Poland

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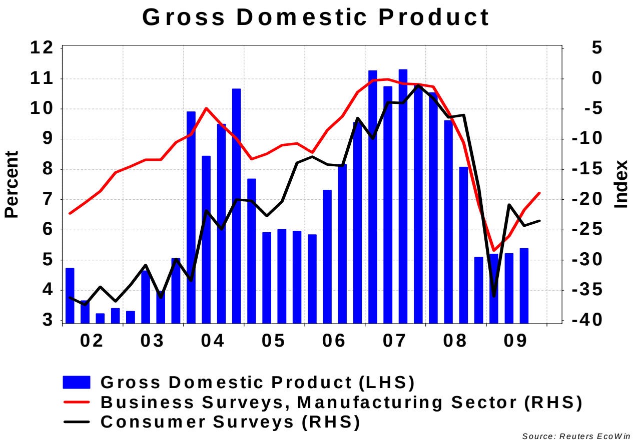
The Polish economy recorded robust growth in 2009 despite the EU recession helped by sound economic policies, a stable government and the precautionary IMF agreement boosting market confidence. However, public finances have deteriorated and euro adoption been postponed.

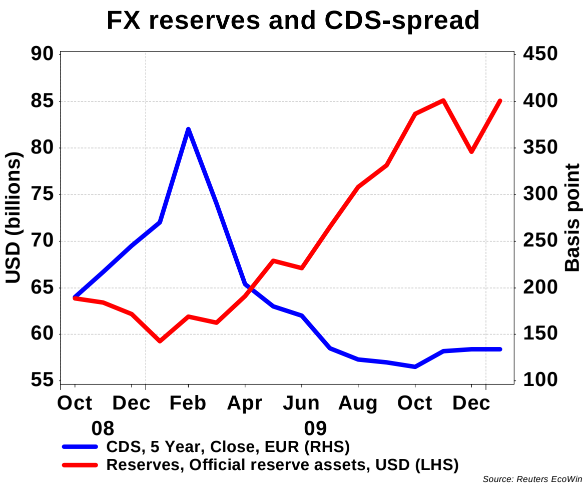
Country Risk Analysis

Robust growth despite EU recession. Despite the sharp slowdown in economic activity to 1.7 % in 2009 from 5 % in 2008, Poland was the only EU country to avoid recession. The relative good performance reflects Poland's moderate macroeconomic imbalances before the crisis, the large domestic economy, the flexible exchange rate and the relatively healthy banking system. GDP growth was mainly driven by exports helped by the sharp depreciation of the zloty and robust domestic demand supported by expansionary fiscal and monetary policies. Quarterly GDP figures indicate that growth accelerated at the end of 2009 and a recovery in growth is expected this year and in particular next year due to the global recovery, stronger investments and an improved labor market. As a result, the Polish government recently revised up its forecast for annual GDP growth to 3 % from 1.2 % in 2010.



Deteriorating public finances. The slowdown in the economy put pressure on the public finances resulting in a sharp widening of the budget deficit to estimated 7.2 % of GDP in 2009 from 3.6 % in 2008 due to lower tax revenues and fiscal stimulus measures, including a public investment plan and personal income tax cuts. The authorities remain committed to bring down the budget deficit to below 3 % of GDP by 2012 as required by the EU's excessive deficit procedure. In January, the Polish Finance Minister presented a fiscal consolidation plan for 2010-2012. The main measures included a gradual increase of retirement age for men and women to 67 years, widening the tax base and acceleration of privatizations starting from 2010. Based on this and the improved economic outlook, the government targets a budget deficit of 2.9 % of GDP in 2012 and expects public debt to peak at 56.3 % of GDP in 2011. Important safeguards to keep public debt under control are the 55 % of GDP threshold under the Public Finance Act and the 60 % of GDP ceiling in the Constitution since a breach of these limits triggers substantial austerity measures. The authorities also took important actions in 2009 to strengthen the fiscal framework and initiated work to introduce expenditure rules (see box 1). In a medium-term perspective, Poland's early implementation of comprehensive pension reforms means that the issue of ageing is less of a burden than in many other European countries.

Sound external position. The current account deficit narrowed to around 1.5 % of GDP in 2009 from 5.5 % of GDP in 2008 mainly due to lower imports and continued net transfers from the EU. The balance of payment position was also supported by a sharp inflow of short-term capital and stabilization of FDI inflows. As a result, the Central Bank's international reserves are back at its pre-crisis level of around USD 85bn after hitting a low of USD 60bn beginning of 2009. In May 2009, Poland concluded a precautionary arrangement with the IMF under the new Flexible Credit Line (FCL) to boost market confidence and support the authorities' policy response to the crisis. This helped stabilizing the exchange rate of the zloty, narrowing CDS spread and maintaining access to international markets enabling both the public and private sector to roll over its external debt. In January, the Ministry of Finance issued a 15-year EUR 3bn bond on favorable terms indicating foreign investors risk appetite for Polish debt.



