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Poland

August 2019

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SOVEREIGN RATING	Initial rating	Review	Review	Review
Date of Rating Committee	28.02.2017	09.08.2018	07.02.2019	02.08.2019
Date of Rating publication	10.03.2017	10.08.2018	08.02.2019	09.08.2019
Long-term rating	A- (ns)	A- (ns)	A (ns)	A (ns)
Outlook	Stable	Positive	Stable	Stable
Short-term rating	A-1 (ns)	A-1 (ns)	A-1 (ns)	A-1 (ns)

- (ns) – not solicited rating

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

BCRA's officially adopted Sovereign Rating Methodology has been applied (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.

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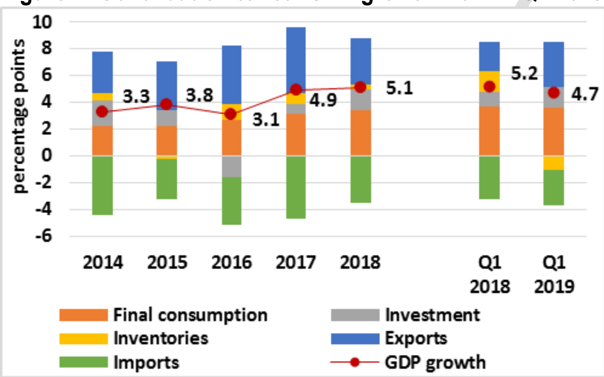
Overview:

Poland has faced the **political** challenge of serious controversy related to their latest legislative initiatives in the field of judiciary. Since taking office, the ruling party (PiS) has conducted a series of disputable reforms that have undermined the country's democratic institutions and worsened the relationship with the EU. The main accusations have been that the changes in the *Law on the Supreme Court* would politicize the institution, making it insufficiently independent from political influence and interests. In July 2019, the Court of Justice of the EU ruled that the Polish *Law on the Supreme Court* breaches the judicial independence. The European Commission now (as of July 2019) attacks the *Law on Ordinary Courts* launching another infringement procedure against the country concerning Rule of Law aiming at protecting *judges in Poland from political control.* However, the ruling party has a stable parliamentary majority and the support of its voters, which was confirmed by the results of the European Parliament election in May 2019.

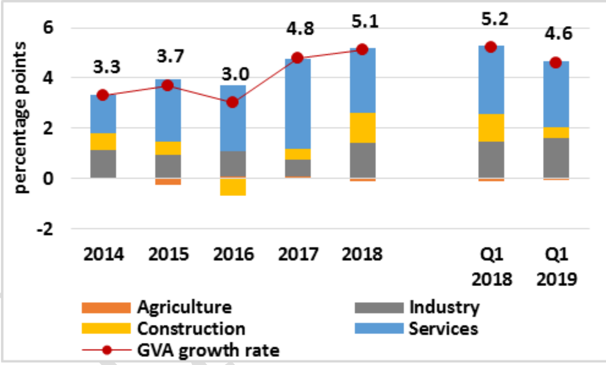
Figure 1: Contribution to real GDP growth: 2014 – Q1 2019



Source: Central Statistical Office of Poland

Poland's **economy** has been expanding robustly since 2014, recording an average growth rate of 4% over the last five years. Driven by strong domestic demand, real GDP growth accelerated to 5.1% in 2018, which was the third-highest rate recorded in the EU and the highest rate since 2007. Economic growth in the first quarter of 2019 remained strong, albeit modestly decelerating to 4.7% from 5.2% in the corresponding quarter of 2018. Consumption remained the key growth driver, whereas both private and public consumption made positive contributions. Thanks to the buoyant labour market performance, households' consumption expanded by 3.9% in real terms (4.6% in Q1 2018). Investment, supported by an increasing utilisation of EU funds, picked up markedly - by 12.6% on an annual basis. In contrast, inventories dragged down the GDP growth in this period. Real growth of exports accelerated to 5.3% (from 3.8% in Q1 2018), while imports growth slowed down to 5% (from 6.1% in Q1 2018), thus, net exports had a positive effect on economic expansion in the first quarter of 2019.

