

2004-58
March 29, 2005

Poland (the Republic of)

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

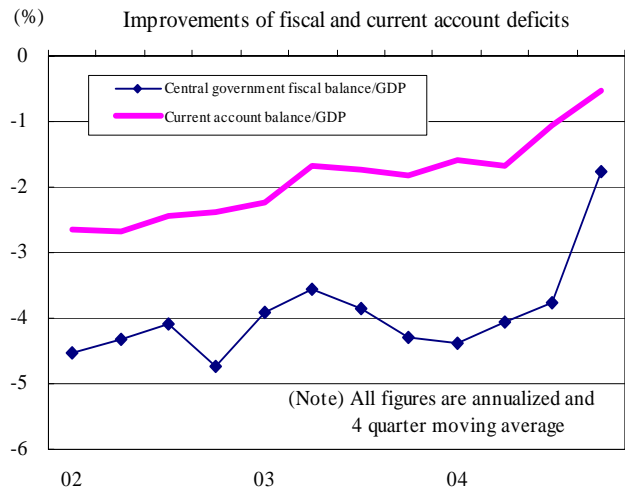
Main Factors for the Ratings

Positive Factors

- A more stable economic structure is likely to be built on progress made in various reforms toward adoption of the euro.
- 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 December 2004 to February 2005

Positive Factors

- The government expressed an intention to move up the repayment of the entire Paris club debts, which amount to EUR 12.3 billion (January 5).
- The central government's 2004 fiscal deficit shrank to 4.8% of GDP, equal to 91.6% of its target for the year. The central government's budget plan for 2005, aimed at cutting fiscal deficit to 3.7% of GDP, was endorsed by the President..
- Consumer price inflation for February 2005 declined to 3.6% year-on-year.
- Due to an expansion of exports, current account deficit for 2004 narrowed to 1.5% of GDP, the lowest since 1996.
- Privatization revenues in 2004 were more than double from the previous year to Zloty 10.2 billion. The state-owned Zelmer, the largest electronic appliance manufacturing company, sold 85% of its stocks in initial public offering (January 27).

Negative Factors

- Prime Minister expressed an intention to resign on May 5 (March 18).
- Deputy Prime Minister Hausner will resign on March 31, after bolting from the ruling Democratic Left Alliance on February 7. Mr. Hausner funded Democratic Party.
- Real GDP in the October-December quarter of 2004 slowed down to 3.9% year-on-year.

<Prospects and Noticeable Points>

Despite improvement on fiscal and current account deficits, fiscal policy after the election remains a key issue

(1) Economic expansion and improvement on external debt burden

Real GDP in 2004 grew by 5.3%, paced by the expansion of both domestic and external demand. In the first half of the year, the economy grew by a strong 6.5% year-on-year, due primarily to one-off factors such as strong external demand following the country's EU accession in May that year and a rapid buildup of inventories. In the latter half of the year, however, the economy decelerated to 4.4% as such temporary factors wore off. The economy in 2005 will grow by 5%, or commensurate with the country's potential economic growth rate, led by both domestic (centering on gross fixed capital formation) and external demand. Consumer price inflation picked up 4.5% year-on-year in the latter half of 2004 due primarily to temporary factors such as higher food prices caused by strong external demand for Polish food products. It declined to 3.6% year-on-year in February 2005. The current account deficit in 2004 shrank to 1.6% of GDP on rapid growth of exports. Increased FDI inflows more than offset the current account deficit. Net portfolio investments substantially increased, driven by government bonds and equity. External debts increased in both private

and public sectors, but external debt burdens improved thanks to the accelerated exports.

In January 2005, the government expressed an intention to move up the repayment of the entire Paris club debts, which amount to EUR 12.3 billion and constitute 50% of its total external public debts (due between 2005 and 2009). The proposed repayment is expected to be financed through the issuance of sovereign bonds (the funds will be exclusively utilized for repayment). The successful transaction would contribute toward reducing refinancing risks and containing outstanding debts as well as debt servicing cost.

