2	19.5	18.2	17.5	18.5

(Note) Figures for criteria 1 and 2 are annual average between November 2006 and October 2007. Figures for 2007, 2008 and 2009 are projection made by JCR
(Source) The European Commission, National Bank of Poland and Ministry of Finance

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