Figure 2: Contribution to real GVA growth: 2014 – Q1 2019



Source: Central Statistical Office of Poland

On the supply side, **gross value added** (GVA) picked up by 4.6% YoY in Q1 2019. Value added growth was predominantly generated by services with the highest contributions coming from trade, transportation, as well as financial and insurance activities. Supported by strong domestic demand, growth in industry *(excl. construction)* accelerated to 5.9%. Concurrently, the positive contribution of the construction sector was markedly lower as its annual growth rate decelerated to 8.5% from 24.7% in the first quarter of 2018.

External trade lost some momentum in 2018 but remained overall robust. The growth of Poland's exports of goods in 2018 was limited due to increased uncertainty related to global trade tensions and Brexit as well as the slowdown of economic activity in the EU. Traditionally Poland trades most actively with the other EU member states. In 2018, the relative share of goods exports to the EU picked up by 0.3 pp. to 80.4% of total exports, while the share of imports from the EU dropped by 2.2 pp. to 58.3% of total imports. The top export destinations of Poland in 2018 were Germany (28.2%), Czechia (6.4%), the United Kingdom (6.2%) and France (5.5%), while top import origins included Germany (22.4%), China (11.6%), Russia (7.4%) and Italy (5%). Given the UK's considerable share in Poland's foreign trade

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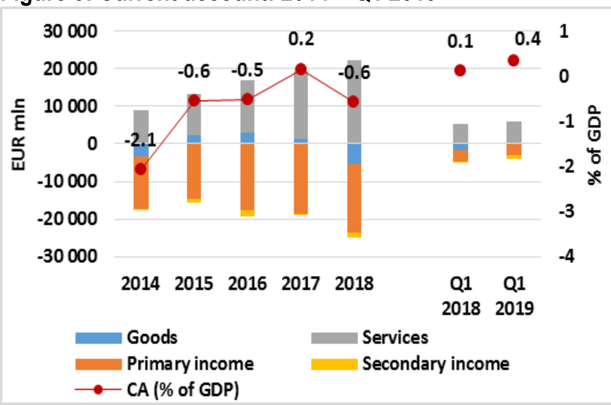
turnover, a no-deal Brexit represents a significant external risk, which could negatively impact Poland's trade and financial flows.

In the first quarter of 2019, the nominal growth of exports slightly accelerated to 7% from 6.7% in the same prior-year period, while imports of goods picked up by a decelerated rate of 4.1% (11% in Q1 2018). In terms of commodity groups, higher annual growth was recorded in exports of intermediate and capital goods, while exports of consumer goods slowed down compared to Q1 2018. At the same time, a slower dynamic was observed in all broad economic categories on the imports' side.

The **exchange rates** of the zloty against the major currencies remained broadly stable over the first half of 2019, reflecting the strong performance of the Polish economy.

Figure 3: Current account: 2014 – Q1 2019

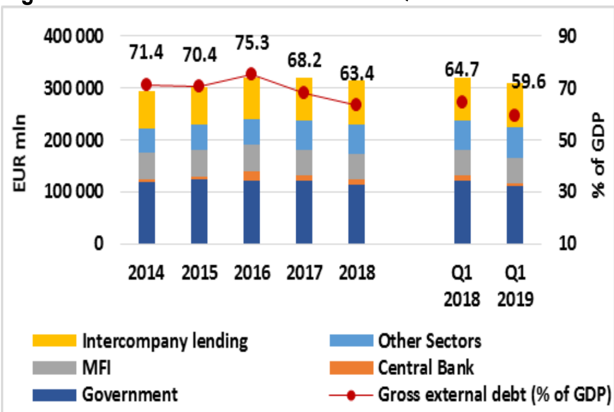


Source: National Bank of Poland

The **current account** balance has improved considerably in recent years, reaching a modest surplus of 0.2% of GDP in 2017. In 2018, the current account has shifted to a small deficit of EUR 2 882 mln or 0.6% of GDP, mainly due to a deterioration in the balance of trade in goods. Concurrently, the large services surplus picked up to 4.5% of GDP, while the primary income deficit (3.7% of GDP in 2018), continued to have the greatest negative impact on the external balance.

In Q1 2019, the current account recorded a positive balance of EUR 1 832 mln (0.4% of the projected GDP), increasing by EUR 1297 mln compared to the corresponding period of 2018. The higher current account surplus reflected primarily the improvement in the goods balance. Exports growth in the first quarter of 2019 exceeded the growth rate of imports, which resulted in a surplus of EUR 327 mln on trade in goods, compared to a deficit of EUR 1 567 mln in the same prior-year period.

