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CEEMEA
Economics

Economics Chartbook

Poland: The Jewel in the CEE Crown?

Poland Chartbook

The Everesty Gala 2009, Warsaw

MORGAN STANLEY RESEARCH

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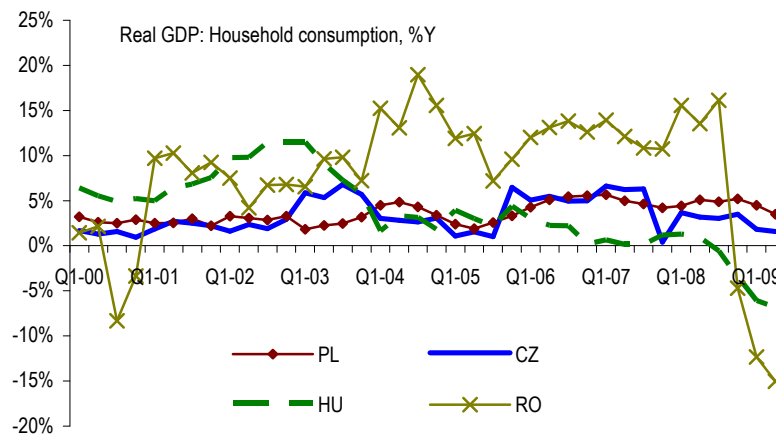
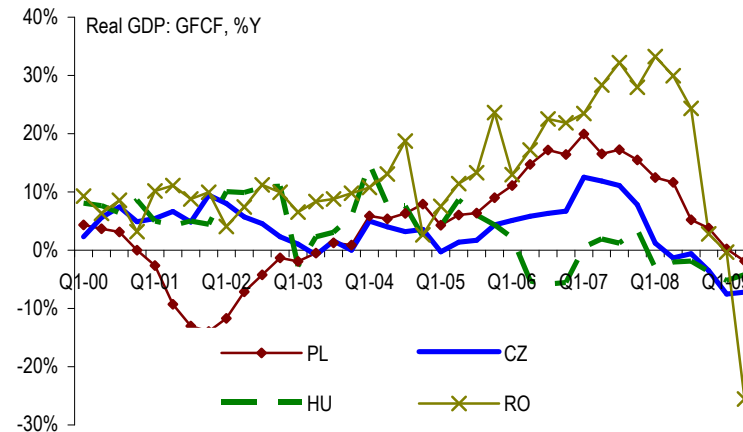
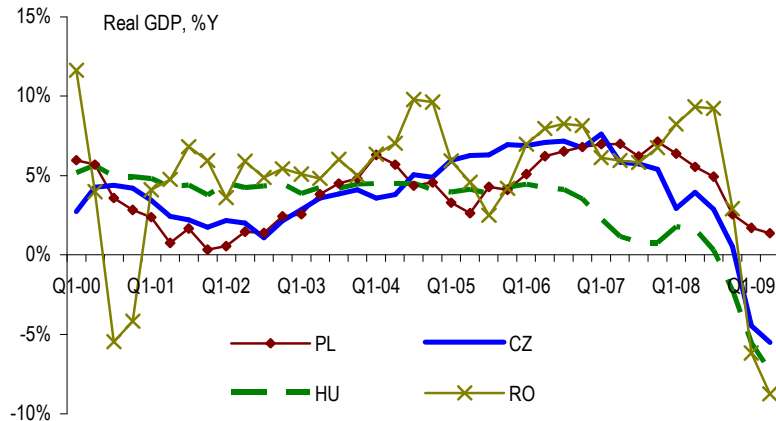
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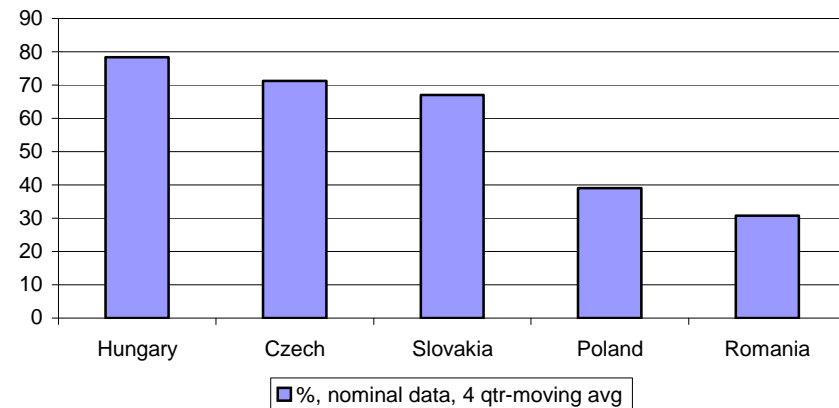
For important disclosures, refer to the Disclosures Section, located at the end of this report.

Poland: A Clear Outperformer in 2009-10

- Growth momentum is changing, with some countries posting q/q GDP increases in 2Q/3Q. Poland has emerged as the region's 'growth star', due to its more closed nature, supportive fiscal policy and less severe credit crunch.



Exports % GDP

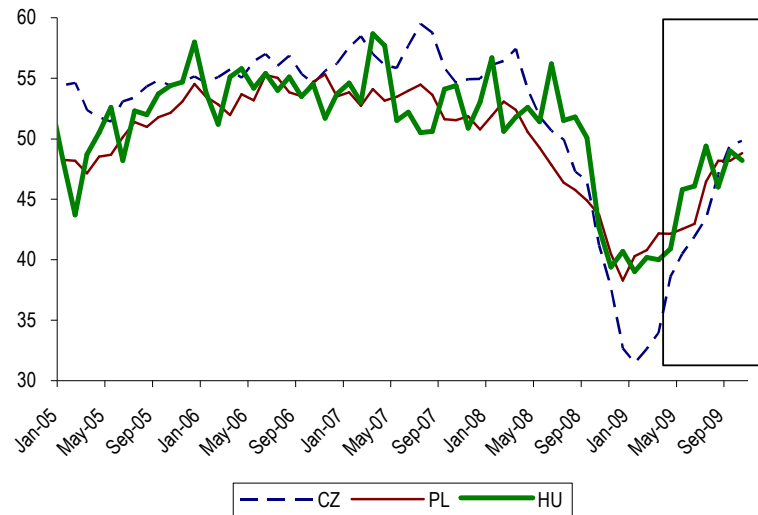


Source: Haver

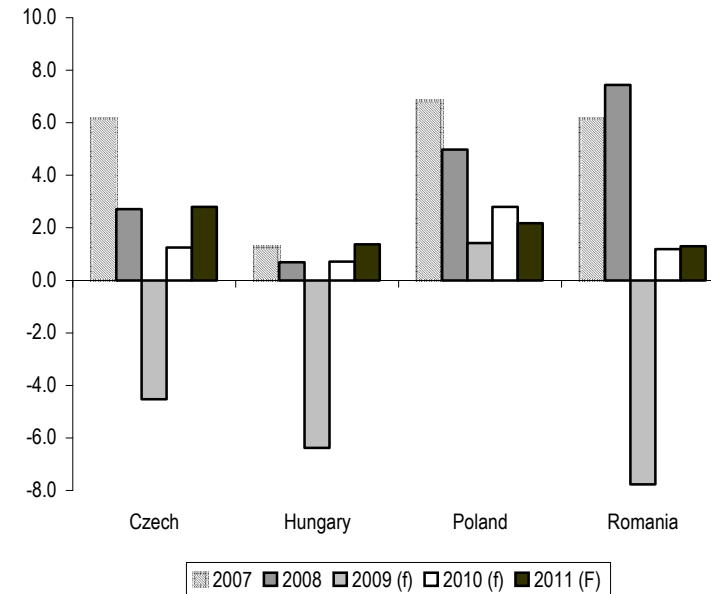
We See a Muted Recovery in Central Europe in 2010-11

- Industrial business surveys have been on a steady uptrend this year, after a sharp correction. An inventory rebuild and likely some incentives in the auto sector explain part of the improvement in manufacturing activity. Still, we expect a muted recovery in 2010-11.

Manufacturing PMI, sa



Source: CEEMarketWatch, Reuters



Source: Morgan Stanley, Haver

CEE Vulnerability Watch: Poland – a Good Starting Point, but No Room for Complacency

- Hungary stands out in Central Europe as having the highest share of external debt in CEE, with the Baltics and Bulgaria. The *stock* of liabilities is low in Poland, but fundamentals have been deteriorating over the recent years (see budget deficit, for instance).

