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# Poland

## February 2018

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| SOVEREIGN RATING | Initial rating | Review |
|---|---|---|
| Date of Rating Committee | 28.02.2017 | 15.02.2018 |
| Date of rating publication | 10.03.2017 | 16.02.2018 |
| Long-term rating | A- (ns) | A- (ns) |
| Outlook | Stable | Stable |
| 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 stable outlook.**

**BCRA's officially adopted Sovereign Rating Methodology has been applied (http://www.bcra-bg.com/files/file_330.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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The political situation in Poland remains tense in the second half of 2017, 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 party, however, continues with attempts to pass controversial legislative acts regarding the country's judicial system, which have been provoking protest actions in society.

Some changes in the Polish government occurred after the resignation of Prime Minister Beata Szydło from December 7, 2017. Mateusz Morawiecki, who had served as Deputy Prime Minister, Minister of Development and Minister of Finance so far replaced Szydło at the head of the cabinet. In the beginning of 2018, the new prime minister made significant changes in the cabinet, trying to improve relations with the EU partners and signalling for more pragmatism in the country's future policy.

The ongoing governmental reforms concerning the country's justice system, which are aimed at improving slow and inefficient courts, continue to provoke criticism from the opposition as well as from parts of civil society in Poland and the European institutions. The laws already adopted by PiS allow power control over the composition of the council that manages the magistrates and the new powers for the appointment of supreme judges and presidents of ordinary courts. Brussels sets out these changes in legislation as a threat to the independence of the judiciary because the so-called reform puts it in direct political dependence on the executive power, thus, abolishing the separation of powers.

Therefore, on the 20 of December 2017, “despite repeated efforts, for almost two years, to engage the Polish authorities in a constructive dialogue in the context of the Rule of Law Framework”, the Commission proposed to the Council to adopt a decision under Article 7(1) of the Treaty on European Union. The action is unprecedented and the procedure is triggered for the first time in the EU's history. However, the EC remains open to talks with the Polish authorities and is able to withdraw its proposal by setting out clear steps that they could take to correct the current situation.

Taking the final measure under the EC procedure - the vote on withdrawing Poland's voting rights within the EU - could cause some tension both at national and at EU level. Yet, the support for the ruling party in Poland continues to grow.

Poland has strong and resilient macroeconomic fundamentals. Following the real GDP growth of 2.9% in 2016, positive economic trends are continued during 2017, as the GDP growth for the first nine months of the year accelerates to 4.3% compared to 2.9% in the corresponding period of 2016. Supported by labour market tightening and rise in wages as well as higher social transfers, private consumption is the main growth driver of the economy. The decline in the absorption of EU structural funds led to an adverse effect on investment growth in 2016, but in the second half of 2017 the investment activity starts to rebound. Owing to domestic demand-driven pressures on the imports side, net exports contribution to GDP growth is almost neutral.

Sectoral decomposition of GDP growth indicates that economic growth encompasses almost all sectors, as confirmed by significantly positive contributions of services, industry and construction to GDP growth.

Poland trades most actively within the EU. In the period January-October 2017, EU member states account for 79.7% of country's exports and 60.2% of country's imports. Germany is the leading trade partner of Poland with over a fourth of all exports and more than a fifth in country's imports. Other EU-members, with considerable shares in country's international trade are Czech Republic, United Kingdom, Italy, France and The Netherlands. China and Russia are among the top import origins of the country.

Although the shares for most trade partners are stable in recent years, an important factor that should be considered is the Brexit. The stemming effects from the upcoming process of separation may have a palpable negative impact on Polish economy, given the considerable share of said leaving member in the country's trade relations.

The depreciation trend of the Polish zloty was interrupted in January 2017, as the national currency started to appreciate gradually against both the US dollar and the euro supported by country's robust economic performance, a relatively tight monetary policy stance and an improved current account balance.

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External imbalances have been significantly reduced over the past years contributed by better terms of trade and low oil prices. In 2016 current account deficit narrowed to 0.3% of GDP. Current account surplus recorded in the first eleven months of 2017 is mainly attributable to the significant increase in services' surplus. As domestic demand strengthens and commodity prices recover, the trade in goods balance records a lower surplus reflecting the higher growth in imports compared with exports of goods. The main source of external imbalances is still the negative primary income component.

At the end of September 2017, gross external debt stands at EUR 313 105 mln or 68.8% of the projected GDP. Compared to the end of 2016, total external debt decreases by 1.8%, reflecting the reduction in Central bank's short-term liabilities in form of currency and deposits. Given the favourable maturity structure, the refinancing risk is relatively low.