Figure 4: Gross external debt: 2014 – Q1 2019

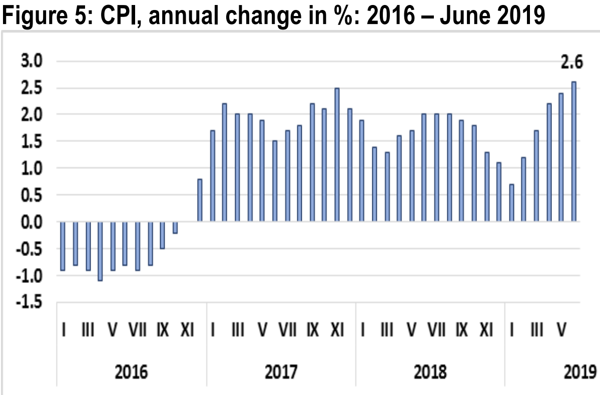


Source: National Bank of Poland

External debt remains elevated, but rollover risk is low. Gross external debt at the end of March 2019 amounted to EUR 309 876 mln (59.6% of the projected GDP), decreasing by EUR 4 662 mln compared to the end of 2018. The external debt reduction in the period was prompted by the public debt while the private sector debt recorded an increase. The level of the **official reserves** is broadly adequate, covering almost 5 months of imports or 247.7% of short-term external debt.

In addition, Poland's external vulnerabilities are limited by stable long-term capital inflows in form of EU structural funds and foreign direct investments which are reflected in the negative **net international investment position** (-53% of the projected GDP as of Q1 2019) of the Polish economy.

Figure 5: CPI, annual change in %: 2016 – June 2019



Source: Central Statistical Office of Poland

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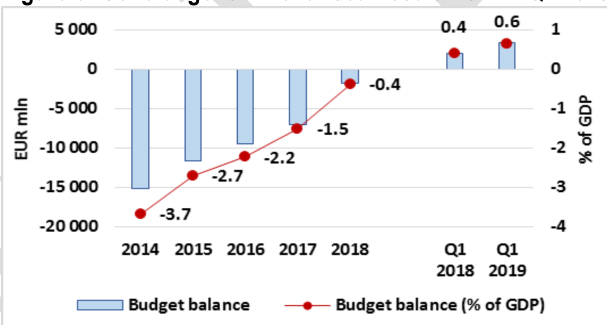
Despite the tight labour market and strong consumption growth, **inflation** pressures in 2018 remained subdued. Following a decline over the last months of 2018, annual consumer price growth accelerated to 2.6% in June 2019 - exceeding the 2.5% NBP target but remaining within the tolerance band. Inflation in the first half of 2019 was largely driven by higher food and services prices, while the increase of energy prices remained relatively low. Upward pressure on prices in the coming quarters are likely to stem from stronger wage growth. However, inflation is expected to remain moderate and a monetary tightening seems unlikely in the medium-term. The NBP **key interest rate** has been kept unchanged at 1.50% since March 2015.

Labour market performance remains favourable in terms of record low unemployment rate (3.9% for 2018 and the same unadjusted value for Q1 2019) and strongly growing wages. The number of unemployed halved in the last three years (to 659 thousand in 2018 and 666 thousand in Q1 2019). Employment on its part turned downward in Q1 2019 after a prolonged period of growth as *Financial and insurance activities* and *Public administration* were the economic sectors that posted increase in the number of employed. Given the low unemployment rate, a continued upskilling and further gains in labour force participation are crucial for the potential growth.

Average monthly net wage picked up by 7.0% in 2018 and by 7.1% YoY as of Q1 2019 owing to rises across all the sectors, and amounted to ~EUR 1076. Disposable income of employed in Poland is expected to increment in the course of 2019 and 2020 due to fiscal measures and policies such as envisaged income tax exemptions (for people aged under 26), as well as this year minimum wage hike effective from January 1st. In 2018, Polish **GDP per capita** (EUR 12 900) reached 42% in euros and 71% in PPS of the EU-average.