External Debt, Reserves, Fiscal Balances

	Poland	Hungary	Czech Republic	Romania	Bulgaria	Lithuania	Latvia	Estonia	Russia	Ukraine
External Debt % of Exports	170.4%	166.7%	57.4%	197.1%	202.7%	154.9%	327.3%	170.8%	120.9%	179.6%
External Debt % of GDP	61.6%	131.3%	41.1%	58.4%	106.1%	79.4%	134.8%	124.4%	34.7%	71.6%
ST External Debt % GDP	16.4%	21.6%	12.1%	11.2%	36.5%	16.5%	34.1%	43.9%	4.7%	14.0%
Med. and LT External Debt % GDP	32.8%	82.8%	24.2%	33.1%	29.7%	51.7%	86.0%	58.0%	26.5%	54.0%
Intercompany Loans % GDP	12.4%	27.0%	4.9%	14.1%	39.9%	11.2%	14.8%	22.6%	3.6%	3.5%
Short-Term Debt/Total reserves	95.1%	68.5%	57.2%	47.2%	101.7%	99.5%	158.7%	256.4%	15.5%	70.2%
Budget Balance % of GDP (2009 E)	-6.5%	-4.1%	-6.1%	-7.8%	-2.0%	-9.8%	-9.0%	-3.0%	-7.5%	-9.0%
Government Debt % GDP (2009 E)	51.5%	80.0%	37.0%	22.0%	15.1%	29.9%	33.2%	7.4%	7.5%	35.0%

Breakdown of ST External Debt

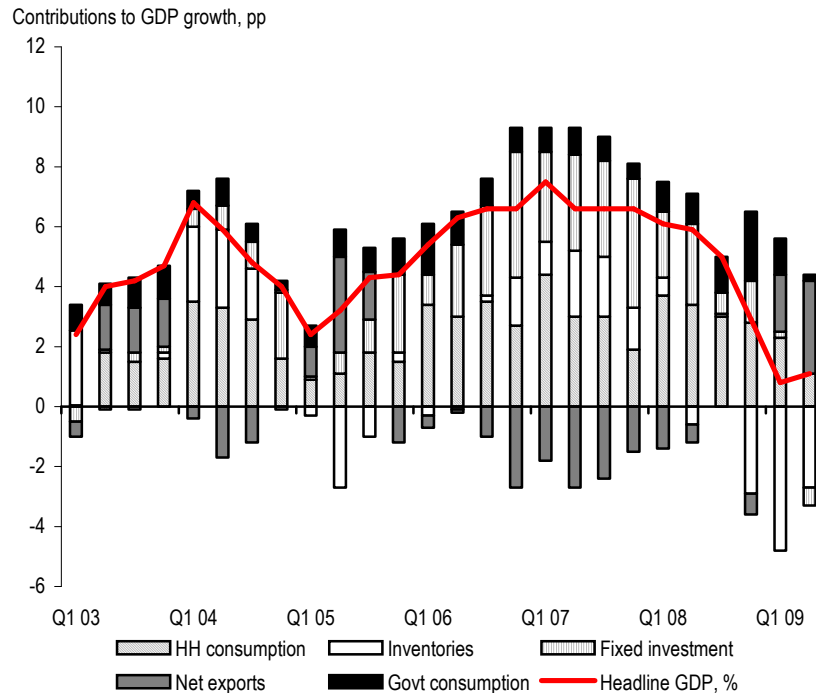
	Poland	Hungary	Czech Republic	Romania	Bulgaria	Lithuania	Latvia	Estonia	Russia	Ukraine	Total, by sectors	%
Government	1,761	4,162	414	164	-		29	0	1,600	-	8,130	3.0%
Monetary institutions	3,612	2,253	99	158	-	79	27	6	2,500	-	8,733	3.2%
Banks	28,894	16,820	14,587	10,781	9,463	4,193	7,703	6,562	33,600	6,547	139,149	51.3%
Other sectors	40,100	6,375	8,394	9,308	8,353	2,422	2,244	2,359	22,500	13,188	115,242	42.5%
Total, mil USD	74,367	29,610	23,493	20,411	17,815	6,694	10,002	8,927	60,200	19,735	271,254	100.0%

Source: Morgan Stanley, Haver; E = Morgan Stanley estimates

Poland: Why We Like the Zloty

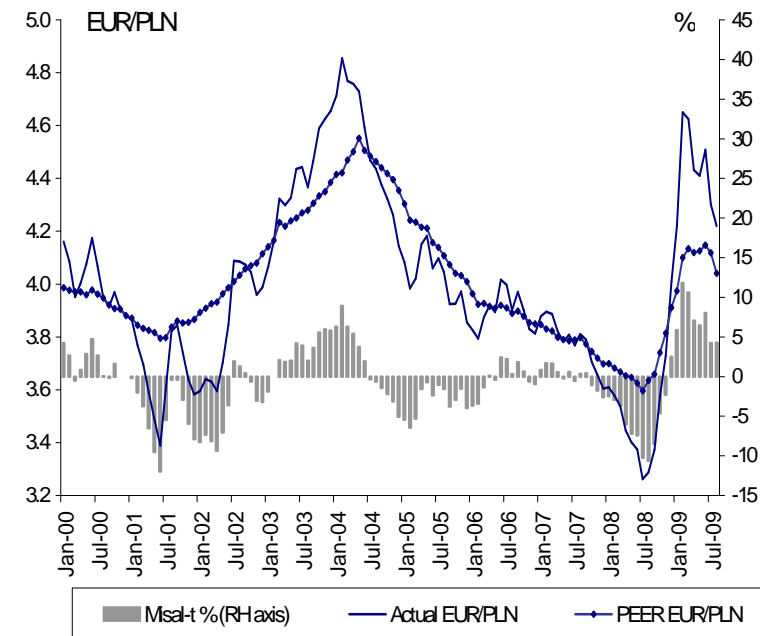
- The zloty remains our favorite currency in the CEE space on both growth and valuation grounds.

Poland – GDP and Components



Source: GUS, Morgan Stanley Research

We Think the PLN Is Undervalued

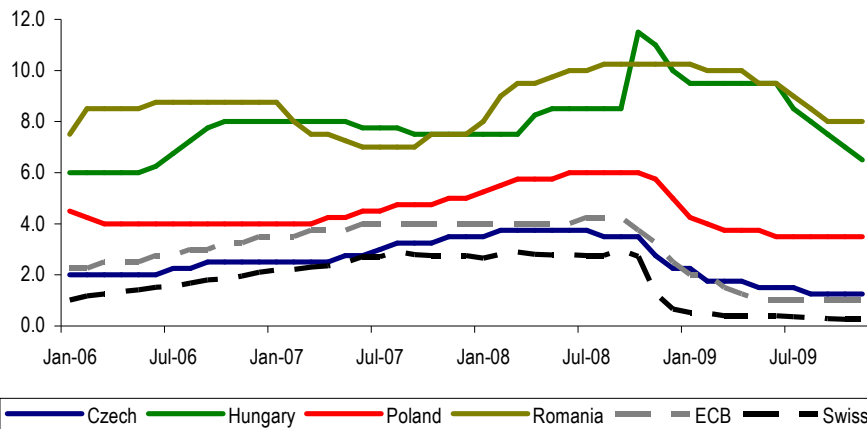


Source: PLN: What's Fair Is Fair by A. Slyusarchuk and P. Diana

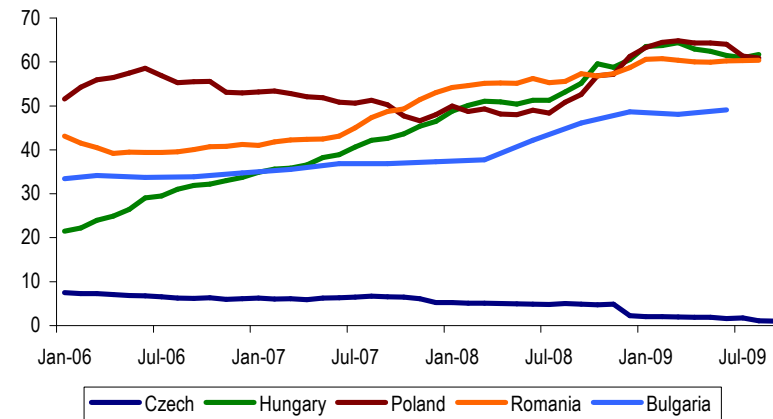
Regional Credit Trends: FX Loans Became Increasingly Popular Over Recent Years

- FX loans represented the bulk of new mortgages in Poland, Hungary and Romania in 2007-08.

