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## Country Profile: Poland

Thomas White Global Investing

June 2010

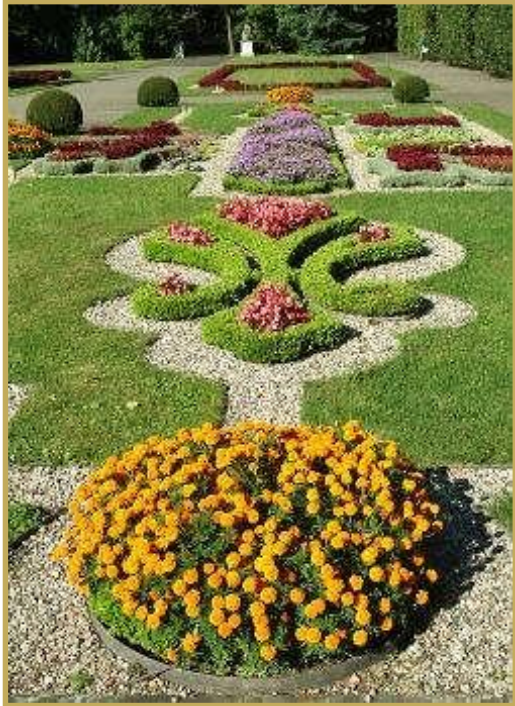
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A handwritten signature in dark blue ink, reading "James S. White, Jr." in a cursive script.

# Poland: The Small Wonder of Europe



Surrounding the 17<sup>th</sup> century Wilanow Palace in Warsaw, the 108-acre Palace garden is a splendid example of the gardening style of the period. The Wilanow Palace, known as the "Polish Versailles", and is a perfect fusion of European and traditional Polish architecture.

*Poland has not yet succumbed,  
As long as we remain,  
What the foe by force has  
seized,  
Sword in hand we'll gain*

**T**hese first four lines of the Polish national anthem adequately embody this ever so spirited country situated in the heart of Europe. They also reflect the tumultuous past and struggles of a country which has survived a legacy of violence, dominance, and aggression, interspersed with periods of freedom. The geometric center of the European continent, Poland enjoys a strategic location, well connected with cities like London, Paris, Vienna, and Berlin. The boundary between the eastern and western European continental masses also runs through Poland.

This diminutive country occupies 1.4% of the area of the European continent, with a population size 12% of the U.S. Yet, like the long-lived oaks that it has

nurtured for several centuries, Poland has always harbored towering ambitions. Home to 11 Nobel Prize winners including the revered Pope John Paul II, brilliant astronomer Copernicus, musical maestro Chopin, and renowned physicist Maria Curie, the country prides itself on its eclectic contributions to the world. Poland also symbolizes one of the most remarkable transitions from communism to a market-

based economy in modern time.

## **Turbulent yet triumphant**

The genesis of Poland, a country that has endured a strife-laden past, can be traced back to the 10th century. Poland has suffered aggression, division and partition of its territory on numerous occasions by Austrians, Prussians, Russians, and Germans. For nearly a century since 1795, it completely lost its existence as an independent entity. However, the indomitable Poles fought resolutely against foreign dominance throughout the 19th century. Following the Great War, Poland literally emerged from obscurity, regaining its identity as a separate country in 1918. Yet, World War II and German occupation proved to be the harbinger of fresh turmoil and violence in Poland. A case in point was the ghastly incident which left a deep scar on the moral

consciousness of a nation, known as the Katyn massacre. During April-May 1940, the Soviet secret police, on the orders of the politburo and Josef Stalin, murdered some 22,000 Polish nationals in the Katyn forest in Russia. The ensuing wartime struggle culminated in 1945 with the Soviet capture of Poland and a subsequent treaty between the USSR and Poland delimiting the Soviet- Polish frontier.