The robust macroeconomic performance supports country's **public finance** sustainability. In 2018, the **general government budget deficit** decreased to a historically low level of 0.4% of GDP, from 1.5% of GDP in 2017. Fiscal result in 2018 was much better than the initially planned (-2.7% of GDP) due to strong nominal GDP growth and improved tax collection. Revenues in the general government budget increased by 10.3% on an annual basis to 41.2% of GDP (39.7% of GDP in 2017), while spending increased at a more moderate rate of 7.2%, reaching 41.5% of GDP in 2018 (41.2% of GDP in 2017). Collections from personal income tax, corporate income tax and social security contributions grew strongly in 2018, reflecting the good situation on the labour market. Indirect tax revenues were also on the rise driven by the high growth in private consumption as well as by the tightening of the tax system. The increase of expenditure in 2018 was mainly a result of the significant acceleration in public investment, which picked up at a double-digit rate of 31.5%. At the same time, interest payments declined by 2.3% on an annual basis, falling to 1.4% of GDP in 2018.

Figure 6: General government fiscal result: 2014 – Q1 2019

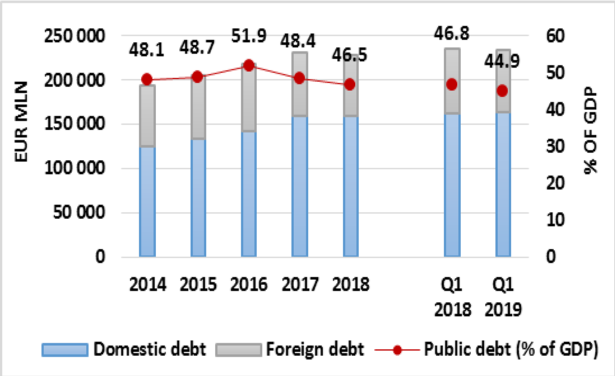


Source: Ministry of Finance

In January – March 2019, total budget revenues grew by 9.0% on an annual basis exceeding the expenditures' growth rate of 6.3%. As a result, the general government sector recorded a surplus in the amount of EUR 3 360 mln as against EUR 2 033 mln in the first quarter of 2018. The budget plan for 2019 envisages a deterioration of the headline deficit to 1.7% of GDP. The higher fiscal deficit would be driven mainly by the increase in social transfers, related to the extension of the child benefit program (Family 500+) to all children, as well as by an extraordinary pension benefit to be paid in 2019. The exension of Family 500+ programme, as from mid-2019, is expected to cost round 0.4% of GDP in 2019 and have a full-year effect in the ammount of 0.8% of GDP in 2020.

Poland's **government debt**-to-GDP ratio is on a declining path. After its increase to 54.2% of GDP in 2016, the general government debt (EU definition) dropped to 48.9% of GDP at the end of 2018, supported by a combination of strong GDP growth and continuous fiscal balance improvement. According to the last Convergence Programme, general government debt is expected to further decrease to 40.6% of GDP at the end of 2022.

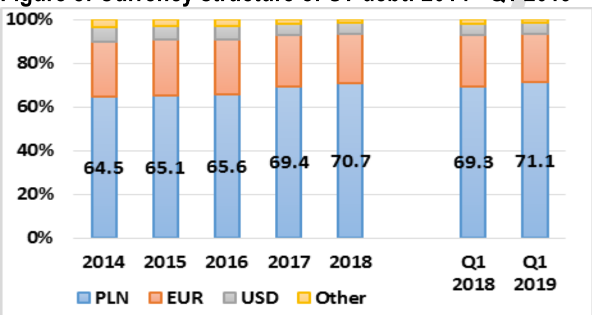
Figure 7: Consolidated public debt (domestic definition): 2014– Q1 2019



Source: Ministry of Finance

At the end of March 2019, consolidated public debt (domestic definition) stood at EUR 233 711 mln or 44.9% of the projected GDP. Compared to the end of 2018 public debt rose by EUR 4 799 mln (2.1%) in nominal terms. Domestic debt, according to the place of issue, constituted the dominant part in public debt structure with a share of 70.3%, up by 0.3 pp. compared with the end of 2018.

Figure 8: Currency structure of ST debt: 2014 –Q1 2019



Source: Ministry of Finance

During the first quarter of 2019, the share of foreign currency debt in total State Treasury debt further decreased to 28.9% from 29.3% at the end of 2018. The level of foreign currency debt is compliant with the target (<30%) of the debt management strategy, however, the public debt still remains relatively sensitive to exchange rate fluctuations.

