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POLAND

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Sound But Not Immune To Eurozone Crisis

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POLAND – MACROECONOMIC DATA & FORECASTS

	2011f	2012f	2013f	2014f	2015f	2016f	2017f	2018f	2019f	2020f	2021f
Nominal GDP, US$bn [1]	547.8	581.2	632.8	691.9	767.4	830.2	894.2	957.9	1,022.9	1,092.4	1,167.0
Nominal GDP, PLNbn [2]	1,516.9	1,613.1	1,715.2	1,826.5	1,949.3	2,082.0	2,224.7	2,375.5	2,536.8	2,709.2	2,894.3
Nominal GDP, EURbn [2]	383.1	421.1	486.7	553.5	613.9	664.1	715.3	766.3	818.3	873.9	933.6
GDP per capita, US$ [2]	14,302	15,167	16,507	18,043	20,007	21,637	23,300	24,957	26,651	28,467	30,422
GDP per capita, EUR [2]	10,002	10,991	12,698	14,435	16,006	17,309	18,640	19,965	21,321	22,774	24,338
Real GDP growth, % change y-o-y [2]	4.0	3.5	4.0	4.2	4.4	4.4	4.4	4.4	4.4	4.4	4.4
Private consumption, % of GDP [2]	61.5	61.8	61.9	61.8	61.5	61.2	60.8	60.3	59.9	59.4	59.0
Private final consumption, PLN real growth % y-o-y [2]	4.0	3.9	4.0	3.9	3.9	3.8	3.7	3.6	3.6	3.6	3.6
Government final consumption, % of GDP [2]	18.6	18.0	17.6	17.3	17.1	16.8	16.6	16.4	16.2	16.0	15.8
Government final consumption, PLN real growth % y-o-y [2]	2.5	0.3	1.5	2.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Fixed capital formation, % Total GDP [2]	20.2	21.1	21.8	22.5	23.0	23.3	23.6	23.9	24.2	24.4	24.7
Fixed capital formation, PLN real growth % y-o-y [2]	7.0	7.8	7.6	7.4	6.7	5.9	5.7	5.7	5.6	5.5	5.5
Population, mn [3]	38.3	38.3	38.3	38.3	38.4	38.4	38.4	38.4	38.4	38.4	38.4
Unemployment, % of labour force, eop [4]	11.5	10.7	10.0	9.5	9.0	8.5	8.2	8.0	7.8	7.5	7.5
Consumer prices, % y-o-y, ave [5]	3.3	3.0	2.5	2.4	2.4	2.4	2.4	2.4	2.4	2.4	2.4
Lending rate, %, ave [6]	8.5	8.5	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0
Central Bank policy rate, % eop [7]	4.50	3.50	4.50	4.50	4.50	4.50	4.50	4.50	4.50	4.50	4.50
Exchange rate PLN/US$, ave [8]	2.77	2.78	2.71	2.64	2.54	2.51	2.49	2.48	2.48	2.48	2.48
Exchange rate PLN/EUR, ave [8]	3.96	3.83	3.52	3.30	3.17	3.13	3.11	3.10	3.10	3.10	3.10
Budget balance, US$bn [9]	-33.8	-25.1	-19.3	-15.6	-13.9	-12.4	-11.2	-10.4	-9.9	-9.8	-9.5
Budget balance, % of GDP [9]	-6.2	-4.3	-3.1	-2.3	-1.8	-1.5	-1.3	-1.1	-1.0	-0.9	-0.8
Goods and services exports, US$bn [7]	236.0	256.5	273.9	296.8	330.0	366.0	405.7	448.3	494.6	545.7	607.5
Goods and services imports, US$bn [7]	252.8	274.3	294.0	318.3	353.7	389.9	428.7	469.7	513.8	561.0	618.2
Balance of trade in goods and services, US$bn [7]	-16.8	-17.9	-20.1	-21.5	-23.7	-23.9	-23.0	-21.4	-19.2	-15.3	-10.6
Balance of trade in goods and services, % of GDP [7]	-3.1	-3.1	-3.2	-3.1	-3.1	-2.9	-2.6	-2.2	-1.9	-1.4	-0.9
Current account, US$bn [7]	-30.0	-31.4	-34.8	-37.5	-41.9	-44.2	-45.8	-47.0	-48.1	-47.9	-46.9
Current account, % of GDP [7]	-5.5	-5.4	-5.5	-5.4	-5.5	-5.3	-5.1	-4.9	-4.7	-4.4	-4.0
Foreign reserves ex gold, US$bn [10]	99.7	102.7	105.8	108.9	112.2	115.6	119.0	122.6	126.3	130.1	130.1
Import cover, months g&s [10]	5.5	5.2	5.0	4.7	4.4	4.1	3.8	3.6	3.4	3.2	2.9

Notes: f BMI forecasts. Sources: 1 EUROSTAT/BMI, US$. 2 EUROSTAT/BMI; 3 World Bank/UN/BMI; 4 UN Population Division; 5 Central Statistical Office/BMI; 6 IMF; 7 National Bank of Poland/BMI; 8 BMI; 9 BMI/Ministry of Finance; 10 IMF/BMI.

Contents

Executive Summary

Core Views

- Notwithstanding an increasingly grim outlook for global growth in 2012, we maintain our relatively constructive view on the Polish economy. Underlying our 3.5% real GDP growth forecast for 2012 is a solid domestic demand story, which helped Poland be the only European economy to avoid recession in 2009.

- Following Prime Minister Donald Tusk's re-election on October 9 2011, we expect the government to establish fiscal consolidation as its main priority. The country is fast approaching a constitutionally mandated debt ceiling which, if breached, would bring automatic retrenchment measures into effect. We believe that the government will take the necessary steps to prevent a fiscal crisis, and we reiterate our budget deficit as percentage of GDP forecasts of 6.2% in 2011 and 4.3% in 2012.

- On the back of a progressive softening of Poland's economic performance, inflationary pressures have started to moderate, with the change in consumer prices coming in at 3.9% year-on-year (y-o-y) in September 2011, down from 4.3% y-o-y in August. Moreover, with our Commodities team currently forecasting a moderation in commodity prices as global growth continues to slow, we see further scope for price growth moderation in Q112.

Major Forecast Changes

- We have amended our current account forecast for 2012 and now expect the deficit to narrow to 5.4% of GDP, from 5.5% in 2011, as opposed to our previous forecast for a 5.0% shortfall. The revision comes on the back of downward revisions to our eurozone growth outlook. Given that the common currency bloc absorbs 55% of Polish exports, we now expect a 13.2% increase in nominal goods exports in 2012, from 14.1% previously, while nominal imports will increase by 13.0%, as opposed to 17.2% previously.

- We have revised our interest rate forecast for end-2012 to 3.50%, from 4.50% previously, on the back of our deteriorating outlook for global growth. With inflation forecast to ease, we expect the National Bank of Poland to shift its attention to growth, as fiscal consolidation will act as a further brake on an already slowing economy.

Key Risks To Outlook

- Poland is growing increasingly dependent on short-term funding to finance its current account deficit. A sudden outflow of hot money amid high financial market volatility and lack of risk appetite could force the National Bank of Poland to draw down foreign exchange reserves, leaving Polish accounts exposed to a sharp correction. This would, in turn, limit the central bank's ability to cut rates at a time when global growth is softening.

- Although not our core scenario at this juncture, rising recessionary risks in the eurozone may force us to further revise downward our growth forecasts for Poland. At a time when countercyclical fiscal policies are not an option because of a constitutionally mandated debt limit (55% of GDP), a recession in the country's main trading partners could severely harm the country's growth outlook. This in turn could easily push the debt-to-GDP ratio above the 55% level, leading to an automatic value-added tax hike which would further squeeze household consumption, on which Poland's growth story has hitherto been based.

Chapter 1:
Political Outlook

SWOT Analysis

Strengths

- Further integration with key EU institutions should facilitate medium-term political stability.
- The Civic Platform-led coalition government continues to ride on a strong wave of support, helping to mitigate risks to political stability.

Weaknesses

- The sudden rise in popularity for a radical reformist party such as Palikot's Movement shows a growing discontent with traditional parties and the electorate's desire for change. Threatened by this rise in popularity, the governing coalition could be tempted to bow to populist reforms in an effort to appease the electorate and halt the rise of Palikot's Movement.

Opportunities

- There is scope for further integration with key Euro-Atlantic institutions, which will elevate Poland's international profile.
- The election of Bronisław Komorowski (formerly of Civic Platform) as president provides the coalition with a head of state sympathetic to the government's agenda, thereby removing the potential roadblock of a presidential veto.

Threats

- The need to undertake deep fiscal consolidation, in an effort to bring the country's fiscal accounts under control, could see support for Civic Platform start to wane.

BMI Political Risk Ratings

Poland enjoys broad political stability, with massive political progress having been made since the fall of communism two decades ago. We award Poland a long-term political risk rating of 86.4, reflecting our expectations that, as long-term economic and political convergence with the West continues, political conditions will remain favourable.

	S-T Political	Rank	Trend
Turkmenistan	82.7	1	=
Czech Republic	82.1	2	=
Estonia	80.4	3	=
Kazakhstan	77.1	4	-
Poland	**75.6**	**5**	**=**
Russia	74.2	6	=
Slovakia	72.7	7	=
Mongolia	71.5	8	=
Hungary	70.6	9	=
Lithuania	70.2	10	=
Latvia	69.8	10	=
Bulgaria	69.6	12	=
Croatia	69.4	13	=
Azerbaijan	68.3	14	=
Ukraine	65.4	15	=
Montenegro	65.4	15	=
Slovenia	65.0	16	=
Uzbekistan	64.0	18	=
Armenia	61.2	19	+
Romania	60.0	20	=
Turkey	59.8	21	=
Macedonia	59.8	22	=
Georgia	58.3	23	=
Serbia	53.1	24	=
Tajikistan	51.2	25	=
Albania	50.8	26	=
Belarus	47.9	27	=
Moldova	40.8	28	=
Bosnia-Herzegovina	34.6	29	=
Kyrgyzstan	34.0	30	=
Kosovo	31.7	31	=

Regional ave 63.9 / Global ave 66.0/ Emerging Markets ave 63.5

	L-T Political	Rank	Trend
Czech Republic	87.0	1	=
Poland	**86.4**	**2**	**=**
Estonia	86.2	3	=
Slovenia	85.2	4	=
Lithuania	80.3	5	=
Latvia	80.1	6	=
Slovakia	79.2	7	=
Hungary	75.6	8	=
Croatia	75.2	9	=
Romania	70.6	10	=
Mongolia	69.7	11	=
Turkey	65.6	12	=
Bulgaria	65.5	13	=
Macedonia	64.9	14	=
Albania	64.8	15	=
Kazakhstan	60.3	16	-
Armenia	59.6	17	=
Montenegro	58.5	18	=
Uzbekistan	57.1	19	=
Russia	57.0	20	=
Serbia	54.0	21	=
Turkmenistan	52.6	22	=
Ukraine	51.6	23	=
Azerbaijan	49.0	24	=
Bosnia-Herzegovina	47.2	25	=
Belarus	45.8	26	=
Georgia	45.0	27	=
Kosovo	43.5	28	=
Tajikistan	42.2	29	=
Kyrgyzstan	37.2	30	=
Moldova	31.2	31	=

Regional ave 63.8 / Global ave 63.8 / Emerging Markets ave 60.2

Domestic Politics

Re-Elected Tusk Now To Focus On Deficit

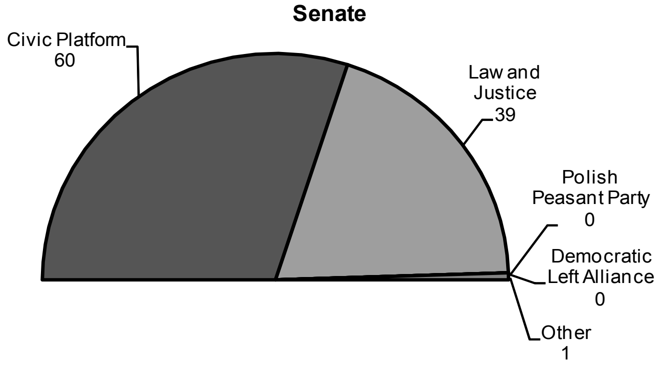
BMI VIEW

Thanks to a good performance by both Prime Minister Donald Tusk's Civic Platform (PO) and the Polish Peasant Party (PSL) in parliamentary elections on October 9 2011, Poland's governing coalition will remain in power. Although with a slightly reduced presence in the lower chamber, the government now has a fresh mandate to tackle the country's fiscal deficit. We expect Tusk to spark an acceleration in reform now that elections have been completed, supporting our medium-term constructive view on the country's fiscal position.

Prime Minister Donald Tusk's Civic Platform (PO) party saw its popular mandate confirmed in the October 2011 parliamentary elections, gaining 39.2% of the popular vote. PO gained a slightly thinner presence in the sejm (lower chamber) but strengthened its absolute majority in the senate. Sound economic management – which saw Poland avoid recession in 2009 – helped Tusk to win re-election; Poland's bolstered international profile as it held the presidency of the Council of the European Union also had a positive impact, in our view. The re-election bodes well for policy continuity in the direction of further fiscal austerity, which is now needed to keep the government's public debt below the constitutionally mandated 60% of GDP threshold.

Solid Majority In 2007-2011

Parliament Composition, Seats In Senate, 2007 Elections



Source: BMI

We previously highlighted that PO looked set to triumph over the main opposition party Law and Justice (PiS) (*see our online service, September 8 2011, 'Tusk To Win But Coalition Com-*

TABLE: POLITICAL OVERVIEW

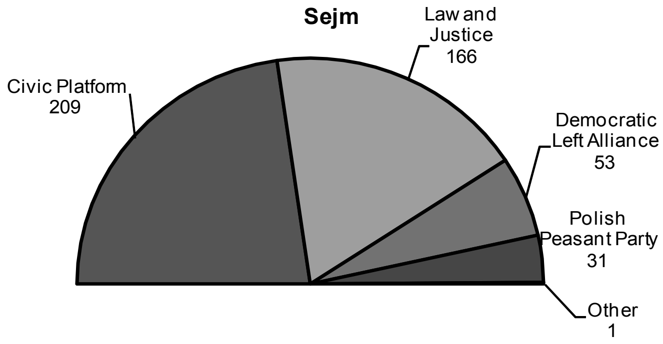
System of Government	Parliamentary representative democratic republic, universal suffrage: 460-seat sejm and 100-seat senate (both serve four-year terms). Executive power rests with prime minister.
Head of State	Bronisław Komorowski, sworn in on August 6 2010, for a 5-year mandate
Head of Government	Prime Minister (Donald Tusk – Civic Platform) appointed by the president
Last Election	Parliamentary – October 9 2011
	Presidential – June 20 2010
Composition Of Current Government	Coalition comprising Civic Platform and the Polish People's Party
Key Figures	Economy – Waldemar Pawlak, Finance – Jacek Rostowski, Foreign Affairs – Radosław Sikorski, Internal Affairs and Administration – Jerzy Miller, National Defence – Bogdan Klich
	President of the Polish National Bank – Marek Belka
Main Political Parties (number of seats in parliament)	Civic Platform (206): Centre-right, Christian-democratic and liberal-conservative party founded by Donald Tusk in 2001. Though remaining liberal on the economic side with a pro-reform agenda, the party remains conservative on social policy.
	Law and Justice (157): Centre-right political party, formed by former president Lech Kaczyński and former prime minister Jaroslaw Kaczyński in 2001. The party formed a coalition government with Self-Defense of the Republic of Poland and League of Polish Families in 2006, which subsequently fell apart amid allegations of corruption, resulting in early elections in 2007.
	Palikot's Movement (40): A radically reformist party founded in October 2010 by a dissenting politician who broke with his former party
	Left and Democrats (26): A coalition formed in 2006 comprising Democratic Left Alliance, Social Democracy of Poland, Labour Union (all social-democratic parties) and the Democratic Party (social-liberal). The alliance promotes further integration with Europe and broader foreign policy, as well as protecting domestic democratic institutions.
	Polish People's Party (3): A centrist agrarian party associated with Christian democracy.
Next Election	Presidential – 2015
	Parliamentary – 2015
Key Relations/ Treaties	Strong alliance with US. Member of EU, IMF, NATO, OECD, Schengen and WTO
BMI Short-Term Political Risk Rating	75.6
BMI Structural Political Risk Rating	86.4

Source: BMI

position Key'). The Polish People's Party (PSL, also known as Polish Peasants' Party), PO's junior coalition partner, obtained 8.4% of the popular vote in the recent elections, thus passing the required 5% threshold to enter parliament, allowing the incumbent governing coalition to remain in place.

Solid Majority In 2007-2011

Parliament Composition, Seats In Sejm, 2007 Elections

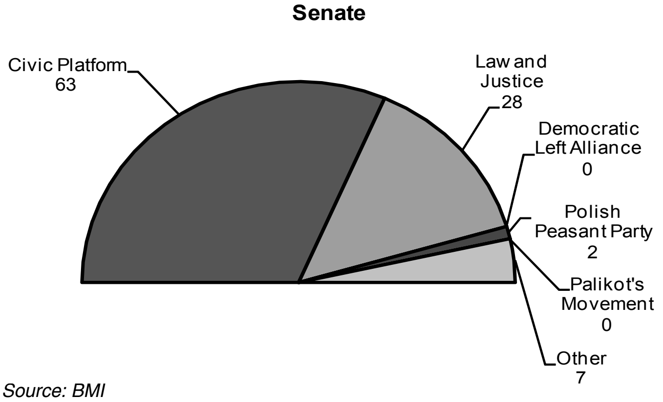


Source: BMI

Although the governing coalition is now only five seats above the 50%+1 majority threshold in the 460-seat sejm, leaving it a potential victim of defections, the PO-PSL coalition is likely to prove stable over the next four years thanks to fragmented opposition. Not only has PiS lost ground following a scandal involving the party's front runner, but the leftist Democratic Left Alliance (SLD) lost 27 seats in the sejm. Moreover, a new party – Palikot's Movement (PR) – will now hold 40 seats in the lower chamber, increasing the number of players in parliament and therefore the difficulty of creating an opposition anti-government axis.

More Players Involved

Parliament Composition, Seats In Senate, 2011 Elections

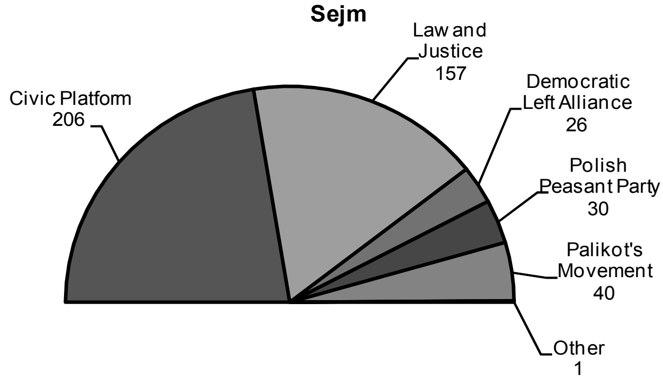


Source: BMI

We expect the Tusk government to possess the necessary firepower to address the country's economic challenges, in particular the 6.2% of GDP fiscal deficit we are forecasting for 2011. Following promises made while campaigning for re-election, we expect the government to push ahead with spending cuts and raise the pension age. A deepening of the eurozone crisis, which would negatively impact the Polish economy, combined with a swiftly deteriorating fiscal picture amid zloty depreciation, will likely spark a reformist zeal in Tusk's cabinet. In the past, both Tusk and Finance Minister Jacek Rostowski have proved reluctant to undertake deep economic and fiscal reforms, most likely fearing the political consequences of doing so. However, we believe the Tusk government is likely to respect voters' appetite for reform in the months ahead given the results of the election and in light of the increasing popularity of reformist Janusz Palikot and his economically liberal PR party. We therefore reaffirm our constructive view on the country's fiscal position and our 2012 fiscal deficit forecast of 4.3% of GDP.

More Players Involved

Parliament Composition, Seats In Sejm, 2011 Elections



Source: BMI

Regional Outlook

Central Europe To Face Constraints On Regional Assertion

BMI VIEW

As the ongoing eurozone debt crisis threatens the stability of the bloc and as regional cooperation in Central Europe increases across a number of fronts, we examine the potential for the region to assert itself militarily, economically and in the energy sector. While we expect the region to come up against a number of challenges, we do see opportunities in the energy sector.

Against the backdrop of the persistent eurozone debt crisis and increasing concerns over the future of the European project, we examine the potential for the Central European region to become a power in its own right. Ultimately, we believe that there are a number of factors that will see to it that the region, in particular Poland, will be frustrated in its ambitions to assert itself both regionally and globally. However, we believe that the region still has the potential to become a player in the energy sector.

In our view, Poland is the natural leader in the burgeoning 'CE-4' (Poland, Czech Republic, Slovakia and Hungary) alliance. Poland is most concerned over Germany's seemingly laissez-faire attitude regarding Russian resurgence, and it boasts a large population, strong domestic-demand-led economy and deep financial markets.

CE-4 Strategically Located
Map Of Europe

Source: BMI

However, we have little confidence that the other CE-4 countries will want to be seen as subordinate to Poland, a country they view, at best, on equal footing. Moreover, Poland cannot compete with the economic and political benefits that the neighbouring EU countries and Russia can offer. Below we outline our views on potential areas of influence for the region, why the region will be somewhat frustrated in its ambitions, and where there is the potential for power.

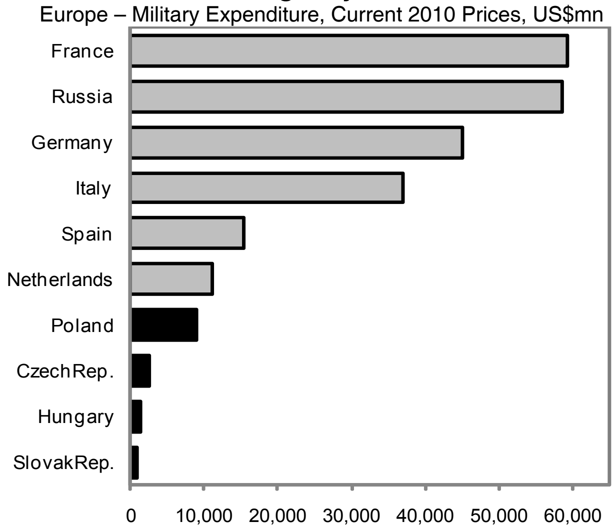
Military And Security

The CE-4 states all to some degree suffer from the hangover of having been dominated by the Soviet Union until 1989. Given the region's history as a buffer zone for Western Europe from Russian aggression, the region harbours a latent fear of Russian resurgence. Each state has attempted to attenuate these fears by moving closer to Western institutions such as the EU and NATO. However, as a result of a number of shifting geopolitical realities, these institutions do not hold the same lustre as they once did. Consequently, Central European states, in particular Poland, appear to be jockeying to set up more localised regional alternatives to the wider European organisations.