A Soviet-backed communist regime came to power in Poland after World War II. Successive agitations by the Poles for greater freedom were throttled by the communist hardliners wielding power. However, winds of change harbored a workers' movement in 1980, resulting in the formation of the Solidarity trade union. The government tried to suppress the movement, but eventually succumbed to the people's will. Partially free elections were held in 1989, which led to the formation of the first non-communist coalition government in Eastern Europe. Widespread success for Solidarity catapulted Lech Walesa, the trade union leader of humble origins, to the position of the first popularly elected President of Poland. Under the Polish constitution, as it stands currently, the President has fewer powers than the Prime Minister, but has a significant say in foreign policy. In the elections held in October 2007, the pro-Europe, Civic Platform party emerged triumphant with Donald Tusk assuming the Prime Minister's position.

### **Cultural Solidarity**

Poland's rich cultural heritage, which has evolved for over 1000 years, is a striking blend of both eastern and western influences. The country's amicable approach to inspirations from other parts of the world is reflected in the versatile character of its own art and culture. Polish traditions, art, dress, and cuisine span the whole spectrum of diverse European styles. While Polish literature dates back to the 14th century, the country also prides its contributions to avante garde literature and theater in the 20th century. At present, more than 98% of the nation's people are Poles, with small groups of Ukrainians, Belorussians, Germans, Slovaks, and Lithuanians. The Polish population is largely urban centric, with 60% of the population living in cities.

<b>Poland and the World</b>	
<i>Nominal GDP (\$)</i>	<i>527.9 billion</i>
<i>GDP Rank</i>	<i>18/191</i>
<i>Per Capita GNI</i>	<i>\$11,730</i>
<i>Per Capita GNI Rank</i>	<i>70/210</i>
<i>Population Rank</i>	<i>33/224</i>
<i>Geographical Area Rank</i>	<i>69/249</i>
<i>Global Competitiveness Rank</i>	<i>46/133</i>
<i>Economic Freedom Index Rank</i>	<i>71/179</i>
<i>Human Development Index Rank</i>	<i>41/182</i>
<i>Major Industries</i>	<i>Automotive, Aviation, White Goods, R&amp;D Center, BPO, Copper and Silver</i>

## No longer separated

The ushering of market-based reforms and large-scale privatization in 1990 heralded a new era of integration of Poland with the world economy. Despite being a victim of disorderly and fractious politics, Eastern Europe's largest democracy has been gradually but surely transformed into a potent force in the European sub-continent. A country with a painfully turbulent past, Poland secured membership in the North Atlantic Treaty Organization (NATO) in 1999, underscoring its commitment to peace and security in Europe. The country is also a member of the Organization of Economic Co-operation and Development (OECD), a body that is focused on strengthening democracy and the market economy. In 2004, Poland was extended membership in the European Union (EU). From an isolated existence, this little wonder of Europe has now taken momentous strides towards integrating itself into a globalized world.

## Emerging Europe's Radical Reformer

The journey of Poland's transition to a market economy since 1990 has been fraught with challenges and tribulations. As it embarked on this path, the erstwhile communist country was riddled with difficult macroeconomic conditions like hyperinflation, high unemployment, unsustainable budget deficits, burgeoning external debt, and an inefficient and archaic state



While many European and Asian countries are battling the burden of an aging demographic, Poland boasts that half its population falls below 35 years of age, a distinct advantage for a burgeoning economy.

sector. The *Leszek Balcerowicz Plan* of the early 1990s, named after the reformist Polish Finance Minister, ushered in an era of widespread economic reforms both on the domestic, as well as the external fronts of the country. Domestic prices that were earlier administered by the government, gradually became market determined and the Polish economy also opened up to the world. The Polish currency, *zloty*, became convertible to other currencies and its value was stabilized against the dollar. Currently, the country has a floating exchange rate regime, which is a step towards the goal of adopting the euro and

amalgamating with the European Monetary System between 2012-14. This fundamentally radical approach to reform has qualified Poland as the most dynamically developing European

country, worthy of the epithet “*the flying eagle of Europe*”.