The level of the official reserves ensures about 5 months coverage over imports, enough adequate to reduces the risk of inability to respond to unexpected events occurring on international markets.

The labour market registers a fourth consecutive year of improvement characterised by expanding economic activity and low unemployment rates. Incomes also accelerate at a moderate pace.

The period of deflation in Poland is ended as the average annual inflation reaches 2.0% in 2017, close to the EU-average as well as the rate targeted by the National bank of Poland (2.5±1%). The rise in inflation is driven mainly by the pickup in food price growth related to the increasing domestic demand and higher energy commodity prices in the global markets.

Due to the external nature of factors contributing to the price level, domestic inflation will be limited by the moderate price growth in the euro area, the base effect of energy prices and the appreciation of the exchange rate of the zloty. Price pressures are likely to arise mainly from labour market developments, in particular accelerating wage growth and rising unit labour costs.

Poland was taken out of the Excessive Deficit Procedure by the European Council in 2015 following a reduction in the deficit to below the three percent of GDP threshold. The deficit has remained below this threshold since then. In 2016, general government deficit to GDP ratio decreased to 2.5% of GDP.

Favourable macroeconomic conditions during 2017 support country's public finance developments. The accelerated revenues' growth coupled with a relatively slow expenditures' growth are likely to translate into considerably better than initially planned fiscal result in 2017.

What raises concerns is the decision of the government to reduce the statutory retirement age to 60 years for women and to 65 years for men as of October 2017, reversing the equalized retirement age of 67 years. This decision is likely to have several adverse effects. Hence, it would be appropriate if the government takes advantage of the current favourable cyclical position of the economy to rebuild fiscal space that could be used to accommodate growth-enhancing reforms and to preserve the sustainability of the pension system.

The 2018 Budget Act provides a relatively slow increase of total spending, in particular owing to freezing wages for the majority of the public administration employees. On the revenue side, major tax rates are set to remain at the current level and further measures to improve tax collection are expected to generate additional income next year. As a result, the general government deficit in 2018 is set at 2.7% of GDP, below the European Union ceiling of 3 percent.

At the end of the third quarter of 2017, consolidated public debt stands at EUR 228 346 mln or 50.2% of the projected GDP. Public debt structure is characterized by prevalence of domestic over external debt. At the end of the third quarter of 2017, the share of external debt in total debt amounts to 32.2%. Marketable instruments comprise 85.1% of public debt, including instruments issued on the domestic market - 62.1%.

A risk emerges with respect to the currency structure as the exchange rate of the zloty to both EUR and USD has depreciated on several occasions in the last 3 years. However, since the beginning of 2017, the dynamics in ST debt is positively affected by the appreciation of zloty. The debt management strategy for the period 2018-

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2020 assumes reduction in the share of foreign currency debt in total ST debt to the level below 30%.

The average maturity of ST debt remains stable at above 5 years with foreign debt standing at a longer average maturity of 6.5 years. The absence of any drastic changes and volatile movements in the indicator points at a sustainable and well-maintained maturity structure, ensuring low refinancing risk to the economy and its debt.

Banking sector continues to bring the needed stability in Polish financial system in 2017 as it remains well capitalised and with increasing capital adequacy. These data are confirmed by the regular AQRs and stress-tests, which the National Bank of Poland carries out. Assets in the system increase at the background of structural changes in it and moderate credit growth.

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 throughout the eleven months of 2017. The rise in deposits of the non-financial sector during the period also slows down, with certain strengthening the positions of foreign currency denominated savings.

What rises concern about future development of banks in Poland remains the profitability of the system, being affected to some extent by legislative decisions and initiatives and rising costs in non-core banking activities.

**Outlook:**

The stable 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. Uncertainty stemming from government policies will likely remain limited in medium term, as strong growth momentum supports the fiscal balance and debt metrics.

BCRA would consider upgrading the Sovereign Rating and the Outlook for Poland if the country marks an improvement in its political situation, especially with respect to its international relations, and continues to record stable positive dynamics in key economic indicators, namely high GDP growth, reduction in external imbalances and decrease in budget deficits.

Negative pressures on the Sovereign Rating and the Outlook would be considered to be further growth in the negative effects of the pension system over the budget balance, resulting in higher public debt. Additional factors will be considered slow-down in economic growth, deterioration of the investment climate in the country and possible problems stemming from the banking system (including spill-over effects).

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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 February 2018, with some exceptions, for which data is released more frequently.