With the United States government drawing down its troops from Afghanistan and President Barack Obama's administration taking a less enthusiastic approach to plans for the Ballistic Missile Defense system in Eastern Europe, there are rising concerns over US commitment to European and, indeed, international security. In this respect, it is interesting to note the relatively limited participation of the US in the recent NATO campaign in Libya. Indeed, as the US builds up to the presidential election in 2012, precious little time has been devoted to foreign policy. Considering the still-high war fatigue of the American public, it is little surprise that the government would look to avoid another potentially drawn-out military engagement.

Moreover, the US is facing domestic and external pressure to consolidate its public finances, which will almost certainly result in cuts to defence spending. Indeed, not only is the country's willingness to continue providing a security guarantee to American allies in question, but also its capacity to do so. It is against this backdrop that the CE-4 agreed on May 12 2011 to found a military group, the Visegrád Battlegroup, led by Poland and set to become operational by 2016. We note, however, that this group is more significant with regard to its motivations, rather than its potential as a serious military challenger.

A Long Way To Go
Europe – Military Expenditure, Current 2010 Prices, US$mn



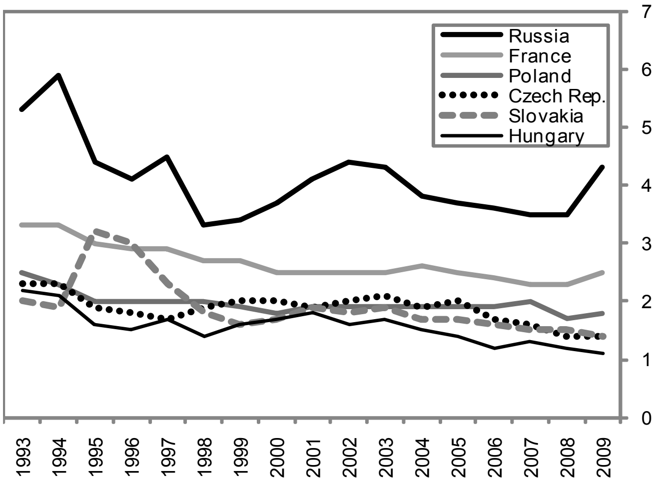
Source: SIPRI

According to the Stockholm International Peace Research Institute (SIPRI), the CE-4 countries' combined military expenditure in 2009 equalled just 8.2% of the top five eurozone countries' spending (France, Germany, Italy, Spain and the Netherlands), 23.5% of Russia's and 2.0% of US military spending in 2010 (at current prices). As a percentage of GDP in 2009, only Poland's military spending rose, to 1.8% of GDP, from 1.7% in 2008. The other CE-4 countries' spending largely held steady or witnessed a slight decline. In comparison, Russia's spending as a share of GDP rose in 2009 to 4.3%, from 3.5% the previous year – though this was likely influenced largely by the 2008 war with Georgia. In order to compete with the likes of the eurozone and Russia or to fill the perceived gap left by the US, Central Europe states would have to massively increase their security spending to invest in technology and military equipment.

In our view, this is unlikely. The region is constrained by the continuing fiscal austerity drive, which is seen as necessary to correct large fiscal imbalances. Indeed, given the increased global scrutiny of public finances on financial markets, a significant increase in expenditures for military purposes would likely inspire the wrath of bond investors and drive up these countries' borrowing costs, an eventuality they cannot afford. Similarly, we do not expect that an increase in military spending would be palatable to the electorates that continue to undergo painful fiscal austerity measures in order to support public finances. In this sense, we see little scope for the CE-4 to become a regional military stalwart over the next decade.

CE-4 Military Spending Declining

Europe – Military Expenditure, % Of GDP



Source: SIPRI

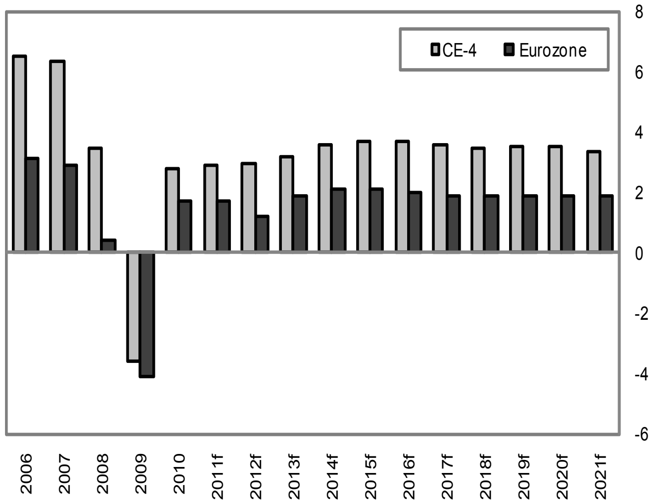
Economic Outperformers, But Yet To Decouple

The global financial crisis of 2008-09 forced a massive rebalancing in most Central Europe countries, in which current account deficits narrowed and stern fiscal austerity programmes were introduced to correct deteriorating public finances. This has put these countries in a generally better position than at the outset of the crisis. Public debt is below the eurozone average (85.1% of GDP in 2010) even in Hungary (the regional outlier, with a public debt ratio of 78.7% of GDP in 2010 compared to 38.5% in the Czech Republic). By our forecasts, this is set to continue through to 2021. For comparison, Germany's public debt load was 72.3% of GDP in 2010; given the potential for higher debt obligations to the eurozone, risks to our forecasts are to the upside.

Without the massive debt overhang plaguing Western Europe, the economic growth outlook in Central Europe looks set to outpace that of its Western counterparts. We forecast average real GDP growth of 3.0% in 2012 for the CE-4, against just 1.2% in the eurozone – though we caution that these forecasts could yet be revised down on the persistently deteriorating external environment. Indeed, the region continues to have the advantage of a relatively cheap and skilled labour force; proximity to key export markets, which keeps transport costs moderate; and trade agreements that limit risks of doing business in these countries.

Debt Overhang To Weigh On EZ Growth Outlook

Europe – Average CE & Eurozone Real GDP, %

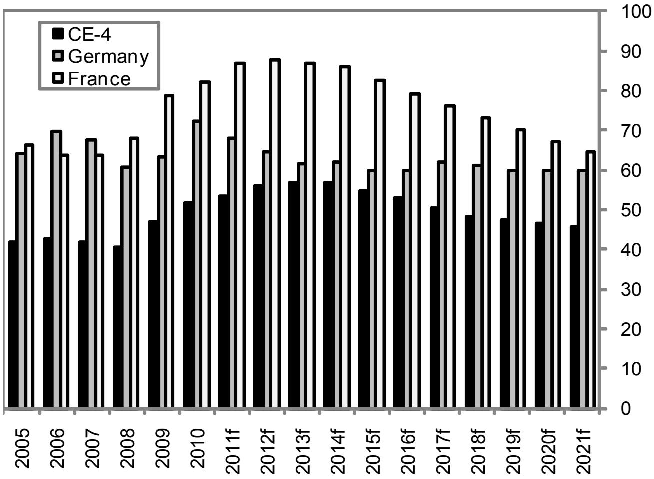


Source: Eurostat, BMI, f=forecast

However, while we expect that Central Europe will remain attractive to investors, a key risk to the region's economic growth outlook is its dependence on export markets, in particular the eurozone. Indeed, with exports making up about 80% of GDP in the Czech Republic, Hungary and Slovakia, the region has yet to significantly decouple from Western European economies. In the event of a more protracted economic slowdown or return to recession in Western Europe, emerging Europe would consequently be pulled down with the tide. While Poland was able to avoid recession in 2008-09, it is not so certain that the country would be able to avoid the same fate as its other export-dependent neighbours. Indeed, Poland now lacks the same policy room to manoeuvre, owing to its high public debt load and large fiscal imbalances.

In this sense, we see little room for the Central European states to act as an economic bloc able to rival the eurozone or Russia, largely due to their high reliance on the external environment for growth. Even Poland, one of our favourite domestic demand stories, is vulnerable to a regional or global slowdown this time around as a result of its high foreign currency-denominated public and private obligations.

CE Debt Load Substantially Lighter Than Eurozone's
Europe – Public Debt, % Of GDP



Source: Eurostat, BMI, f=forecast

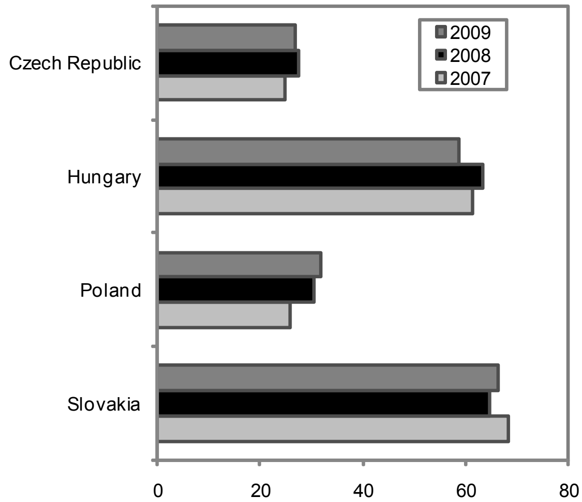
Energy Holds Most Potential

We expect that the energy sector presents the most potential for the Central Europe region to assert itself. Key to this view is the region's ongoing efforts to diversify energy supplies away from reliance on sometimes unstable Russian sources. Central Europe as a whole remains highly dependent on natural gas imports, mainly from Russia, with Slovakia and the Czech Republic's gas import dependency above 100% in 2009, the latest data available. From a wider scope, the region's total energy import dependency ratios have generally risen in recent years to average 46.0% in 2009, kept from rising higher only because of the region's large coal deposits. However, with environmental concerns rising on the global political agenda, there is a continued push away from heavily polluting energy sources.

One alternative is nuclear power. The devastating Fukushima earthquake and subsequent nuclear meltdown in Japan led to an international re-evaluation of the risks of nuclear power. In many EU states, this resulted in a turn away from nuclear energy, most notably in Germany and Switzerland. However, the same cannot be said of Central Europe states. Slovakia reaffirmed its dedication to nuclear energy, and Poland, with public opinion split on the matter, holds to its goal for 16% of its energy needs to come from nuclear sources by 2030. This shift has opened up opportunities for Central Europe states to fill the void left by Western European states' policy changes.

Our Oil and Gas team has highlighted that the changing domestic regulatory framework in Poland contrasts greatly with that of Western Europe, and this leaves open the door for domestic and international companies to take advantage of the country's vast shale gas potential (*see 'Warsaw Seeks A Slice Of Shale Gas Bounty With New Regulatory Framework', September 9 2011*).

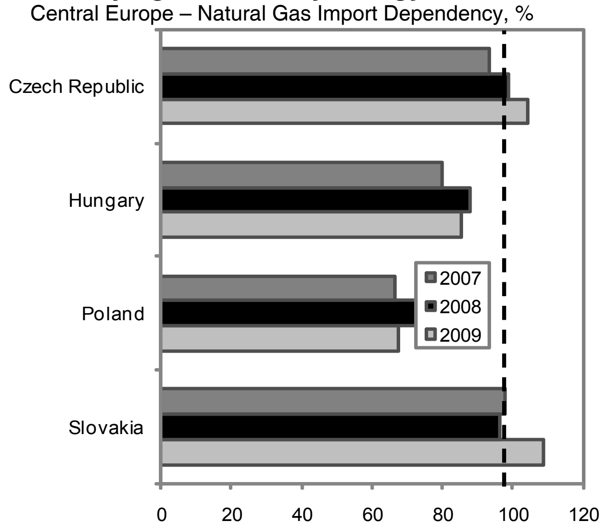
High Energy Dependence Ups Stakes Of Diversification
Central Europe – Total Energy Import Dependency, %



Source: European Commission

This has not been lost on Poland, as the country works to increase energy cooperation in its backyard while taking advantage of the current vacuum in power provisions (*see 'Poland-Czech Republic Pipeline To Boost Regional Energy Security', August 23 2011*). Indeed, the region has benefited both from increased demand for wind power and for coal following decisions to put nuclear plans on ice. In the first three months of 2011, Poland's surplus in the trade of power more than doubled to 1.6 gigawatt-hours.

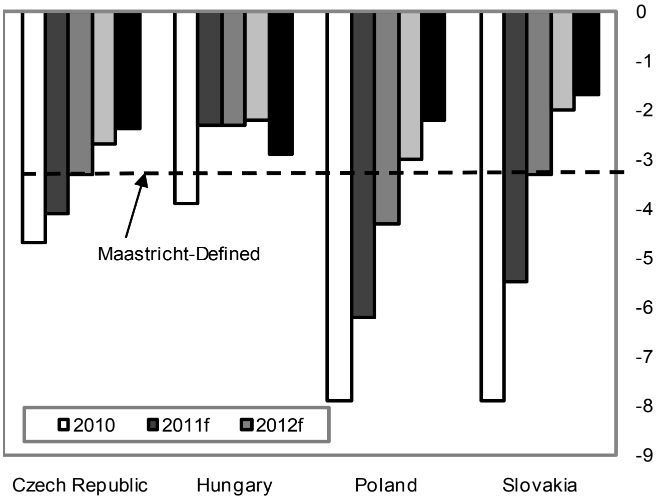
Still Trying To Diversify Energy Sources
Central Europe – Natural Gas Import Dependency, %



Source: European Commission

In this context, we see the most opportunities in the energy and power sector. Our view for Poland to embark on fiscal austerity in 2012 and our expectation for other CE-4 states to broadly continue with their austerity programmes mean that government spending on energy infrastructure is likely to be hard to come by. With a large amount of the Central European energy grid unable to deal with large power capacity additions due to its outdated nature, we expect tenders to crop up in the coming years to upgrade infrastructure.

Austerity To Weigh On Public Spending
Central Europe – Budget Balances & Maastricht Limit, % Of GDP



Source: Eurostat, BMI, f=forecast

Our Oil and Gas team also continues to see opportunities in the shale gas sector in Poland. With Europe's largest proven shale gas reserves, the country has garnered attention from **Chevron** and **Exxon Mobil** as well as other smaller companies (*see '3Legs IPO Offers Direct Exposure To Polish Shale Gas', June 10 2011*). With energy set to remain top of the international agenda, we see scope for interest in regional energy potential to continue.

Long-Term Political Outlook

A Maturing Regional Power

BMI VIEW

We consider Poland's long-term political risk profile to be on an upward trajectory, reflecting the country's maturing political institutions and greater confidence in the conduct of external affairs. Solid macroeconomic fundamentals also underpin our expectation for improvement over the long run. Nevertheless, Poland still faces significant challenges to political stability in its external relations and at home.

We expect Poland's political risk profile to improve over the course of our 10-year forecast as the country assumes greater responsibility at the regional and international level and as the domestic political environment continues to mature. Our core scenario envisages Poland emerging as a solid 'middle power' of Europe. A strong macroeconomic outlook, coupled with greater maturity on the part of domestic policymakers, will facilitate this progression over the years ahead.

A member of the EU and NATO since 2004 and 1999 respectively, Poland is established within a Western policy trajectory track. We expect the EU to remain a key policy anchor for Warsaw as Poland's political and economic dynamics become more intimately intertwined with those of its EU neighbours, particularly Germany. The handling of the six-month rotating presidency of the Council of the European Union by Prime Minister Donald Tusk's government amid the escalation of the eurozone's sovereign debt crisis also highlighted the country's increasing political maturity and integration in European affairs.

Strongly impacting Poland's political risk profile over the long term will be the way it conducts foreign relationships with regard to the US, the EU and – last but not least – Russia. Warsaw's close-knit relationship with Washington should persist over the long term. Polish designs for influence at the European level, however, could strain relations with Warsaw's partners on both sides of the Atlantic. What is more, the country's relationship with the Kremlin will remain key to regional tensions and may suffer as Warsaw's confidence grows in the years ahead.

On top of significant foreign policy questions, the country will face challenges at home. While economic growth remains far from negative and has imbued Poland with a sense of optimism and confidence after the country was among the few to avoid recession in 2009, the future will not be without policy choices and challenges, not least of which is related to the unwinding of massive fiscal stimulus initiated between 2008 and 2010. We also highlight that a possible clash between an older, conservative generation and younger, more liberal voters could be on the cards in the years ahead.

External Relations: A Distinctly Polish Affair

Foreign policy will likely be a cornerstone of Poland's long-term political risk trajectory. Considering Poland's tumultuous history, which has been typified by a relatively precarious national security position as well as its geostrategic importance in the European theatre, any consideration of the country's political risk outlook must consider the possible permutations of foreign affairs. Below, we consider Warsaw's relations with three major states whose power and influence could come to intersect in Poland: the US, Russia and the EU.

The Hinge Of Europe
Regional Map

Source: BMI

US-Poland Relations: Warsaw and Washington are likely to maintain close ties over the course of our forecast period. For Poland, the US was a major ally in the country's aspirations for independence from communist rule and later a key pillar of support as the country underwent a dramatic economic transition from a command-based to market-based economy in the 1990s. The US is likely to remain key to Poland's historically conditioned aspirations to secure some form of sovereign guarantee and as a way to increase the country's influence abroad.

From the perspective of Washington, Poland serves as a useful and staunch ally in Central Europe. Warsaw supported the US's 'War on Terror' at a much higher level that its Western European peers, in particular Germany and France, sending troops not only to Afghanistan but also Iraq. The May 2011 decision to base a US F-16 fighter wing in Poland for the first time reflects the prospect that the US-Polish relationship is a key strategic consideration for both parties. While Poland clearly represents the junior partner in the relationship, the US's strategic interests in a Central European presence, and Polish aspirations towards an existential security guarantee as well as regional power and influence, mean that the basic underpinnings of the relationship are likely to remain in place through the next decade.

Russia-Poland Relations: In stark contrast to the warm relationship enjoyed with Washington based on mutual interests, Warsaw's relationship with the Kremlin is likely to remain less than rosy over our forecast period. Historical tensions between the two countries run deep, not least because of the legacy of Soviet dominance. Nevertheless, our core scenario envisages Russia-Poland relations becoming more pragmatic as increased political maturity in Warsaw translates into more consistent foreign policy procedures and pronouncements, and this should reduce the likelihood of major diplomatic ructions.

First and foremost, considering that we believe the outlook for Warsaw-Washington relations is relatively well established over the long run, increased political and military integration with the US could strain tensions with Russia. Moreover, we cannot discount the possibility that Polish lawmakers will attempt to score political points at home by raising the level of nationalist rhetoric, which would most likely paint Russia in an antagonistic light.

EU-Poland Relations: Our core scenario for Warsaw's relationship with Brussels and its fellow members of the EU envisages continued cooperation. Parallel to a relatively positive macroeconomic growth picture and maturing political arena, Poland will likely enjoy growing influence at the supranational level, eventually establishing itself as an effective middle power. In particular, we believe Poland could become one of the leaders of the 'younger' members of the European integration project. While this may unsettle some of the more established member states such as Germany and France, Warsaw's relations with the EU will likely remain constructive over our forecast period.

The tone and trajectory of relations with the EU could conversely present a challenge to Poland's long-term political risk profile. In particular, the Warsaw-Brussels relationship could be strained by Poland's attempts to foster closer ties with the US – something that may place it at odds with major European powers and may undercut European foreign policy options. Moreover, and as alluded to above, Poland will likely enjoy increasing status and influence at the supranational level over the coming decade – something that will undoubtedly challenge Europe's traditional dominance by France and Germany. EU immigration may also come under the spotlight, as the significant flows of Polish workers into other European nations could come under increasing scrutiny by foreign politicians hoping to boost their political popularity at home amid weak domestic economies.

Challenges And Threats To Stability

Domestic Political Maturity: A key question and challenge for Poland's long-term political outlook will be the level of maturity shown by both institutions and politicians. Prime Minister Donald Tusk's re-election on October 9 2011, the first re-election of an incumbent government since the end of communist rule, bodes well for policy continuity and marks an increased maturity in the country's political system. We highlight this as a positive development as Poland's political landscape remains heavily fractured along ideological and social lines.

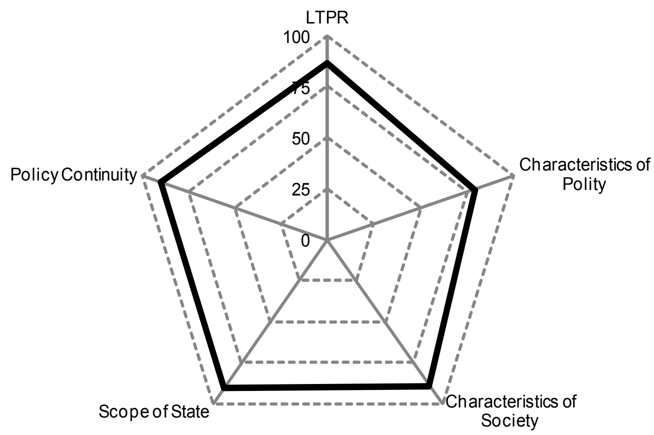
Social Challenges Ahead: Overall, we consider that Poland's sound macroeconomic fundamentals should keep disputes over social and economic policy relatively muted. Poland remains one of the most socially conservative countries in Europe, with strong Roman Catholic roots. However, we cannot rule out more divisive social policy issues coming to the fore, as a relatively benign macroeconomic backdrop enables voters to increasingly shift their voting preference formulation along social lines. In such an event, we highlight that a younger, more liberal class of voters that harbours little memory of life under communist rule and the movement for independence could come into conflict with an older and generally more conservative class. Furthermore, we believe that as the country enters a period of fiscal austerity, greater questions regarding the socially optimal allocation of wealth could come to the forefront of domestic policy considerations.

Long-Term Political Risk Rating

Poland's long-term political risk rating stands at 86.4 out of 100, according to **BMI**'s proprietary risk rating system, which ranks the country 13th out of 177 countries assessed worldwide. Moreover, the rating marks Poland as a clear outperformer in Europe, outranking the eurozone average of 82.4. The high rating reflects what we see as a well-established domestic policy trajectory, with Poland scoring particularly well in 'policy continuity'. Moreover, domestic public policy disputes as well as issues regarding minority rights are relatively limited, boding well for the 'characteristics of policy' and 'characteristics of society' components.

Political Risk Outperformer

Long-Term Political Risk Rating & Component Scores (Out Of 100)



Source: BMI

Over the long term, we expect Poland's membership in the EU to be secure, providing a key policy anchor. To us, the key risk to Poland's political risk rating over our forecast horizon relates to how the country adapts to increasing influence in regional and international affairs. Below, we present a wide range of scenarios towards 2021. We assign scores for likelihood out of 10, with 10 being highly likely and 1 being highly unlikely.

Scenarios For Political Change

Scenario One – A European 'Middle Power' Within The EU: Our core scenario entails Poland establishing itself as an effective middle power of Europe and achieving greater integration with the EU and its constituent supranational institutions. Under such a sequence of events, this would see Poland leveraging its clear economic outperformer status in the Central and Eastern European space and should see the country gain increasing influence among its European peers. Moreover, we expect Poland's young democratic political culture and institutions to grow more mature over the course of our forecast period, which should bode well for policy continuity and implementation. In turn, a more consistent and steady hand at the wheel of both domestic and foreign policymaking bodes well for increasing Poland's influence abroad. In terms of foreign policy, a strong relationship with the US will persist and Poland will prove adept at handling affairs with Russia.