The structural reforms have slowly but surely borne fruit. The economy, after growing at a reasonable rate of 4% since 1995, has witnessed a remarkable acceleration after accession to the EU. The country grew at 5.8% in 2006 and 6.5% in 2007, the fastest pace in a decade. The economy grew at the rate of 4.8% in 2008. Consumer prices, which hovered around 20% in 1996, had dramatically dropped to 1.3% in 2006. Despite global inflationary pressures, inflation continued to remain at a reasonable annual rate of 4.3% in April 2008. The unemployment rate also substantially declined to around 10% in 2007 compared to 20% in 2005. In addition, the government’s fiscal balance showed an upward trend.

In addition to robust growth rates, what sets Poland apart from its peers in Central Europe is the sound macroeconomic fundamentals the economy clearly enjoys. The country now boasts of moderate inflation rates, a restrained current account deficit, and fiscal balance.

### **A polish-ed destination**

An upper middle-income country, which ranks high on human development as well, Poland touts one of the most youthful and best educated societies in Europe. While many European countries are battling the burden of an aging demographic, Poland boasts that half its population falls below 35 years of age. Moreover, a large proportion of this young population has an inclination towards higher education. Augmenting its geographical natural advantage, Poland has successfully created a skilled human resources base, and has devised investor-friendly economic policies.

Hence it is not surprising that Poland offers a fertile ground for global corporations to set up their research and development centers, as well as manufacturing units. International corporations also view Poland as an excellent location for transferring non-production functions, resulting in Poland becoming the European center of modern Business Process Offshoring (BPO) services. This has helped Poland tackle the critical problem of unemployment. Given this, the economy is powered by its services sector, which contributes to about 64% of the gross domestic product (GDP).

The bulk of the country’s remaining output is devoted to industry. Located in the southeastern region of the nation, Poland’s *Aviation Valley* is famous for its aerospace industry and pilot training centers. The *Aviation Valley* produces 90% of Polish aerospace industry output, and highlights Poland’s 100-year experience in the aviation industry. Exporting to over 11 countries the world over, Poland aspires to transform this southeastern outpost into one of Europe’s leading aerospace regions.

The Polish automotive industry is also playing an increasingly important role in the emerging

economy, accounting for 10.2% of industrial production and 16% of total exports in 2006. One of the first sectors to be privatized in the early 1990s, the industry exports around 95% of its output, and specializes in the production of spare parts and accessories. The sector is also a magnet for global auto majors. Poland is luring these auto behemoths with low-cost, highly skilled labor, as well as a comprehensive network of subcontractors, many of them holding the highest certificates of quality.

In addition, Poland has proved to be an excellent location for foreign companies manufacturing domestic household appliances. Foreign investments have been pouring into this sector in the special economic zone (SEZ) at Lodz, the second largest centrally located city in Poland. Lodz has earned its title as the largest white goods production center in Europe.



Low-cost, highly skilled labor is the major factor driving the automotive industry in Poland.

Coal is the most abundant, as well as the cheapest fossil fuel in Poland, and is used predominantly for power production and energy generation in the country. Though not richly blessed with oil resources, Poland is home to a major European oil refiner, as well as a petroleum retailer who has the distinction of being Central Europe's largest publicly traded company. In the metals and mining sector too, Poland touts the second largest producer of silver and the sixth largest producer of copper in the world, exporting the world over. The country is also a pioneer in organic agriculture and a leading exporter of milk, meat, fruits and vegetables to EU members. In addition, Poland boasts of a globally recognized and flourishing yacht building industry, and is a favored destination for health tourism in Europe.

Poland is evolving as a leader in the capital markets, with Warsaw developing as the financial center in central and Eastern Europe. With the onset of the EU accession, the Warsaw Stock Exchange witnessed a spurt in market capitalization, increasing to 44% of GDP in 2006 compared to 31% of GDP in 2005. Marking a stage in the exchange's progress, the Nasdaq OMX, NYSE Euronext, and the London Stock Exchange have expressed interest in modernizing the Polish bourse's trading platform. The Polish exchange will announce the winner of the contract by July 2010. Apart from modernization, the exchange also wants a tie-up with one of these leading trading power houses. The exchange, currently, 98% owned by the state, tried to partially sell itself in 2009.