Central Bank Rates



% of Mortgages Denominated in FX



% GDP	Czech Republic						Hungary						Poland						Romania					
	Households		NFC		Total PS credit		Households		NFC		Total PS credit		Households		NFC		Total PS credit		Households		NFC		Total PS credit	
	local ccy	FX	local ccy	FX	local ccy	FX	local ccy	FX	local ccy	FX	local ccy	FX	local ccy	FX	local ccy	FX	local ccy	FX	local ccy	FX	local ccy	FX	local ccy	FX
end-2004	11.1	0.0	13.3	3.1	24.4	3.1	12.6	1.8	13.7	10.5	26.3	12.3	9.2	2.9	9.8	3.2	19.0	6.1						
end-2005	13.9	0.0	14.5	3.1	28.4	3.1	12.2	5.0	13.9	12.1	26.1	17.1	10.3	4.1	9.7	2.8	20.0	6.9	4.1	3.3	5.0	7.1	9.1	10.4
end-2006	16.6	0.0	16.0	3.7	32.6	3.7	11.5	8.5	14.8	12.5	26.3	21.0	12.2	5.5	10.3	2.8	22.5	8.3	6.7	4.7	6.9	7.5	13.6	12.2
end-2007	20.4	0.0	17.4	3.6	37.8	3.6	10.4	12.8	13.8	14.8	24.2	27.6	15.8	6.3	12.0	2.8	27.8	9.1	8.3	9.4	8.0	10.0	16.3	19.4
end-2008	23.6	0.0	18.7	4.2	42.3	4.2	9.6	19.4	12.8	17.5	22.4	36.9	17.7	11.9	13.3	4.3	31.0	16.2	8.2	11.6	8.2	10.7	16.4	22.3
Latest	25.0	0.0	18.3	3.7	43.3	3.7	10.3	20.1	13.2	17.7	23.6	37.8	18.6	12.5	13.0	4.6	31.6	17.1	7.9	12.0	7.8	11.3	15.7	23.3

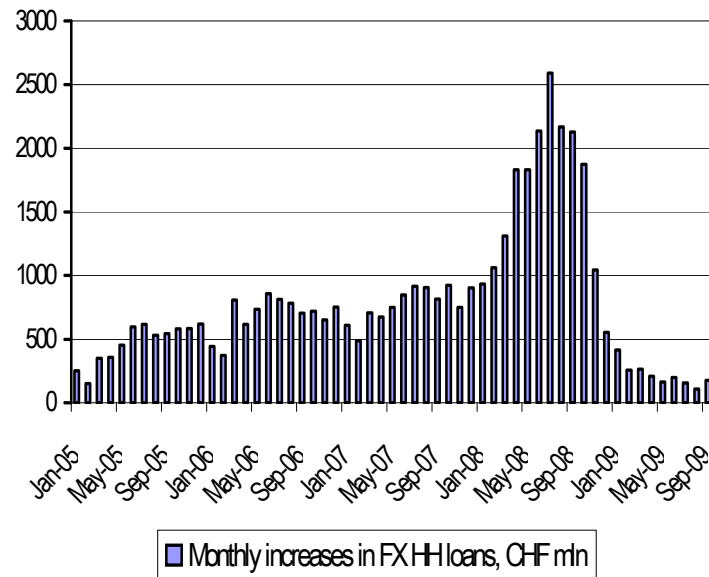
Source: Morgan Stanley, Haver

Source: Morgan Stanley, Haver; for Romania this shows % total HH loans

Poland: FX Loans Have Ground to a Halt, but Overall Lending Has Remained More Resilient

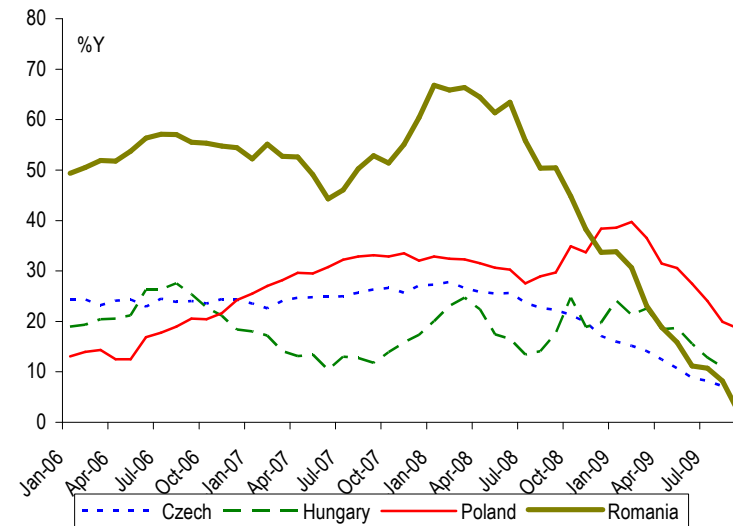
- Some banks have suspended FX loans and others have reduced their availability or started charging higher spreads. On the demand side, low confidence has made borrowers much more cautious. While central banks cannot deal with the existing stock of loans, we think that regulators and central banks will try to make FX lending more difficult in the future.

Poland: New FX Loans



Source: Morgan Stanley calculations, NBH

Private Sector (HH+NFC) Credit



Source: Morgan Stanley calculations, NBP

CEE: Large C/A Gaps Are Unwinding Fast, Asset Bubbles Have Burst

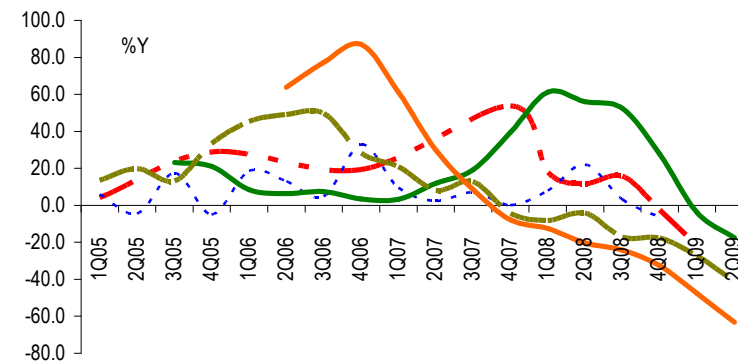
- In a world where capital inflows were abundant, CEE countries accumulated large C/A deficits, financed by debt-generating inflows, such as FX loans to households. As funding dries up, economies contract and asset prices deflate, C/A deficits are shrinking to levels well below 'normal'.

Anatomy of BoP in CE

% GDP, 12m latest	Czech	Hungary	Poland	Romania	Bulgaria
Current Account	-2.2	-4.7	-2.0	-5.8	-14.7
Goods& Services	5.2	2.7	-0.9	-6.5	-12.6
Income	-7.0	-7.1	-2.9	-3.0	-3.2
Current Trsfrs	-0.5	-0.4	1.7	3.7	1.1
Capital Account	1.0	1.6	1.1	0.2	1.2
Financial Account	3.3	12.7	6.5	5.9	7.1
FDI	1.5	0.4	1.8	4.3	10.0
Portfolio flows	1.3	-6.5	1.6	-0.9	-0.8
Financial derivatives	0.9	-1.5	-0.5	-0.3	n/a
Other	-0.4	20.2	3.6	2.8	-2.1
Errors and Omissions	-0.8	-0.1	-5.3	-0.1	-2.6
Change in reserves (- is an increase)	-1.2	-9.5	-0.3	-0.1	9.0

