BCRA CREDIT RATING AGENCY

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Poland

February 2019

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

RATIONALE

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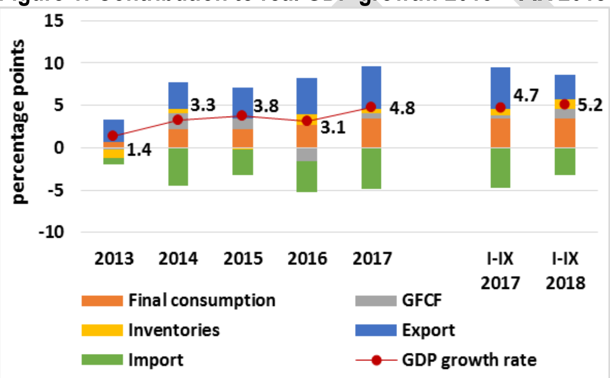
Overview:

Poland has faced the political challenge of serious controversy related to the new legislative act that lowered the statutory retirement age for the Supreme Court judges. 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 would politicize the Supreme Court, making it insufficiently independent from political influence and interests. In mid-2018, the European Commission launched an infringement procedure *to protect the independence of the Polish Supreme Court* regarding this case and in end-September the Commission decided to refer Poland to the Court of Justice of the EU for *violations of the principle of judicial independence created by the new Polish Law on the Supreme Court.* Since the Commission has requested an expedited procedure, a ruling should be expected within six months. However, the ruling party has a stable parliamentary majority and the support of its voters, which was confirmed by the results of the latest municipal elections in October 2018. We expect that the diplomatic tensions would remain constrained and would not have any negative consequences on country's robust economic development.

Figure 1: Contribution to real GDP growth: 2013 – I-IX 2018



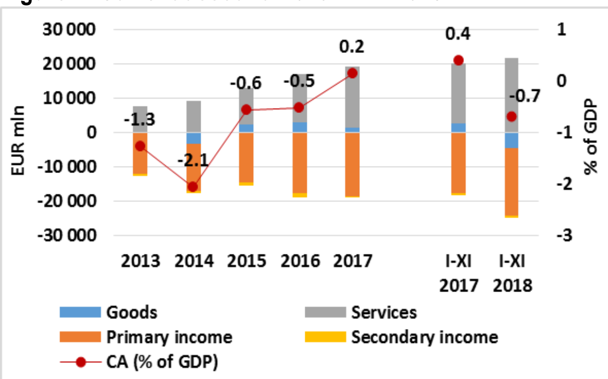
Source: Central Statistical Office of Poland

Poland has strong and resilient macroeconomic fundamentals, resulting in limited growth volatility. Following the real **GDP growth** of 4.8% in 2017, positive trends have been well continued into 2018. For the first three quarters of the year, GDP accelerated by 5.2% in real terms compared to 4.7% in the same period of 2017, positioning the economy among best EU performers. Domestic demand remained the main growth driver. Amid the buoyant labour market development, households' consumption grew by 5.7%. Gross fixed capital formation marked a noticeable increase supported by higher EU funds absorption. Besides fixed investment, the rise in inventories also had a positive contribution. In contrast, Poland's export and import growths decelerated in the first nine months of 2018, which may be attributable to the weaker economic activity in the Eurozone, the region's central trading place. Exports growth decelerated to 5.3% (9.2% in Q1-Q3 2017), while exports surged by 6.3% (9.5% in Q1-Q3 2017), thus generating negative contribution of the net exports to the real GDP growth in the period.

Gross value added increased by 5.1% in the first nine months of 2018. Industry sector remained robust, increasing by 5.6%. The most notable sectoral increase is observed in construction (19.8%) in line with the recovery in investment of local government units associated with the growing absorption of EU funds from the 2014-2020 financial framework. The services sector retained its contribution to GVA growth in Q1-Q3 2018, as in the respective period of 2017. Trade and transport-ation and storage formed 25.1% of total GVA and were the main drivers of growth in this sector along with financial and insurance activities.

Flash estimates from the country's statistical office show that Polish GDP is outperforming the prognosis for its growth rate in 2018, as the last is expected to reach 5.1%, which would be the fastest expansion since 2007. Also, the investment growth in the next years is expected to continue benefiting from the faster drawing of EU funds, which is typical at the end of programme periods.