## **Holding up Against Recession**

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The Polish government under Prime Minister Donald Tusk was basking in the growth rate seen during 2006-2008 when the global financial crisis struck. The country escaped relatively unhurt by the crisis, making it the only EU member technically not in recession when it clocked a growth rate of 1.5% in 2009. However, unemployment rose due to the large number of migrant laborers returning from Western European nations hit hard by recession. Industrial production and exports stalled as demand slumped from many of Poland's trade partners. The Polish government stepped in immediately to control the damage, rolling out a \$31 billion stimulus program, which included loan guarantees and infrastructure spending. Notably, Poland, like South Korea, let its currency slide, while it discarded deficit-swelling policies of the U.K. and the U.S.

However, if Poland found itself better-off vis-à-vis some of the Euro-zone countries, it had better thank luck. A tight monetary policy implemented in the beginning of the decade kept an asset-price bubble under control, while the property boom was kept under check by a bureaucratic government. Moreover, tough banking regulation restrained the borrowing, especially in foreign currency, which bogged down Hungary during the financial crisis. Needless to say, Polish banks survived the crisis well, with most of the banks ending 2009 with profits. Thanks to the decrease in provisions for bad debts and an increase in interest income and fees, profits of banks are projected to increase by 30% in 2010. Overall, the economy is expected to expand by about 3% this year, which would make Poland the fastest growing country in the EU this year. Moreover, FDI inflow into Poland fell by only 16% year-on-year in 2009 to EUR8.4 billion. The downslide is significant when compared to the global capital flows, which fell about 40% during the year. As well, Poland's competitors the Czech Republic and Hungary, witnessed big drops in FDI flow, recording declines of -63% and -165% respectively.



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Poland did approach the IMF for a US\$20.5 billion loan in April 2009 despite a firm stance that its public finances were in robust health along with some of its neighbors such as the Czech Republic, Slovenia, and Slovakia. All these countries had low relatively low levels of public debt, under-control debt repayment options, and reasonably healthy banking systems. However, the point to be noted is that the no-strings attached IMF credit line is generally offered to most stable emerging-market states. Moreover, the size of the loan amounted to just 3.8% of Poland's 2008 GDP. Poland's decision to approach the IMF was likely driven by the need to strengthen

the position of the zloty by boosting the central bank's reserves and as a fallback option if the country found it difficult to tap credit markets later in the year.

But, Poland's central bank and the government seem to differ on the question of whether to ask the IMF to extend the credit facility, which will expire in May 2010. The bank seems to hold the view that Poland's currency reserves are large enough to protect its banking system and that macroeconomic conditions also do not warrant an extension of the facility. The government's take is that the credit line is needed amid the recent downgrades of Greece, Portugal, and Spain. The debate apart, the fact is that Poland's reserves stand at \$85.2 billion, far below those of many other emerging markets. Moreover, availing the facility would incur expenses of only about \$50 million a year, a pretty cheap way to get additional insurance.

However, the debt crisis which has engulfed the Euro-zone countries will further delay Poland's adoption of the common currency. The Polish government had to give up its 2012 target for euro adoption after the sovereign debt crisis drove up its budget deficit to more than 3% of the GDP allowed under the EU's Maastricht Treaty. It has been pointed out that 2015 now may be the earliest target by which Poland can hope to embrace the euro. On the political front too, the plans to adopt the euro have met with stiff resistance as the Opposition continues to stall the government's efforts to make the necessary amendment to the Constitution.

## **The Curse of Katyn**

Amidst Poland's current strides forward, the country received a major body blow on April 10, 2010, when a plane carrying Polish President Lech Kaczynski, the country's central bank governor, its army chief, several senior military officers, and some members of Parliament, crashed near the city of Smolensk in Russia, killing all 96 people on board. The Polish delegation was traveling to Russia to commemorate the 70<sup>th</sup> anniversary of the Katyn massacre. Kaczynski's death will not lead to any kind of political instability in Poland as the role of the president is mostly ceremonial, though the incumbent has the right to veto legislation and has a say in foreign policy. Polish parliament speaker Bronislaw Komorowski, the new acting president, a close ally of Prime Minister Donald Tusk, is seen to be the frontrunner in the presidential polls likely to be held in June 2010. In fact, the tragedy has served to strengthen the hands of reformist Prime Minister Donald Tusk. The late president was a staunch critic of the EU as well the Russian leadership under Vladimir Putin, and had backed Ukraine and Georgia against what he called Russia's "new imperialism." The slain central bank governor Slawomir Skrzypek also challenged Tusk's pro-market economic policies. Poland and Russia differ on various issues such as missile defense, NATO enlargement, and gas pipelines. Poland, a Soviet satellite during the Cold War, is now a member of the NATO and a close U.S. ally. The tragedy might help normalize the strained ties between the two Slavic nations as Putin personally reached