Likelihood: 8

Scenario Two – Greater Assertiveness At The EU's Expense: This entails the country undergoing a similar increase in confidence regarding its domestic and external affairs, underpinned by a strong macroeconomic story at home. However, the country's increased assertiveness comes at the expense of good relations with the EU. Indeed, considering the fundamental way that Poland's historical insecurity shapes the conduct of its external affairs, the country may find itself frustrated in its attempts to find a satisfying security guarantee within the European structure. At that point, Warsaw may be forced to adopt a more assertive foreign policy stance than that of its EU peers in order to satisfy a sense of self-security, much like it did in backing the US-led 'War on Terror'. This may strain relations with the EU, not least in the foreign policy sphere. Furthermore, we see scope that Poland could forego joining the euro. Indeed, Poland has already delayed the adoption of the single currency indefinitely, having originally planned to enter the eurozone sometime in 2012.

Likelihood: 6

Scenario Three – An Economic Faltering: While our core scenario for Poland sees economic growth chugging along at an average rate of 4.2% in real terms over 2012-2021, we cannot rule out the possibility that macroeconomic expansion falters and the current optimism surrounding the future of the country concomitantly wanes. In such an event, we highlight the risk that a more populist brand of politics takes hold in Poland, derailing the maturing market-based, liberal policy consensus that is currently on the ascendancy. This would lead to less-consistent domestic policymaking. This could also derail Poland's aspirations to take on a larger role at the EU and international level.

Likelihood: 4

Scenario Four – Excessive Assertiveness: While much less likely, in our view, we do see scope that Poland becomes much more assertive in its foreign policy stance. Fiscal austerity and military retrenchment on both sides of the Atlantic (against the backdrop of a Russian military modernisation drive) pose the risk that Warsaw begins to become more bellicose in its rhetoric towards Russia, which could lead to a deterioration in relations – something that may make Poland's key allies in the EU and the US more nervous. Efforts by the US to roll back its presence in NATO and in Europe could lead to greater assertiveness and seeking of existential guarantees by Polish politicians. Indeed, Warsaw was in need of reassurance following the US's decision in 2009 to scale back an anti-ballistic missile shield based in Poland while also seeking rapprochement with the Russians. As mentioned above, Poland's efforts to effect material security guarantees under the EU framework would also likely fail to assuage Polish concerns.

While we believe the direct threat of greater Russian assertiveness over its former satellite states is remote, the fundamental 'security question'-driven nature of Polish foreign policy formation means that a more bellicose and confrontational Warsaw cannot be ruled out. While our likelihood rating for this outcome is low, we caution that, combined with a faltering of Poland's strong domestic growth story, a swing towards more populist politics – which would most likely tap latent nationalism – would raise the probability of this outcome materially.

Likelihood: 2

Chapter 2:
Economic Outlook

SWOT Analysis

Strengths

- Strong domestic demand and high export competitiveness make Poland less exposed to the unwinding macroeconomic headwinds originating from the Eurozone.
- A credible and independent central bank continues to bolster economic stability and investor confidence.

Weaknesses

- Social protection largesse – including eligibility for early retirement schemes, payments to farmers and disability pensions – needs to be reduced to improve economic competitiveness and mitigate the associated fiscal burden.

Opportunities

- Eventual eurozone entry (expected in 2015 at the earliest) will allow further expansion of Poland's export markets and will attract more foreign investment over the long term.

Threats

- The zloty has increasingly been used as a liquid benchmark for the wider Central and Eastern European region, with any period of financial distress likely to see the currency overshoot its Central Europe peers on the downside. This in turn will continue to pose a risk to financial stability.

BMI Economic Risk Ratings

Poland's long-term economic risk rating comes in at a healthy 65.4. This reflects the nation's potential for long-run convergence-led growth bolstered by a solid domestic demand base. However, Poland fails to score more highly owing to its persistent current account deficits. That said, these should reduce as Poland increasingly builds its domestic capital base, reducing the need for imports over the long term.

	S-T Economy	Rank	Trend
Azerbaijan	75.6	1	=
Uzbekistan	74.6	2	=
Kazakhstan	73.5	3	=
Turkmenistan	70.8	4	=
Estonia	67.7	5	=
Russia	64.0	6	=
Tajikistan	59.8	7	=
Kyrgyzstan	58.3	8	=
Slovenia	55.4	9	=
Slovakia	54.2	10	=
Hungary	53.3	11	=
Bulgaria	52.7	12	=
Lithuania	51.7	13	=
Czech Republic	51.2	14	=
Mongolia	50.0	15	=
Albania	49.4	16	=
Croatia	48.8	17	=
Turkey	48.3	18	=
Poland	**47.9**	**19**	**=**
Montenegro	47.3	20	=
Latvia	45.2	21	=
Georgia	44.2	22	=
Armenia	41.0	23	=
Macedonia	40.6	24	=
Ukraine	40.0	25	=
Serbia	37.9	26	=
Romania	37.3	27	=
Belarus	36.7	28	=
Moldova	36.7	28	=
Bosnia-Herzegovina	33.1	30	=

Regional ave 51.8 / Global ave 53.7/ Emerging Markets ave 52.4

	L-T Economy	Rank	Trend
Poland	**65.4**	**1**	**=**
Russia	65.2	2	=
Azerbaijan	63.4	3	=
Slovenia	60.4	4	=
Czech Republic	58.5	5	=
Estonia	56.6	6	=
Bulgaria	55.6	7	=
Hungary	54.9	8	=
Uzbekistan	54.9	8	=
Kazakhstan	54.3	10	=
Croatia	53.7	11	=
Slovakia	53.7	11	=
Turkey	53.6	13	=
Romania	53.0	14	=
Turkmenistan	49.7	15	=
Lithuania	49.4	16	=
Montenegro	48.0	17	=
Latvia	47.1	18	=
Macedonia	45.9	19	=
Albania	45.8	20	=
Armenia	43.0	21	=
Tajikistan	41.2	22	=
Bosnia-Herzegovina	41.2	22	=
Serbia	40.3	24	=
Georgia	39.7	25	=
Kyrgyzstan	39.5	26	=
Moldova	39.0	27	=
Mongolia	38.4	28	=
Ukraine	37.8	29	=
Belarus	16.8	30	=

Regional ave 49.7 / Global ave 52.2 / Emerging Markets ave 50.1

Economic Activity

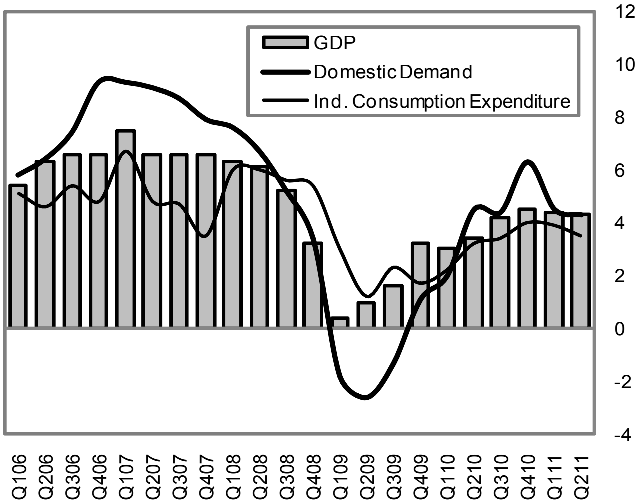
Domestic Demand To Sustain The Economy

BMI VIEW

Amid a sharply deteriorating economic picture in Europe, Poland remains a regional outlier thanks to relatively strong domestic demand. However, the country's economy will not prove completely immune to the worsening macroeconomic outlook for the wider region, as 55% of its exports are bound to eurozone economies. Moreover, major fiscal austerity means that domestic demand, too, will begin to weaken in 2012.

Consumer-led Growth

Real GDP, Individual Consumption Expenditure & Domestic Demand, % chg y-o-y



Source: BMI, GUS

Notwithstanding an increasingly grimmer outlook for global growth in 2012 and our recent downgrade of Poland's economic growth forecast on the back of mounting macroeconomic headwinds originating from the eurozone, we maintain our relatively constructive view on the Polish economy. Underlying our 4.0% and 3.5% real GDP growth forecasts for 2011 and 2012 respectively is a solid domestic demand story, which previously helped Poland to avoid recession in 2009 – the only European economy to do so. We caution, however, that there are strong risks to the downside, as high public debt and a fiscal deficit will firmly limit the government's room for countercyclical policy this time around.

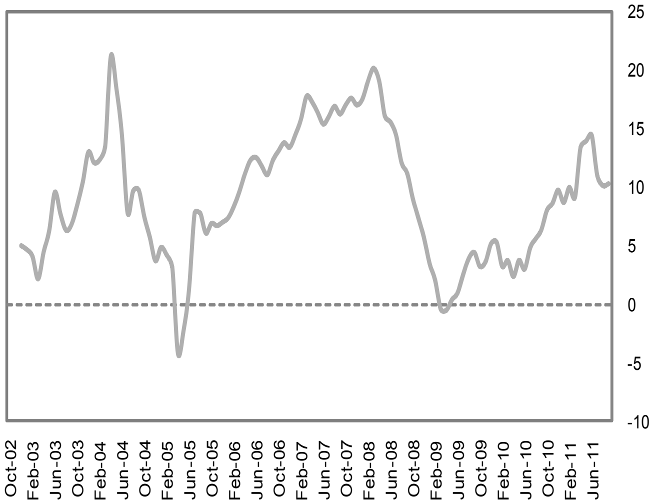
We expect major fiscal austerity measures over the course of 2012 now that Prime Minister Donald Tusk's has been re-elected, with the government seeking to prevent public debt from reaching a constitutionally mandated ceiling of 55% of GDP (*see 'Debt Ceiling Requires Sharp Fiscal Correction', October 21 2011*). This will undoubtedly weigh on domestic demand, which is already factored into our latest growth forecasts. We believe, however, that the National Bank of Poland will cut its policy rate by 100 basis points to 3.50% in 2012, which will help to offset some of the negative effects of fiscal tightening on the economy (*see Monetary Policy section*).

Robust Consumption Trend Still In Place For Now

Looking at several recent leading indicators, we see no signs to suggest that domestic demand has started to drop off throughout the third quarter of 2011, underpinning our view that the economy is on track to meet our 4.0% growth target for the year. Indeed, following real GDP growth of 4.4% y-o-y and 4.3% in Q111 and Q211 respectively, we see limited downside risks to our 2011 real GDP growth forecast.

Retail Sales Remain Strong

Retail Sales, % chg y-o-y, 3-month moving average



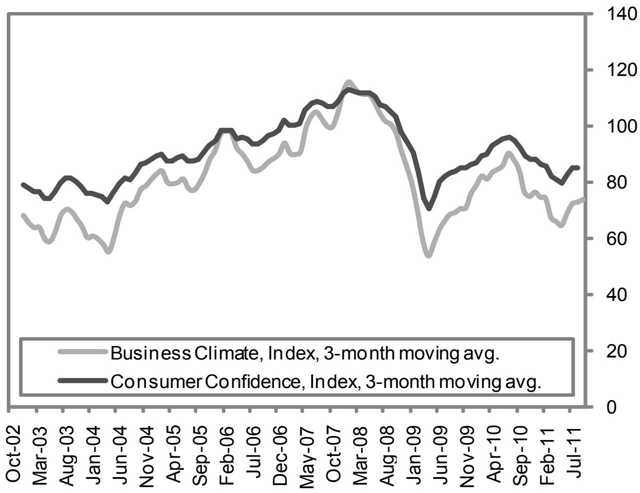
Source: BMI, GUS

Indeed, with growth in retail sales coming in at 11.4% y-o-y in September 2011, the country's domestic demand-driven growth story still seems to be in place, even as macroeconomic headwinds are mounting in the neighbouring eurozone. Although this marks a drop with respect to the April 2011 figure, when retail sales were expanding by 18.6%, the overall picture remains quite positive, with average growth coming in at 11.3% in the period January to September 2011.

In addition, consumer confidence indicators remain strong by historical levels and have been on the upside since March 2011. This trend has been matched by business environment indicators, which are, however, a notch lower, reflecting an ongoing concern about weakening demand in key export economies.

Looking at selected domestic sectors which make up a proportionally large part of the economy, we note that both industrial production and construction sales remain strong and have seen growth accelerate in the past few months. After a sluggish performance in June and July 2011, when it grew by 2.0% y-o-y and 1.8% y-o-y respectively, industrial production in real terms came back to stronger levels in August and September, coming in at 8.1% y-o-y and 7.7% y-o-y respectively. Similarly, construction sales were up 18.1% y-o-y in real terms in September.

Keep Calm And Carry On
Business Climate & Consumer Confidence Index, 3-month Moving Average



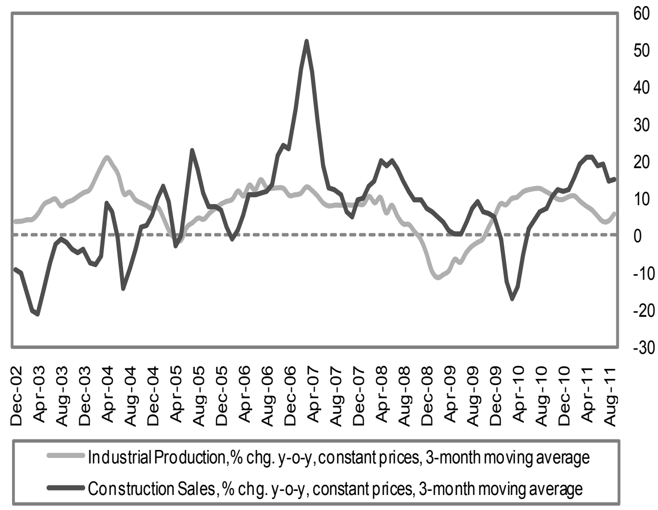
Source: BMI, Ipsos-demoskop

Not Immune To Regional Woes

Although, as we have highlighted, Poland's growth story revolves heavily around its strong household sector and healthy signs of investment growth, the country continues to rely on its export sector to sustain the economic trend seen so far in 2011. As such, Poland will not be immune to the wider deteriorating economic climate in the region. Following a wave of growth downgrades for the eurozone economies, we have already adjusted our projections for Poland's growth, given that 55% of the country's exports are bound to the common currency bloc (see 'Eurozone Woes Prompt Growth Downgrade', September 14 2011). However, we caution that risks remain strongly skewed to the downside, as another wave of downgrades across the region could be on the cards soon.

For now, Poland's exports have been holding up relatively well, in large part due to the country's high degree of competitiveness. With growth in wages remaining subdued since 2009, the country's exports growth has quickly come back into positive territory following the 2009 financial crisis and is likely to remain sustained notwithstanding the weakening global demand.

Still Selling Europe
Real Industrial Production & Construction Sales



Source: BMI, GUS

Exports of goods were up by 17.1% y-o-y in August 2011 and 13.5% in the period January to August 2011 with respect to the same period of the previous year. At the same time, imports of goods were up by only 11.7% y-o-y in August, boding well for Poland's growth. We caution, however, that export growth will likely moderate in 2012, as external demand weakeness filters through, and we currently expect it to come in at 13.2% in 2012.

Risks To Outlook

Although not our core scenario, we caution that a sharp contraction in core eurozone economies following an escalation of the common currency bloc's sovereign debt crisis would force us to revise down our growth forecasts for Poland. Furthermore, were the constitutionally mandated debt ceiling to be reached and con-

TABLE: ECONOMIC ACTIVITY

	2011f	2012f	2013f	2014f	2015f	2016f
Nominal GDP, PLNbn [1]	1,516.9	1,613.1	1,715.2	1,826.5	1,949.3	2,082.0
Nominal GDP, US$bn [2]	547.8	581.2	632.8	691.9	767.4	830.2
Real GDP growth, % change y-o-y [1]	4.0	3.5	4.0	4.2	4.4	4.4
GDP per capita, US$ [1]	14,302	15,167	16,507	18,043	20,007	21,637
Population, mn [3]	38.3	38.3	38.3	38.3	38.4	38.4
Unemployment, % of labour force, eop [4]	11.5	10.7	10.0	9.5	9.0	8.5

Notes: f BMI forecasts. Sources: 1 EUROSTAT/BMI. 2 EUROSTAT/BMI, US$; 3 World Bank/UN/BMI; 4 UN Population Division.

sequent automatic fiscal austerity measures to come into place, this would result in a major fiscal drag on the Polish economy.

Balance Of Payments

2012 Current Account Outlook Deteriorating

BMI VIEW

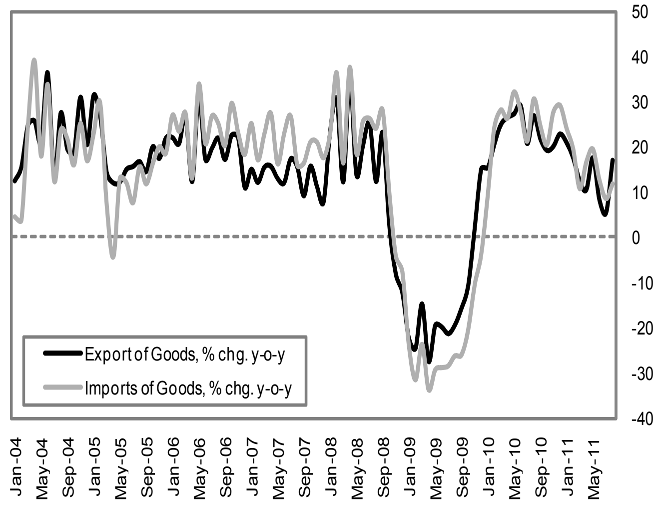
Amid concerns about the eurozone's growth prospects and fiscal retrenchment at home, we are revising up our 2012 current account deficit forecast for Poland from 5.0% of GDP to 5.4%, while we expect the deficit in 2011 to remain in line with our previous forecast of 5.5% of GDP, as a surge in service exports will compensate for the slowdown in goods exports. Although we do not see significant financing risks, we caution that Poland's growing reliance on short-term money is a growing cause of concern.

We have amended our Poland current account forecast for 2012 and now expect the deficit to reach 5.4% of GDP, as opposed to our previous forecast for a 5.0% shortfall. The revision comes on the back of downward revisions to our eurozone growth outlook. We recently lowered our growth forecasts for Germany to 1.3% in 2012, from 2.0% (*see 'Lower Growth Amid Deteriorating External Environment', September 6 2011*). This tales our 2012 eurozone growth forecast down to 1.2%, from 1.7% previously. Given that the common currency bloc absorbs 55% of Polish exports, we now expect a 13.2% increase in nominal goods exports in 2012, from 14.1% previously, while nominal imports will increase by 13.0%, as opposed to 17.2% previously. We expect a similar pattern for services, with exports set to increase by 9.5% (from 10.2% previously) and imports to increase by 9.0% (from 10.2% previously). To be sure, in the first seven months of 2011, the trade deficit for goods widened by 57.3% y-o-y to EUR6.1bn on the back of slowing export growth. We expect this trend to accelerate into 2012 as eurozone real GDP growth slows further.

Although the risks are to the downside given the potential for escalation in the eurozone sovereign debt crisis, we currently do not forecast a more pronounced expansion of the current account deficit for Poland in 2012. Indeed, the government will have to implement a severe austerity package in order to keep public debt within its constitutional limit. This will squeeze households' purchasing power and weigh on public sector pay and, although the successful Polish consumer story remains broadly in place, we expect imports growth to moderate.

Still Buying Polish Goods

Exports & Imports of Goods, % chg y-o-y

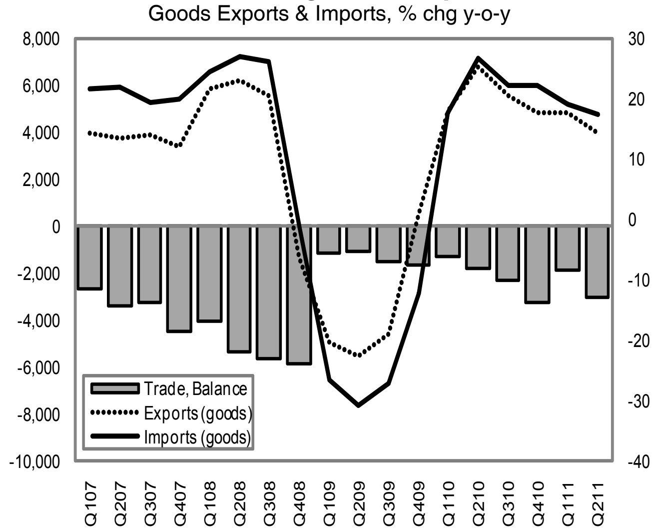


Source: BMI, NBP

Although the eurozone's slowdown is already affecting Polish exports, we have kept our current account forecast for 2011 unchanged at 5.5% of GDP, equal to EUR21.0bn, mainly due to a strong bounce in service exports. The services surplus rose by 37.4% y-o-y in July 2011, and we now expect an end-2011 services surplus of EUR1.8bn, which will offset the widening trade in goods deficit this year.

Widening Trade Gap

Goods Exports & Imports, % chg y-o-y



Source: BMI

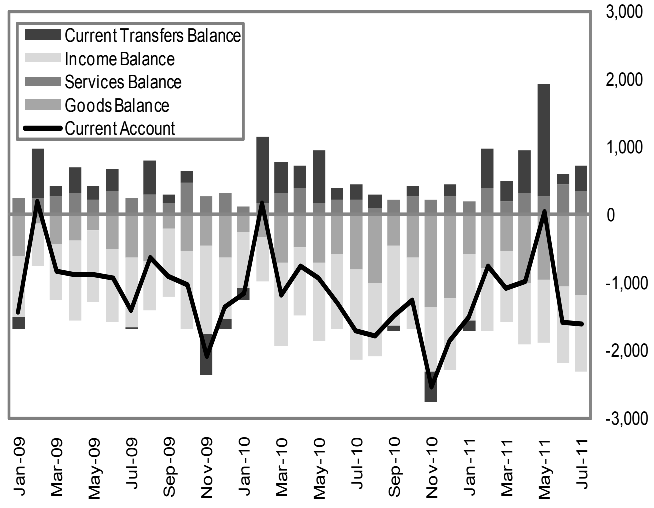
Moreover, in the period January-July 2011, Poland experienced a surge in remittance inflows, together with a one-off record EUR1.97bn transfer from the EU in May. As a result, the transfer balance experienced a 28.1% increase with respect to the same period of the previous year and we now forecast the 2011 transfer surplus to hit the EUR3.5bn level.

Increasingly Dependent On Short-Term Money

We currently expect Poland to have little difficulty financing the current account deficit in 2012, as a strong foreign reserve position (6.8 months of import covers in 2011) and solid financial account surpluses provide ample ammunition. To be sure, international reserves are still building up, increasing by EUR544mn in Q211, feeding into the strong overall US$106bn print in July.