Credit Stalls, Imports Plunge, House Prices Correct

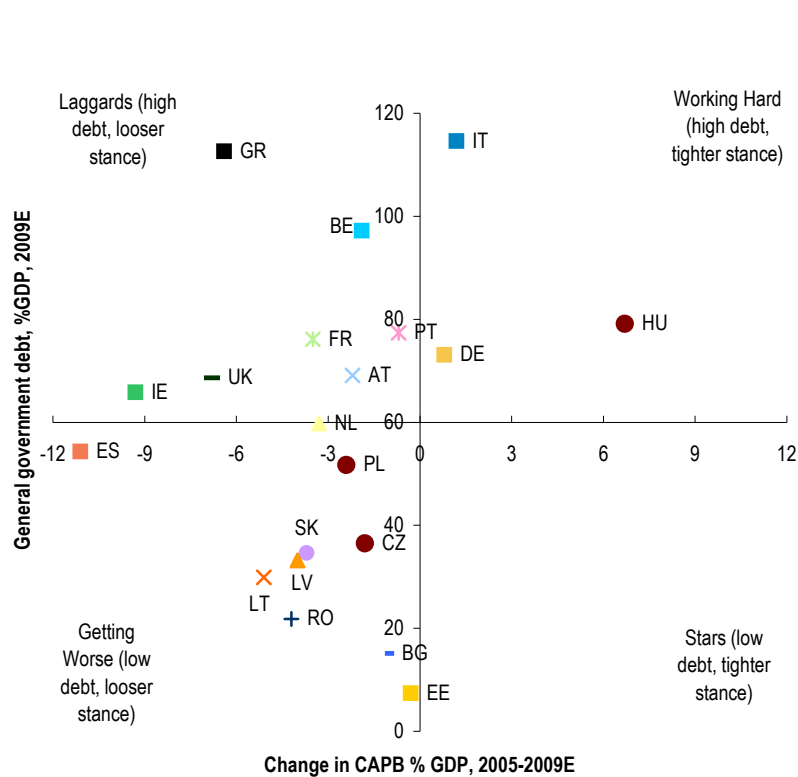
	CA deficit, % GDP, 12m		Exports %Y		Imports %Y		Monthly increase in FX cons credit (EUR bn)	
	Peak	Latest 2008 avg	latest	2008 avg	latest	2008 avg	latest	
Czech	3.4	2.4	-0.2	-8.8	1.0	-14.2	0.0	0.0
Hungary	8.4	4.7	6.0	-17.6	5.9	-23.6	0.5	0.1
Poland	5.5	2.6	12.9	-17.1	14.4	-26.4	1.1	0.1
Romania	13.6	6.3	14.4	-18.1	10.2	-34.2	0.3	0.0
Bulgaria	26.8	16.7	14.2	-20.2	17.1	-35.0	0.2	0.0



Source: Morgan Stanley, Haver, European Commission, Global Property Guide

CE-3: Anatomy of the Fiscal Position

- Hungary’s fiscal rigor has been unparalleled anywhere else in the EU; its debt stock however is a worry. Poland’s debt stock is still contained, but we are dangerously close to debt ceilings.



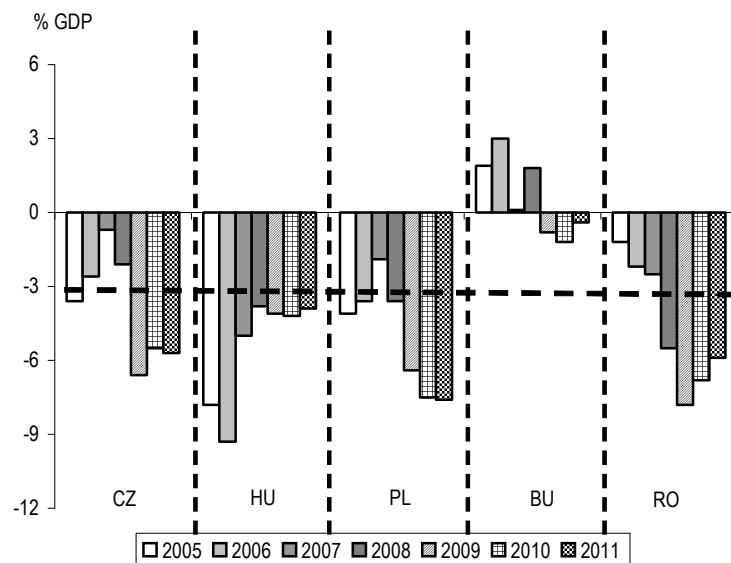
	% GDP	2005	2006	2007	2008	2009 (f)	2010 (f)	2011 (f)
Czech Republic								
Expenditures		45.0	43.8	42.6	43.0	46.9	46.5	46.6
Revenue		41.4	41.1	41.9	40.9	40.3	41.0	40.9
Budget Balance		-3.6	-2.6	-0.7	-2.1	-6.6	-5.5	-5.7
Interest Expenditure		1.2	1.1	1.2	1.1	1.4	1.6	1.6
Primary Balance		-2.4	-1.5	0.5	-1.0	-5.2	-3.9	-4.1
Cyclically Adjusted Budget Balance		-4.0	-4.2	-3.1	-4.1	-6.0	-4.5	-4.8
Cyclically Adjusted Primary Balance		-2.8	-3.1	-1.9	-3.0	-4.6	-2.9	-3.2
Government Debt		29.7	29.4	29.0	30.0	36.5	40.6	44.0
Hungary								
Expenditures		50.1	51.9	49.8	49.3	50	49.4	49
Revenue		42.2	42.6	44.8	45.5	45.9	45.1	45.1
Budget Balance		-7.9	-9.3	-5	-3.8	-4.1	-4.2	-3.9
Interest Expenditure		4.1	3.9	4.1	4.2	4.3	4.2	3.8
Primary Balance		-3.8	-5.4	-0.9	0.4	0.2	-0.1	-0.2
Cyclically Adjusted Budget Balance		-8.7	-10.9	-6.4	-5.1	-2.2	-2.1	-3
Cyclically Adjusted Primary Balance		-2.8	-3.1	-1.9	-3	-4.6	-2.9	-3.2
Government Debt		61.8	65.6	65.9	72.9	79.1	79.8	79.1
Poland								
Expenditures		43.4	43.9	42.2	43.3	44.0	46.1	45.9
Revenue		39.4	40.2	40.3	39.6	37.6	38.6	38.3
Budget Balance		-4.1	-3.6	-1.9	-3.6	-6.4	-7.5	-7.6
Interest Expenditure		2.8	2.7	2.3	2.2	2.7	3	3
Primary Balance		-1.3	-1.0	0.4	-1.4	-3.8	-4.6	-4.6
Cyclically Adjusted Budget Balance		-4	-4.1	-2.9	-4.7	-6.3	-6.6	-6.7
Cyclically Adjusted Primary Balance		-1.2	-1.4	-0.6	-2.5	-3.6	-3.7	-3.7
Government Debt		47.1	47.7	45	47.2	51.7	57	61.3

Source: European Commission

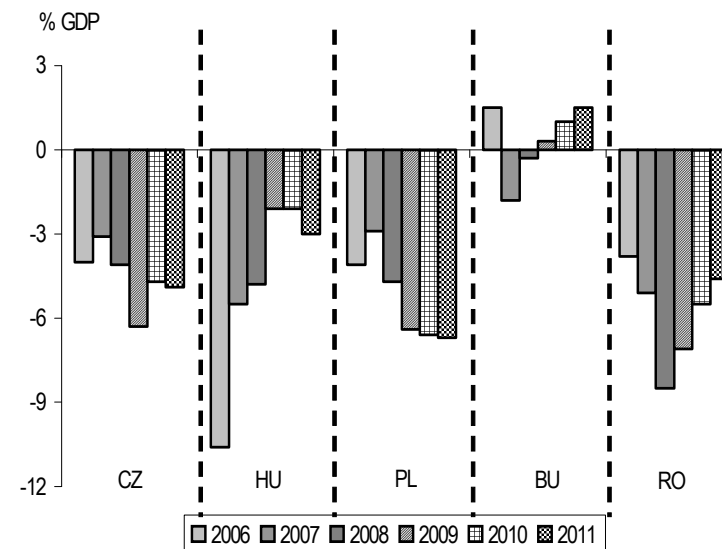
Poland: Fiscal Concerns Take Centre Stage – Latest EC Projections

- The growth collapse is taking a heavy toll on public finances everywhere; Hungary remains forced to apply pro-cyclical fiscal tightening, due to the strictures of the IMF package; Romania will also need to rein in spending; the Polish authorities have deferred structural fiscal adjustment for the moment, but the debt thresholds put them under pressure.

Headline Budget Balances



Structural Budget Balances



Source: European Commission, structural budget balance is the cyclically adjusted budget balance ex-one-offs

Poland: Debt Ratios in Focus

- The MinFin has adopted a pretty passive stance with respect to the widening fiscal gap. However, the threat of a breach of the 55% debt threshold in 2010 has made authorities aware of further overshoots. Thus far, however, no fiscal tightening has been put in place.

