

2009-16  
July 30, 2009

## Poland (the Republic of)

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

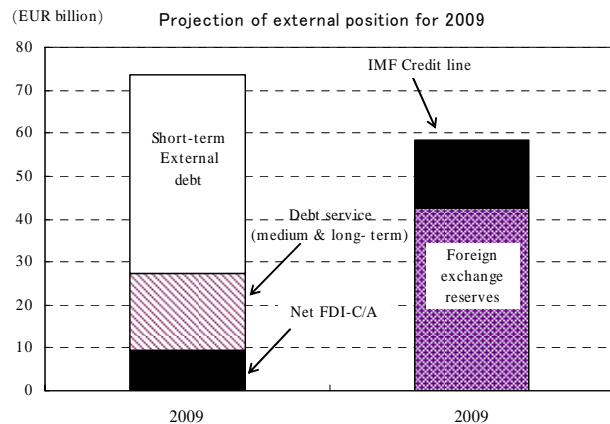
### <Rating Perspective>

#### Positive Factors

- Diversified economic structure with lower dependence on exports
- Expansion of production capacity enabled by massive inflows of foreign direct investment and EU subsidies

#### Negative Factors

- Chronic fiscal deficit
- Relatively heavy external burdens
- Rigid labor market



### <Updated: from April 2009 to July 2009>

#### Positive Factors

- Contraction of the industrial production appeared moderating, with year-on-year falls improving to 5.1% in May from 6.6% in April and 9.8% in March
- Total foreign debt outstanding at the end of March 2009 shrank by 9.4% to EUR167.7 billion as compared with the end of September 2009
- The current account balance in the January-May period of 2009 improved noticeably to register a surplus equivalent to 0.2% of GDP, a turnaround from a deficit equivalent to 2.3% a year earlier
- The National Bank of Poland (NBP) cut its policy rate on June 25 by 25bps to 3.50%, lowering the rate by a total 250bps since November 2008
- In the European Parliament election held in early June, the Civic Platform (PO) won the largest number of votes, securing 25 out of 50 seats at stake

#### Negative Factors

- The Ecofin Council of EU economy and finance ministers has put five EU member countries including Poland under the excessive deficit procedures
- The government on June 23 revised its projection of the fiscal deficit for 2009 to 4.6% of GDP from 3.0%, downgrading the economic growth rate for the year to 0.2% from 1.7%
- Real GDP growth in the January-March quarter of 2009 slowed further to 0.8% year-on-year from 2.9% in the previous quarter
- Net capital inflows into Poland (foreign direct investment, portfolio investment and other investments) in the January-May period of 2009 fell 90% from a year earlier

### <Outlook and Points to Watch>

#### External position continues improving

##### (1) Deep economic recession likely to be averted

The Polish economy, which grew 4.8% in 2008, decelerated to a 2.9% year-on-year growth in the October-December quarter of that year, further slowing down to 0.8% in the January-March quarter of 2009 on slumped exports amid the recession in its major European trading partners and weak domestic private-sector demand. The industrial production remains weak, but its contraction appears to be moderating, with year-on-year falls improving to 5.1% in May 2009 from 6.6% in April and 9.8% in March. While Poland may suffer a modest economic contraction in 2009, it will be able to avert a deep recession unlike other Central and East European countries (CEECs). The country is less affected by slumped exports as its exports/GDP ratio is only around 50%, much lower than those of other CEECs. Despite rising unemployment and credit tightening of the banks, the Polish economy will be supported by steady personal consumption spurred by tax cuts and an expansion of infrastructure investment underpinned by EU subsidies. Amid the subsiding inflationary pressure and deteriorating economic outlook, the central bank started easing its monetary policy in November 2008, cutting its policy rate by total 250bps so far to 3.50%.

## (2) Stable financial system has enough capacity to absorb increased credit cost

The country's financial system remains stable. Banks saw their profit eroded by increased loan-loss provisions but managed to raise their capital adequacy ratio to 10.6% at the end of April from 10.1% in 2008. As Polish banks make less foreign currency-denominated loans than peers in CEECs, they have been little affected so far by the impact of depreciation of the zloty. However, the ratio of nonperforming loans rose to 5.3% at the end of March 2009 from 4.4% at the end of 2008. With the economic slowdown still continuing, a further increase of nonperforming loans looks inevitable. However, the country's financial system retains enough capacity to absorb the increased credit cost, barring a deeper recession. Most of the major Polish banks are subsidiaries of big European banks and dependent on their parents for much of their liquidity. JCR holds that the possibility of those parent banks withdrawing their funds is rather slim as their exposure in Poland is based on their long-term investment strategy.