One-off EU Pocket Money

Current Account & Constituent Parts, EURmn

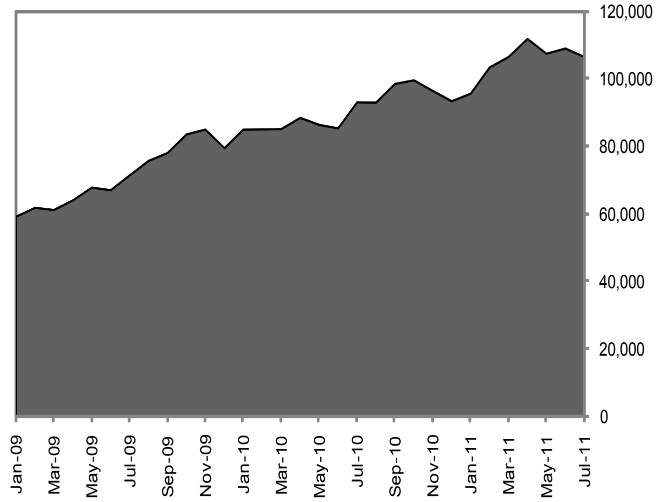


Source: BMI

However, we caution that the financial account has been rapidly shrinking recently, coming in at EUR11.0bn year-to-date in July 2011, from EUR20.7bn in the same period in 2010. Moreover, as illustrated by the latest National Bank of Poland(NBP) balance of payment data, Poland is growing increasingly dependent on short-term funding to finance its current account deficit. Indeed, in the first seven months of 2011, foreign direct investment in the country has been shrinking rapidly, with net direct investment dropping by 86% y-o-y. Moreover, foreign investors are showing less appetite for Poland's financial assets, with investment in Polish equities down 54.6% y-o-y year-to-date in July 2011 and investment in debt securities down 37.1% y-o-y year-to-date. As a consequence, net portfolio investments were down 43.4% y-o-y in January to July 2011.

No Shortage Of Coverage

International Reserves, US$mn



Source: BMI

We highlight this as a negative development that could lead to a brusque readjustment in the Polish balance of payment dynamics, especially in an environment of high financial market volatility and lack of risk appetite, as we are experiencing in these months. In fact, a sudden outflow of hot money could draw down reserves and leave Polish assets exposed to a sharp correction, while the NBP would be presented with limited scope for rate cuts in a moment in which global growth is softening.

TABLE: BALANCE OF PAYMENTS

	2008	2009	2010	2011f	2012f	2013f	2014f	2015f	2016f
Goods imports, EURbn [1]	141.8	107.2	131.0	151.8	171.6	196.1	221.4	246.2	271.3
Goods exports, EURbn [1]	120.9	101.8	122.4	138.3	156.6	177.9	201.2	223.9	248.5
Goods exports, % of imports [1]	85.2	94.9	93.4	91.1	91.3	90.7	90.9	90.9	91.6
Balance of trade in goods, EURbn [1]	-20.9	-5.4	-8.6	-13.5	-15.0	-18.2	-20.2	-22.3	-22.8
Services imports EURbn [1]	20.7	17.3	21.9	25.0	27.2	30.1	33.2	36.7	40.6
Services exports EUR [1]	24.2	20.7	24.5	26.7	29.3	32.8	36.3	40.1	44.3
Balance of trade in services, EURbn [1]	3.5	3.4	2.6	1.8	2.1	2.7	3.0	3.4	3.7
Goods and services exports, EURbn [1]	145.1	122.5	146.9	165.1	185.9	210.7	237.4	264.0	292.8
Goods and services imports, EUR [1]	162.5	124.5	152.9	176.8	198.8	226.2	254.6	282.9	311.9
Balance of trade in goods and services, EURbn [1]	-17.5	-2.0	-6.0	-11.8	-12.9	-15.5	-17.2	-19.0	-19.1

Notes: f BMI forecasts. Sources: 1 National Bank of Poland/BMI

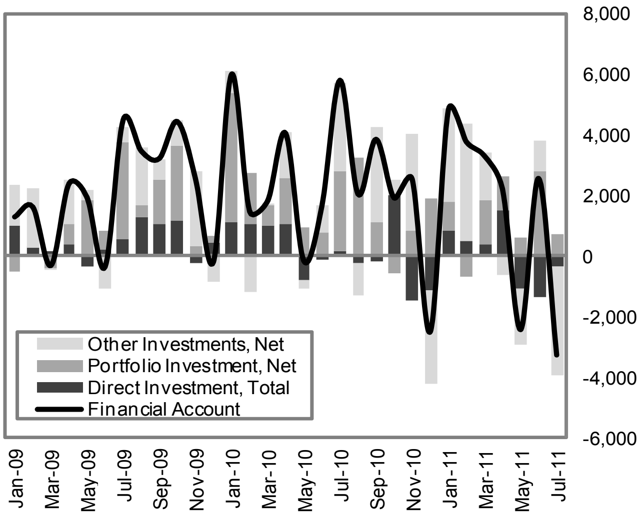
Fiscal Policy

Debt Ceiling Requires Sharp Fiscal Correction

BMI VIEW

Following Prime Minister Donald Tusk's re-election on October 9 2011, we expect the government to set fiscal consolidation as its main priority. Facing a constitutionally mandated debt ceiling, the government is likely to act in an effort to prevent automatic retrenchment measures from coming into effect. While the recent sharp depreciation of the zloty has exacerbated the current situation, we believe that the government will take the necessary steps to prevent a fiscal crisis, and we reiterate our deficit-to-GDP forecasts of 6.2% in 2011 and 4.3% in 2012.

Portfolio Investment Becoming Key
Financial Account EURmn Monthly (LHS)

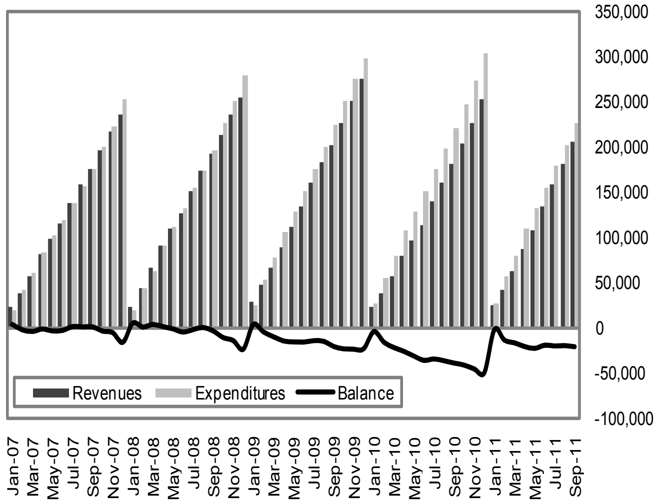


Source: BMI

Following Prime Minister Donald Tusk's re-election on October 9 2011, we remain sanguine in our long-held view regarding Poland's fiscal position, and we reiterate our forecast for Poland's budget deficit of 6.2% of GDP in 2011, moderating to 4.3% in 2012.

Underlying our forecasts is the expectation that deep fiscal consolidation measures and reforms, a platform on which Tusk campaigned, will soon be put in place (*see Domestic Politics section*). According to recent data released by the Polish Ministry of Finance (MoF) on October 17 2011, the government budget deficit in the period January to September 2011 stood at PLN21.9bn, with government revenues and expenditures coming in at PLN205.0bn and PLN226.9bn respectively. As compared to the same period in 2010, these figures indicate 13.3% and 2.7% y-o-y increases in revenues and expenditures respectively, which feeds in well with our fiscal forecasts.

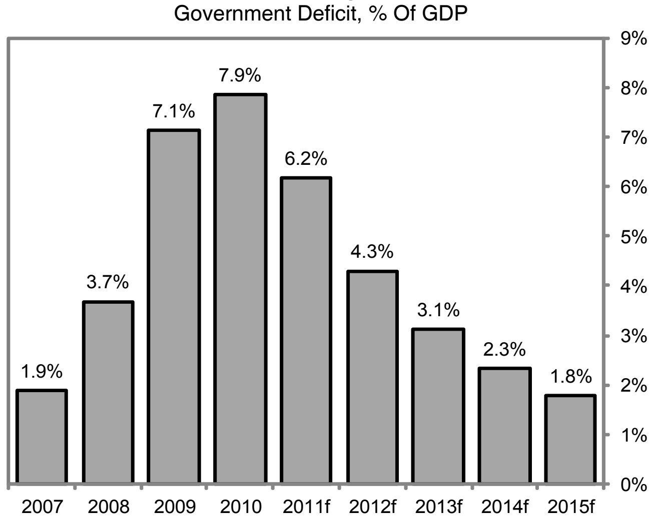
Time To Replenish The State's Coffers
Cumulative Revenues, Expenditures & Balance, PLNmn



Source: BMI

Although Poland's public debt level, coming in at 52.5% of GDP in 2010 according to our calculations, is not worrying by European standards, the government is under severe pressure to bring the fiscal accounts onto a sustainable trajectory after the budget deficit exceeded 7% of GDP in 2009 and 2010. Poland was the only European country to avoid recession during the 2009 financial crisis, but this required a strong expansionary fiscal policy on behalf of the government and consequentially large fiscal deficit figures.

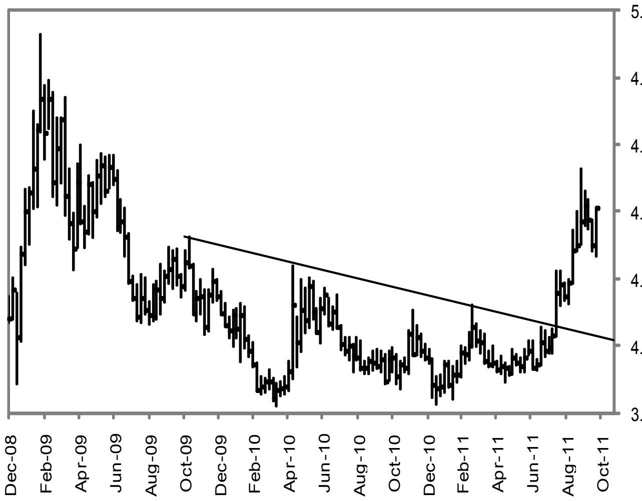
The Debt Pyramid
Government Deficit, % Of GDP



Source: BMI, f=BMI forecast

The large shortfalls of recent years have worked to push the debt-to-GDP ratio dangerously close to a constitutionally mandated ceiling of 60%. The country's public finance laws set three thresholds for the debt-to-GDP ratio at the 50%, 55%, and 60% level. Above the 50% level, the government's budget deficit must be cut with respect to the previous year. Were the country's debt to reach the 55% threshold, automatic fiscal retrenchment measures would come in place to forcibly lower the public debt-to-GDP ratio. We expect the government to do what is necessary to avoid such a scenario, as it would prove highly unpopular with the electorate and illustrate unsound fiscal management on behalf of Tusk's cabinet. Finally, were the 60% threshold to be reached, the government would be banned from borrowing and therefore be forced to run a balanced budget. Tusk campaigned on pension reform and social spending cuts, and, given the governing coalition's solid majority in both chambers, we remain positive about Poland's medium-term fiscal outlook. Indeed, we expect the government to run a primary surplus from 2013 onwards and the country's debt-to-GDP ratio to progressively contract towards the 50% level by 2016.

Through The Floor
Exchange Rate, PLN/EUR



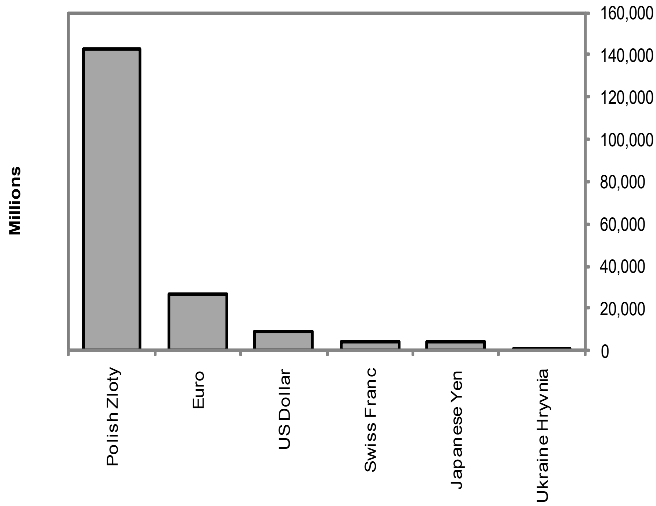
Source: BMI, Bloomberg

Financial markets have reacted positively to Tusk's re-election and to the fiscal consolidation that he and re-confirmed Finance Minister Jacek Rostowski are expected to bring. Credit default swaps sharply readjusted and broke through key resistance at the 250bps level following the election results.

Foreign Currency Debt To Generate Problems

One major development that has most likely weighed heavily on Polish policymakers is the steep depreciation of the Polish zloty against other major currencies. Since August 1 2011, the Polish currency has lost 10.2% of its value against the euro, breaking several key technical support levels. Losses would have been even more pronounced had the central bank and state-owned **Bank Gospodarstwa Krajowego** (BGK) not intervened in the foreign exchange market beginning September 30 2011 by selling euro-denominated assets in an effort to sustain the zloty.

Small Foreign Debt To Prove Key
Public Debt Breakdown, EURmn



Source: BMI, Bloomberg

This sharp depreciation represents a particularly worrying development for Poland as roughly a quarter of the country's debt is denominated in foreign currencies. Substantial zloty depreciation will further increase the country's debt burden, pushing it closer to the 55% of GDP level. At a time when major political parties were preoccupied with campaigning for

TABLE: FISCAL POLICY

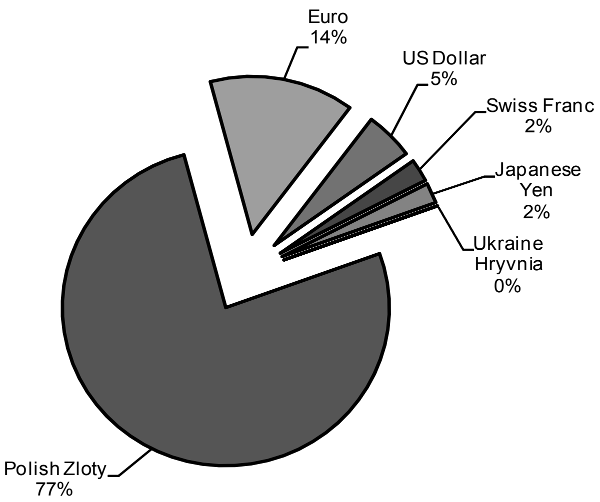
	2008	2009	2010	2011f	2012f	2013f	2014f	2015f	2016f
Fiscal revenue, PLNbn [2]	504.0	499.2	531.1	580.5	628.1	672.7	716.4	760.1	804.2
Revenue, % of GDP [2]	39.5	37.2	37.5	38.3	38.9	39.2	39.2	39.0	38.6
Fiscal expenditure, PLNbn [2]	550.9	597.9	642.1	674.2	697.8	725.0	757.6	795.5	835.3
Expenditure, % of GDP [2]	43.2	44.5	45.4	44.4	43.3	42.3	41.5	40.8	40.1
Budget balance, PLNbn [2]	-46.9	-98.7	-111.0	-93.7	-69.7	-52.3	-41.2	-35.4	-31.1
Budget balance, % of GDP [2]	-3.7	-7.3	-7.8	-6.2	-4.3	-3.1	-2.3	-1.8	-1.5
Primary balance PLNbn [1,3]	-18.6	-63.2	-72.9	-54.1	-28.7	-9.7	3.3	11.4	18.0
Primary balance % of GDP [1,3]	-1.5	-4.7	-5.2	-3.6	-1.8	-0.6	0.2	0.6	0.9

Notes: f BMI forecasts. 1 Fiscal balance stripping out interest payments on government debt; Sources: 2 BMI/Ministry of Finance. 3 EUROSTAT/BMI.

re-election and the scope for fiscal retrenchment was limited, the National Bank of Poland (NBP) found itself facing a policy dilemma as slowing growth would call for monetary easing, which would however lead to a further devaluation of the zloty and an increase in consumer price inflation, which is already running above the NBP's target (*see Monetary Policy section*).

As expenditures are brought under control from 2012 onwards, we believe the NBP will increasingly focus its attention on growth, partially offsetting the negative effects of fiscal retrenchment on the country's economic performance. As we do not expect the overall fiscal deficit to turn into a surplus over our forecast horizon, growth will be key to bringing down the debt-to-GDP ratio.

Small Foreign Debt To Prove Key
Public Debt Breakdown, % Of Total



Source: BMI, Bloomberg

Risks To Outlook

Although not our core scenario at this juncture, recessionary risks in the eurozone may force us to further revise downwards our growth forecasts for Poland. At a time when countercyclical fiscal policies are not an option, a recession in the country's main trading partners could severely harm the country's growth outlook. This in turn could easily push the debt-to-GDP ratio above the 55% level, leading to an automatic value-added tax (VAT) hike which would further squeeze household consumption on which Poland's growth story has been based.

Furthermore, we highlight the growing potential for a speculative attack on the zloty in the coming months, as the market might test the government's and the NBP's determination in defending the zloty and preventing the automatic VAT-hike from coming into effect. Were the 55% of GDP threshold to be breached, economic growth would be weighed down by fiscal retrenchment, potential monetary hikes, and macroeconomic headwinds originating in the eurozone.

Monetary Policy

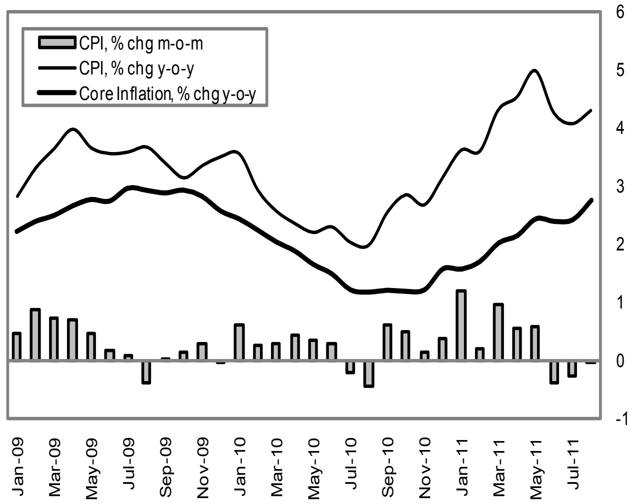
100bps Rate Cut In 2012

BMI VIEW

The decision of the National Bank of Poland to keep rates on hold on October 5 2011 is in line with our view that the policy rate will remain at 4.50% until the end of 2011. Heading into 2012, we expect a total of 100 basis points of rate cuts to 3.50% as easing cost-push factors allow scope for monetary easing at a time when fiscal retrenchment and softening regional growth contribute to a slowdown of the Polish economy.

The National Bank of Poland (NBP) elected to keep its benchmark interest rate on hold at 4.50% on October 5 2011 for the third consecutive time following a total of 100 basis points (bps) of rate hikes in H111, in line with our view for no further hikes in 2011 (*see 'No More Hikes In 2011', June 9*). We have, however, revised our interest rate forecasts for end-2012 to 3.50%, from 4.50% previously, on the back of our deteriorating outlook for global growth and rising macroeconomic headwinds in Poland.

Not Cooling Yet
Consumer Price Inflation & Core Inflation, % chg y-o-y



Source: BMI, NBP

Notwithstanding a progressive softening of Poland's economic performance, we see little scope for a rate cut before the end of 2011, as inflation remains well above the NBP's target of 2.5% (± 1.0%), coming in at 4.3% y-o-y in August 2011. What is more, price increases are on an uptrend as supply-side pressures continue to feed through to the consumer price basket. However, with our Commodities team forecasting a moderation in commodities prices as global growth enters a soft patch, we see inflation slowing towards our end-2011 target of 3.4%.

Weaker Zloty A Problem

Exchange Rate, PLN/EUR

Source: BMI

The NBP will further be reluctant to begin easing monetary conditions prematurely in light of the sharp depreciation of the Polish zloty, observed since early August 2011. The Polish zloty was down 9.8% over the period August-October amid heightened risk aversion in global markets. This creates a policy dilemma for the central bank as Poland's partly euro-denominated public debt pile is increasingly close to the constitutionally mandated limit of 55% of GDP. The monetary authorities have already been intervening in the foreign exchange market through state-owned banks by selling euro holdings in an effort to slowdown the zloty's depreciation. An interest rate cut at the current stage would exacerbate Poland's large foreign-exchange-denominated debt problem, bringing the country even closer to exceeding the debt limit and sparking the automatic austerity measures that this would imply.

Cuts Expected In 2012

Heading into 2012, concerns about growth will start to dominate. With inflation forecast to ease as fiscal consolidation acts as a further brake on an already slowing economy, we now forecast the NBP to cut rates by a total 100bps over 2012 to 3.50%. We have long maintained that Poland would have to pursue fiscal tightening in order to bring its fiscal accounts under control, and the bulk of this consolidation will take place in 2012, now that parliamentary elections are behind (*see Domestic Politics section*).

Risks To Outlook

Although not our core scenario, we caution that further escalation of the eurozone sovereign debt crisis could lead to a recession in core European economies, potentially leading to earlier and deeper rate cuts by the NBP. Alternatively, a renewed major bout in volatility on financial markets could lead to an even sharper depreciation of the zloty that could force the central bank to hike rates in an effort to cap massive capital outflows and risk major balance of payment difficulties down the line.

Regional Banking Sector

CEE Banks Better Placed, But Risks Remain

BMI VIEW

While we hold a generally constructive view towards Central and Eastern European banking sectors, we caution that the ongoing slowdown in economic growth combined with more cautious lending practices will weigh on banks' profitability. We hold positive views on the Czech and Polish banking systems, while see elevated risks to the Hungarian banking sector's outlook.

We maintain our broadly constructive view on Central and Eastern European (CEE) banking sectors owing to lower levels of leverage as compared with Western European banks and more sound macroeconomic backdrops that will help promote growth. We expect the broad-based recovery to continue at a relatively

TABLE: MONETARY POLICY

	2008	2009	2010	2011f	2012f	2013f	2014f	2015f	2016f
Exchange rate PLN/US$, ave [2]	2.64	2.86	3.01	2.77	2.78	2.71	2.64	2.54	2.51
Consumer prices, % y-o-y, ave [3]	4.2	3.5	2.6	3.3	3.0	2.5	2.4	2.4	2.4
Central Bank policy rate, % eop [4]	5.00	3.50	3.50	4.50	3.50	4.50	4.50	4.50	4.50
Lending rate, %, ave [5]	12.8	10.0	10.0	8.5	8.5	8.0	8.0	8.0	8.0
Real lending rate, %, ave [1,6]	8.6	6.5	7.4	5.2	5.5	5.5	5.6	5.6	5.6

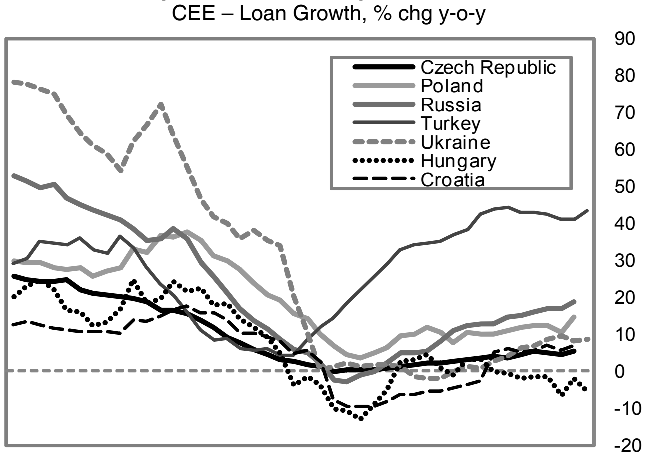
Notes: f BMI forecasts. 1 Real rate strips out the effects of inflation; Sources: 2 BMI. 3 Central Statistical Office/BMI; 4 National Bank of Poland/BMI; 5 IMF; 6 IMF/BMI.

slow pace in most markets. However, we caution that risks to this outlook are mounting in light of the ongoing eurozone debt crisis and signs that the global slowdown may be more sustained than we had previously expected. Indeed, we expect this continued moderation of economic expansion combined with more cautious lending practices to weigh on banks' profitability. We also believe that given the less supportive external environment, which could strain banks' abilities to raise new funds, that banking sectors with a more domestic-focused funding structure are better placed to weather the slowdown.