Overview of the Debt Rules

Public Debt between 50% and 55% of GDP

The draft budget for the following year must not propose a higher deficit-to-revenue ratio than in the current year. This applies to every territorial entity (i.e. to local governments also)

Public Debt between 55% and 60% of GDP

Draft budget must not increase the ratio of State Treasury (practically the same as central government) debt to GDP in the following year. Also, no increase in public sector salaries, no new loans from the State Budget and no revaluation of pensions above CPI is allowed.

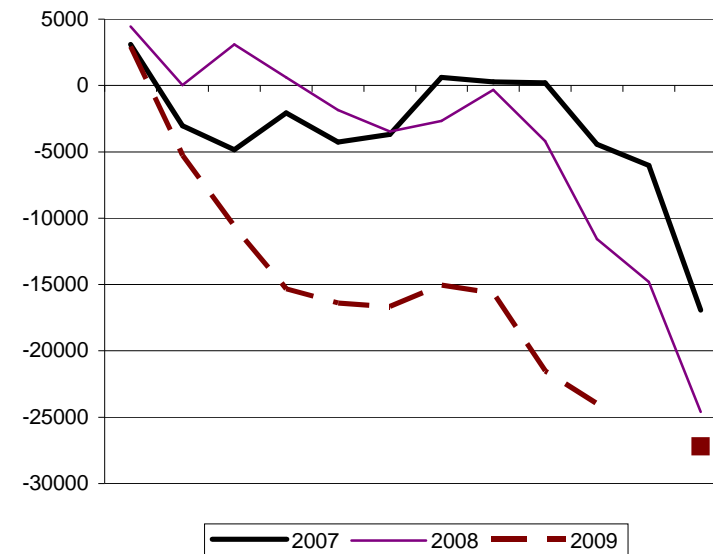
Public Debt above 60% of GDP

Any government borrowing is forbidden in the subsequent year, and ministers have one month to provide an adjustment program to take the debt ratio below 60%

Source: Min Fin

Cash Deficit Headed Towards the New 27bn Target (Or Higher)

Cumulative deficit, mIn PLN

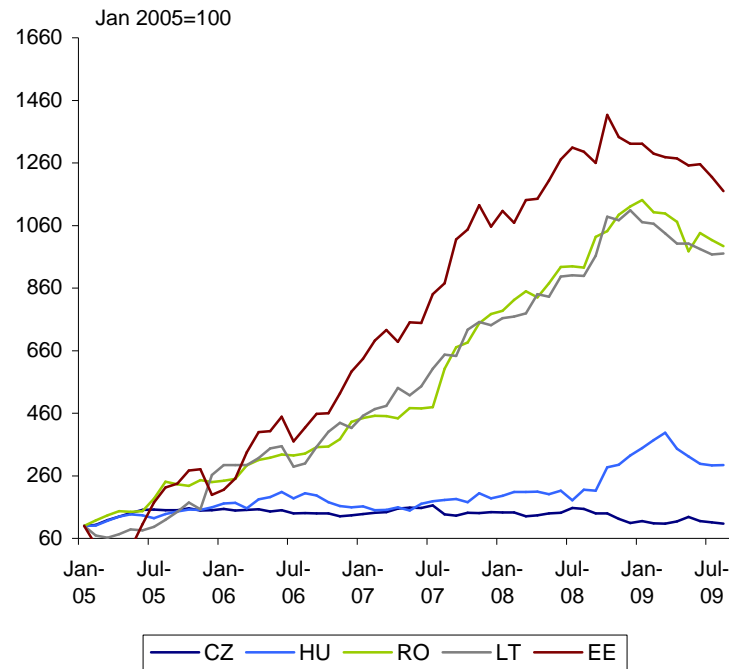


Source: CSO, Morgan Stanley

Foreign Banks: No Withdrawal from CEE

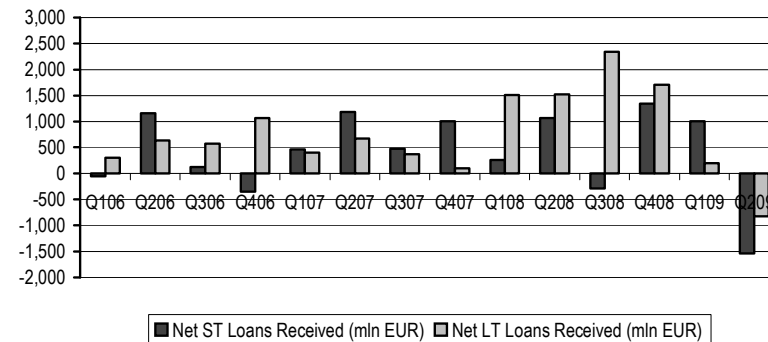
- Apocalyptic predictions did not materialize: parent banks have maintained exposure to the region overall, rolling over most of the existing interbank loans.

Commercial banks: Net Foreign Liabilities

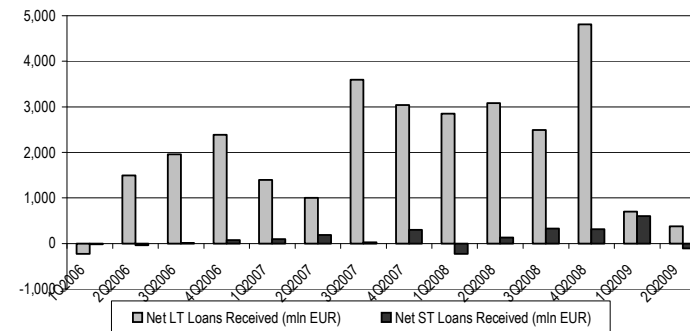


Source: IFS, Haver

Hungary: Some Net Outflows in 2Q



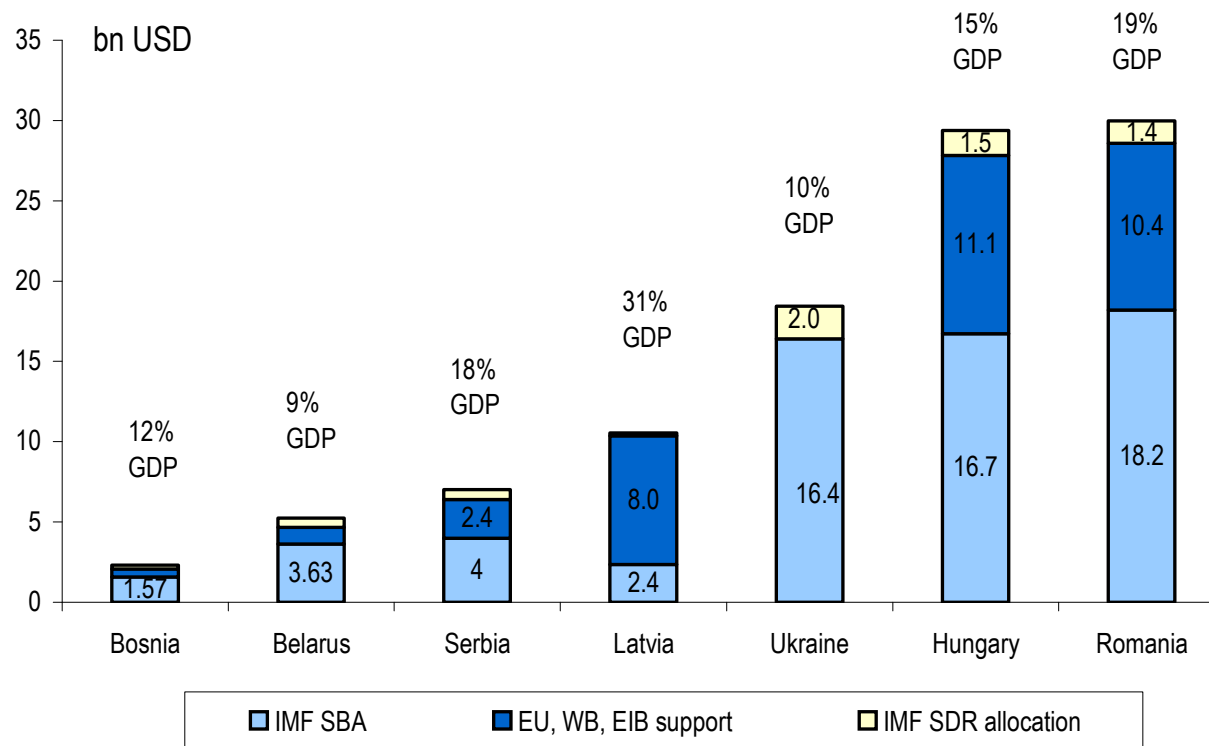
Poland: Net Inflows Slow, But Remain Positive