(2) Fiscal deficit may shrink in 2005 on partial implementation of medium-term fiscal reform program

Though revised from its original version, the medium-term fiscal reform program proposed by Deputy Prime Minister Hausner would be imperative to contain the fiscal deficit. It seeks to cut social security and administrative expenses by the amount equivalent to 4.7% of GDP between 2004 and 2007. About a half of the program is scheduled to be carried out, including those measures that have been enacted to date. Fiscal deficit of the central government for 2004 shrank to a level equal to 91.6% of its target, due primarily to restrained expenditures and increased tax revenues amid economic expansion. The central government's budget plan for 2005 is aimed at cutting fiscal deficit to 3.7% of GDP from 4.8% in the previous year. The government intends to cut the fiscal deficit of below 3.0% of GDP by 2007 to meet all Convergence criterions. JCR considers that Poland needs to further reduce fiscal deficit by taking additional measures to cut back on expenditures if it is to adopt the euro in 2009 as planned.

(2) Ratings and outlooks remain unchanged. Focal point is fiscal policy to be taken by post-election new government

The current center-left coalition government led by the Democratic Left Alliance has no longer enough power to pursue further fiscal tightening because of its dwindling popularity and minority status in parliament. Furthermore, Deputy Prime Minister Hausner has already submitted his resignation to the Prime Minister (due to resign on March 31) and Prime Minister Belka expressed his intention to resign on May 5. With an election expected to be called in June 2005 (originally the election was due to be held this fall), the most crucial issue, a further reduction of the fiscal deficit in pursuit of the euro adoption, has in effect been carried over to the next administration. In the next election, it is highly likely that the Civic Platform, which enjoys a high popularity rating, will emerge victorious and form a coalition government. Should this happen, the new government would be able to implement more proactive fiscal reforms. Given the current popularity standing of the new centralist Democratic Party founded by Deputy Prime Minister Hausner, it is unlikely to become a ruling party. JCR retains the country's ratings and outlooks but will closely watch the new administration's fiscal policy, which might sway depending on its coalition partner.

Main Economic Indicators: The Republic of Poland

		2000	2001	2002	2003	2004(f)	2005(f)	2006(f)
(Convergence criteria)	Criteria (2004)							
1.CPI (annual average)	2.6%	10.1	5.5	1.9	0.7	3.5	3.2	3.0
2.10 year government bond yield	5.6%	11.8	9.0	5.6	6.5	6.8	6.5	6.0
3.General gov't budget deficit/GDP(ESA95)	Below -3%	-2.8	-3.9	-3.6	-4.5	-4.8	-4.0	-3.3
4.General gov't debt/GDP(ESA95)	Below 60%	51.3	36.7	41.2	45.4	43.6	45.0	47.5
Real GDP growth rate	(%)	4.0	1.0	1.4	3.8	5.3	5.0	5.0
Unemployment rate (year-end)	(%)	14.0	18.0	19.7	20.0	19.6	18.8	18.0
Current account balance/GDP	(%)	-6.1	-2.9	-2.7	-2.2	-1.6	-2.3	-3.0
Trade balance/GDP	(%)	-7.5	-4.2	-3.9	-2.8	-2.6	-3.2	-3.8
Net Foreign Direct Investment/GDP	(%)	5.8	3.2	2.1	1.9	2.2	2.7	1.9
Forex reserves (excl. gold)	(EURm)	27,215	26,747	25,504	25,310	25,313	26,500	27,500
Imports (G&S) coverage	(months)	5.3	4.9	4.6	4.4	3.8	3.5	3.1
Forex reserves/short-tem external debt	(times)	2.7	2.1	1.9	1.6	1.5	1.6	1.6
Gross external debt/ exports (G&S)	(%)	148.3	141.8	135.3	131.8	123.6	119.5	115.6
Gross external debt/ GDP	(%)	42.0	39.8	40.5	45.6	49.5	50.5	52.2
Gross public external debt/exports (G&S)	(%)	71.3	58.5	57.1	55.0	55.1	56.9	58.8
Debt service ratio	(%)	20.7	27.9	22.4	18.4	13.0	15.5	16.5

(Note) Some figures for 2004 are JCR's estimate based on actual figures and figure for 2005 and 2006 are based on JCR forecast.

(Sources) The European Commission, Central Bank, and Ministry of Finance.

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