## (3) External position improved with IMF's FCL

Poland's external position has improved after it secured a line of credit totaling EUR16 billion in April under the IMF's Flexible Credit Line (FCL) program. The current account balance turned into a surplus equivalent to 0.2% of GDP in the January-May period from a deficit equivalent to 2.3% a year earlier. The total foreign debts outstanding at the end of March decreased by 9.4% from September 2008 to EUR167.7 billion. Short-term debts and private-sector debts accounted for 26% and 71%, respectively. The foreign exchange reserves stood at EUR42.6 billion at the end of June, little changed in the past three months. By contrast, net capital inflows into Poland (foreign direct investment, portfolio investment and other investments) in the January-May period decreased by around 90% from the year earlier.

JCR estimates the country's annual external finance requirements for 2009 (consisting of [Net FDI-C/A] plus medium- and long-term debt services and short-term debts) at around EUR70 billion. The total sum of the foreign exchange reserves and the FCL credit line is not sufficient enough to cover that amount. However, JCR sees little concern over the country's external finance. The IMF support has helped a great deal to improve the international investors' confidence in Poland. Furthermore, the short-term debts are highly likely to be rolled over without any difficulties.

## (4) Government to keep stringent fiscal policy in preparation for euro adoption

The Ecofin Council of EU economy and finance ministers has put Poland under the *excessive deficit procedures*. The Council has called on the country to cut its fiscal deficit to less than 3.0% of GDP by 2012. Faced with a bleak economic outlook, the government in June revised its projection of the 2009 fiscal deficit to 4.6% of GDP from 3.0%, downgrading the economic growth rate for the year to 0.2% from 1.7%. JCR considers that the deficit may slightly widen on reduced revenues unless a further spending cut is implemented. Meanwhile, the general government fiscal debt was estimated at 47.1% of GDP at the end of 2008, a slight increase from the previous year. But it stayed well below the 60% threshold of the Maastricht Convergence criteria.

The fiscal deficit may again head for improvement as the center-right coalition government led by the Civic Platform with a strong political base is expected to keep expenditures under strict control after 2010 in a bid to prepare for the adoption of the euro. The government remains committed to its plan to adopt the euro in 2011-13 by joining the EU's exchange rate mechanism II within 2009. However, JCR sees the timetable as premature not only because of the persistent currency volatility in the unsettled financial market but also because of a constitutional amendment needed for euro adoption.

## Main Economic Indicators: The Republic of Poland

		2005	2006	2007	2008	2009(f)	2010(f)
Convergence criteria for adopting the euro							
1. CPI (annual average)	2.8%	2.2	1.3	2.6	4.0	3.0	2.5
2. 10 year government bond yield	5.1%	5.2	5.2	5.5	6.0	n.a.	n.a.
3. General gov't fiscal balance/GDP(ESA95)	Below-3.0%	-4.3	-3.9	-1.9	-3.9	-5.6	-3.0
4. General gov't debt/GDP(ESA95)	Below 60%	47.1	47.7	44.9	47.1	50.3	53.5
Real GDP growth rate	(%)	3.6	6.1	6.7	4.8	-0.5	1.5
Unemployment rate (year-end)	(%)	17.7	13.8	8.5	9.1	12.0	11.6
Current account balance/GDP	(%)	-1.6	-3.2	-4.7	-5.5	-3.9	-2.7
Trade balance/GDP	(%)	-0.9	-2.0	-4.0	-4.7	-5.4	-3.5
Net FDI/GDP	(%)	2.3	3.0	4.2	3.1	0.8	2.6
Forex reserves (excl. gold)	(EUR mn)	32,797	34,242	37,141	40,637	49,400	57,500
Imports /monthly imports	(months)	4.3	3.6	3.3	3.1	4.7	5.3
Forex reserves/short-tem external debt	(times)	1.4	1.3	0.9	0.9	1.1	1.2
Gross external debt/ exports	(%)	123.7	116.6	125.0	119.8	151.6	156.6
Gross external debt/ GDP	(%)	45.9	47.0	51.0	48.8	56.7	60.0
Gross public external debt/exports	(%)	56.6	47.8	46.9	34.5	43.6	41.4
Debt service ratio	(%)	28.6	17.4	16.4	17.6	20.7	19.3

(Note) Figures for criteria 1 and 2 are annual average between June 2008 and May 2009. Figures for 2009 and 2010 are projection made by JCR

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

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