## Summary of the minutes of the Rating Committee:

On the 15th of February 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 reviewed the current political situation in the country, including the conflict with the European institutions on charges of violations of the rule of law and of the independence of the judiciary. It was discussed in detail that the macroeconomic stability of the country has strengthened over the last six months (accelerated economic growth; balanced external sector; moderate inflation; strengthening of the local currency). The socially-oriented government policy does not negatively affect the public finance indicators as the measures taken stimulate consumption, which helps to sustain economic growth. Improved performance on the labour market and the sustainability of the banking system were also taken into account in the assessment.

**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 | | | | | | | |
|---|---|---|---|---|---|---|---|
| *in millions EUR[1]* | 2017 I-IX | 2016 I-IX | 2016 | 2015 | 2014 | 2013 | 2012 |
| Gross domestic product | 332 743 | 306 117 | 426 049 | 430 075 | 410 917 | 394 734 | 389 349 |
| Gross domestic product (real growth rate, %) | 4,3 | 2,9 | 2,9 | 3,8 | 3,3 | 1,4 | 1,6 |
| Final consumption | 262 158 | 242 099 | 325 312 | 328 732 | 321 304 | 312 120 | 309 335 |
| Gross fixed capital formation | 49 943 | 47 665 | 76 974 | 86 400 | 81 093 | 74 257 | 77 049 |
| Changes in inventories | 6 307 | 3 318 | 6 491 | 1 594 | 2 556 | 627 | 4 630 |
| Exports of goods and services | 182 733 | 164 039 | 222 652 | 212 977 | 195 544 | 182 840 | 173 041 |
| Imports of goods and services | 168 446 | 151 029 | 205 409 | 199 669 | 189 621 | 175 151 | 174 755 |
| | 2017 Q3 | 2016 Q3 | 2016 | 2015 | 2014 | 2013 | 2012 |
| Unemployment rate (%) | 4,7 | 5,9 | 6,2 | 7,5 | 9,0 | 10,3 | 10,1 |
| Employment rate (%) | 58,9 | 57,8 | 57,6 | 56,5 | 55,6 | 54,4 | 54,4 |
| Activity rate (%) | 61,9 | 61,5 | 61,3 | 61,1 | 61,1 | 60,7 | 60,5 |
| Average monthly nominal gross wage (EUR)[1] | 1 000 | 934 | 944 | 948 | 917 | 883 | 857 |
| GDP per capita (current prices; EUR) | | | 11 200 | 11 200 | 10 700 | 10 300 | 10 100 |
| | 2017 I-XII | 2016 I-XII | 2016 | 2015 | 2014 | 2013 | 2012 |
| Annual average inflation rate (RPI; %) | 2,0 | -0,6 | -0,6 | -0,9 | 0,0 | 0,9 | 3,7 |
| Annual average inflation rate (HICP; %) | 1,6 | -0,2 | -0,2 | -0,7 | 0,1 | 0,8 | 3,7 |
| PLN/USD - period average exchange rate | 3,78 | 3,94 | 3,94 | 3,77 | 3,16 | 3,16 | 3,26 |
| PLN/EUR - period average exchange rate | 4,26 | 4,36 | 4,36 | 4,18 | 4,19 | 4,20 | 4,19 |

| EXTERNAL SECTOR | | | | | | | |
|---|---|---|---|---|---|---|---|
| *in millions EUR[1]* | 2017 I-XI | 2016 I-XI | 2016 | 2015 | 2014 | 2013 | 2012 |
| Current account | 1 459 | -1 147 | -1 254 | -2 405 | -8 534 | -5 031 | -14 456 |
| Current account (% of GDP)[3] | 0,3 | -0,3 | -0,3 | -0,6 | -2,1 | -1,3 | -3,7 |
| Goods | 1 725 | 2 888 | 2 935 | 2 213 | -3 255 | -335 | -8 131 |
| Services | 16 360 | 12 752 | 14 075 | 10 911 | 9 059 | 7 646 | 6 004 |
| Primary income | -16 314 | -15 789 | -16 864 | -14 683 | -13 961 | -11 915 | -12 204 |