We view the Czech banking system as one of the most sound in the region owing to favourable macroeconomic dynamics, low foreign-exchange exposure and only light penetration. Similarly, we expect Poland's relatively strong macroeconomic backdrop to pay dividends for the country's banking sector by way of healthy loan growth relative to its peers. In contrast, we see the Hungarian commercial banking sector as the most ill-placed at the moment with a combination of macroeconomic headwinds and anti-business government policies likely to significantly weigh on the sector. On the whole, while we remain relatively positive on CEE banks, below we highlight a number of risks.

Generally Slow Recovery With Few Outliers

CEE – Loan Growth, % chg y-o-y



Source: Central Banks

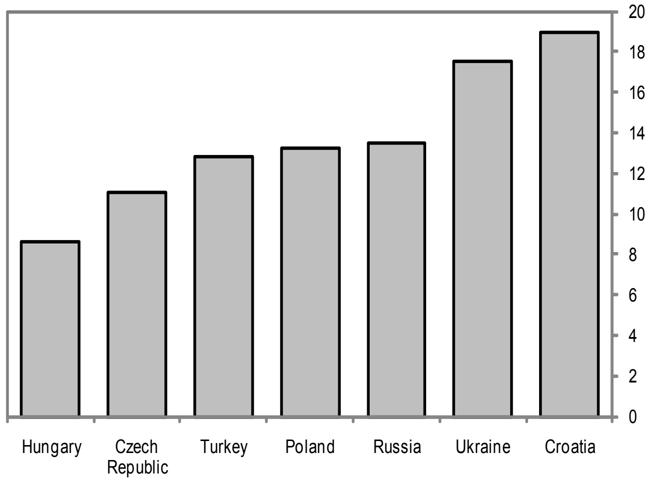
Eurozone Exposure Key Risk

Perhaps the most prominent risk to many CEE banking sectors is exposure to the eurozone debt crisis. CEE exposure to the common currency bloc comes via a number of avenues. First, many CEE banking systems are majority foreign owned by Western European parent banks. This is most certainly the case in central and south-eastern Europe, especially in the Czech Republic, Croatia, Bulgaria, Romania and Slovakia. The main channel of dispersion here comes from the potential for lower funding and capital availability as Western European banks re-trench to repair balance sheets. Second, CEE is exposed via exports, with a large portion of CEE exports destined for the eurozone. Lower demand from the bloc will result in weaker exports and slower economic growth, thereby weighing on credit demand and deposit growth, which will put pressure on banks' margins.

Finally, CEE countries are exposed via exchange rate volatility. This is especially the case in Poland, Hungary and Croatia, where foreign exchange lending boomed pre-crisis, in particular in lower interest rate currencies such as the Swiss franc and the euro. Governments have attempted to ease the burden on over strapped households by fixing exchange rates (in Croatia and Hungary). However, in Hungary, the government's policy that banks will shoulder the burden on foreign-exchange-related losses will weigh heavily on the banking sector (*see 'Banks Fighting Battles On Many Fronts', October 25 2011*), underpinning our less rosy outlook for the Hungarian banking sector.

Lower Leverage Than Western Europe

CEE – Assets To Equity Ratio, July 2011

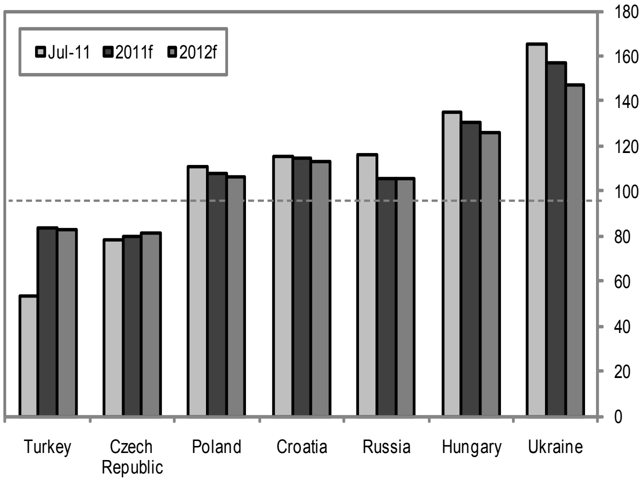


Source: Central Banks

Liquidity Could Become Troublesome

In light of the global economic slowdown and uncertainty about future growth prospects, business and consumer confidence remains muted in a number of CEE countries. Similarly, cautious lending practices and rising concerns over the economic situation on the part of banks has seen interbank rates spike in a number of markets (*see 'Banks To Suffer From Monetary Policy Shift', October 27 2011 and 'Growing Concerns For Economic And Banking Sector Outlook', October 21 2011*). Given our view that the eurozone crisis is not yet over and that policy responses will be fraught with implementation risks, we see scope for bouts of risk aversion to continue; this uncertainty could translate to spikes in interbank rates. With loan-to-deposit ratios exceeding the 100% mark in many CEE markets, liquidity squeezes could work to undermine stability in banking sectors. That said, with ongoing deleveraging and our expectation for the recovery in the deposit base to continue apace, we forecast these ratios to fall in the coming years to more manageable levels.

Liquidity Issues Abound
CEE – Loan To Deposit Ratios, %



Source: Central Banks, BMI, f=forecast

Accommodative Monetary Policy By Central Banks To Help

We expect central banks to remain committed to ensuring liquidity in banking systems, which should be helped along by the increasing bias towards monetary easing that we are seeing across CEE. Indeed, with consumer price inflation under control in many of these countries, we are seeing central banks continue to refocus their efforts on positioning economies and banking systems for the expected economic slowdown. This is most visible in Russia, where the Bank of Russia concomitantly lowered the repo rate by 25 basis points (bps) to 5.25% and raised the deposit rate by the same amount to 3.75% on September 14 2011 in an effort offset liquidity tightness and alleviate money market volatility (*see 'Liquidity Concerns To Dominate Monetary Policy', September 15 2011*).

The outlier to this trend is the Central Bank of the Republic of Turkey (CBRT), which continues to whip markets around with its unorthodox monetary policy decisions. After having adopted an easing stance earlier in 2011, the bank quickly changed tack and began de facto monetary tightening in an attempt to tackle above-target inflation. The decision to have banks use the higher overnight lending rate, at 12.50%, rather than the benchmark repo rate, at 5.75%, on October 26 2011 was effectively reversed a day later by the governor of the CBRT Erdem Basci when he offered TRY8bn to banks at the lower repo rate of 5.75%. We expect this high degree of uncertainty regarding funding to weigh on the banking sector. That said, Turkey's banking sector remains fundamentally sound. The sector is underleveraged, with an assets-to-equity ratio of 12.8 in July 2011, and is well capitalised. The capital adequacy ratio (CAR) is robust and well above the government-mandated 8%, coming in at 17% at the end of H111.

Potential For Strains On Raising Capital

With economic growth slowing and high market volatility, particularly regarding bank stocks, we could see scope for CEE banks to face difficulties in raising capital. While CEE banks are well capitalised, with CARs well above the Basel II mandate of 8%, we cannot discount the potential for banks to come up against funding difficulties in the event of a more pronounced slowdown in economic growth. Moreover, the potential for government intervention in the event of banking sector troubles has been severely hampered by ongoing fiscal tightening in many countries and investor focus on sovereign debt, which makes ramping up public debt in exchange for higher government financing costs an unattractive option. That said, CEE sovereigns are better placed than their Western European counterparts now than before the 2008-09 financial crisis in terms of lower external imbalances, generally lower public debt and higher foreign reserves, which could translate to leeway in the event of a banking crisis.

Chapter 3:
10-Year Forecast

The Polish Economy To 2021

Favourable Growth Dynamics To Remain Over The Longer Term

BMI VIEW

We believe the Polish economy will continue to expand at a healthy clip over our forecast period. This will primarily be driven by ongoing economic convergence with Western Europe.

We maintain a positive long-term view on Poland's growth dynamics. Indeed, we expect the robust outperformance of the economy relative to its European peers in 2010 – in which it posted real GDP growth of 3.8% – to continue over our forecast horizon. We forecast economic growth to average 4.4% during 2015-2021, double the rate of the eurozone and continuing to underpin real convergence.

Structural Dynamics To Support Sustainable Growth

Our positive view for the economy over the long term is supported by a high degree of institutional development and structural economic stability. Poland's broad-based economy has sufficiently diversified into the manufacturing (32% of GDP) and services (64% of GDP) sectors, limiting the impact of boom-bust commodity cycles that can wreak havoc on primary sector-driven economies. Similarly, the export sector is well diversified, with the trade concentration ratio for the top five export destinations standing at 51% of total exports by volume. This limits the extent to which the economic cycle of any one trade partner impacts Poland's own growth dynamics.

Since the beginning of our historical data series, domestic demand has been the predominant driver of economic growth, and we see few reasons not to extrapolate this trend going forward. Over the course of 2011-2021, we expect domestic consumption to account for more than half of real GDP growth, with gross fixed capital formation close behind.

In addition to our forecast 4.4% average real GDP growth for 2015-2021, we expect volatility in GDP outturns to remain low, anchoring the Polish economy onto a sustainable growth path. This will help ensure more efficient resource allocation as well as improve the accuracy of financial planning and the certainty of incomes, thus preventing the substantial distortions that can arise from large swings in economic growth.

Current Account To Continuing Posting Deficits

As a result of a persistent shortfall on the trade account, we expect the current account to continue posting deficits (2-4% of GDP) over our forecast period. We project import and export growth moderating substantially, largely owing to the infeasibility of sustaining double-digit growth rates. Although the EU will remain Poland's most important trade partner, export penetration will likely peak, and export share may even decline as competition from low-cost exporters in south east Europe intensifies. Meanwhile, although we expect industrial expansion to slow, with a concomitant moderation in capital import growth, the strength of domestic consumption will ensure that

TABLE: LONG-TERM MACROECONOMIC FORECASTS

	2014f	2015f	2016f	2017f	2018f	2019f	2020f	2021f
Nominal GDP, US$bn [1]	691.9	767.4	830.2	894.2	957.9	1022.9	1092.4	1167.0
Real GDP growth, % change y-o-y [2]	4.2	4.4	4.4	4.4	4.4	4.4	4.4	4.4
Population, mn [3]	38.3	38.4	38.4	38.4	38.4	38.4	38.4	38.4
GDP per capita, US$ [2]	18,043	20,007	21,637	23,300	24,957	26,651	28,467	30,422
Consumer prices, % y-o-y, ave [4]	2.4	2.4	2.4	2.4	2.4	2.4	2.4	2.4
Current account, % of GDP [5]	-5.4	-5.5	-5.3	-5.1	-4.9	-4.7	-4.4	-4.0
Exchange rate PLN/US$, ave [6]	2.6	2.5	2.5	2.5	2.5	2.5	2.5	2.5

Notes: f BMI forecasts. Sources: 1 Eurostat/BMI, US$; 2 Eurostat/BMI; 3 World Bank/BMI calculation/BMI; 4 Central Statistical Office/BMI; 5 National Bank of Poland/BMI; 6 BMI.

demand for consumer imports remains in play.

Despite the persistence of the current account deficit, we do not believe this will pose a significant risk to macroeconomic stability owing to the continued strength of the financial account. We believe that favourable macroeconomic fundamentals, a high degree of political stability and a skilled workforce will continue to lure in foreign investment sufficient to cover the current account shortfall.

External Debt Dynamics To Remain Sustainable

We expect to see a continued accumulation of external debt over the long term. However, growth in debt accumulation will likely slow over 2011-2021, with the ratio of gross external debt to GDP remaining relatively stable at around 60% of GDP. The private sector will be a key driver of external debt dynamics, with domestic banks borrowing capital from abroad in order to fund domestic lending activities. In addition, external financing will be required to expand bank operations as the growth in economic transactions and development of new financial products necessitate more sophisticated banking services. External debt in the form of inter-company lending will also be an important driver of debt accumulation as strategic investors continue transferring money to their Polish subsidiaries to maintain or expand market share.

Euro Adoption On The Distant Horizon

Despite efforts of Prime Minister Donald Tusk to bring forward Poland's euro membership, the inability to keep a lid on the fiscal deficit has led to a significant setback to the government's ambitious timetable for euro adoption. As a result, we do not see euro adoption until 2015 at the earliest. Furthermore, this will depend considerably on the ability of the National Bank of Poland to maintain domestic price stability over the long term. We believe this is feasible given the credibility of the central bank and its commitment to targeting inflation.

BMI's long-term macroeconomic forecasts are based on a variety of quantitative and qualitative factors. Our 10-year forecasts assume in most cases that growth eventually converges to a long-term trend, with economic potential being determined by factors such as capital investment, demographics and productivity growth. Because quantitative frameworks often fail to capture key dynamics behind long-term growth determinants, our forecasts also reflect analysts' in-depth knowledge of subjective factors such as institutional strength and political stability. We assess trends in the composition of the economy on a GDP by expenditure basis in order to determine the degree to which private and government consumption, fixed investment and the export sector will drive growth in the future. Taken together, these factors feed into our projections for exchange rates, external account balances and interest rates.

Chapter 4:
Business Environment

SWOT Analysis

Strengths

- Thanks to a stable political environment bolstered by EU membership, a comparatively strong macroeconomic outlook, and the implementation of pro-business reforms likely to continue following Prime Minister Donald Tusk's re-election, foreign investors' appetite for entering Poland remains strong.
- With a few exceptions, foreign businesses are permitted unrestricted ownership of Polish assets.

Weaknesses

- Foreign direct investment per capita remains considerably lower than in comparable countries such as the Czech Republic and Hungary.
- Infrastructure is still in need of considerable investment, particularly the road network, which requires extension and repair to existing sections.

Opportunities

- On the basis of its comparatively low labour costs, Poland offers a strategic entry point to external investors looking to exploit its unfettered access to most EU markets.
- Local capital markets are deepening and should provide opportunities for greater financial intermediation and investment.

Threats

- The 'brain drain' of migration to higher-paid jobs in Western Europe poses a minor – but rising – threat to the availability of skilled labour in Poland.

BMI Business Environment Risk Ratings

Although Poland's business environment has become increasingly attractive to foreign investors, the transport network is still in need of improvement. The quality of the road network is particularly poor, which has somewhat hindered freight transport across the country. While the government is pushing forward with road expansion and development, we caution that pressure from the EU to rein in the bloated fiscal deficit could impact infrastructure development, which may need to be scaled back in some areas.

	Business Environment	Rank	Trend
Estonia	67.4	1	=
Slovenia	66.6	2	=
Hungary	64.4	3	=
Latvia	62.8	4	=
Poland	**60.6**	**5**	**=**
Czech Republic	59.3	6	=
Romania	58.0	7	=
Lithuania	57.1	8	=
Slovakia	55.4	9	=
Bulgaria	55.2	10	=
Macedonia	54.4	11	=
Croatia	54.4	11	=
Turkey	53.4	13	=
Montenegro	53.1	14	=
Serbia	53.0	15	=
Kazakhstan	52.1	16	=
Georgia	50.2	17	=
Russia	50.2	17	=
Armenia	47.0	19	=
Mongolia	47.0	19	=
Ukraine	46.5	21	=
Albania	44.0	22	=
Belarus	44.0	22	=
Moldova	44.0	22	=
Bosnia-Herzegovina	43.1	25	=
Azerbaijan	41.0	26	=
Kyrgyzstan	39.5	27	=
Tajikistan	34.0	28	=
Uzbekistan	33.9	29	=
Turkmenistan	23.7	30	=

Regional ave 49.2 / Global ave 45.3 / Emerging Markets ave 40.9

Business Environment

Introduction

Poland's business environment continues to benefit from a well-educated, skilled workforce, sustained foreign direct investment and freer trade under EU membership. The government's pro-business, pro-reform agenda will further help to open up the economy to private investors. However, there remain substantial failings that adversely impact the business environment. One of these is the inability for Poland to retain skilled workers. An increasing number of Polish workers are migrating to wealthier EU countries in search of higher pay, which may create a painful dearth of skilled labour. Also, transport networks remain woefully inadequate compared with Western European standards, which seriously limits mobility, integration and industrial efficiency. Although some development of transport routes is taking place, progress is slow.

Institutions

Legal Framework

Poland benefits from an independent judiciary, with the legal framework improving in recent years and converging towards EU standards. The judicial system still suffers from inefficiency and corruption, although efforts have been made to tackle the latter at the court and enforcement level. Local knowledge is particularly important in the legal system, which is why relatively few international firms have set up operations in Poland and why those that have mainly employ Polish lawyers. Foreign firms routinely complain about excessive red tape and the inefficiency of the judiciary.

Property Rights

Poland's legal system protects property rights, with expropriations only being carried out in the public interest and with fair

TABLE: BMI BUSINESS AND OPERATION RISK RATINGS

	Infrastructure Rating	Institutions Rating	Market Orientation Rating	Business Environment
Albania	44.8	47.8	39.5	44.0
Armenia	44.5	56.8	39.6	47.0
Azerbaijan	42.0	43.6	37.5	41.0
Belarus	50.9	56.3	24.9	44.0
Bosnia-Herzegovina	50.5	31.9	46.9	43.1
Bulgaria	50.8	55.8	59.1	55.2
Croatia	54.0	50.7	58.5	54.4
Czech Republic	61.7	62.7	53.7	59.3
Estonia	56.7	79.2	66.5	67.4
Georgia	50.2	54.3	46.2	50.2
Hungary	67.3	69.7	56.2	64.4
Kazakhstan	49.1	54.3	53.0	52.1
Kyrgyzstan	36.2	41.6	40.8	39.5
Latvia	59.0	68.9	60.6	62.8
Lithuania	56.2	57.3	57.7	57.1
Macedonia	48.4	54.8	60.0	54.4
Montenegro	59.4	48.0	52.0	53.1
Mongolia	36.0	48.5	56.5	47.0
Poland	**63.6**	**62.1**	**56.0**	**60.6**
Romania	43.3	66.3	64.3	58.0
Russia	59.1	41.7	49.9	50.2
Serbia	56.5	44.3	58.3	53.0
Slovakia	57.2	61.1	47.8	55.4
Slovenia	66.8	70.5	62.4	66.6
Tajikistan	32.0	33.9	35.9	34.0
Turkey	47.9	55.7	56.5	53.4
Turkmenistan	34.8	0.7	35.6	23.7
Ukraine	54.8	40.6	44.2	46.5
Uzbekistan	39.9	41.8	19.9	33.9

Source: BMI. Scores out of 100, with 100 representing the best score available for each indicator

compensation. Domestic and foreign firms are treated equally within the legal system. However, both domestic and foreign firms suffer from frequent and unexpected changes in laws and regulations, as well as the general inefficiency over processing property rights disputes.

Intellectual Property Rights

Poland passed the Intellectual Property Law in 2000 to help satisfy its obligations for the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights as well as EU regulations on property rights protection. Despite efforts to improve the regulation and enforcement of intellectual property, piracy is a still a significant hindrance. However, stricter punishment for violations, as well as the ongoing improvement in judicial competence, will help to weed out intellectual property rights piracy.

Corruption

Poland ranked 41st out of 178 covered countries in the 2010 Transparency International Corruption Perceptions Index (up from 49th in 2009). Although far from being clean and transparent, Poland is ranked higher than Bulgaria, Romania, Croatia and Ukraine. Corruption is a widespread problem that reduces the transparency and efficiency of the business environment and, in the past, has typically been associated with privatisations and the award of government contracts.

Poland maintains laws that combat corruption. The law prohibits bribery and prevents public officials from engaging in business where they have a conflict of interest. In July 2003, new penal code regulations combating corruption became effective, providing a wider definition of public officials who come under the regulations and greater powers to seize assets. In addition,

TABLE: BMI LEGAL FRAMEWORK RATING

	Investor Protection Score	Rule Of Law Score	Contract Enforceability Score	Corruption Score
Albania	31.9	44.0	51.7	47.8
Armenia	45.3	37.5	84.5	65.5
Azerbaijan	22.7	20.9	80.0	16.9
Belarus	68.7	10.5	80.4	16.3
Bosnia-Herzegovina	19.3	43.6	30.2	59.2
Bulgaria	52.1	62.4	53.7	60.0
Croatia	36.6	64.5	69.8	59.0
Czech Republic	57.8	81.8	33.6	79.1
Estonia	70.5	87.6	61.3	90.4
Georgia	34.2	46.3	65.4	58.1
Hungary	51.8	77.9	87.1	80.1
Kazakhstan	59.7	17.5	75.9	23.7
Kyrgyzstan	46.7	18.2	68.5	17.0
Latvia	59.2	69.0	76.9	80.7
Lithuania	34.7	70.2	77.9	83.2
Macedonia	41.3	52.1	57.2	79.3
Montenegro	39.7	40.6	52.2	58.8
Mongolia	29.0	79.5	62.3	38.5
Poland	**59.7**	**73.0**	**56.3**	**75.3**
Romania	45.2	56.6	49.9	65.4
Russia	37.7	18.1	92.7	12.8
Serbia	29.8	49.4	36.8	59.1
Slovakia	49.0	74.2	42.1	70.7
Slovenia	55.7	83.0	50.1	80.6
Tajikistan	36.0	14.2	61.8	22.6
Turkey	44.0	57.8	75.8	48.4
Turkmenistan	0.0	3.9	0.0	1.9
Ukraine	30.7	38.2	52.6	31.4
Uzbekistan	16.4	5.7	84.6	4.4

Source: BMI. Scores out of 100, with 100 representing the best score available for each indicator

a new anti-corruption initiative was launched in 2004.

Infrastructure

Physical Infrastructure

Despite the benefits a relatively flat country might have on transport, Poland has a relatively poor transport network when compared with Western Europe. Poland's temperate weather is conducive to transport, although flooding still proves disruptive. Poland has the use of 123 airports, 22,072km of railway, 3,997km of waterways and 423,997km of road (one-third of which are unpaved).