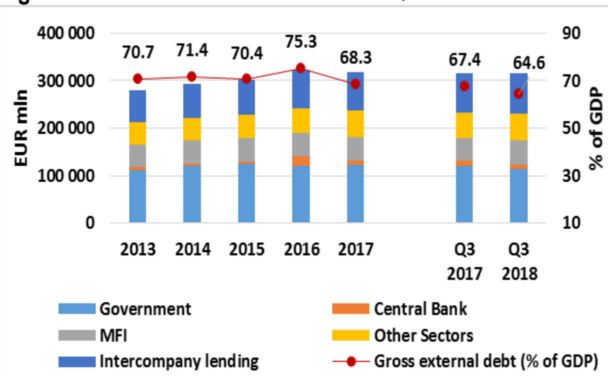
Figure 2: Current account: 2013 – I-XI 2018



Source: National Bank of Poland

Current account vulnerabilities remain moderate. In 2017, Poland recorded a positive **current account balance** (0.2% of GDP) for a first time since the mid-1990s. In the first eleven months of 2018, the current account recorded a deficit of EUR 3 324 mln, compared to a surplus of EUR 1 815 mln reported in the same prior year period. Lower overall balance in the period reflected the deficit on trade in goods, which posted a surplus in the corresponding prior year period, as well as the increase in primary and secondary income deficits. Concurrently, the large surplus in trade in services increased.

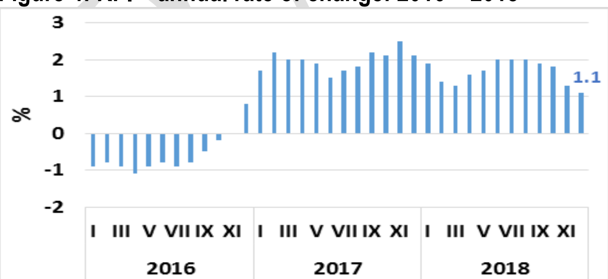
Figure 3: Gross external debt: 2013 – Q3 2018



Source: National Bank of Poland

Gross external debt at the end of September 2018 stood at EUR 316 003 mln (64.6% of the projected GDP), decreasing by 0.9% compared to the end of 2017. 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, ensuring almost 5 months coverage over imports and 226% coverage of short-term external debt.

Figure 4: RPI – annual rate of change: 2016 – 2018



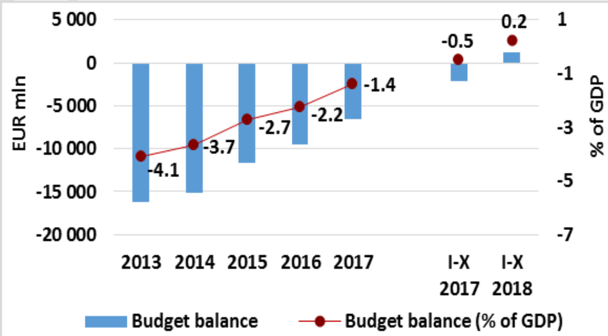
Source: Central Statistical Office of Poland

Inflation remained moderate as domestic and global inflationary pressures remained subdued. The average annual consumer price inflation decelerated to 1.7% in 2018 from 2.0% in 2017. In this regard the leading contribution to inflation level in 2018 came from food prices, followed by energy prices and transport services. Amid the mild inflation the Monetary Policy Council kept NBP interest rates unchanged with the reference rate at 1.50%.

Along with the growth of the real economy, the number of unemployed continued to reduce at high rates during the three quarters of 2018. Polish **labour market** recorded lowering unemployment rate (to 3.8% in Q3 2018) bringing the country among the best performing EU-members. Meanwhile, despite the favourable gains in employment, the economic activity of the population has been still lagging behind the EU average.

Labour income in the economy has kept its uprising tendency. Average monthly net wage accumulated 7.6% annual increase as of Q3 2018 owing to rises across all the sectors, and amounted to ~EUR 1 064. In 2017, however, Polish **GDP per capita** (EUR 12 000) had reached 41% in euros and 70% in PPS of the EU average.

Figure 5: Consolidated budget balance: 2013 – I-X 2018



Source: Ministry of Finance

The robust macroeconomic performance supports country's **public finance** sustainability. The budget deficit of the general government sector narrowed from EUR 9 537 mln (2.2% of GDP) in 2016 to EUR 6 569 mln (1.4% of GDP) in 2017 being one of the country's lowest in years.

