

2004-29
September 22, 2004

Poland (the Republic of)

Foreign LT: A-/Stable, Local LT: A/Stable (Affirmed on March 30, 2004)

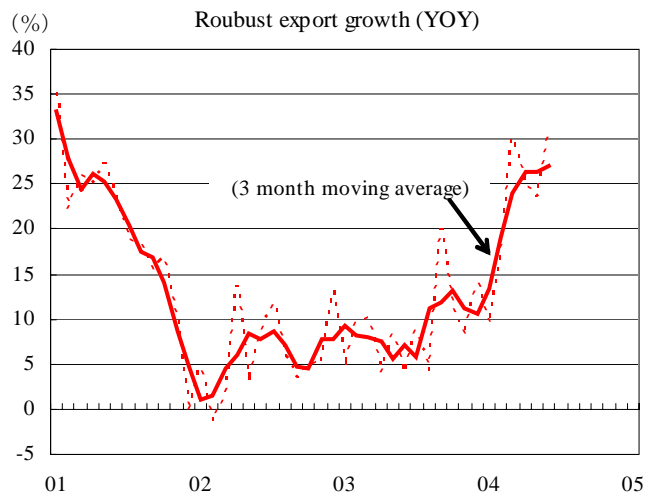
Main Factors for the Ratings

Positive Factors

- With the adoption of the euro in sight, a more stable economic structure is likely to be built.
- Increasing exports brought by the expansion of production capacity through inflows of foreign direct investment.

Negative Factors

- Increasing government debt caused primarily by persistent budget deficits.
- Rise in structural unemployment impeding economic flexibility.
- Heavy external debt consisting mainly of private sector debt.



Updated: from June 2004 to August 2004

Positive Factors

- On June 24, the caretaker government led by Prime Minister won a second vote of confidence in parliament.
- Real GDP grew 6.9% year-on-year in the January-March quarter of 2004, up from 4.7% in the previous quarter.
- Merchandise exports accelerated by 30.5% year-on-year in June, helping to turn the trade balance into a surplus.
- Due to restrained expenditures and increased tax revenues, the fiscal deficit in the first half of 2004 was held at 46% of the target set by the government for 2004.

Negative Factors

- The government's medium-term spending cut plan has been forcibly scaled back.
- Higher energy and food prices pushed up inflation by 4.6% year-on-year in July.

<Prospects and Noticeable Points>

Strong economic expansion having favorable effect on public finance

Caretaker government won a second vote of confidence

On June 24, the caretaker government led by Prime Minister Marek Belka won a second vote of confidence by a majority of 236 votes in favor versus 215 votes against. As a result, a political crisis was averted at least for the present. The minority government had to enlist the backing of the opposition Polish Social Democracy to carry the confidence motion. In return, however, it had to compromise not only to scale back its medium-term spending cut plan (the Hausner plan) but also agree to undergo another vote of confidence in October.

Economic expansion spurred by exports and inventory investment

Real GDP grew 6.9% year-on-year in the January-March quarter of 2004, substantially up from 4.7% in the previous quarter. Exports and inventory investment were the main propellants. Exports grew a robust 22.7% year-on-year in the quarter, due in part to the depreciation of the zloty that continued until early 2004 and due in part to growing EU demand for Polish products, particularly foodstuffs. Inventory investment pushed up the whole economic growth by more than 2 percentage points. The growth of gross fixed capital formation further improved to 3.5% year-on-year while consumer spending rose 4%. The Polish economy has been growing faster than JCR had initially projected. Real GDP in the April-June quarter is forecast to grow as fast as in the previous quarter, considering a 16.6% gain in industrial production registered in the same quarter. In 2004 as a whole, the economy is likely to grow nearly 6%, or the highest since 1998. The rate of inflation has been accelerating amid the surging energy and food prices. The rate jumped

to 4.6% year-on-year in July, exceeding the target set by the central bank. The bank has raised its key policy rate three times since June by a total 150bp to 6.5%. The current account deficit in the first half of 2004 narrowed by 25% from the year before with the balance turning into a surplus in June. Growing inflows of foreign direct investment in the first half of 2004 more than offset the current account deficit. Furthermore, portfolio investment from abroad increased rapidly centering on bonds.