Outside Warsaw and other major cities, the road network is substantially undeveloped and in need of significant repair, with long-distance travel proving arduous. Construction of the A1 motorway, which is planned to stretch the length of the country from the port city of Gdansk in the north to Gorzyczki in the south, is still under way. In addition, the planned A2 motorway will run through the centre of Poland linking Germany and Belarus. A consortium of Polish companies will build and operate the toll road, with the contract expiring by 2037. The rate of progress is slow, but improvements are gradually being made. Similarly, the rail network is extremely inefficient, with English-speaking staff a rarity outside Warsaw.

Although Poland is connected with seven other countries (Belarus, the Czech Republic, Germany, Russia, Slovakia, Ukraine and Lithuania), getting across borders can prove difficult and time-consuming, particularly when travelling to other Eastern European states. This is mainly the result of lengthy queues and inefficient passport control systems.

Poland is well connected to international airports, including

TABLE: LABOUR FORCE QUALITY

	Literacy Rate,%	Labour Market Rigidity Score	Female Labour Participation, %
Albania	98.7	25.0	42.6
Armenia	99.4	21.0	50.3
Azerbaijan	98.8	0.0	48.3
Belarus	99.6	11.0	49.1
Bosnia-Herzegovina	96.7	33.0	46.6
Bulgaria	98.2	19.0	46.6
Croatia	98.1	50.0	44.8
Czech Republic	99.0	11.0	44.4
Estonia	99.8	51.0	50.2
Georgia	100.0	7.0	46.6
Hungary	99.4	22.0	45.6
Kazakhstan	99.5	17.0	49.7
Kyrgyzstan	98.7	18.0	43.0
Latvia	99.7	43.0	48.6
Lithuania	99.6	38.0	49.8
Macedonia	96.1	14.0	39.4
Montenegro	96.4	13.0	0.0
Mongolia	97.8	17.0	49.8
Poland	**99.8**	**25.0**	**45.7**
Romania	97.3	46.0	45.4
Russia	99.4	38.0	49.8
Serbia	96.4	35.0	42.8
Slovakia	99.6	22.0	44.9
Slovenia	99.7	54.0	46.1
Tajikistan	99.5	49.0	46.9
Turkey	87.4	35.0	25.7
Turkmenistan	98.8	0.0	0.0
Ukraine	99.4	31.0	49.5
Uzbekistan	99.3	32.0	46.2

Source: BMI/World Bank/ILO. Labour Market Rigidity score from Ease of Doing Business report, 1 = highest score most European countries as well as some US cities such as New York and Chicago. Flights from outside Poland typically land in Warsaw, although flights within Poland between major cities are also available. Flights operate between Krakow, Lodz, Wroclaw, Poznan and Gdansk.

Poland's telephone network is extensive and has undergone significant modernisation in line with growing competition in the telecommunications market. Wireless services are becoming deep-rooted, with an estimated 47.2mn mobile phone subscribers in 2010, compared with 9.3mn fixed lines in use. Coverage by mobile phone providers in eastern Poland is more limited, as is the development of fixed-telephone lines in rural parts of the country. There are some 23.6mn internet users in Poland, which is illustrative of Poland's ongoing convergence towards Western European levels of technology and communication.

Labour Force

Poland has a labour force of around 17.25mn. Given significant migration to elsewhere in the EU, migration into Poland from poorer countries in Europe is likely to increase. Traditionally, labour costs have been comparatively cheap in Poland. Average gross salary and wages were PLN3,225 in 2010, although these are likely to rise significantly as a result of the tightening labour market.

Poland was previously a mainly agrarian country, but it is gradually making the switch towards services, as well as improving the sophistication and efficiency of industrial production and

TABLE: EMERGING EUROPE – ANNUAL FDI INFLOWS

	2008		2009		2010	
	US$bn	Per Capita	US$bn	Per Capita	US$bn	Per Capita
Albania	1.0	310.6	1.0	306.8	1.1	342.3
Armenia	0.9	303.8	0.8	252.0	0.6	186.7
Azerbaijan	0.0	1.6	0.5	52.2	0.6	61.3
Belarus	2.2	225.2	1.9	195.8	1.3	140.7
Bosnia-Herzegovina	0.9	122.8	0.2	32.6	0.1	8.5
Bulgaria	9.9	1,298.2	3.4	444.3	2.2	289.6
Croatia	6.2	1,398.5	2.9	660.0	0.6	132.3
Cyprus	4.0	3,760.4	5.7	5,250.4	4.9	4,403.6
Czech Republic	6.5	1,468.1	2.9	669.2	6.8	1,558.2
Estonia	1.7	1,289.8	1.8	1,370.0	1.5	1,147.8
Georgia	1.6	355.9	0.7	150.5	0.5	126.1
Greece	4.5	398.4	2.4	215.1	2.2	192.6
Hungary	7.4	736.8	2.0	204.5	2.4	238.1
Kazakhstan	14.3	914.8	13.8	869.3	10.0	621.5
Kyrgyzstan	0.4	112.2	0.2	56.7	0.2	70.3
Latvia	1.3	555.4	0.1	41.5	0.3	155.2
Lithuania	2.0	608.5	0.2	51.5	0.6	189.4
Macedonia	0.6	285.4	0.2	97.9	0.3	142.3
Moldova	0.7	196.1	0.1	35.5	0.2	55.7
Montenegro	1.0	1,526.5	1.5	2,422.5	0.8	1,204.2
Mongolia	0.8	319.8	0.6	233.4	1.7	626.0
Poland	**14.8**	**388.3**	**13.7**	**358.1**	**9.7**	**252.9**
Romania	13.9	644.3	4.8	225.0	3.6	166.3
Russia	75.0	523.9	36.5	255.1	41.2	288.2
Serbia	3.0	402.1	2.0	267.6	1.3	182.3
Slovakia	4.7	861.3	0.0	-9.1	0.5	96.2
Slovenia	1.9	965.0	-0.6	-287.3	0.8	411.0
Tajikistan	0.4	56.2	0.0	2.3	0.0	6.5
Turkmenistan	1.3	259.6	3.9	776.6	2.1	413.1
Ukraine	10.9	237.3	4.8	105.3	6.5	142.9
Uzbekistan	0.7	26.5	0.7	26.2	0.8	30.0

Source: UNCTAD, BMI

management practices. That said, some 15% of the population still derives a living from agriculture, while 30% works in industry and around 55% in the services sector. Expanding employment areas include information technology, science, hotels and retail. The public sector is now a much smaller employer than previously, with employment in coal mining, steel and other old industries waning. The public sector still employs around 25% of the workforce. The grey economy is a significant problem, accounting for 10-15% of official GDP.

The 1996 Labour Code governs most employment rules in both public and private sectors. This has been revised to take into account EU membership and other changes. Parliament passed a series of amendments, effective in 2003, aimed at liberalising the job market and tackling joblessness. Among these were measures to enable employers to renegotiate labour contracts with unions during difficult times and increasing the number of fixed-term contracts an employer can agree with workers before these are automatically converted into indefinite long-term contracts.

Regulations relating to employee dismissal are usually based on the duration of employment and the length and type of the contract. Compensation is usually payment during the notice period or the cash equivalent in lieu of a notice period and the cash equivalent of any unused holiday entitlement. Some groups are protected from dismissal, including pregnant women.

Union membership is voluntary. The main unions are Solidarity and the All-Poland Trade Alliance. Employers must consult unions on redundancies, wages and other labour issues. Poland also abides by the International Labour Organization Convention on workers' rights. Despite sporadic strikes, Poland's industrial relations record is now average for the region. Strikes in the private sector are rare.

TABLE: TRADE AND INVESTMENT RATINGS

	Openness To Investment Score	Openness To Trade Score
Albania	47.8	55.1
Armenia	38.7	13.8
Azerbaijan	8.4	32.6
Belarus	23.4	53.2
Bosnia-Herzegovina	51.5	61.2
Bulgaria	69.8	57.4
Croatia	65.5	46.9
Czech Republic	56.0	74.2
Estonia	75.1	84.4
Georgia	59.2	45.4
Hungary	86.6	71.6
Kazakhstan	67.4	8.6
Kyrgyzstan	40.5	38.9
Latvia	64.0	72.0
Lithuania	77.9	73.9
Macedonia	63.9	55.9
Montenegro	39.1	64.0
Mongolia	95.0	36.7
Poland	**47.9**	**65.7**
Romania	40.3	41.7
Russia	46.6	20.6
Serbia	98.1	45.9
Slovakia	43.5	65.1
Slovenia	39.5	72.1
Tajikistan	79.5	34.6
Turkey	48.8	41.5
Turkmenistan	30.6	69.4
Ukraine	58.3	53.0
Uzbekistan	7.6	24.7

Source: BMI. Scores out of 100, with 100 representing the best score available for each indicator

Market Orientation

Foreign Investment Policy

Since the collapse of communism and the subsequent transition to a market economy, Poland has embraced foreign investment. The principal investors in Poland remain the US and Western European states. Membership of the EU in March 2004 has further consolidated Poland's reputation as a stable and open economy that is open to foreign investment. Indeed, strengthening trade links as well as convergence towards Western European levels of wealth and standards of corporate regulation have provided further incentives for the foreign investor.

Successive governments since 1990 have passed legislation aimed at cutting red tape surrounding foreign acquisitions. These include passing the Law on Economic Freedom in 2004, which has simplified the process of registering a company. Further reforms include the improvement in regulation regarding bank loans and bankruptcy law, as well as a reduction in the corporate income tax rate to 19% from 27%. The current coalition government is widely seen as pro-reform and pro-business, which will likely encourage further foreign investment. The government's commitment to privatising state-owned industries will provide further opportunities for foreign investors to gain exposure to key industries.

Foreign investors are permitted to operate in almost all Polish markets, with the exception of some strategic industries (including air transport, broadcasting and gambling) as well as real estate. Foreign firms are treated in the same manner as domestic companies with regard to property rights and are not restricted in remitting profits abroad. Foreign investors who maintain permanent residence in Poland are permitted to set up joint-stock companies, limited liability companies, limited joint-stock partnerships, professional partnerships, registered partnerships and limited partnerships.

In July 2004, the government amended the Economic Freedom Act, with updated rules and compliance procedures regarding the operation of branches and representative offices in Poland. Foreign investors wishing to establish a branch in Poland must register with the National Court Register. While a branch is permitted to conduct all activities of the parent company, a representative office, on the other hand, is limited to promotional activities on behalf of the parent firm. Registration of either a branch or representative office no longer requires the acquisition of permits, which greatly improves the efficiency and transparency of the process.

Foreign Trade Regime

Upon membership of the EU in 2004, Poland agreed to adhere to the same trade regulations, including the Community Customs Code and Community Tariff. There are now no customs barriers to trade with other EU countries, while trade with non-EU countries is dictated by EU regulations. EU tariffs are generally lower than previous Polish tariffs.

Poland adheres to the EU's Generalised System of Preferences. Licensing regulations, which are the same as elsewhere in the EU, restrict trade in some goods and with some non-EU countries. Notably, EU import quotas apply to steel products and textiles as well as some Chinese products, for example.

Trade in some agricultural products may also be restricted or subject to preferential tariffs under the EU's Common Agricultural Policy. Among goods subject to quota limits are petrol, diesel fuel and heating oils, alcohol and cigarettes. Imports of strategic goods, including weapons and some chemical and transport equipment require a licence or concession. A licence is also needed for most alcoholic drinks, gas and some agricultural products.

Tax Regime

The tax regime has become more benign for investors in the years approaching the country's EU membership. Legislation has been streamlined. Revisions of corporate, individual and VAT regulations are under discussion in parliament, but implementation has been postponed.

Corporate Tax: The principal rate is 19%. Resident firms are taxed on global income. Non-resident firms are taxed only on income earned in Poland. Dividends to corporate and individual shareholders are subject to a 19% withholding tax. Dividends paid by a Polish firm to a firm in an EU member state are exempt under certain circumstances. Dividends paid between elements within a corporate group are also exempt. A tax credit regime is in effect, unless tax treaties state otherwise.

Individual Tax: Rates increase progressively to a maximum of 32%. Individuals may be subject either to limited or unlimited tax liability. Resident individuals are taxed on global income. Non-resident individuals are taxed only on income earned in Poland. An 18% tax applies to some income, such as dividends and interest. An individual may elect to be taxed at a flat rate of 18% on business income in some circumstances.

Indirect Tax: Polish VAT regulations were generally harmonised with EU directives on EU accession in May 2004. The main rate is 23%. Poland permits VAT refunds based on rules in EU directives.

Capital Gains: Gains of individuals and companies from disposal of business assets are taxed as income. Gains by individuals from share sales are taxed separately from income at 19%. Income of an individual on the sale of a residence, other building or non-business land is taxed at 10%. This income may be tax-exempt if the proceeds are used to buy another similar asset within two years, or the sale takes place five years after purchase.

Operational Risk

Security Risk

Although crime remains a widespread problem in Poland, it tends to be of a low level and usually does not pose any serious risk to life or property. General crime levels are moderate and tend to centre around petty offences such as vandalism and car thefts. For this reason, crime remains an inconvenience rather than a serious threat to safety and is unlikely to affect the normal operation of business. Data provided by Eurostat show that the number of reported crimes totalled 1,082,057 in 2008, a decrease of 26% since 2004, placing Poland in sixth position behind Germany, Spain, France, Italy and the UK. In 2008 there were a reported 460 homicides, 21,085 robberies, 17,669 motor vehicle thefts and 3,317 incidences of drug trafficking.

As a member of the EU, Poland suffers from an underlying threat of terrorism, although this is not as significant as in Western Europe. However, owing to Poland's lack of prominence on the world political stage and limited involvement in the global 'War on Terror', it remains a low-risk country.

TABLE: TOP EXPORT DESTINATIONS

	2002	2003	2004	2005	2006	2007	2008	2009
EXPORTS TO FRANCE	2,473.30	3,277.10	4,454.30	5,547.90	6,906.30	8,548.00	10,617.10	9,494.10
EXPORTS TO ITALY	2,264.00	3,083.60	4,513.60	5,481.60	7,256.20	9,293.60	10,263.00	9,344.00
EXPORTS TO UNITED KINGDOM	2,126.30	2,698.70	3,986.50	4,990.40	6,337.50	8,339.10	9,837.10	8,790.80
EXPORTS TO CZECH REPUBLIC	1,639.90	2,171.80	3,188.50	4,072.10	6,144.30	7,777.30	9,730.60	8,013.10
EXPORTS TO NETHERLANDS	1,841.30	2,406.70	3,166.20	3,716.40	4,263.60	5,362.90	6,874.80	5,747.00
TOTAL	41,513.60	54,106.70	74,429.40	90,368.30	112,380.90	142,156.00	173,948.60	139,237.10
TOP 5	21,751.90	28,512.30	38,276.90	45,276.90	56,738.40	70,274.80	83,272.20	71,353.00
% from top 5 trade partners	52.4	52.7	51.4	50.1	50.5	49.4	47.9	51.2

Source: IMF, Direction of Trade Statistics.

Chapter 5:
Key Sectors

Infrastructure

Executive Summary

Our view for a slowdown in Polish construction industry growth is firmly in place following confirmation of the 2010 growth figure and leading indicators from the first half of 2011. Despite exceptionally strong growth over recent years, which culminated in one of the highest growth rates globally in 2009 (9%), the sector is now on a slower trajectory, as artificial stimulus from the Euro 2012 preparations dissipates and the industry moves to a more sustainable growth path.

The slowdown witnessed in 2010 looks set to continue in 2011. In 2010 industry value growth dropped to 3.8%, far below the average of 8.9% between 2005 and 2009. Data for the first quarter of the year showed a 7% y-o-y contraction in construction industry value. The number of infrastructure project announcements has fallen considerably in the first half of 2011 and housing activity contracted. Conversely, with permit approvals for residential construction growing, we do think the residential and non-residential sector will return to growth over the year as a whole. At the same time, the momentum created by the rush to complete last-minute infrastructure projects ahead of the Euro 2012 tournament should sustain activity in the infrastructure sub-sector. Consequently, we anticipate 3.2% y-o-y real growth for the construction industry as a whole.

Key growth drivers included:

Euro 2012 Preparations: this has catalysed planned investment in th e transport sector, specifically in airports, roads and railways. In addition, construction of stadia, hotels and related tourism infrastructure has buoyed the residential and non-residential building sub-sector. However, with the tournament drawing closer and the artificial stimulus it has created coming to an end, we anticipate a lull in activity from 2012 and beyond – akin to that seen in previous host nations of sporting tournaments.

Road-Building Programme: Poland's road building programme, running from 2007 to 2015, is expected to lead to US$60bn worth of investments into the sector. The programme has been a blessing for European construction majors and Poland's largest builders over the past 24 months, who have faced depleted contract opportunities in other core European markets.

Eu Cohesion Funds: The EU has allotted substantial funding for Poland's infrastructure sector in an effort to integrate the country into the EU's transport and energy networks. Geographically placed between Eastern and Western Europe, it is hoped Poland will act as a bridge between the two.

Market Overview

Poland's transport infrastructure still requires considerable investment to bring it up to the standard of other EU nations. The country's road network is in need of investment and rejuvenation to repair a sector that has suffered from maintenance cutbacks and, in some cases, still features the unfinished remains of Hitler's Autobahn system. The country has developed good rail links with neighbouring countries, which helps the flow of Polish goods and aids the country's import market. Poland's port infrastructure is located on the Baltic Sea and services a considerable chunk of the country's freight transport sector. In addition, the country has developed passageways for ships on its natural waterways – the Vistula and Oder rivers. Poland is developing a tourist sector and, as well as servicing the tourist industry, the country's airports also cater for business travellers and Poles travelling abroad.

The country's power infrastructure is not only advancing towards becoming diversified, but electricity supply meets demand. Poland's power-generation sector allows for a surplus, which the country uses for export. The country is over-reliant on coal as a fuel source, which is a cause for concern, as dependence on any one fuel increases the risk of power problems should that fuel fail. In Poland's case, coal is indigenous, so the country does not have to worry about supply problems. However, the country may find itself hit by EU CO2 emissions targets as coal-fuelled power plants are high polluters. The country's oil and gas-fired facilities are few, and **BMI** doubts that there will be further developments in these areas during the forecast period.

The government has given the go-ahead for the development of a domestic nuclear-power sector, with the construction of two power plants in the pipeline. In the medium term, the country is planning to participate in the development of a new nuclear power unit in Lithuania. Poland may struggle to reduce the size of its CO2-emitting coal sector, but it has taken the EU's green initiatives to heart and is expanding its renewable energy sector by developing its wind-power potential.

Privatisations Key To Deficit Reduction: In order to reduce the strain on Poland's fiscal deficit, the government announced plans to raise PLN25bn (US$8.4bn) from asset sales.

So far, the government has raised PLN13.1bn (US$4.4bn) from the sale of the country's second largest utility, **Tauron Polska Energia**, which is also a copper producer and an insurance company. In June 2011 it successfully listed Tauron on the Warsaw Stock Exchange in an initial public offering (IPO) which raised US$1.28bn. In addition to this, in October 2010 the government sold a 10% stake in **Polska Grupa Energetyczna** (PGE), the largest energy group in Poland, on the open market, with both international and domestic investors buying shares worth US$1.4bn, bringing the total raised so far to almost US$6bn.

Two other stake sales are still in progress. The sale of an 84% stake in the country's fourth-largest power group **Energa** to **PGE**, for PLN7.5bn (US$2.5bn), is in doubt following the blocking of the sale by the country's regulator. PGE is appealing the decision, and government movies broadly supportive, as it would allow the company a better base from which to build the planned nuclear reactors. For this reason the outcome of the Energa sale is still unclear. Either way, the banking of important revenue for state coffers will be markedly delayed. Another important deal is the sale of a 51% controlling stake in utility Enea, which is currently at the bidding stage. In October 2010, Poland's richest man, Jan Kulczyk, was awarded exclusive negotiating rights for the 51% stake in Enea, for US$1.8bn, with the potential to buy the entire company for US$3.6bn. However, negotiations fell apart, with the government later entering talks with France's EDF over the stake. Problematically, in early 2011, this second round of negotiations with the French company also broke down, with the sale now on hold.

The construction sector as a whole has been boosted by Poland's status, along with Ukraine, as joint host of the 2012 UEFA European Football Championships. As the country prepares for the tournament a number of investment projects have been initiated for roads, hotels, stadia and other facilities.

Poland is upgrading and rejuvenating its football venues, and three new stadiums are being developed. In Warsaw, a 55,000-seat stadium, the National Stadium, is to be built; in Wroclaw, the Olympic Stadium with 44,000 seats is to be constructed; and in Gdansk, the Baltic Arena, a 44,000-seat stadium, will be operational from 2011. In Poznan, the 47,000-seat Municipal Stadium is due for refurbishment.

As well as the construction of stadia, Poland is also implementing modernisation projects in key infrastructure sectors which need to be upgraded in time for kick-off in 2012. In May 2007, it was announced that Poland will have at least five new airports by 2012. In September 2007, a five-year road-construction plan was announced that will see US$45.2bn spent on road expansion and upgrade projects. Construction within the country's hotels sector also seems likely as Poland prepares for an influx of fans to watch the tournament, with KPMG predicting 21.4mn tourists will visit Poland in 2012.

Industry Forecast

Energy And Utilities Infrastructure: Poland's energy and utilities infrastructure industry accounts for the minor portion of Poland's total infrastructure industry value, forecast at 43.9% in 2011, equal to PLN25bn (US$9.3bn). The sub-sector's share of total infrastructure investment has increased steadily over recent years; however, beyond 2011 it is forecast to stabilise at around 44%.

Real value growth in the sub-sector is forecast to outperform that of transport infrastructure by an average of 1% per year, as investment into transport infrastructure loses momentum. In turn, Poland's energy and utilities infrastructure industry will generate momentum in the overall infrastructure sector's performance between 2011 and 2015, when the sub-sector will see average growth of 4.1% y-o-y. Upside potential for the sector, owing to a large number of power projects announced in 2009 and 2010, is finally feeding into improved forecasts for the medium term. A number of gas, coal and renewable projects are underway, driving industry growth expectations, with the power plants and transmission grids sub-sector expected to be the driving force behind our outlook.

Over the longer term, the biggest potential for growth in the industry is from the plans to construct two nuclear power plants. The projects are planned to start in 2016 (to be completed in 2022), at an estimated combined cost of EUR15-18bn. However, there are some concerns over delays to the project, already one year behind schedule. Further safety checks, requested by the

EU following the Fukushima crisis in March 2011, are likely to further delay the project. Financing is also a concern and, with the merger between PGE and Energa blocked by the regulator, PGE's ability to move forward with the plans is in jeopardy.

The Power Mix: Poland's power infrastructure is heavily reliant on one fuel type. **BMI** normally cautions against a power sector with a lack of diversification, as dependence on one fuel type can increase the risk of power deficits and shortages if a sustainable alternative is not available. However, Poland's power generating sector more than meets demand. In 2009, we estimated that generation would reach 169.7 terawatt hours (TWh), while demand would climb to 154.2TWh. This gives Poland a surplus of 15.5TWh, which it could export. Poland's power infrastructure is expected to offer a secure and reliable supply throughout the forecast period. By 2013, consumption is predicted to reach 179.9TWh, with approximately 197.6TWh estimated to be generated. Poland's capability to produce a surplus will allow it to further develop its power export sector.