Stable government. The political climate in Poland has improved in recent years. The centre-right coalition government enjoys a stable majority in the parliament and the previous political infighting between the President and the Prime Minister has been reduced enabling a coherent policy response to the crisis. The pro-euro government led by PM Donald Tusk since 2007 remains committed to adopt the euro despite abandoning the official timetable of joining the euro in 2012. The government has set no new target date but has recently stated that it would be possible to join in 2015. The Central Bank is also generally in favor of adopting the euro as soon as possible. Upcoming elections – presidential elections in October this year and parliamentary elections in 2011 – pose some uncertainty to the fiscal consolidation plan. However, prospects of continued sound economic policies has improved since Prime Minister Donald Tusk announced in January that he would not run in the presidential elections this fall, but instead continue with the government's work on economic reforms to sustain economic recovery and prepare Poland for euro entry.

Box 1 New Public Finance Act

The authorities have introduced important changes to their medium-term fiscal framework. The new Public Finance Act, signed by the President on September 18, will become effective as of 2010. The main changes introduced by the new law are:

- **Medium-term framework**: The framework will consist of a 4-year rolling fiscal plan including policy goals, state budget revenue and expenditure projections, and the projected general government deficit and debt. Still, the medium-term fiscal plan, which does not require approval by parliament, remains non-binding, with only the state budget deficit for the following year constituting a limit for that year's budget.
- **Enhanced debt safety procedures:** The law maintains previous debt safety thresholds (50, 55, and 60 percent of GDP) but requires additional corrective actions if debt exceeds 55 percent of GDP. In that case, the government has to submit a debt reduction plan, together with the annual budget for year t+2, which should include: a nominal freeze in budgetary wages, pension indexation not higher than CPI inflation, and reviews of multi-year investment programs and spending programs financed by foreign credits. These actions aim to reduce the debt-to-GDP ratio in year t+2 below year t's level, implying either a balanced budget or a surplus that year.

Source: Based on IMF Country report no. 09/143

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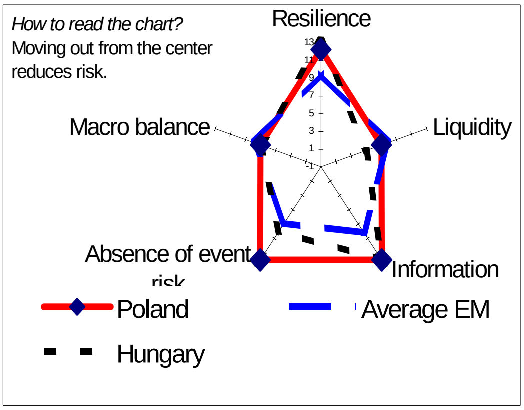
Sound economic policies and a stable government helped Poland weather the global economic crisis. Moderate external and domestic imbalances when entering the crisis, allowed the Polish authorities to implement countercyclical policies, cushioning the downturn. The precautionary agreement with the IMF concluded in last May also helped calm the markets and allowed Poland to remain access to international markets throughout the crisis. Economic activity is set to accelerate this year and especially next year helped by the global recovery, higher investments and an improving labor market. Better economic prospects, fiscal consolidation measures and an ambitious privatization program should support the authorities' efforts to bring down the budget deficit to below 3 % of GDP in 2012 or 2103 and keep public debt to GDP below 60 % - the limit set out on the Maastricht Treaty but also in the Polish constitution. The upcoming elections pose some uncertainty to the fiscal consolidation process, but the authorities' commitment to adopt the euro as soon as possible should work as an anchor for fiscal policies keeping public debt at an acceptable level.

Key figures	2009
Population (millions)	37896
GDP/capita ($)	11426
GDP (change)	1.7%
Inflation	3.8%
Curr.Acc. balance/GDP	-1.3%
Reserves/imports (months)	5
Budget balance/GDP	-7.2%
Government debt/GDP	49%



External ratings:
Fitch: A-, stable
Moody's: A2, stable
S&P: A-, stable

Peers:
Czech Rep.
Hungary
Estonia

Graph: The pentagon shows Poland's risk profile to be stronger than the average of all emerging market countries when it comes to longer term factors such as resilience, absence of event risk and information.

