

<p><b>Poland</b></p> <p><b>August 2018</b></p>	Kalina Dimitrova, Lead Economic Analyst <a href="mailto:k.dimitrova@bcra-bg.com">k.dimitrova@bcra-bg.com</a>
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SOVEREIGN RATING	Initial rating	Review
Date of Rating Committee	28.02.2017	09.08.2018
Date of Rating publication	10.03.2017	10.08.2018
Long-term rating	A- (ns)	A- (ns)
Outlook	Stable	Positive
Short-term rating	A-1 (ns)	A-1 (ns)

• (ns) – not solicited rating

**BCRA – CREDIT RATING AGENCY AD (BCRA)** is the third fully recognized rating agency in the EU, registered pursuant to Regulation No. 1060/2009 of the European Parliament and of the Council. The credit ratings, assigned by the BCRA are valid throughout the EU and are fully equal to those, of the other agencies, recognized by the European Securities and Markets Authorities, without any territorial or other limitations.

“BCRA - CREDIT RATING AGENCY” AD rates Poland with unsolicited sovereign long-term rating A- (ns) and short-term A-1 (ns) with positive outlook.

BCRA’s officially adopted Sovereign Rating Methodology has been applied ([https://www.bcra-bg.com/files/Sovereign\\_Methodology\\_2014\\_en.pdf](https://www.bcra-bg.com/files/Sovereign_Methodology_2014_en.pdf)).

The report has been prepared and the rating – assigned, based on public information, made available by the Central Statistical Office of Poland, National Bank of Poland, Ministry of Finance, the World Bank, the International Monetary Fund, the European Commission, BCRA’s database etc. BCRA uses sources of information, which it considers reliable, however it cannot guarantee the accuracy, adequacy and completeness of the information used.

## Overview

The **political situation** in Poland remains tense in mid-2018, with internal conflicts being reflected in the country's international relations. The ruling Law and Justice Party (PiS) has the support of its voters and a stable parliamentary majority.

The main political challenge that Poland faces in the first half of 2018 is the ongoing controversy around the new legislative act that lowers the statutory retirement age for judges from the Supreme Court. The main accusations against the ruling party and the new law are that the changes would politicize the Supreme Court, making it insufficiently independent from political influence and interests.

On the 2<sup>nd</sup> of July, the European Commission took the case to the European Court based on violation of human rights, rule of law and undermining democracy to which the Court responded by giving Poland one month to reverse the changes.

Poland has strong and resilient macroeconomic fundamentals. Following the real **GDP growth** of 4.6% in 2017, positive trends are well continued into early 2018. In the first quarter of the year, GDP increases by 5.2% in real terms compared to 4.4% in the corresponding quarter of 2017. Domestic demand remains the main growth driver. As a result of the ongoing gains in employment and wages, final consumption growth accelerates to 4.5%. Gross fixed capital formation marks a noticeable increase supported by the higher EU funds absorption. Besides fixed investment, the rise in inventories also has a positive contribution. In contrast, Poland's export and import growth decelerates significantly in the first quarter of the 2018, thus net exports generate negative contribution to GDP growth. The slowdown may be due to general deceleration in the Eurozone, the region's central trading partner. Exports growth decelerates to 1.1% (11.2% in Q1 2017), while imports incur more moderate deceleration to 3.5% (11.1% in Q1 2017) supported by the rising domestic demand.

External imbalances have been significantly reduced over the past years. In 2017, Poland records a positive **current account balance** (0.2% of GDP) for a first time since the mid-1990s. In the first quarter of 2018, the current account balance stands at EUR 378 mln, compared with a surplus of

EUR 2 047 mln reported in the first quarter of 2017. Lower overall balance in the period reflects the deficit on trade in goods and secondary income accounts, which both reported surpluses in the corresponding prior year period, as well as the increase in primary income deficit. The large surplus in trade in services increases, thus supporting the positive current account balance.

At the end of March 2018, **gross external debt** stands at EUR 318 129 mln or 65.7% of the projected GDP. The level of the **official reserves** is broadly adequate, ensuring about 5 months coverage over imports and 225% coverage of short-term external debt.

Price growth remains moderate and in line with the target set by the NBP (2.5 ± 1%). The average annual **inflation** (measured by RPI) in the last 12 months reaches 1.9% in June 2018.

The strong economic growth in 2017 is accompanied by further **labour market** tightening. Employment keeps expanding and the unemployment rate hits new record low. Given the low unemployment rate, a continued upskilling and further gains in labour force participation are crucial for the potential growth.

The statutory **retirement age** is reduced as it was planned. Starting October 1, 2017 men get the right to retire at 65 and women – at 60 (down from 67 for both sexes) despite the EC critics of discrimination. In upcoming years, this could unfavourably affect the achieved improvement on Polish labour market through the activity of population aged 60 and over.

The favourable real sector developments support country's **public finance** sustainability. The budget deficit of the general government sector narrows from EUR 10 004 mln (2.3% of GDP) in 2016 to EUR 7 740 mln (1.7% of GDP) in 2017. The country's 2017 budget deficit is one of the lowest in years, which is a result of an accelerated revenues' growth coupled with a relatively slow expenditures' growth.