Minimal Gas Output: Gas made up just 3.5% of the country's total electricity generation in 2009. Its percentage, however, is increasing slowly and is expected to grow to 4.5% by 2013. Concerns over growing gas import dependency, especially following the gas row between Ukraine and Russia in January 2009, which prevented supplies reaching many European countries for weeks, have led to a slowing in the rate of gas-fired power station construction or conversion from coal.

Poland has moved closer to realising its Swinoujscie liquefied natural gas (LNG) terminal, located in the north-west port city. The US$1bn terminal will bolster the country's energy diversity and security, most obviously away from Russian supply, and an agreement has been in place with Qatar for 1mn tonnes of LNG a year since 2009. The terminal has been touted as capable of meeting a third of Poland's gas demand at 5bn cubic metres (bcm) per year. Financing for the project was secured in March 2010 when a syndicate of 10 commercial banks signed an agreement to each provide a minimum of EUR75mn (US$102.46mn) in debt, with the total amount offered currently standing at EUR750mn (US$1.02bn). The European Bank for Reconstruction and Development (EBRD) also signed a letter of intent, in early March 2010, supporting the project with funding up to EUR200mn (US$273.24mn). Construction of the terminal is expected to be wrapped up by mid-2014.

Project company **Polskie LNG** intends to finance the project by issuing bonds to commercial banks which will mature within two years. The syndicate includes **Credit Agricole**, **BGK**, **Bank Caja de Madrid**, **Bank of Tokyo-Mitsubishi**, **BNP Fortis**, **La Caixa Barcelona**, **Nordea**, **Societe Generale**, **Pekao SA** and **PKO BP**.

Coal Reliant: Poland's power sector is heavily reliant upon coal as a fuel source. The share of coal in electricity generation is the highest among EU member states. Coal's dominant position is down to the fact that the fuel is indigenous to the country. The June 2008 'BP Statistical Review of World Energy', estimates that Poland's coal reserves stood at 7,502mn tonnes. In 2009, coal was expected to have made up 84% of the total fuel mix and will fall to 78.6% by 2013. **BMI** believes that the usage of coal in Poland's power infrastructure will gradually decrease, as the country – a member of the EU – will have to implement greener initiatives. Current EU targets call for the reduction of CO2 emissions by 20%.

Nuclear Power: A Dream Of The Future: Poland has long had plans to add nuclear capacity to the electricity mix. Following the announcement that Lithuania would have to shut down the Ignalina Nuclear Power Plan (which has now been closed), Poland was in discussions with Latvia, Estonia and Lithuania to jointly develop another nuclear power plant (NPP) on the same site; however, it has instead decided to develop a domestic nuclear power sector. In January 2009, the government approved PGE's plan to build two nuclear power plants with a combined capacity of 3,000MW. It is estimated that combined, the plants will cost between EUR15bn and EUR18bn. The projects are moving forward and, while three feasibility studies been planned, the site for the first nuclear plant was selected in March 2010 – the northern village of Zarnowiec (see project table).

In the energy strategy document for the years 2005-2025, which has been approved by the state, the government confirmed its intention to have the country's first nuclear power plant in operation by 2022. Until that time, Poland has plans to participate in a nuclear power project, but one outside of its borders. The country is to join Estonia, Lithuania and Latvia in constructing a new reactor in Lithuania to replace the Ignalina units that were shut down as a condition of EU entry.

Although Poland relies heavily on coal, the timing of the government's decision to re-introduce nuclear power – amid the gas row between Russia and Ukraine – highlights, we believe, the energy security concerns relating to reliable supplies from the east; concerns which have been accentuated since the suspension of natural gas supplies to Europe. Poland's concerns run even deeper, as the plans for the construction of the Nord Stream pipeline, which will carry Russian natural gas to Germany via the seabed of the Baltic Sea, have been ill-received in Poland, which is being bypassed as a transit route.

Renewables Set To Grow: Poland has developed a hydropower sector, which represents almost three-quarters of renewable electricity generation in the country. The sector is centred on small installations. Expansion is expected within this power segment with its percentage within Poland's power mix forecast to increase from an estimated 2.8% in 2009 to 5% in 2013.

The country's renewables sector is also expected to expand. In 2009, **BMI** estimated that renewables took up 8% of Poland's total power generation; this percentage is expected to increase to 10.6% in 2013. Growth in this sector will be spurred on by the EU Directive 2001/77/EC on electricity from renewable energy sources, which required the EU to increase renewable energy's share of total energy consumption to 12% and electricity produced from renewables to 22.1% by 2010. This will require Poland to increase its share of electricity consumed from renewables to 7.5% of total gross consumption in order for an enlarged EU to meet its 22.1% target by 2010. **BMI** believes that the potential of biomass, landfill gas and onshore wind power is high.

Transmitting Power: The P**olish Power Grid Company Polskie Sieci Elektroenergetyczne** (PSE) was created by the Polish Ministry of Trade and Industry in August 1990, as a joint-stock company, wholly owned by the Polish state treasury. PSE is the owner of Poland's high-voltage electricity grid and is responsible for grid operations and power dispatching. The distribution sub-sector consists of 33 distribution companies, all of which are joint-stock companies, and utilises 110-kilovolt (kV), 15kV, and 0.4kV lines to supply electricity to customers. Distribution companies represent approximately 40% of all Polish electricity sector assets.

Once part of the POKOJ power distribution system (the former power distribution system of the Ukraine and Eastern European countries), CENTREL (the new power distribution system of Poland, the Czech Republic, Slovakia, and Hungary) is now fully integrated into the Western European Union for the Co-ordination of Production and Transmission of Electricity (UCPTE) system. Poland also maintains very strong links with distribution systems in the Ukraine and Belarus. These links provide Poland with exchange potential with Western Europe

TABLE: ENERGY AND UTILITIES INFRASTRUCTURE INDUSTRY DATA

	2010e	2011f	2012f	2013f	2014f	2015f
Energy and Utilities Infrastructure Industry Value As % Of Total Infrastructure	43.8	43.9	44.2	44.4	44.7	44.9
Energy And Utilities Infrastructure Industry Value, PLNbn	23.2	25.0	26.7	28.3	30.1	32.1
Energy and Utilities Infrastructure Industry Value, US$bn	7.7	9.3	10.2	10.8	11.4	12.6
Energy and Utilities Infrastructure Industry Value Real Growth (%)	6.2	4.6	4.0	3.4	4.1	4.2
Energy and Utilities Infrastructure Industry Value As Percent Of Total Construction (%)	26.8	27.2	27.4	27.7	27.9	28.2
Power Plants and Transmission Grids Infrastructure Industry Value As % Of Total Energy and Utilities	84.2	84.1	84.0	83.9	83.9	83.8
Power Plants and Transmission Grids Infrastructure Industry Value, PLNbn	19.6	21.0	22.5	23.7	25.3	26.9
Power Plants and Transmission Grids Infrastructure Industry Value, US$bn	6.5	7.8	8.5	9.1	9.6	10.6
Power Plants and Transmission Grids Infrastructure Industry Value Real Growth (%)	7.3	4.4	3.9	3.3	4.1	4.1
Power Plants and Transmission Grids Infrastructure Industry Value As % of Total Infrastructure	36.8	36.9	37.1	37.3	37.5	37.6
Power Plants and Transmission Grids Infrastructure Industry Value As % of Total Construction	22.6	22.8	23.1	23.2	23.4	23.6
Oil and Gas Pipelines Infrastructure Industry Value As % Of Total Energy and Utilities	3.8	3.8	3.7	3.7	3.7	3.7
Oil and Gas Pipelines Infrastructure Industry Value, PLNbn	0.9	0.9	1.0	1.1	1.1	1.2
Oil and Gas Pipelines Infrastructure Industry Value, US$bn	0.3	0.4	0.4	0.4	0.4	0.5
Oil and Gas Pipelines Infrastructure Industry Value Real Growth (%)	-5.2	4.8	3.3	2.6	3.4	3.4
Oil and Gas Pipelines Infrastructure Industry As % of Total Infrastructure	1.6	1.7	1.7	1.7	1.6	1.6
Oil and Gas Pipelines Infrastructure Industry As % of Total Construction	1.0	1.0	1.0	1.0	1.0	1.0
Water Infrastructure Industry Value As % Of Total Energy and Utilities	12.0	12.2	12.3	12.3	12.4	12.5
Water Infrastructure Industry Value, PLNbn	2.8	3.0	3.3	3.5	3.7	4.0
Water Infrastructure Industry Value, US$bn	0.9	1.1	1.2	1.3	1.4	1.6
Water Infrastructure Industry Value Real Growth (%)	2.3	5.6	4.9	4.1	4.9	4.9
Water Infrastructure Industry As % of Total Infrastructure	5.3	5.3	5.4	5.5	5.5	5.6
Water Infrastructure Industry As % of Total Construction	3.2	3.3	3.4	3.4	3.5	3.5

e/f=estimate/forecast, Source: Central Statistics of Poland, BMI and former Soviet Union states, in the order of 3,000 megawatt electricals (MWe) per system.

Poland's electricity infrastructure is not very well connected with neighbouring EU member states, so network reinforcements have been planned to expand capacity at the connection points with Germany and the Czech and Slovak Republics.

Poland also has electricity connections with Ukraine and Belarus. Currently, both north-south and east-west connections are being expanded, as part of the EU's Trans-European Energy Network project, including a new link to Lithuania. The four countries are also members of the Union for the Co-ordination of Transmission of Electricity (UCTE) – the European electricity transmission system. UCTE coordinates the interests of transmission system operators in 20 European countries.

Progress was made on the link with Lithuania in April 2009, when Baltic prime ministers met and announced that preparations for the project would be completed by the end of 2010 and that the 1,000MW link will be completed by 2015. In October 2010, plans were being drawn up for the power link's construction. The chairman of LitPol Link, the joint company set up to manage and implement the project, has said the total estimated cost of the project is close to EUR1bn (US$1.6bn), of which EUR240mn is for the construction of the common power grid and another EUR700mn is needed for upgrades and expansions to individual electricity networks.

Residential/Non-Residential Construction: Poland's residential and non-residential construction sector contracted for the second consecutive year in 2010, experiencing negative growth of -16.5%. This deep contraction can be attributed to a sharp slowdown in residential construction activity and the completion of the majority of commercial projects related to UEFA Euro 2012, which have buoyed the sector in recent years.

It is expected activity will pick up in 2011 and 2012, with the sector anticipated to expand by a modest 1.8% and 2% respectively. A number of signs indicate that a recovery is now underway which, while not at the levels seen prior to 2009, will see growth remain moderate and relatively stable over the next few years. **BMI** notes that with average real growth forecast to be 2.2% y-o-y between 2011 and 2015, we expect residential and non-residential building industry value to continue its gradual decline as a percentage of total construction; falling from a peak of 53% in 2007 to just 37% in 2015.

Oil & Gas

Executive Summary

This latest Poland Oil & Gas Report from **BMI** is published as interest is increasing over the country's much-vaunted shale-gas potential. With Poland attracting upstream interest from across the world, shale gas production is becoming a realistic long-term possibility. For the time being, however, Poland is likely to remain only a minor gas producer, largely dependent on Russian supplies. We expect Polish gas production to remain relatively stable, falling from 5.98bn cubic metres (bcm) in 2011 to 5.51bcm in 2015, as a natural decline fails to be offset by the first minor stirrings of shale gas production. Consumption should rise slightly from 17.91bcm in 2011 to 21.52bcm in 2015.

In terms of oil, consumption is growing due to an increase in car ownership, which will need to be balanced against the requirement for greater fuel efficiency. Consumption is set to rise from 575,000 barrels per day (b/d) in 2011 to 610,000b/d by 2015. Production is likely to remain far behind, falling from 25,000b/d in 2011 to only 23,000b/d by 2015. This should mean Poland becomes increasingly dependent on oil imports, which we expect to rise from 549,000b/d in 2011 to as much as 587,000b/d by 2015.

In the longer term, Poland is likely to see the first stirrings of shale gas production towards 2020 as companies bring relatively minor projects onstream. Although overall production should fall from 5.51bcm in 2015 to 5.34bcm by 2020, this disguises a slight recovery in 2019 and 2020 – from the lows of 2018. Even with the first production of shale gas, Poland will remain heavily dependent on Russian gas imports due to growth in consumption, which will rise from 21.51bcm in 2015 to 24.94bcm by 2020.

Although Russia will continue to dominate oil supply in the region, backed by huge and under-exploited reserves, the Caspian states have an important role to play, with Azerbaijan and Kazakhstan an increasingly significant factor. The growth rate in Russian oil supply has slowed appreciably since the early-2000s but the acceleration of Caspian expansion means that the region will make a growing contribution to world oil production.

Market Overview

Overview/State Role: PGNiG dominates the upstream oil and gas segment, although this could change if the increasing IOC involvement in unconventional gas exploration results in commercial discoveries. PGNiG provides gas supply to industry and households, purchasing gas from Russia, Central Asia, Norway and Germany. Downstream oil is in the hands of partly state-owned domestic companies **PKN Orlen** and **Grupa Lotos**, but there is extensive IOC participation in fuels distribution.

Exploration and production licences in Poland are granted by the Ministry of the Environment's geological unit. The unit, known as the Department of Geology and Geological Concessions (DGGC), has a wide range of responsibilities, which includes shaping the direction of Poland's concession policy, levying charges and royalty payments, promoting the country's oil and gas reserves, and supervising the collection and processing of geological data.

Government Policy: Like many other central European countries, Poland's energy policy focuses on security of supply. As a transit state hosting the Yamal-Europe gas pipeline and the Druzhba oil pipeline, Poland's status is threatened by developments such as Nord Stream that seek to bypass it. Being a transit state has, however, provided Poland with a number of problems as well as benefits.

One problem has been that Poland's attitude towards its major supplier, Russia, is tinged with a great deal of distrust, leading it to look at ways of reducing its dependence on the country. This has been pursued through a variety of schemes, including the construction of storage capacity, plans to become Central Europe's first LNG importer and a policy of encouraging state-owned companies to source oil from more 'reliable' countries such as Norway.

While on a political level this degree of distrust has led to numerous minor disputes with Russia, it has meant that Poland is remarkably well placed to resist supply shocks compared with some of its neighbours. In terms of oil, Poland has sufficient import and storage capacity to supply its two major refineries with crude oil for a long period in the event of disruption to Russian piped supplies. In terms of gas, with its 1.6bcm of storage capacity growing fast and numerous interconnectors to Germany, Poland could sustain a disruption to 2010 levels of gas imports for an average of around 64 days, depending upon the season.

As with transit and imports, Poland's policy towards its own natural resources is based on security of supply. This is to be achieved through encouraging domestic production through a relatively open approach to international investors. While the country appears to see little upside potential in conventional resources, evidenced by PGNiG's own long-term target of increasing the share of domestic production in its total by only two percentage points, Poland has succeeded in encouraging many smaller players to enter. It has also played to the current global trend towards unconventional resources by designating specific blocks for the exploration of CBM and shale.

Although in general Poland's downstream policy is relatively open to outside investors, the government has acted in the past to promote the interests of Polish companies in the region when it saw regional energy security as being threatened. A particularly clear example of this was seen in 2006 when the Polish and Lithuanian governments reportedly intervened in the sale of Lithuania's Orlen Lietuva (formerly Mažeikiai Nafta) refinery, which was a target for Russian buyers. Both of Poland's two major refineries are domestically owned, by PKN Orlen and Grupa Lotos, and PKN Orlen has also expanded into refining and marketing in other countries in the region.

PKN Orlen-Grupa Lotos Merger Talks: PKN Orlen and Lotos have held talks in the past on cooperation with a view to a potential merger. This appears to have been postponed for the time being following the government's offer in 2010 to divest its Lotos stake, and following remarks made in February 2008 by Polish treasury minister Aleksander Grad who said that the further privatisation of PKN Orlen and Grupa Lotos had been put on hold for at least four years. Both companies are concerned by the threat of a hostile takeover, either from a major Central European player or a Russian company. The latter option is particularly worrisome for the Polish firms following PKN Orlen's acquisition of the Mažeikiai Nafta refinery in Lithuania from Yukos in 2006, a decision that disappointed Russian bidders including Lukoil and TNK-BP.

PKN Orlen has in the past appeared the more eager of the two companies to push on with the merger talks. Any decision to merge the two companies rests with the Polish treasury, however, which owns 28% of PKN Orlen's shares and 10.01% of Lotos, with the state privatisation vehicle Nafta Polska holding a further 75%. If the two companies did merge they would create a PLN28bn refiner capable of competing with the biggest energy players in Central Europe. This view has attracted high level support in the past, with the treasury minister having citing concerns that the two state-controlled firms in the same sector were competing against each other, a situation that would not be tenable in the private sector. Should a merger go ahead today, the treasury's share would be less than 40%, making the company more, rather than less, likely to be a hostile takeover target. These issues will take some time to negotiate.

In March 2009, the Polish economy minister suggested that the government may buy fuel reserves from PKN Orlen and Lotos in order to free up the company's balance sheets and provide sought-after cash to the refiners. State regulations on energy supply security require the companies to hold large strategic reserves. This leaves them highly vulnerable to oil price fluctuations, with the drop in crude prices from mid-2008 battering both companies' inventory valuations and therefore their balance sheets and resulting in record Q408 losses. The cash injection would relieve pressure on the refiners as well as addressing the distortion of their financial performance metrics by removing the reserves from their balance sheets. As of June 2010 PKN Orlen was in discussions with banks on an independent solution that would see a third party (rather than the government) holding some of the oil off the balance sheet, with the company's Chief Financial Officer Slawomir Jedrzejczyk telling Bloomberg of plans to transfer more than half its PLN5.4bn of reserves in 2010.

Gas Supply Contracts With Russia: In recent years, Poland's gas imports have been governed by three supply contracts. The first, the so-called 'Yamal contract' with Gazprom, runs from September 25 1996 until December 31 2022 and involves Poland purchasing 7-8bcm per year. The second contract, running from August 17 2006 until October 1 2016, is with Germany's Verbundnetz Gas, which supplies around 1bcm a year. The third agreement was with Switzerland-based intermediary RosUkrEnergo for up to 2.5bcm annually from Uzbekistan via Russia and Ukraine, and was expected to run from January 1 2007 until January 1 2010. In January 2009, however, RosUkrEnergo stopped supplying the contracted volumes to Poland after the resolution of the Russia-Ukraine gas crisis left it without access to Central Asian gas.

This led Poland to open negotiations with Gazprom with two aims: to put in place a temporary supply deal for 2009 to plug the gap left by the Central Asian imports and to renegotiate the terms of the Yamal contract to increase the volumes supplied to 10.2bcm from 2010. Although a temporary supply contract secured an additional 1.02bcm for 2009, the agreement over the renegotiation of the Yamal contract hit difficulties over the ownership structure of the Yamal-Europe pipeline operator EuRoPol Gaz, which includes a 4% stake held by Poland's Gas Trading, with Gazprom (48%) and PGNiG (48%) holding the rest. The two sides also disagreed over transit fees payable to EuRoPol Gaz for onward gas supplies to Germany via the Yamal-Europe pipeline.

In October 2009, PGNiG and Gazprom announced that they had agreed to increase gas supplies to Poland to 10.2bcm, to extend the Yamal contract until 2037 and to extend their agreement over gas transit to Germany until 2045. Under the deal, Gazprom and PGNiG were to take over the 4% stake in EuRoPol Gaz cowned by Gas Trading and invest jointly in upgrading EuRoPol Gaz's pipeline network. The deal was ratified by the Polish government on February 10 2010, despite the government's fears that the deal could increase long-term dependence on Russia at a time when other sources of supply, such as domestic shale gas or imported liquefied natural gas (LNG), may become available in the medium term.

Although this deal appeared to have solved the dispute, the fact that it granted exclusive shipping rights through the Yamal-Europe pipeline to EuRoPol Gaz caused concern in the EU. Under EU law, all gas pipelines must allow TPA, with exemptions only being granted to the most important pipelines, which are given Trans-European Network (TEN) status. TEN status imposes stringent conditions, one of which is that pipelines cannot be wholly owned by companies linked to a country's gas system operator. Although Yamal-Europe has always had this status, the fact that the deal eliminated Gas Trading appears to have alerted the EU to a potential breach of the TEN-status conditions. On September 1 2010, the European Commission said it would check whether the deal complied with EU law. In November 2010, however, the deal was approved by the EU authorities, avoiding the risk of supply disruption.

Industry Forecast

Oil And Gas Reserves: Poland's proven oil reserves are estimated at just 96mn bbl, while there are estimated gas reserves of 109bcm in the country. The latter figure is expected to decline gradually unless shale gas exploration yields early results. Oil reserves seem certain to drift lower by 2015, to no more than 84mn bbl.

Italy's Eni has become the first European integrated major to invest in Poland's emerging unconventional gas plays. It has agreed to acquire Minsk Energy Resources and consequently become the operator of three licences in the Polish Baltic Basin, the company said on December 10 2010. Eni claims that the 1,967sq km area, located in north-east Poland, is in a highly prospective shale gas play. Eni intended to start drilling in 2011, with a total exploration commitment of six wells.

Talisman Energy has also outlined its 2011 drilling programme for Poland. The company will drill one well each in the Braniewo and Szczawno blocks in the Baltic Basin in north of the country

. Drilling operations atthe first well began on August 1 2011, according to Talisman's manager, Tom Maj. He said that the company expects to complete drilling all three wells by end-January 2012.

Oil Supply And Demand: The oil market is undeveloped in comparison with Western Europe, so potential exists for demand growth to track that of the underlying GDP trend, albeit at a somewhat lower level.

A growing number of motor vehicles and renewed economic activity should push oil demand to 610,000b/d by 2015, implying up to 1.5% annual growth. Given an unpromising outlook for local supply, import volume can be expected to reach 587,000b/d.

Poland consumed an estimated 16.7bcm of gas in 2010. Production for the year was around 5.9bcm, requiring imports of 10.8bcm, almost entirely from Russia. BMI currently forecasts gas consumption to increase to 21.5bcm by 2015, requiring imports of 16.0bcm.

Concerns over growing gas import dependency have been slowing the rate of gas-fired power station construction and conversion from coal.

Radosław Dudzinski, CEO of PGNiG, has said that he expects Polish gas demand to increase considerably by 2015 as the country develops new gas-fired power stations, Reuters has reported. Nonetheless, he has warned that energy companies' projections – which see them adding 4-5GW of generating capacity – appear overambitious, estimating that an additional 1.5-2GW of power 'is possible by 2015'. The Polish government forecasts that about 14% of electricity will be generated from natural gas by 2020, up from just 2% in 2000, and just under 8% in 2006, but still a relatively small share.

Currently the major user of gas in Poland is the household consumer section, which accounts for over a quarter of total demand. Industrial chemical producers are the second largest single consumer group, accounting for just under a fifth of Poland's gas demand. Industry as a whole, including chemicals, power and other industrial uses, account for around three-fifths of Poland's total gas needs.