Source: Balance of Payments Statistics

CEE: IMF Lifeline Was Key in Stabilizing the Region

- IMF and EU assistance, and the growing sense that more would be coming if needed, supported confidence and asset prices in CEE

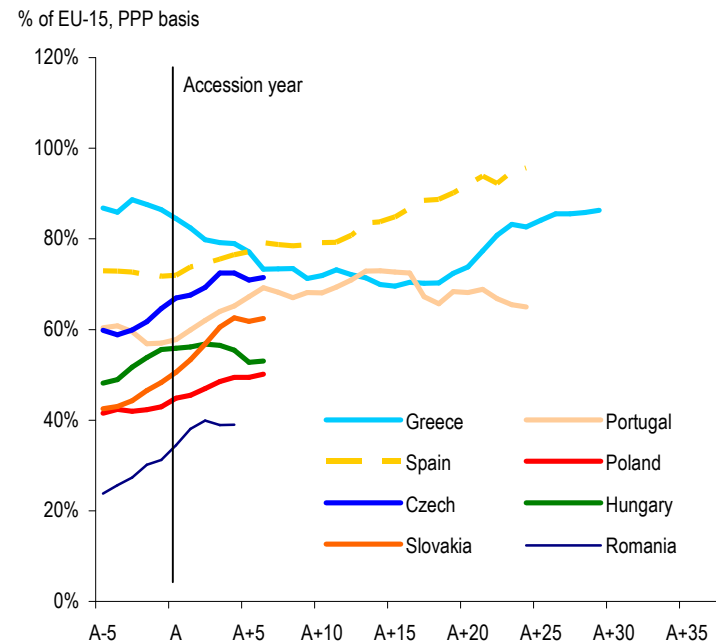


Source: IMF

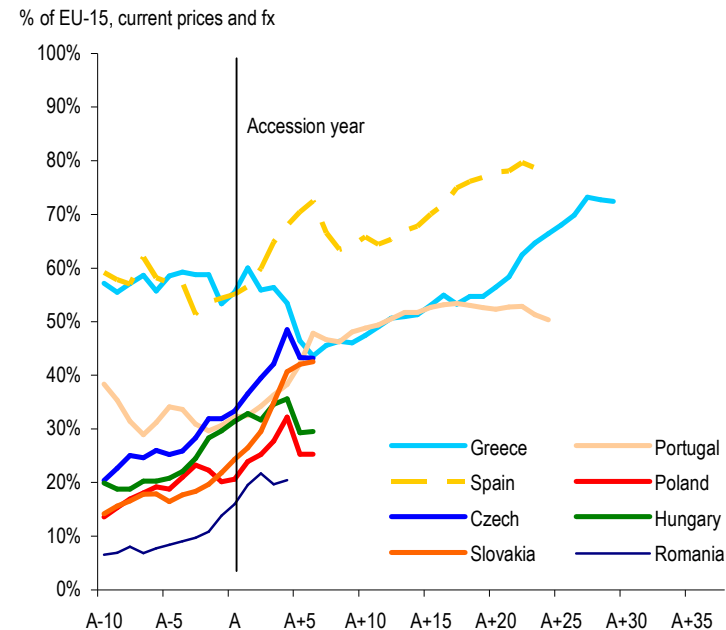
The Case for Convergence Remains Strong: Slower, Not Over

- CEE countries remain poor in an EU context (especially on a nominal GDP basis). While potential growth is likely slower than we previously thought, convergence is a multi-year process which remains on track, barring major policy failure in any given country.

PPS-Adjusted GDP Per Capita



Nominal GDP Per Capita

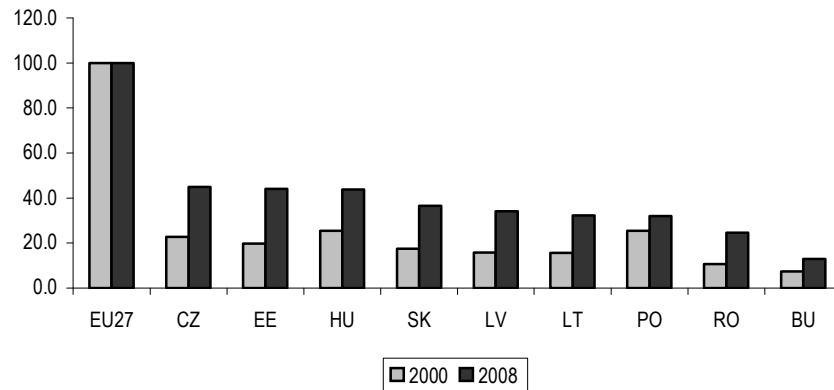


Source: European Commission, Morgan Stanley calculations. A=date of accession (Greece 1981, Spain, Portugal 1986, CE4 2004, Romania 2006)

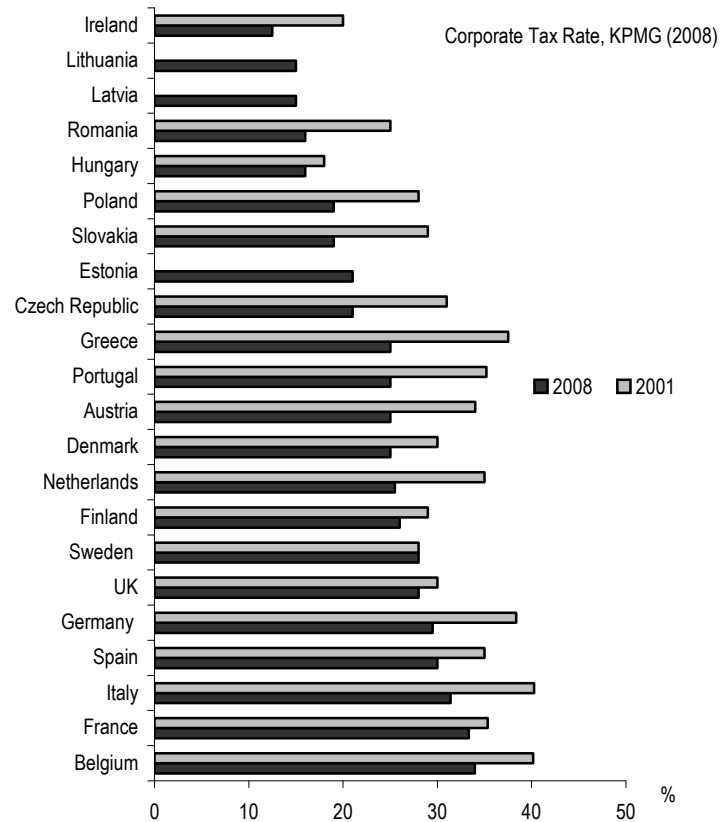
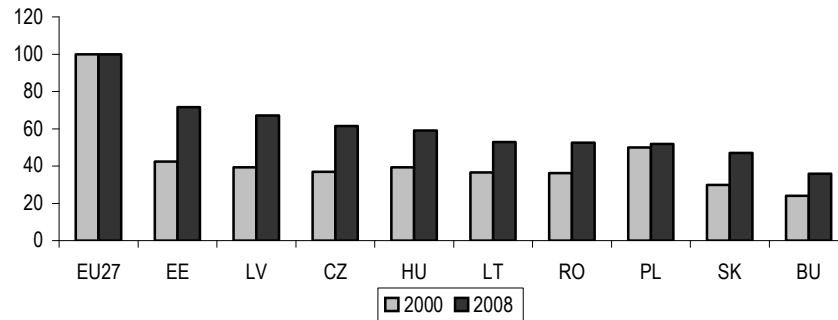
Still Cheap, Though Less than Before

- The region remains cheap, though admittedly not as much as before. Even adjusted for lower productivity, Polish wages are 50% of the EU average.