out to Tusk in Poland's hour of grief, and Russian President Dmitry Medvedev braved the closure of European air space caused by Iceland's volcanic ash cloud to attend Kaczynski's funeral.

## Quo Vadis: The road ahead

Witness to a troubled economic and political existence, Poland has indeed come a long way since 1990 when it commenced its transition to a democratic and market-based economy. Its growth performance after the EU accession in 2004 has seen a remarkable acceleration, and the process of catch-up with the higher-income countries seems to have gained fresh momentum. Today, Poland enjoys a well-balanced growth and robust demand, with only limited pressures on core inflation and the current account deficit.

Yet, this aggressively expanding country is not exempt from challenges.

The country has to counter emerging resource constraints, in particular, skilled labor shortages. The record-high capacity utilization rates and the pick-up in labor costs may impede the country's external competitiveness as well as its price stability.



The plane crash which killed the Polish president and the country's top brass may mark a new beginning in the relationship between Poland and Russia.

The country's notorious infrastructure, which consists of bad roads,

antiquated railways, and crumbling public buildings got a shot in the arm with some financial assistance from the European bloc. It was the European football authority's decision to make Poland along with the Ukraine the joint hosts of the 2012 Euro football championship which spurred the ruling politicians, including the football-loving Prime Minister Donald Tusk, into action. Half of the 20 billion euros budgeted for the construction of railways, hotels, and stadiums will come from the domestic tax payers, while the EU will contribute the rest. What is notable is that a private-sector enterprise is coordinating the construction works, seen to be better at project management than the civil service.

The political cold war between the late president Lech Kaczynski and Prime Minister Donald Tusk, who has only a razor-thin majority in Parliament, had delayed the signing of the Lisbon Treaty. Though Poland eventually signed the treaty, the country won an opt-out from the EU Chapter of Fundamental Rights, because it wanted to retain national control over family issues

and morality, such as abortion. Moreover, the Polish opposition parties allege that Tusk seems to be more interested in gearing up for the presidential polls to be held in June 2010 than in ruling the country.



Fundamental and far-reaching economic reforms have earned Poland the distinction of being one of the fastest growing economies in emerging Europe. The TPS tower in Warsaw is one of the many modern offices that represent the dynamically progressive face of Poland.

Unlike some of its neighbors in eastern Europe, Poland's government remains strong and stable. However, critics are quick to point out that in addition to its massive public relations exercises, the government should undertake reforms in bureaucracy, which has put the country to shame. Poland, for instance, falls 76<sup>th</sup> in the World Bank's rankings for ease of doing business, below Kazakhstan. Increasing corruption in government is something the country should watch out for as it moves forward. To give the Tusk government its due, it has undertaken limited reforms in health care, pensions, and labor market. Prime Minister Tusk recently said he hoped economic growth would help to reduce the budget deficit to about 6 percent of the GDP in 2010 from 6.3% of the GDP in 2009. The premier said the country plans to limit growth in discretionary public spending to 1% annually as part of a financial recovery plan. The prime minister also exuded confidence that the country would be able to reduce its deficit to 3% by 2013, a daunting task indeed.

However, for the feisty and unrelenting Poles, these challenges pose an opportunity, rather than an obstacle. Clearly, the Polish eagle seems poised to fortify its position as a formidable EU player in the globalized world. 🌐

[1]: *Quo Vadis*, (Latin for 'Where are you going?'), is a Polish historical novel, written in 1895 by the Nobel Prize winner Henryk Sienkiewicz.

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