In late October 2010, PGNiG and Gazprom agreed to increase the volumes of gas supplied under their existing 'Yamal Contract'. PGNiG and Gazprom have signed an annex to the existing contract, under which gas supplies to Poland will be increased while keeping the length of the contract the same. Under the deal, Poland will be able to import up to 9.03bcm in 2010 (9.7bcm according to Russian norms), rising to 9.77bcm in 2011 (10.5bcm), and then to 10.24bcm (11.0bcm) over 2012-2022. Any gas above the contractual minimum will be sold at a discount. PGNiG valued the deal at around PLN8.5bn (US$2.94bn) per year and said that it could save US$250mn per year using the full discount.

PGNiG sold an estimated 14.4bcm of gas in 2010, compared with 13.3bcm in 2009. The company's sales were an estimated 4.4bcm of gas in Q410. The vast majority of Poland's gas production in 2009 came from PGNiG. Two of the company's subsidiaries currently produce gas, in the western region of Lubuskie and in the far south-eastern Podkarpackie Voivodeship. PGNiG is aiming to boost production from 28% of national consumption in 2008/09 to an ideal level of 30%.

Several smaller international companies are also involved in

TABLE: OIL AND GAS SECTOR KEY INDICATORS

	2009	2010	2011	2012	2013	2014	2015
Proven oil reserves, bn barrels 1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Oil production, 000b/d 1	25.9	25.9	25.4	24.9	24.4	23.9	23.4
Oil consumption, 000b/d 1	535.3	560.7	574.7	583.3	592.1	600.9	610.0
Oil refinery capacity, 000b/d 1	421.6	421.6	421.6	421.6	421.6	421.6	421.6
Oil imports, US$mn 1	11,335.60	15,105.00	20,430.10	20,255.90	20,145.90	19,635.90	19,958.90
Petroleum imports, US$mn 1	14,528.22	19,259.58	26,475.62	26,712.58	26,827.65	26,689.00	27,381.73
Import of refined products, 000b/d 1	72.8	96.7	109.3	116.5	123.9	131.4	139.0
Proven gas reserves, bcm 1	109.0	109.0	105.0	103.0	100.9	98.9	96.9
Gas production, bcm 1	5.9	5.9	6.0	6.0	5.9	5.7	5.5
Gas consumption, bcm 1	16.4	16.7	17.9	19.1	19.7	20.9	21.5
Gas imports, bcm 1	10.5	-	-	-	-	-	-

Notes: e BMI estimates. f BMI forecasts. Sources: 1 EIA/BMI.

gas exploration in Poland, with some in the process of starting up commercial production. US-based independent FX Energy is now producing gas from the Roszków well, located in the Fences area in western Poland. In January 2009 Aurelian Oil and Gas announced details of its plans for the Siekierki gas project. Aurelian has entered into a deal with Kulczyk Investments to supply gas produced from the field. The deal covered an initial six-month contract wherein gas was supplied from test wells, and a subsequent contract that will run for a minimum of 10 years.

LNG: In July 2010, a consortium led by Italy's Saipem was awarded a contract to build Poland's first LNG import terminal by the developer, Polskie LNG. Under the PLN2.95bn (US$940mn) deal, the terminal is scheduled for completion by June 2014. The Świnoujście terminal will have a regasification capacity of 2.5bcm per annum following the first stage of development. Capacity can be expanded initially to 5bcm and, depending on demand, to 7.5bcm at a later stage.

PGNiG signed an LNG supply deal with Qatar in April 2009. Under the agreement, Qatargas will supply 1mn tonnes per annum (tpa) of LNG for 20 years starting in 2014. This will provide around 1.4bcm of gas per annum, equivalent to 9% of Poland's projected gas demand in 2014. The deal with Qatargas will provide 56% of the Świnoujście terminal's initial capacity and Poland is likely to look for further LNG deals with other suppliers to make up the difference. North or West African producers may be suitable candidates.

Other Key Sectors

Latest Forecast Data

Below are the latest forecast tables for our other core key sectors:

TABLE: AUTOS SECTOR KEY INDICATORS

	2009	2010	2011f	2012f	2013f	2014f	2015f
Vehicles, units [1]	879,198	869,376	795,471	852,853	910,038	959,725	1,009,929
Vehicles, units mn [1]	0.88	0.87	0.80	0.85	0.91	0.96	1.01
Passenger cars, units [2]	819,000	785,000	702,575	752,480	797,629	835,097	873,099
Passenger cars, units mn [2]	0.82	0.79	0.70	0.75	0.80	0.84	0.87
Commercial vehicles, units [1]	60,198	84,376	92,896	100,373	112,409	124,628	136,830
Commercial vehicles, units, % chg y-o-y [1]	-42.1	40.2	10.1	8.0	12.0	10.9	9.8
Vehicles, units [3]	372,142	387,851	351,376	370,336	388,659	418,329	449,461
Vehicles, units, % chg y-o-y [3]	-7.3	4.2	-9.4	5.4	4.9	7.6	7.4
Passenger cars, units [4]	320,206	333,492	290,138	301,744	312,305	334,403	357,363
Passenger cars, units, % chg y-o-y [3]	0.1	4.1	-13.0	4.0	3.5	7.1	6.9
Commercial vehicles, units [3]	51,936	54,359	61,238	68,592	76,355	83,927	92,098
Commercial vehicles, units, % chg y-o-y [3]	-36.0	4.7	12.7	12.0	11.3	9.9	9.7
Passenger Car Density, cars per 1,000 of population [5]	433.1	440.1	449.9	465.5	482.1	498.6	515.5

Notes: e BMI estimates. f BMI forecasts. Sources: 1 OICA/BMI calculation. 2 OICA; 3 ACEA/BMI calculation; 4 ACEA; 5 World Bank.

TABLE: FOOD & DRINK SECTOR KEY INDICATORS

	2009	2010e	2011f	2012f	2013f	2014f	2015f
Food consumption, US$bn [1,2]	55.5	55.6	58.5	69.8	77.5	83.8	92.8
Food consumption PLNbn [2]	159.0	168.4	181.6	194.7	207.9	221.3	235.6
Per-capita food consumption US$ [2]	1,455.0	1,455.5	1,535.4	1,832.0	2,036.2	2,205.6	2,443.7
Confectionery sales, US$mn [1,2]	3,148.1	3,230.8	3,424.7	4,180.1	4,758.8	5,236.4	5,879.7
Confectionery sales, PLNmn [2]	9,017.03	9,792.74	10,624.94	11,661.05	12,772.57	13,823.99	14,934.45
Soft drinks sales, US$mn [1,2]	8,491.0	8,359.0	8,481.0	9,857.5	10,681.8	11,322.5	12,280.9
Soft drink sales, PLNmn [2]	24,320.63	25,336.10	26,311.86	27,499.33	28,669.82	29,891.49	31,193.59
Total mass grocery retail sales, US$bn [1,2]	23.0	24.6	27.3	34.3	40.0	45.5	52.8
Total mass grocery retail sales, PLNbn [2]	65.9	74.6	84.8	95.8	107.5	120.2	134.1
Exports of food and drink, US$mn [2]	9,349	10,174	10,876	11,233	11,851	12,617	13,364
Imports of food and drink, US$mn [2]	7,341	7,907	8,509	8,865	9,343	9,899	10,443
Food and drink trade balance US$mn [2]	2,007.9	2,266.4	2,366.3	2,368.0	2,507.5	2,718.3	2,921.4

Notes: e BMI estimates. f BMI forecasts. 1 US$ Forecast Shown Using Moving FX Rates; Sources: 2 Central Statistical Office, National Bank of Poland, BMI.

TABLE: PHARMA SECTOR KEY INDICATORS

	2010	2011f	2012f	2013f	2014f	2015f
Pharmaceuticals sales, US$bn [1,3]	10.587	12.030	12.160	13.064	14.186	15.665
Pharmaceutical sales, US$bn, % y-o-y [1,3]	0.3	13.6	1.1	7.4	8.6	10.4
Pharmaceutical sales, PLNbn [1,3]	31.841	33.115	33.753	35.414	37.451	39.790
Pharmaceutical sales, PLNbn, % y-o-y [1,3]	5.3	4.0	1.9	4.9	5.8	6.2
Health expenditure, US$bn [1,4]	33.15	37.52	39.12	42.24	45.88	50.45
Health expenditure, US$bn, % y-o-y [1,4]	-0.8	13.2	4.3	8.0	8.6	10.0
Health expenditure, PLNbn [1,4]	99.71	103.89	108.58	114.51	121.12	128.13
Health expenditure, PLN bn, % y-o-y [1,4]	4.2	4.2	4.5	5.5	5.8	5.8
Communicable, maternal, perinatal and nutritional conditions, DALYs [2,5]	160,843	156,628	152,476	148,389	144,366	140,407
Non-communicable diseases, DALYs [2,5]	3,811,997	3,787,017	3,761,888	3,736,627	3,711,224	3,685,677

Notes: e BMI estimates. f BMI forecasts. 1 Last Updated: 18/10/2011; 2 Data is DALYS, disability-adjusted life years; Sources: 3 Association of the European Self-Medication Industry (AESGP), IMS Health, BMI. 4 World Health Organization (WHO), BMI; 5 WHO, World Bank, IMF, BMI research.

TABLE: TELECOMS SECTOR KEY INDICATORS	2010	2011f	2012f	2013f	2014f	2015f
Number of Main Telephone Lines in Service ('000) [1]	9,276.0	9,026.6	8,811.5	8,613.2	8,427.9	8,268.6
Number of Main Telephone Lines in Service, % change y-o-y [1]	-3.2	-2.7	-2.4	-2.3	-2.2	-1.9
Number of Main Telephone Lines/100 Inhabitants [1]	24.2	23.6	23.0	22.5	22.0	21.6
Number of Cellular Mobile Phone Subscribers ('000) [1]	47,160.0	48,857.8	49,102.0	48,905.6	48,563.3	48,126.2
Number of Cellular Mobile Phone Subscribers, % change y-o-y [1]	4.9	3.6	0.5	-0.4	-0.7	-0.9
Number of Mobile Phone Subscribers/100 Inhabitants [1]	123.2	127.6	128.1	127.6	126.6	125.5
Number of Mobile Phone Subscribers/100 Inhabitants [1]	123.2	127.6	128.1	127.6	126.6	125.5
Number of Mobile Phone Subscribers/100 Inhabitants, % change y-o-y [1]	4.8	3.5	0.5	-0.4	-0.7	-0.9
Number of Internet Users ('000) [1]	23,561.2	24,510.8	25,373.5	26,127.1	26,485.1	26,617.5
Number of Internet Users, % change y-o-y [1]	4.9	4.0	3.5	3.0	1.4	0.5
Number of Internet Users/100 Inhabitants [1]	61.6	64.0	66.2	68.2	69.1	69.4
Number of Internet Users/100 Inhabitants, % change y-o-y [1]	4.9	4.0	3.5	2.9	1.3	0.5
Number of Broadband Internet Subscribers ('000) [1]	9,679.0	11,105.1	12,317.8	13,422.7	14,261.6	14,960.4
Number of Broadband Internet Subscribers, % change y-o-y [1]	33.1	14.7	10.9	9.0	6.2	4.9

Notes: e BMI estimates. f BMI forecasts. Sources: 1 World Bank (International Telecommunications Union (ITU)), BMI research, Operators.

TABLE: DEFENCE & SECURITY SECTOR KEY INDICATORS	2009	2010e	2011f	2012f	2013f	2014f	2015f
Defence expenditure, PLNmn [1]	27,169.0	25,719.0	27,536.0	29,668.5	31,546.5	33,592.9	35,850.2
Defence expenditure, PLN, % change y-o-y [1]	6.1	-5.3	7.1	7.7	6.3	6.5	6.7
Defence expenditure, % of GDP [2]	2.0	1.9	1.9	1.8	1.8	1.8	1.8
Defence expenditure, PLN per capita of population [2]	710.3	671.9	719.0	774.3	823.0	876.1	934.6
Defence expenditure, PLN per serviceman [2]	-	-	-	-	-	-	-
Defence expenditure, US$mn, constant prices [1]	10,860.0	9,518.7	10,745.2	11,281.9	12,012.5	12,846.2	13,940.9
Defence expenditure, US$, constant prices % change y-o-y [1]	2.2	-12.4	12.9	5.0	6.5	6.9	8.5
Defence expenditure, constant US$ per capita of population [1]	283.9	248.7	280.6	294.4	313.4	335.0	363.5
Defence expenditure, constant US$ per serviceman [1]	-	-	-	-	-	-	-

Notes: e BMI estimates. f BMI forecasts. Sources: 1 SIPRI/BMI. 2 SIPRI, BMI calulation.

TABLE: FREIGHT KEY INDICATORS	2009	2010	2011f	2012f	2013f	2014f	2015f
Port of Gdansk container throughput, TEU	240,623	511,876	670,250	781,771	894,462	1,005,056	1,122,744
Port of Gdansk container throughput, TEU, % y-o-y	29.60	112.73	30.94	16.64	14.41	12.36	11.71
Air Freight Tonnes (000)	53.51	61.24	65.75	72.62	79.65	86.75	94.25
Air Freight Tonnes % Change y-o-y	-7.98	14.44	7.37	10.44	9.69	8.91	8.65
Rail Freight Tonnes (000)	200,819	216,767	231,225	242,905	254,879	266,958	279,723
Rail Freight Tonnes % Change y-o-y	-19.30	7.94	6.67	5.05	4.93	4.74	4.78
Road Freight Tonnes (000)	1,170,478	1,276,672	1,339,525	1,415,287	1,492,959	1,571,315	1,654,121
Road Freight Tonnes % Change y-o-y	7.05	9.07	4.92	5.66	5.49	5.25	5.27

Source: BMI

Chapter 6:
BMI Global Assumptions

Global Outlook

Hanging On, Avoiding Recession

Our global real GDP growth forecasts for 2011 and 2012 are unchanged at 3.1% and 3.2% respectively. Global leading and coincident indicators suggest that economic activity has slowed in H211. However, our core scenario sees no recession on a global basis in 2011 or 2012, despite risks of recession in the US and the eurozone.

The European crisis presents the biggest risk. Our core view is that a break-up of the monetary union will be avoided, but not without significant cost. We expect a significant negative event to occur in the eurozone that will temporarily depress global activity and hit financial markets, after which eurozone leaders will finally have the wherewithal to forge a long-term solution to the bloc's structural problems. Meanwhile, recent incoming manufacturing and real estate data suggest that our China growth fears are finally starting to be realised. While we are still forecasting growth of 8.1% in 2012, the risks to our forecast are to the downside. This presents a major risk to global demand, and would hit commodities particularly hard.

Also worrying is that policy options are more limited now than

TABLE: GLOBAL ASSUMPTIONS

		2010	2011f	2012f	2013f	2014f	2015f	2016f
Real GDP Growth (%)								
	US	3.0	1.6	1.6	2.5	2.6	2.5	2.4
	Eurozone	1.7	1.7	1.2	1.9	2.1	2.1	2.0
	Japan	4.3	-0.7	1.8	1.2	1.2	1.3	1.2
	China	10.3	9.2	8.1	7.5	6.9	6.8	6.7
	World	4.4	3.1	3.2	3.7	3.8	3.7	3.7
Consumer Inflation (ave)								
	US	1.6	3.0	2.1	2.0	2.0	2.2	2.2
	Eurozone	1.6	2.2	1.9	1.9	1.9	1.8	1.8
	Japan	0.0	0.2	0.4	0.8	1.3	1.8	2.3
	China	3.3	5.6	3.2	3.0	3.0	2.9	2.9
	World	3.0	4.0	3.6	3.6	3.6	3.4	3.4
Interest Rates (eop)								
	Fed Funds Rate	0.00	0.00	0.00	0.00	2.50	4.00	4.25
	ECB Refinancing Rate	1.00	1.50	1.50	1.50	2.50	3.50	3.50
	Japan Overnight Call Rate	0.10	0.10	0.10	0.10	0.10	0.10	0.25
Exchange Rates (ave)								
	US$/EUR	1.33	1.43	1.38	1.30	1.25	1.25	1.25
	JPY/US$	87.18	78.50	72.50	75.00	78.75	81.25	82.50
	CNY/US$	6.77	6.48	6.40	6.33	6.20	6.08	5.96
Oil Prices (ave)								
	OPEC Basket (US$/bbl)	77.39	102.00	99.00	97.00	93.00	93.00	93.00
	Brent Crude (US$/bbl)	80.26	106.00	102.00	100.00	96.00	96.00	96.00

Source: BMI

at the onset of the 2008-2009 recession, with austerity rather than stimulus being the watchword in legislatures worldwide. There are limited monetary resources left in most developed states, with Japan, the US and the UK among major economies employing quantitative easing strategies. On the positive side, emerging market (EM) policymakers should have further room to ease, as commodity prices have begun to moderate, particularly for food. This should help take the edge off EM inflation in 2012.

On the whole, developed states' growth will remain erratic and weak. Emerging markets will continue to grow more strongly than developed states, but not all EM countries are in the same places in the growth cycle.

Developed States

Our forecasts for developed states' real GDP growth in 2011 and 2012 have fallen to 1.3% (down from 1.4%) and 1.5% (from 1.6%) respectively. Conditions have deteriorated fairly rapidly, owing in large part to a drop in business and consumer confidence surrounding the European crisis – our 2012 growth forecast was 2.1% as recently as August.

The most significant forecast downgrades are in Canada, the UK and Denmark. We have lowered our Canadian real GDP growth forecasts to 2.3% in 2011 (from 2.7% previously) and 1.8% in 2012 (from 2.4%). A weaker export outlook, a downward revision to Q111 real GDP expansion and moderating

TABLE: EMERGING MARKETS AGGREGATE GROWTH

	2010	2011f	2012f	2013f
Emerging Markets Aggregate Growth	7.0	5.7	5.5	5.6
Latin America	6.1	4.2	4.2	3.8
Argentina	9.2	7.0	4.1	4.2
Brazil	7.5	3.8	4.8	4.3
Mexico	5.4	3.8	3.1	2.7
Middle East	3.9	4.6	4.4	4.5
Saudi Arabia	4.1	6.3	4.0	3.8
UAE	1.4	3.3	3.3	3.5
Egypt	5.1	1.8	2.8	6.0
Africa	5.1	4.7	6.5	5.8
South Africa	2.8	3.2	3.9	4.1
Nigeria	7.9	7.8	7.6	7.8
Emerging Asia	9.1	7.5	6.9	6.7
China	10.3	9.2	8.1	7.5
Hong Kong	7.0	5.0	3.9	3.5
India*	8.5	7.4	7.5	7.9
Indonesia	6.1	6.3	5.8	6.2
Malaysia	7.2	4.8	4.2	3.6
Singapore	14.5	5.0	4.4	4.1
South Korea	6.2	4.1	4.1	4.1
Taiwan	9.9	3.0	4.3	5.1
Thailand	7.8	3.6	4.0	4.2
Emerging Europe	4.5	4.1	3.7	4.7
Russia	4.0	3.3	3.2	4.7
Turkey	8.9	7.0	4.5	5.4
Czech Republic	2.2	2.3	2.3	2.5
Hungary	1.1	2.0	2.6	2.8
Poland	3.8	4.0	3.5	4.0

**Fiscal years ending March 31 (2010 = 2009/10)* growth in private consumption are the primary contributors to our downgraded forecasts. On the back of the subdued signs for economic activity heading into H211, we have revised down our UK 2011 growth forecast to 1.1% from 1.4% previously. We have also lowered the medium-term growth profile, targeting growth of 1.6% in 2012 and 2.1% in 2013, from 2.2% and 2.5% previously. Our view remains for a UK slowdown, but not a recession, with the economy treading water. While we hold to our forecast for Danish real GDP growth to come in at 1.5% for 2011, we have been prompted by pressures facing the domestic banking sector and deterioration in the global macroeconomic backdrop to downgrade our 2012 growth forecast to 1.7%, from 2.3% previously.

Emerging Markets

Our aggregate forecast for emerging markets' real GDP growth remains at 5.7% for 2011, but has ticked down slightly to 5.5% (from 5.6%) for 2012.

The biggest changes to our forecasts are in emerging Europe, where we now see regional aggregate GDP growth at 4.1% in 2011 and 3.7% in 2012 (we had previously projected growth of 4.6% and 4.3% respectively). We have lowered our real GDP growth forecasts for Russia to 3.3% and 3.2% in 2011 and 2012 respectively, placing us substantially below consensus (of 4.0% in 2011 and 3.6% in 2012), as the external environment grows increasingly more challenging. With the risk of major contagion

TABLE: DEVELOPED STATES REAL GDP GROWTH FORECAST

	2010	2011f	2012f	2013f
Developed States Aggregate Growth	2.7	1.3	1.5	2.1
G7	3.0	1.3	1.5	2.1
Eurozone	1.7	1.7	1.2	1.9
EU-27	1.8	1.8	1.4	2.1
Selected Developed States				
Australia	2.6	1.8	1.6	2.7
Austria	2.0	2.0	2.0	1.9
Belgium	2.2	2.5	1.7	2.2
Canada	3.2	2.3	1.8	2.4
Denmark	2.1	1.5	1.7	2.0
Finland	3.6	3.5	2.0	2.2
France	1.5	1.8	1.4	1.9
Germany	3.7	3.1	1.3	2.1
Ireland	-1.0	1.3	2.1	2.2
Italy	1.3	0.8	0.7	1.1
Japan	4.3	-0.7	1.8	1.2
Netherlands	1.7	1.9	2.3	2.7
Norway	0.4	2.5	2.4	2.3
Portugal	1.3	-1.6	-1.8	2.0
Spain	-0.1	0.7	1.0	2.0
Sweden	5.7	4.5	2.0	2.2
Switzerland	2.6	1.9	2.1	2.0
United Kingdom	1.3	1.1	1.6	2.1
US	3.0	1.6	1.6	2.5

Source: BMI

TABLE: REAL GDP GROWTH CONSENSUS FORECASTS

		US	Eurozone	Japan	Brazil	China	Russia	India
2011	Bloomberg Consensus	1.7	1.7	-0.4	3.7	9.3	4.0	N/A
	BMI	1.6	1.7	-0.7	3.8	9.2	3.3	7.4
2012	Bloomberg Consensus	2.0	1.0	2.5	N/A	N/A	3.6	N/A
	BMI	1.6	1.2	1.8	4.8	8.1	3.2	7.5

Source: BMI

spreading from the eurozone periphery to regional banks, we note that the domestic picture also looks set to be more moderate.

Elsewhere in the emerging markets universe, our forecasts are relatively unchanged. Our Latin America growth forecast for 2011 has edged higher to 4.2% (from 4.1% previously). For emerging Asia, our 2011 and 2012 forecasts remain steady at 7.5% and 6.9% respectively. We have been below consensus on Asian growth for the best part of a year, and have had little reason to revise down our forecasts amid the current global slowdown.

Sub-Saharan Africa's 2011 forecast remains at 4.7% from 4.8%, though it has risen slightly for 2012 to 6.5% (from 6.4%). For the Middle East and North Africa region, our 2011 and 2012 forecasts are unchanged at 4.6% and 4.4% respectively.

We are in line with Bloomberg consensus estimates on US and eurozone growth in 2011, though for 2012 we are above consensus on the eurozone. For 2012, however, we are well below consensus on US and Japanese growth.

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