Poland benefits from moderate public debt level and low financing costs. The **general government debt** (*EDP debt, part of the government finance Maastricht criterion*) decreases from 54.2% of GDP in 2016 to 50.6% at the end of 2017 as a result of accelerated nominal GDP growth, a lower budget deficit and appreciation of the zloty. Poland's debt

to GDP ratio is below the Maastricht treaty and well below than the average ratio for the European Union and the euro area.

At the end of the first quarter of 2018, **consolidated public debt** (according to domestic definition) stands at EUR 235 043 mln (48.1% of the projected GDP). Compared to the end of 2017 public debt increases by 2.8%.

The refinancing risk and interest rate risk are low. The average maturity of State Treasury debt remains stable at 5.06 years with foreign debt standing at a longer average maturity of 6.29 years. The absence of any drastic changes and volatile movements in the indicators points at a sustainable and well-maintained maturity structure, ensuring low refinancing risk to the economy and its debt.

In 2017, Polish banking sector remains stable and in support of the country's economic development. Assets in the system increase backed by the moderate credit growth. The non-performing share of the total credits remains relatively low indicating good asset quality although the impairments made to non-financial sector's loans and advances have recorded a slight increase through the year. At the same time, banks continue to be well capitalised with domestic deposits strengthening their capital position.

The changeability in generated profitability of the system remains a cause of concern about its future development. Potential sources of tense in the banking system could stem from external environment uncertainty as well as from internal legislative decisions and initiatives.

#### Outlook:

The **positive** outlook of the Sovereign Rating of Poland reflects the BCRA's opinion that the country has strong macroeconomic fundamentals and limited vulnerability to external shocks. Uncertainties stemming from government policies are expected to remain limited in medium term, as strong growth momentum supports the fiscal balance and debt metrics.

BCRA would consider **upgrading** the Sovereign Rating for Poland if:

- The country marks an improvement in its political situation, especially with respect to its international relations;
- The country continues to record high GDP growth;
- The government takes fiscal consolidation measures.

**Negative** pressures on the Sovereign Rating and the Outlook would be considered:

- Escalating conflicts with the European Union;
- Growing fiscal pressures streaming from the pension system reform;
- Institutional uncertainties leading to deterioration of the investment climate in the country.

## Regulatory announcements:

### Rating initiative

*This is an unsolicited sovereign rating. Neither the rated entity, nor a related third party has participated in the credit rating process. BCRA did not have access to the accounts, management and other relevant internal documents for the rated entity or a related third party.*

Please, visit [www.bcra-bg.com](http://www.bcra-bg.com) to review BCRA's full policy on unsolicited credit/sovereign ratings.

### Clarifying Notes:

There may be some differences in the stated values and changes in the analysed indicators due to the conversion of those values in another currency (namely in EUR). The used exchange rate is the publically announced by the National Bank of Poland as the average value for the corresponding period (i.e. yearly, quarterly, monthly). There may also be some differences stemming from using average values for the period rather than end-period values. The cited growth rates in the current report are based on changes in national currency, with the exception of data recorded in EUR (i.e. Balance of payments, External debt, Net international investment position). The data on which the current report is based includes the public data available until August 2018, with some exceptions, for which data is released more frequently.

## Summary of the minutes of the Rating Committee:

On the 9<sup>th</sup> of August 2018 Rating Committee of BCRA – CREDIT RATING AGENCY (BCRA) had a session, on which was discussed the **Report regarding the review of an unsolicited sovereign rating of Poland.**

The members of the Rating Committee discussed the grades of numerous credit rating factors included in the **Model for grading** and analysed in the **Credit Rating Report** according to the **Sovereign Rating Methodology.**

The members of the Committee commented on the current political situation in the country. Dynamics of the macroeconomic indicators, indicative for a favourable development of the economic system over the past six months (accelerated economic growth, balanced external sector, moderate inflation), was reviewed in detail. Consumption and investment are the main drivers of the generated economic growth that further supports the rising of employment and income of the population. The members of the Committee positively assessed the improvement in the country's public finance indicators. The sustainability of the banking system was also taken into account in the assessment.