The average time to maturity of State Treasury debt picked up to 5.1 years as of Q1 2019, whereas foreign debt recorded a longer average maturity of 6.3 years. The absence of any drastic changes and volatile movements in these indicators points at a sustainable and well-maintained maturity structure, ensuring low refinancing risk.

Banking sector has key importance for the financial system in Poland. It is characterized by ongoing reshaping and faster reduce the number of foreign controlled banks while total assets further grow. There was, however, notable differences in banks performance, which contributed to the 2018 decline in banks' aggregated profit reported for the second consecutive year.

After the 2017 delay in deposit growth, the non-financial sector savings at Polish banks accelerated again in 2018 and in early 2019, with current deposits being preferred to term ones. Credit growth remains moderate, close to the nominal GDP growth, hence, risks of excessive lending in the system are low. It is still being supported by the stable low interest rate levels and favourable macroeconomic environment. Polish banking system maintains healthy asset quality and its capital position remains solid. Financial problems in individual institutions remain challenging in 2019 as well as possible changes in regulatory funds or tensions in external financial environment.

Outlook:

The **stable outlook** of the Sovereign Rating of Poland reflects the BCRA's opinion that the risk are broadly balanced. Poland has a large-scale and well-diversified economy with strong fundamentals. The vulnerability to external shocks is expected to remain relatively low despite country's reliance on capital inflows. Strong growth momentum supports the fiscal balance and debt metrics. Tensions with the EU are expected to remain constrained.

Positive pressures on the Sovereign Rating and the Outlook may arise in case of:
- Stronger than anticipated fiscal results, lowering the public debt to GDP ratio;
- Further reduction in external imbalances;
- Strengthened banking system performance.

Negative pressures on the Sovereign Rating and the Outlook would be considered:
- Deterioration in the fiscal position;
- Deterioration of the investment climate in the country and capital outflows;
- Escalating tensions with EU institutions;
- Materialisation of risks related to no-deal Brexit.

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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 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 2019, with some exceptions, for which data is released more frequently.

Summary of the minutes of the Rating Committee:

On the 2th of August 2019 Rating Committee of BCRA – CREDIT RATING AGENCY (BCRA) had a session, on which the **Report regarding the affirmation of an unsolicited sovereign rating of Poland** was discussed**.**

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 considered the current political situation in the country as well as their relations with the EU. Levels and dynamics of main macroeconomic metrics, indicative for a favourable development of the economic system (stable economic growth, moderate inflation, low unemployment), were positively assessed. The state and potential risks associated with the external sector were viewed. The members of the committee considered the main elements of the country's fiscal policy and their practical implementation.

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

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Tables:

Country	Development classification
Poland	Emerging and Developing Europe (IMF classification)

BASIC MACROECONOMIC INDICATORS							
	2019 Q1	2018 Q1	2018	2017	2016	2015	2014
Gross domestic product (EUR million)	120 876	116 520	496 369	467 238	426 616	430 275	411 075
Final consumption	96 845	94 378	376 860	355 099	325 835	328 932	321 462
Gross fixed capital formation	16 075	14 376	90 260	82 751	76 793	86 400	81 093
Changes in inventories	2 612	3 843	12 177	10 602	6 739	1 594	2 556
Exports of goods and services	69 986	65 979	274 539	253 889	222 670	212 977	195 544
Imports of goods and services	64 682	62 057	257 563	234 348	205 450	199 669	189 621
Real GDP growth (%)	4.7	5.2	5.1	4.9	3.1	3.8	3.3
Unemployment rate[1] (%)	3.9	4.2	3.9	4.9	6.2	7.5	9.0
Average monthly nominal gross wage (EUR)	1 150	1 106	1 076	1 006	929	934	902
GDP per capita (current prices; EUR)	3 100	3 000	12 900	12 200	11 100	11 200	10 700
Annual average inflation rate (RPI; %)	1.7	1.3	1.7	2.0	-0.6	-0.9	0.0
PLN/USD - period average exchange rate	3.79	3.40	3.61	3.78	3.94	3.77	3.16
PLN/EUR - period average exchange rate	4.30	4.18	4.26	4.26	4.36	4.18	4.19
EXTERNAL SECTOR							
EUR million	2019 Q1	2018 Q1	2018	2017	2016	2015	2014
Current account	1 832	535	-2 882	715	-2 248	-2 405	-8 534
Goods	327	-1 567	-5 179	1 426	2 935	2 213	-3 255
Services	5 668	5 424	22 227	17 956	13 963	10 911	9 059
Primary income	-3 076	-3 094	-18 520	-18 541	-17 746	-14 683	-13 961
Secondary income	-1 087	-228	-1 410	-126	-1 400	-846	-377
Capital account	877	1 362	10 126	5 894	4 472	10 158	10 034
Gross external debt	2 412	2 296	2 408	2 657	1 116	1 265	873
International investment position, net	-275 475	-285 285	-276 736	-290 850	-259 036	-262 306	-278 766
Official reserve assets	100 738	96 913	102 268	94 550	108 064	86 894	82 645
% of GDP							
Current account	0.4	0.1	-0.6	0.2	-0.5	-0.6	-2.1
Goods	0.1	-0.3	-1.0	0.3	0.7	0.5	-0.8
Services	1.1	1.1	4.5	3.8	3.3	2.5	2.2
Primary income	-0.6	-0.6	-3.7	-4.0	-4.2	-3.4	-3.4
Secondary income	-0.2	0.0	-0.3	0.0	-0.3	-0.2	-0.1
Capital account	0.2	0.3	2.0	1.3	1.0	2.4	2.4
Gross external debt	59.6	64.7	63.4	68.2	75.3	70.4	71.4
International investment position, net	-53.0	-57.5	-55.8	-62.2	-60.7	-61.0	-67.8
Official reserve assets	19.4	19.5	20.6	20.2	25.3	20.2	20.1