The general government deficit remained on a decreasing path in 2018. As a result of an accelerated revenues' growth coupled with a relatively slow expenditures' growth, budget balance posted a surplus amounting to EUR 1 158 mln (0.2% of the projected GDP) for the period

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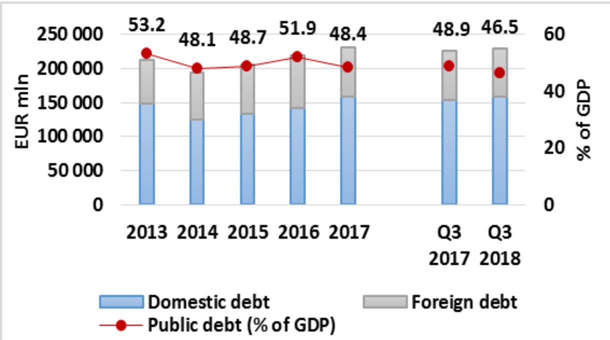
January-September 2018, contrary to the corresponding period of 2017 when a deficit was present.

Poland's debt to GDP ratio is below the Maastricht treaty and well below the EU-average. The **general government debt** (EDP debt*)* decreased further from 50.6% of GDP at the end of 2017 to 49.4% as of Q3 2018 backed by the accelerated nominal GDP growth and an improved budget performance.

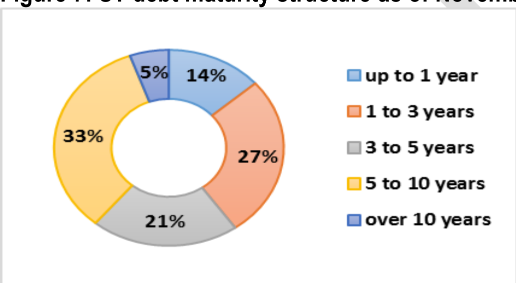
Figure 6: Consolidated public debt (domestic definition): 2013 – X 2018



Source: Ministry of Finance

At the end of September 2018, **consolidated public debt** (according to domestic definition) stood at EUR 228 953 mln (46.5% of the projected GDP). Compared to the end of 2017 public debt increased by 1.7% in nominal terms. The share of foreign debt in total debt amounted to 30.5%, down by 0.6 p.p. compared with the end of 2017.

Figure 7: ST debt maturity structure as of November 2018



Source: Ministry of Finance

The refinancing risk and interest rate risk are low. The share of State Treasury debt denominated in national currency increased from 69.4% at the end of 2017 to 70.5% in November 2018. The average maturity of State Treasury debt remained stable at 4.98 years with foreign debt standing at a longer average maturity of 6.12 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.

Banking sector has key importance for the financial system in Poland. It is characterized by ongoing consolidation and faster reduce the number of foreign controlled banks while total assets further grow. During the three quarters of 2018, bank returns have restored their positive growth after a year of decline (2017). The gains from banking activity have helped achieving a rise in aggregated profit generated until end-November 2018 compared to the same prior year period. Non-financial sector deposit and lending reported further rising with faster growth in the segment of households supported by the stable interest rate levels and favourable macroeconomic environment.

As a whole Polish banking system remains resilient, with appropriate levels of capital and good asset quality. Potential sources of tension could include uncertainty in external financial environment as well as from imposing new legislative decisions and regulations.

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 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;

Negative pressures on the Sovereign Rating and the Outlook would be considered:
- Deterioration in the government's 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.

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

Summary of the minutes of the Rating Committee:

On the 7th of February 2019 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 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 over the past six months (accelerated economic growth, moderate inflation, low unemployment), were positively assessed. Possible risks associated with external sector balances were viewed. The improvement in the country's public finance indicators and the sustainability of the banking system was also taken into account in the assessment were taken into consideration.

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

RATIONALE

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Tables:

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

BASIC MACROECONOMIC INDICATORS							
	2018 I-IX	2017 I-IX	2017	2016	2015	2014	2013
Gross domestic product (real growth rate, %)	5.2	4.7	4.8	3.1	3.8	3.3	1.4
Gross domestic product (EUR million)	357 467	334 513	467 101	426 616	430 275	411 075	394 734
Final consumption	280 083	263 582	356 292	325 835	328 932	321 462	312 120
Gross fixed capital formation	55 382	50 520	82 751	76 793	86 400	81 093	74 257
Changes in inventories	8 452	5 794	9 182	6 739	1 594	2 556	627
Exports of goods and services	200 074	186 813	253 602	222 670	212 977	195 544	182 840
Imports of goods and services	186 590	172 261	234 814	205 450	199 669	189 621	175 151
	Q3	Q3					
Unemployment rate[1] (%)	3.8	4.7	4.9	6.2	7.5	9.0	10.3
Employment rate (%)	59.6	58.9	58.6	57.6	56.5	55.6	54.4
Activity rate (%)	62.0	61.9	61.6	61.3	61.1	61.1	60.7
Average monthly nominal gross wage (EUR)	1 064	1 000	1 006	929	934	902	872
GDP per capita (current prices; EUR)	-	-	12 200	11 100	11 200	10 700	10 300
	I-XII	I-XII					
Annual average inflation rate (RPI; %)	1.7	2.0	2.0	-0.6	-0.9	0.0	0.9
Annual average inflation rate (HICP; %)	1.2	1.6	1.6	-0.2	-0.7	0.1	0.8
PLN/USD - period average exchange rate	3.61	3.78	3.78	3.94	3.77	3.16	3.16
PLN/EUR - period average exchange rate	4.26	4.26	4.26	4.36	4.18	4.19	4.20
EXTERNAL SECTOR							
EUR million	2018 I-XI	2017 I-XI	2017	2016	2015	2014	2013
Current account	-3 324	1 815	715	-2 248	-2 405	-8 534	-5 031
Goods	-4 695	2 647	1 426	2 935	2 213	-3 255	-335
Services	21 671	17 644	17 956	13 963	10 911	9 059	7 646
Primary income	-19 522	-17 830	-18 541	-17 746	-14 683	-13 961	-11 915
Secondary income	-778	-646	-126	-1 400	-846	-377	-427
Capital account	10 026	4 505	5 894	4 472	10 158	10 034	9 006
% of GDP[2]							
Current account	-0.7	0.4	0.2	-0.5	-0.6	-2.1	-1.3
Goods	-1.0	0.6	0.3	0.7	0.5	-0.8	-0.1
Services	4.4	3.8	3.8	3.3	2.5	2.2	1.9
Primary income	-4.0	-3.8	-4.0	-4.2	-3.4	-3.4	-3.0
Secondary income	-0.2	-0.1	0.0	-0.3	-0.2	-0.1	-0.1
Capital account	2.0	1.0	1.3	1.0	2.4	2.4	2.3

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EUR million	**Q3**	**Q3**					
Gross external debt	316 003	314 898	318 851	321 305	303 120	293 510	278 948
NIIP	-277 382	-281 218	-290 850	-259 036	-262 306	-278 766	-275 431
Official reserve assets	97 130	94 368	94 550	108 064	86 894	82 645	77 144
% of GDP[2]							
Gross external debt	64.6	67.4	68.3	75.3	70.4	71.4	70.7
NIIP	-57.3	-60.2	-62.3	-60.7	-61.0	-67.8	-69.8
Official reserve assets	20.1	20.2	20.2	25.3	20.2	20.1	19.5

PUBLIC FINANCE

EUR million	**2018 Q3**	**2017 Q3**	**2017**	**2016**	**2015**	**2014**	**2013**
General government revenues	145 957	133 732	185 464	165 830	167 685	159 132	151 901
General government expenditures	144 799	135 895	192 033	175 367	179 305	174 273	168 136
General government budget balance	1 158	-2 163	-6 569	-9 537	-11 621	-15 141	-16 235
General government gross debt	240 672	235 238	241 120	228 123	216 639	203 492	222 501
% of GDP[2]							
General government revenues	29.5	28.7	39.7	38.9	39.0	38.7	38.5
General government expenditures	29.2	29.2	41.1	41.1	41.7	42.4	42.6
General government budget balance	0.2	-0.5	-1.4	-2.2	-2.7	-3.7	-4.1
General government gross debt	48.8	51.0	54.2	51.3	50.4	55.7	53.7

BANKING SECTOR

EUR million	**2018* IX**	**2017 IX**	**2017**	**2016**	**2015**	**2014**	**2013**
Total assets	437 299	406 622	425 998	385 621	374 275	358 790	338 712
Profit or loss for the year	2 724	2 438	3 278	3 134	3 001	3 722	3 651
Deposits from the non-financial sector	256 470	236 480	254 733	230 814	219 032	199 248	185 985
Credits to the non-financial sector	250 697	242 029	249 410	227 788	224 463	209 385	201 492
Impairment on credits to the NFS	9 864	9 108	9 534	8 632	9 115	9 327	9 482
Impairment on credits to NFS (% of total credits)	3.9	3.8	3.8	3.8	4.1	4.5	4.7
Own funds	48 936	43 464	47 386	39 668	37 562	34 062	-
Total risk exposure amount	254 719	233 068	249 954	223 837	228 134	223 413	-
Capital adequacy (%)	19.2	18.6	19.0	17.7	16.5	15.2	-
ROA[3] (%)	0.8	0.8	0.8	0.8	0.8	1.1	1.1
ROE[3] (%)	7.3	6.9	7.1	7.7	7.5	10.0	10.2

** 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] 2018 data are calculated on the basis of GDP amounting to PLN 2 104 600 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