Nominal Compensation per Employee, EMU = 100



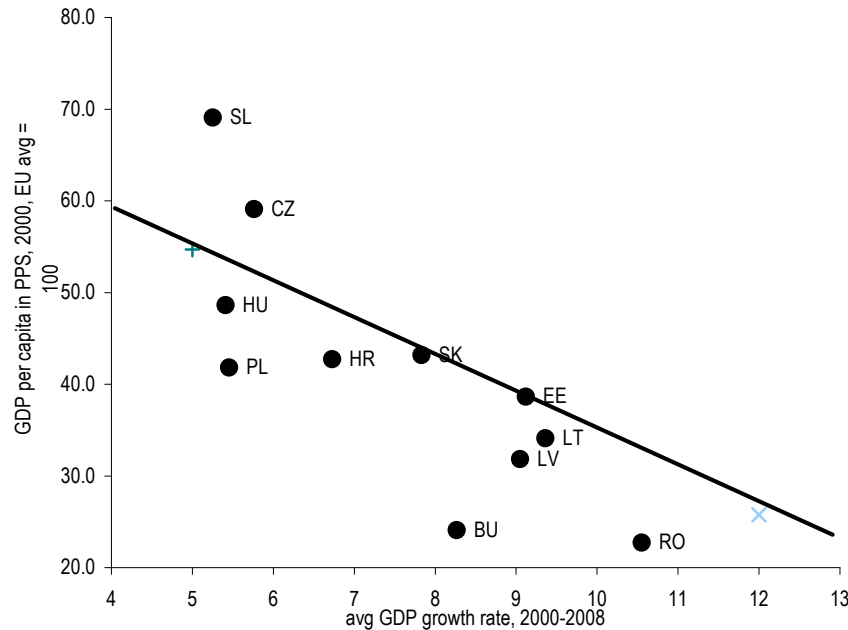
Compensation/Productivity (ULC), EU27=100



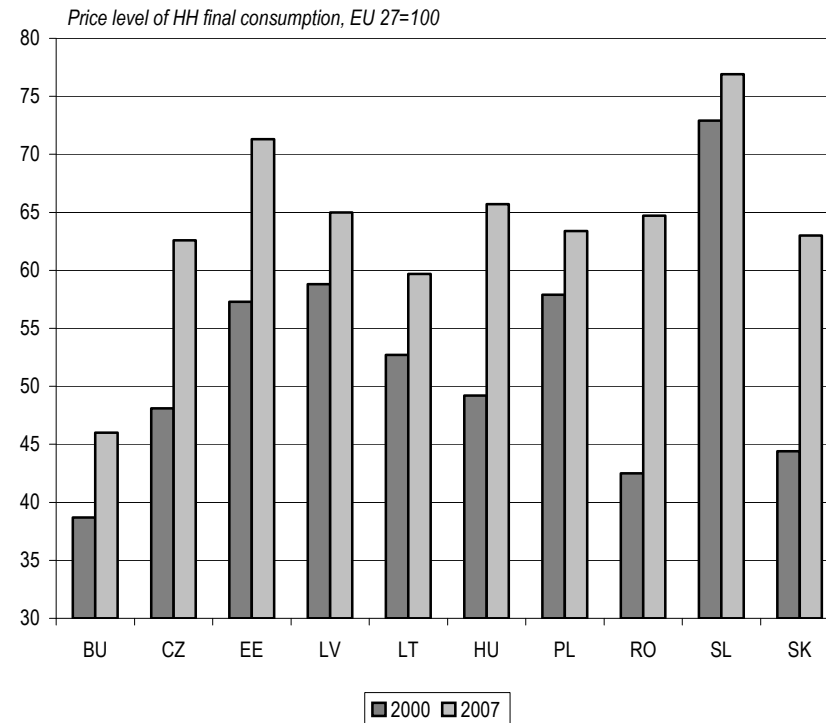
Source: Eurostat, Morgan Stanley Research calculations; the top chart just shows nominal compensation per employee in the total economy; the bottom chart is our attempt at correcting for the fact that productivity levels in Eastern Europe are lower than in Western Europe. We use overall economy productivity data from Eurostat and simply divide compensation by productivity level, having indexed both at EMU=100

Price Level Convergence Implies Higher Inflation, FX Gains or Both

- Countries with lower income levels have converged faster over recent years; price level convergence (Balassa-Samuelson effect) is an integral part of the catch-up process, and involves either higher inflation or a stronger FX, or a combination of the two.



Source: European Commission. Morgan Stanley

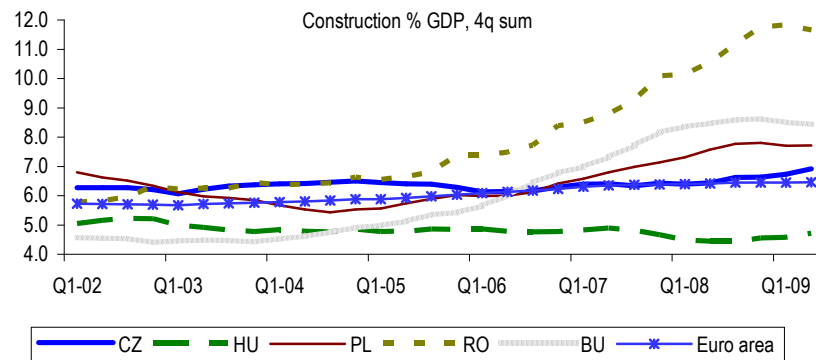
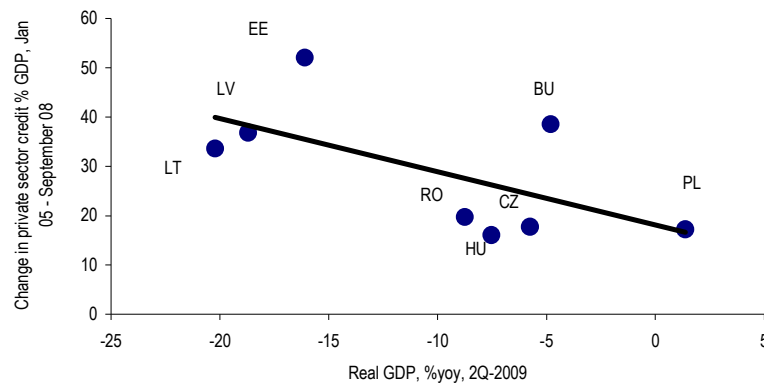


Source: European Commission

What Does the 'New Normal' Look Like?

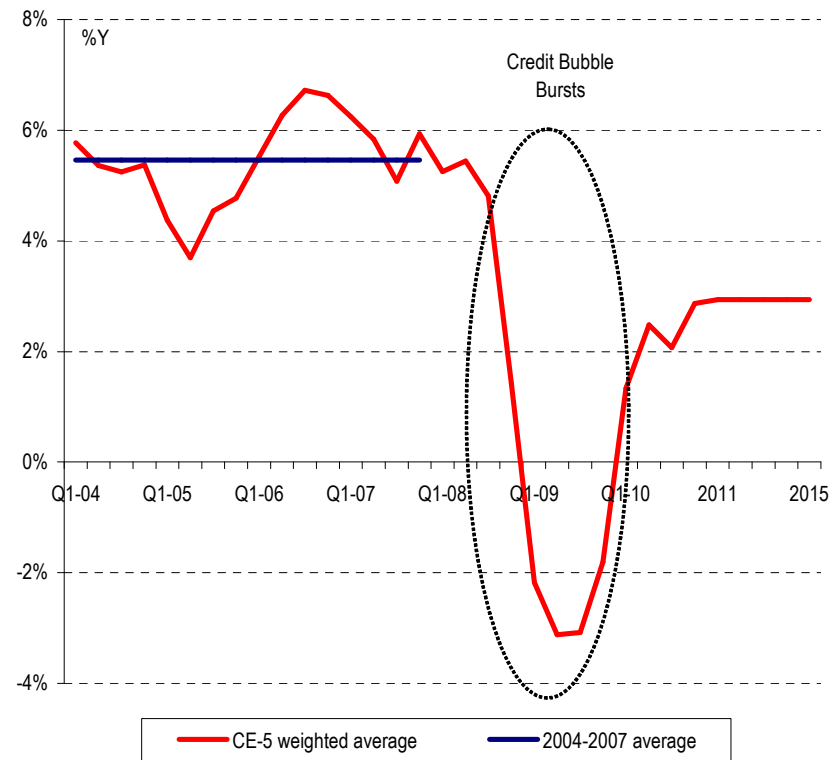
- The end of easy credit will mean slower construction and real estate activity, no return to unsustainable current account deficits and slower trend growth in the post-crisis period.