Economic expansion putting brake on further deterioration of fiscal deficit

The fiscal deficit in the first half of 2004 was held at 46% of the target set by the government for 2004. While the growth of expenditures was kept at 3.8% in the twelve months to June, revenues grew by 7.3% in the same period on increased tax revenues amid solid economic expansion. If the current pace continues for the rest of 2004, the target deficit set by the government is likely to be achieved. In fact, the government has already expressed an intention to lower the target deficits for both 2004 and 2005. On the other hand, the Hausner plan, which is crucial to contain the fiscal deficit in the medium term, had to be scaled back in return for the opposition support of the confidence motion.

Ratings and outlooks retained

JCR believes that a full implementation of the Hausner plan remains extremely important for Poland to adopt the euro in 2008 or 2009 as planned by the government. Although the current strong economic expansion is putting a brake on further deterioration of the fiscal deficit, such a high growth rate will be hard to maintain in the medium term. Therefore, the Hausner plan is inevitable in order to contain the fiscal deficit over the medium term. Prime Minister Belka has expressed his support of the Hausner plan. However, he has been forced to trim the program to enlist cooperation from the opposition camp. Whether the minority government will weather the next vote of confidence in October remains to be seen. JCR will watch with greater attention whether the country's next general election will be held in September 2005 as scheduled or whether the government, defeated in the vote of confidence, would be forced to dissolve parliament and call an early election. In either case, the next election is highly likely to see the birth of a new coalition government led by the right-wing Civic Platform, which has been gaining popularity. Should this happen, the government would be able to push ahead with more proactive fiscal reforms. JCR has retained its ratings and outlooks for the present primarily in consideration of the strong economic growth, which is preventing a further deterioration of the fiscal deficit.

Main Economic Indicators: The Republic of Poland

		2001	2002	2003	2004(f)	2005(f)
(4 Convergence criteria)						
1.CPI (annual average)	(%)	5.5	1.9	0.7	3.7	3.5
2.10 year government bond yield	(%)	9.0	5.6	6.6	8.0	7.7
3.General gov't budget deficit/GDP(ESA95)	(%)	-3.5	-3.6	-4.1	-5.0	-4.5
4.General gov't debt/GDP(ESA95)	(%)	36.7	41.2	45.4	48.5	53.0
Real GDP growth rate	(%)	1.0	1.4	3.8	5.8	5.3
Unemployment rate (year-end)	(%)	18.0	19.7	20.0	19.6	19.2
Current account balance/GDP	(%)	-2.9	-2.7	-2.0	-2.1	-2.7
Trade balance/GDP	(%)	-4.2	-3.9	-2.8	-2.6	-3.5
Exports goods & services	(EUR mn)	57,450	59,881	63,680	72,758	77,505
Imports goods & services	(EUR mn)	65,101	66,729	68,321	77,208	84,338
Net Foreign Direct Investment/GDP	(%)	3.2	2.1	1.9	2.4	2.6
Forex reserves (excl. gold)	(EURmn)	26,747	25,504	25,157	27,000	29,000
Imports (G&S) coverage	(months)	4.9	4.6	4.4	4.2	4.1
Forex reserves/short-tem external debt	(times)	2.1	1.9	1.7	1.6	1.8
External debt/ exports (G&S)	(%)	141.7	135.1	129.3	120.9	121.3
External debt/ GDP	(%)	39.8	40.5	44.7	45.7	44.3
Public external debt/exports (G&S)	(%)	58.5	57.2	54.8	53.6	54.2
Debt service ratio	(%)	27.9	22.4	18.5	15.9	16.3

Note: figures for 2004 and 2005 are based on JCR estimation.

Sources: The central bank, Ministry of Finance, The European Commission

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