**The current sovereign rating and the related outlook have been determined based on the above discussion.**

## Tables:

Country	Development classification						
Poland	Emerging and Developing Europe (IMF classification)						
<b>MAIN MACROECONOMIC INDICATORS</b>							
	2018 Q1	2017 Q1	2017	2016	2015	2014	2013
Gross domestic product (EUR mln)	116 095	105 612	465 539	426 010	430 075	410 917	394 734
Final consumption	94 458	86 637	354 862	325 589	328 732	321 304	312 120
Gross fixed capital formation	14 110	12 480	82 281	76 793	86 400	81 093	74 257
Changes in inventories	3 883	1 785	9 153	6 380	1 594	2 556	627
Exports of goods and services	63 953	60 992	251 532	222 670	212 977	195 544	182 840
Imports of goods and services	60 308	56 297	232 356	205 450	199 669	189 621	175 151
Real GDP growth (%)	5.2	4.4	4.6	3.0	3.8	3.3	1.4
Unemployment rate <sup>1</sup> (%)	4.2	5.4	4.9	6.2	7.5	9.0	10.3
Average monthly nominal gross wage (EUR)	1 106	1 007	1 019	944	948	917	883
GDP per capita (current prices; EUR)	-	-	12 259	11 200	11 200	10 700	10 300
Annual average inflation rate (RPI; %)	1.9	1.7	2.0	-0.6	-0.9	0.0	0.9
PLN/USD - period average exchange rate	3.40	4.06	3.78	3.94	3.77	3.16	3.16
PLN/EUR - period average exchange rate	4.18	4.32	4.26	4.36	4.18	4.19	4.20
<b>EXTERNAL SECTOR</b>							
	2018 Q1	2017 Q1	2017	2016	2015	2014	2013
<i>EUR mln</i>							
Current account	378	2 047	896	-1 254	-2 405	-8 534	-5 031
Goods	-888	655	821	2 935	2 213	-3 255	-335
Services	4 583	4 164	18 598	14 075	10 911	9 059	7 646
Primary income	-3 122	-2 828	-18 417	-16 864	-14 683	-13 961	-11 915
Secondary income	-195	56	-106	-1 400	-846	-377	-427
Capital account	1 364	617	5 899	4 472	10 158	10 034	9 006
Gross external debt	318 129	322 932	316 839	318 956	303 120	293 510	278 948
NIIP	-281 910	-276 986	-289 864	-255 178	-262 306	-278 766	-275 431
Official reserve assets	96 913	104 706	94 550	108 064	86 894	82 645	77 144
<i>% of GDP<sup>2</sup></i>							
Current account	0.1	0.4	0.2	-0.3	-0.6	-2.1	-1.3
Goods	-0.2	0.1	0.2	0.7	0.5	-0.8	-0.1
Services	0.9	0.9	4.0	3.3	2.5	2.2	1.9

Primary income	-0.6	-0.6	-4.0	-4.0	-3.4	-3.4	-3.0
Secondary income	0.0	0.0	0.0	-0.3	-0.2	-0.1	-0.1
Capital account	0.3	0.1	1.3	1.0	2.4	2.4	2.3
Gross external debt	65.7	69.4	68.1	74.9	70.5	71.4	70.7
NIIP	-58.2	-59.5	-62.3	-59.9	-61.0	-67.8	-69.8
Official reserve assets	20.0	22.5	20.3	25.4	20.2	20.1	19.5
<b>PUBLIC FINANCE</b>							
	<b>2018</b>	<b>2017</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>
	<b>Q1</b>	<b>Q1</b>					
<i>EUR mln</i>							
General government revenues	49 274	42 783	184 147	165 223	167 384	158 764	151 901
General government expenditures	46 165	41 927	191 887	175 227	178 768	173 659	168 136
General government budget balance	3 110	856	-7 740	-10 004	-11 384	-14 895	-16 235
General government gross debt	244 508	240 150	240 566	227 528	215 860	202 764	222 501
<i>% of GDP<sup>2</sup></i>							
General government revenues	10.0	9.3	39.6	38.8	38.9	38.6	38.5
General government expenditures	9.4	9.1	41.2	41.1	41.6	42.3	42.6
General government budget balance	0.6	0.2	-1.7	-2.3	-2.6	-3.6	-4.1
General government gross debt	50.0	51.1	50.6	54.2	51.1	50.3	55.7
<b>BANKING SECTOR</b>							
	<b>2018*</b>	<b>2017</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>
	<b>Q1</b>	<b>Q1</b>					
<i>EUR bln</i>							
Total assets	-	409.8	426.0	385.7	374.3	358.8	338.7
Deposits from the non-financial sector	-	238.8	254.7	230.8	219.0	199.2	186.0
Credits to the non-financial sector:	-	240.6	249.4	227.8	224.5	209.4	201.5
Impairment on credits to the NFS	-	9.1	9.5	8.6	9.1	9.3	9.5
Profit or loss for the year	-	0.7	3.3	3.1	3.0	3.7	3.7
<i>%</i>							
Total capital ratio	18.9	17.9	19.0	17.7	16.5	15.2	-
Impairment on credits to NFS (% of total credits)	-	3.8	3.8	3.8	4.1	4.5	4.7
Liquidity	-	21.6	21.5	21.6	20.1	20.6	21.4
ROA	-	0.8	0.8	0.8	0.8	1.1	1.1
ROE	-	8.7	8.2	9.2	9.1	12.3	12.1

\* Due to the practical implementation of the International Financial Reporting Standard (IFRS9) effective from January 1, 2018, the National Bank of Poland is yet to publish the 2018 balance sheet and profit and loss reports.

[1] Eurostat data – LFS for population aged 15-74.

[2] 2018 data are calculated on the basis of GDP amounting to PLN 2 057 200 mln (MoF estimate).

Source: Central Statistical Office of Poland, National Bank of Poland, Ministry of Finance, the World Bank, the International Monetary Fund, the European Commission, BCRA's database