The Bigger the Bubble, the Harder the Crash



Source: Haver, Morgan Stanley

Real GDP: The 'New Normal'

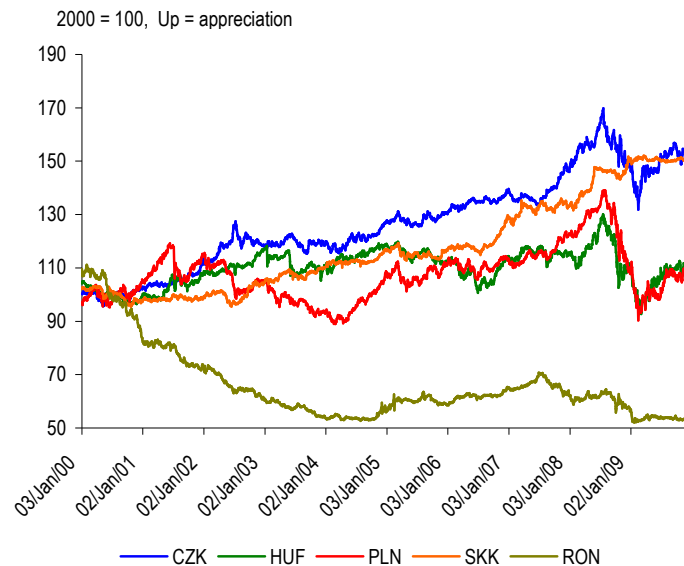


Source: Morgan Stanley Forecasts

CEE FX: Worst Phase of Deleveraging Is Over

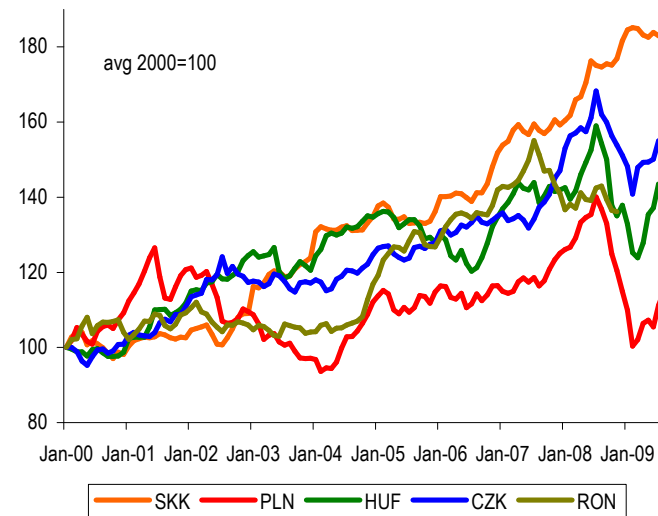
- Deleveraging creates a challenging environment for CEE currencies, though the worst is likely behind us. Local FX should remain supported as long as risk appetite is favorable, but it is definitely not a one-way trade. Intra-region, PLN remains our favorite currency.

Nominal Effective Exchange Rates



Source: Haver

CPI-Deflated Effective Exchange Rates



Source: BIS, Haver

EMU Watch: Inflation, Fiscal Deficits and Electoral Calendars Point to Delays

- Countries in CE vary widely in their attitude towards EMU. No country could make a serious bid for ERM2/EMU in the next few months, we think. Meeting the HICP criterion will be hard for most, but deficits may pose the main challenge; outside of Hungary, debt levels are contained but direction is worrying.

Central Europe: Compliance with Maastricht Criteria

	Budget Balance % GDP	Debt % GDP	Inflation, %Y	LT Interest rates, %
	2009 (E)	2009 (E)	latest	latest
reference value	-3.0	60.0	1.8	6.0
Czech Republic	-6.1	37.0	1.7	4.9
Hungary	-4.1	80.0	3.8	9.4
Poland	-6.5	51.5	3.9	6.1
Romania	-7.8	22.0	6.2	8.5

Deficit and Debt to GDP ratios are MS 2009 estimates and include costs of pension reform

HICP: reference value is avg of the three lowest HICP rates in the 12 months to September 09 + 1.5%

LT Int. rates: reference value is avg bond yield of the best-performing HICP countries +2%. NB Romania unofficial

Source: Haver, Morgan Stanley; E = Morgan Stanley estimates

Morgan Stanley Economic Forecasts

Czech Republic

	2006A	2007A	2008E	2009E	2010E	2011E
Real GDP	6.8	6.2	2.7	-4.5	1.3	2.8
Private Consumption	5.1	5.0	3.4	1.4	0.4	1.8
Gross Fixed Investment	6.0	10.9	-1.0	-7.5	-0.5	3.3
Exports	16.4	15.0	6.4	-13.4	1.6	5.0
Imports	14.3	14.4	5.4	-14.7	2.0	5.6
CPI Inflation (Annual Average)	2.5	2.9	6.4	1.0	1.4	2.1
Current Account Balance (% of GDP)	-2.4	-3.2	-3.1	-1.5	-1.3	-1.0
Trade balance (EURbn)	1.4	3.3	2.5	4.3	4.3	4.2
Govt. Budget Deficit (% of GDP)	-2.6	-0.6	-1.5	-6.1	-5.5	-4.9
Policy Interest Rate (% year end)	2.50	3.50	2.25	1.25	2.00	3.25
Exchange rate against EUR	27.8	26.5	26.9	26.0	24.6	23.3

Hungary

	2006A	2007A	2008E	2009E	2010E	2011E
Real GDP	3.9	1.3	0.7	-6.4	0.7	1.4
Private Consumption	1.9	-1.5	0.1	-4.5	-0.7	0.8
Gross Investment	0.5	3.4	2.0	-37.5	1.6	4.6
Exports	18.4	16.5	5.2	-12.3	2.5	5.0
Imports	15.0	13.5	5.1	-18.5	1.8	5.0
CPI Inflation (Annual Average)	3.4	7.8	6.1	4.3	3.9	3.0
Current Account Balance (% of GDP)	-7.5	-6.5	-7.2	-1.9	-2.5	-2.9
Trade balance (EURbn)	-2.4	-0.1	-0.4	4.3	4.9	0.2
Govt. Budget Deficit (% of GDP)	-9.2	-4.9	-3.4	-4.1	-4.3	-4.5
Policy Interest Rate (% year end)	8.00	7.50	9.50	6.00	6.00	6.00
Exchange rate against EUR	255.0	253.0	265.0	270.0	260.0	250.0

Poland

	2006A	2007A	2008E	2009E	2010E	2011E
Real GDP	6.2	6.8	5.0	1.4	2.8	2.2
HH Consumption	5.0	4.9	5.4	2.3	1.2	2.4
Investment	14.5	25.9	6.5	-13.1	5.3	7.7
Exports	15.0	9.2	7.4	-7.1	6.7	6.3
Imports	17.6	13.8	8.5	-15.4	5.6	8.0
CPI Inflation (Annual Average)	1.0	2.1	4.3	3.4	2.4	2.3
Current Account Balance (% of GDP)	-3.3	-4.7	-5.1	-1.3	-1.3	-1.3
Goods Trade balance (EURbn)	-5.5	-12.4	-17.7	-4.3	-3.4	-5.6
Govt. Budget Deficit (% of GDP)	-3.9	-1.9	-3.9	-6.5	-6.9	-5.5
Policy Interest Rate (% year end)	4.00	5.00	5.00	3.50	4.00	4.50
Exchange rate against EUR	3.80	3.60	4.15	4.10	3.70	3.50

Romania

	2006A	2007A	2008E	2009E	2010E	2011E
Real GDP	7.9	6.2	7.4	-7.8	1.2	1.3
Private Consumption	12.4	11.9	10.1	-8.8	2.3	2.0
Gross Fixed Investment	19.3	28.0	22.6	-15.2	-3.8	0.0
Exports	10.6	7.9	19.4	-13.7	0.5	7.3
Imports	22.4	27.9	18.3	-21.2	1.5	7.0
CPI Inflation (Average)	6.6	4.9	7.9	5.5	3.4	3.8
Current Account Balance (% of GDP)	-10.4	-13.5	-12.3	-5.0	-5.0	-6.5
Trade balance (EUR bn)	-11.8	-17.8	-18.2	-11.8	-12.3	-17.0
Govt. Budget Balance (% of GDP)	-2.2	-2.5	-5.4	-7.8	-6.5	-5.8
Policy Interest Rate (% year end)	8.75	7.50	10.25	8.00	6.50	6.00
Exchange rate against EUR	3.38	3.61	4.00	4.40	4.15	3.90

Source: Morgan Stanley forecasts

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