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PUBLIC FINANCE							
EUR million	2019 Q1	2018 Q1	2018	2017	2016	2015	2014
General government revenues	51 583	48 736	204 360	185 501	165 828	167 665	159 132
General government expenditures	48 223	46 703	206 234	192 642	175 367	179 305	174 273
General government budget balance	3 360	2 033	-1 874	-7 141	-9 539	-11 641	-15 141
General government gross debt	245 243	245 100	240 553	241 128	228 132	216 651	203 492
Public debt	233 711	235 057	228 912	230 608	218 173	205 862	193 974
External (% of public debt)	29.7	31.3	30.1	31.1	34.7	35.0	35.3
Domestic (% of public debt)	70.3	68.7	69.9	68.9	65.3	65.0	64.7
% of GDP[2]							
General government revenues	9.9	9.6	41.2	39.7	38.9	39.0	38.7
General government expenditures	9.3	9.2	41.5	41.2	41.1	41.7	42.4
General government budget balance	0.6	0.4	-0.4	-1.5	-2.2	-2.7	-3.7
General government gross debt	47.2	48.8	48.9	50.6	54.2	51.3	50.4
Public debt	44.9	46.8	46.5	48.4	51.9	48.7	48.1

BANKING SECTOR							
EUR million	2019 III	2018* III	2018*	2017	2016	2015	2014
Total assets	450 577	430 796	438 863	425 998	385 621	374 275	358 790
Profit or loss for the year	681	799	3 090	3 278	3 134	3 001	3 722
Deposits from the non-financial sector	270 197	251 291	267 718	254 733	230 814	219 032	199 248
Credits to the non-financial sector	256 870	246 296	251 905	249 410	227 788	224 463	209 385
Impairment on credits to the NFS	10 178	11 305	9 873	9 534	8 632	9 115	9 327
Impairment on credits to NFS (% of total credits)	4.0	4.6	3.9	3.8	3.8	4.1	4.5
Own funds	48 069	47 499	47 374	47 386	39 668	37 562	34 062
Total risk exposure amount	253 482	251 849	248 843	249 954	223 837	228 134	223 413
Capital adequacy (%)	19.0	18.9	19.0	19.0	17.7	16.5	15.2
ROA[3] (%)	0.7	0.8	0.7	0.8	0.8	0.8	1.1
ROE[3] (%)	6.3	7.3	6.5	7.1	7.7	7.5	10.0

** Starting January 1, 2018, implementation of the IFRS 9 influenced the values of some financial indicators, so there is not full comparability with the preceding time periods.*

[1] Eurostat data – LFS for population aged 15-74.
[2] 2019 data are calculated on the basis of GDP amounting to PLN 2 236 500 mln (MoF estimate).
[3] Data are calculated by means of the Trailing twelve months (TTM) method.

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