Key data:	2005	2006	2007	2008	2009	2010	2011	2012
GDP (bill.US$)	304	342	427	534	433	473	494	533
GDP/capita (US$)	7969	8972	11235	14080	11427	12495	13070	14153
GDP, real (change)	3.6%	6.2%	6.8%	4.9%	1.8%	1.7%	3.0%	4.2%
Investments/GDP	19%	21%	23%	24%	23%	23%	23%	24%
Budget deficit/GDP	-4.1%	-3.6%	-1.9%	-3.7%	-5.3%	-6.8%	-6.2%	-5.1%
Govt debt/GDP	47%	48%	45%	47%	49%	55%	59%	59%
CPI inflation (%)	2.1%	1.1%	2.4%	4.3%	3.8%	2.4%	2.6%	3.1%
Money demand (%)	14%	13%	15%	17%	12%	6%	-4%	2%
Stock prices (%change)	29542	43127	59022	40658	31990	43085		
Interest rates	5%	4%	4%	6%	4%	4%	5%	5%
Exch. Rate ($)	3.2	3.1	2.8	2.4	3.1	3.0	3.0	3.0
Trade/GDP (%)	64%	71%	72%	72%	66%	72%	74%	76%
Oil price (Brent)$	$55	$65	$73	$98	$62	$76	$80	$82
Millions US $								
Export of goods	96,450	117,418	145,300	178,702	139,507	166,211	179,734	197,757
Imports of goods	99,218	124,450	162,401	204,735	144,326	173,567	188,002	207,229
Other:	-945	-2,367	-3,159	-813	-2,353	-3,760	-807	251
Current account	**-3,713**	**-9,399**	**-20,260**	**-26,846**	**-7,172**	**-11,116**	**-9,075**	**-9,221**
% of GDP	-1.2%	-2.8%	-4.7%	-5.0%	-1.7%	-2.4%	-1.8%	-1.7%
Net FDI	7,001	10,674	17,966	11,630	8,470	10,038	13,457	15,576
Loan repayments	-30,835	-32,244	-41,439	-47,732	-50,002	-52,780	-55,430	-58,300
Net other capital flows	30,362	36,757	49,646	79,746	45,798	70,768	62,298	53,910
Balance of payments	**2,815**	**5,788**	**5,913**	**16,798**	**-2,906**	**16,911**	**11,251**	**1,965**
Reserves	36,773	42,561	48,474	65,272	62,366	79,277	90,528	92,493
Total debt	129,200	153,568	203,152	267,856	258,704	297,430	310,714	320,655
o/w short term debt	25,408	31,401	49,619	78,407	67,051	76,302	81,944	87,982

Source: OEF (Oxford Economic Forecasting) and SEB estimates

Rating history

Fitch (eoy)	BBB+	BBB+	BBB+	A-	A-	A-
S&P (eoy)	BBB+	BBB+	BBB+	A-	A-	A-

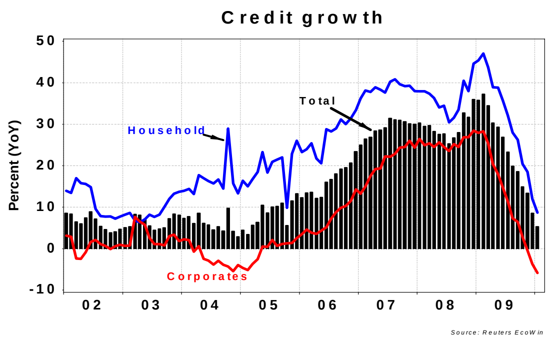
Type of government: Coalition of centre-right Civic Platform and centrist Polish Peasant Party

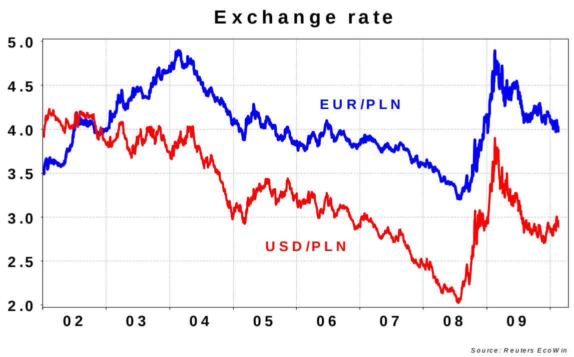
Next elections: Presidential elections Oct. 2010. Parliamentary elections Oct. 2011

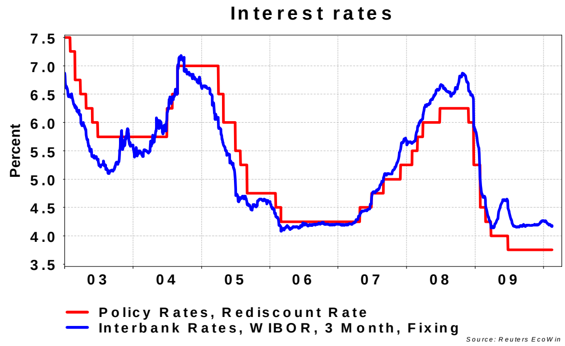
Other:

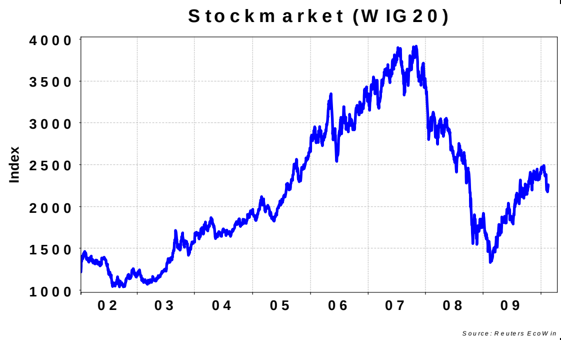
Latest PC deal: 1991

Recent IMF programs: Stand-By agreements in -93 and -94. FCL in 2009









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