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| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Secondary income | -312 | -998 | -1 400 | -846 | -377 | -427 | -125 |
| Capital account | 3 329 | 3 210 | 4 472 | 10 158 | 10 034 | 9 006 | 8 549 |
| Financial account | 105 | -1 149 | -499 | 603 | -4 689 | -4 478 | -8 902 |
| Official reserve assets flows | -6 231 | 16 595 | 20 430 | 941 | 456 | 754 | 8 733 |
| | **2017** | **2016** | **2016** | **2015** | **2014** | **2013** | **2012** |
| *in millions EUR[1]* | **Q3** | **Q3** | | | | | |
| Gross external debt | 313 105 | 316 518 | 318 956 | 303 120 | 293 510 | 278 948 | 279 739 |
| Gross external debt (% of GDP)[3] | 68,8 | 74,3 | 74,9 | 70,5 | 71,4 | 70,7 | 71,8 |
| NIIP | -280 654 | -265 087 | -255 178 | -262 306 | -278 766 | -275 431 | -260 441 |
| NIIP (% of GDP)[3] | -61,6 | -62,2 | -59,9 | -61,0 | -67,8 | -69,8 | -66,9 |
| Official reserve assets | 94 368 | 100 078 | 108 064 | 86 894 | 82 645 | 77 144 | 82 577 |
| Official reserve assets (% of GDP)[3] | 20,7 | 23,5 | 25,4 | 20,2 | 20,1 | 19,5 | 21,2 |
| **PUBLIC FINANCE** | | | | | | | |
| | **2017** | **2016** | **2016** | **2015** | **2014** | **2013** | **2012** |
| *in millions EUR[1]* | **I-VI** | **I-VI** | | | | | |
| General government revenues | 87 783 | 79 348 | 164 883 | 167 428 | 158 893 | 151 900 | 152 425 |
| General government expenditures | 87 360 | 81 814 | 175 404 | 178 757 | 173 660 | 168 148 | 166 882 |
| General government budget balance | 423 | -2 466 | -10 521 | -11 353 | -14 766 | -16 224 | -14 456 |
| *as a share of GDP[3]:* | | | | | | | |
| General government revenues | 19,3 | 18,6 | 38,7 | 38,9 | 38,7 | 38,5 | 39,1 |
| General government expenditures | 19,2 | 19,2 | 41,2 | 41,6 | 42,3 | 42,6 | 42,9 |
| General government budget balance | 0,1 | -0,6 | -2,5 | -2,6 | -3,6 | -4,1 | -3,7 |
| | **2017** | **2016** | **2016** | **2015** | **2014** | **2013** | **2012** |
| *in millions EUR[1]* | **Q3** | **Q3** | | | | | |
| General Government Gross Debt | 236 944 | 224 525 | 230 667 | 219 792 | 206 436 | 219 834 | 209 142 |
| General Government Gross Debt (% of GDP)[2] | 52,2 | 52,6 | 54,1 | 51,1 | 50,2 | 55,7 | 53,7 |
| **BANKING SECTOR** | | | | | | | |
| | **2017** | **2016** | **2016** | **2015** | **2014** | **2013** | **2012** |
| *in billions EUR[4]* | **XI** | **XI** | | | | | |
| Total assets | 420,7 | 387,0 | 385,7 | 374,3 | 358,8 | 338,7 | 330,1 |
| Deposits from the non-financial sector (NFS) | 247,6 | 224,6 | 230,8 | 219,0 | 199,2 | 186,0 | 176,3 |
| Credits to the non-financial sector | 248,2 | 228,3 | 227,8 | 224,5 | 209,4 | 201,5 | 197,7 |
| Impairment on credits to the NFS | 9,4 | 8,9 | 8,6 | 9,1 | 9,3 | 9,5 | 9,5 |
| Profit or loss for the year | 3,0 | 2,9 | 3,1 | 3,0 | 3,7 | 3,7 | 3,8 |
| *annual growth rates (in %)* | **XI** | **XI** | | | | | |
| Assets - annual growth | 3,0 | 6,1 | 7,0 | 4,3 | 8,9 | 4,1 | 4,3 |
| Deposits - annual growth | 4,5 | 9,9 | 9,4 | 9,9 | 10,1 | 7,0 | 3,6 |
| Credits - annual growth | 3,0 | 5,3 | 5,4 | 7,2 | 6,8 | 3,4 | 1,2 |

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| *ratios (%)* | **Q3** | **Q3** | | | | | |
|---|---|---|---|---|---|---|---|
| Impairment on credits to NFS (% of total credits) | 3,8 | 3,9 | 3,8 | 4,1 | 4,5 | 4,7 | 4,8 |
| Liquidity | 21,4 | 21,4 | 21,6 | 20,1 | 20,6 | 21,4 | 20,9 |
| ROA | 0,8 | 0,8 | 0,8 | 0,8 | 1,1 | 1,1 | 1,2 |
| ROE | 8,1 | 8,4 | 9,2 | 9,1 | 12,3 | 12,1 | 14,0 |

[1] The values in EUR are calculated by using the average exchange rate of the PLN//EUR for the corresponding period
[2] Eurostat data for population aged 15-74.
[3] 2017 data are calculated on the basis of GDP amounting to PLN 1 938 300 mln (MoF estimate)
[4] The values in EUR are calculated by using the exchange rate of the PLN//EUR at the corresponding period's end.

*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*