Republic of Poland
Rating Report

SCOPE A+ NEGATIVE OUTLOOK

Credit strengths

- Strong macroeconomic fundamentals
- Liquid, well-capitalised banking system
- Reduction of external debt
- Strong market access, cash cushion and deep capital markets

Credit challenges

- Weakening of governance institutions
- Weakening of public finances since Covid-19 crisis
- Elevated inflation and rising rates
- Social and environmental risk

Rating rationale:

Robust macroeconomic fundamentals: Poland's credit rating is anchored by a large, diversified economy and strong macroeconomic fundamentals. The Polish economy has proven resilient thus far in the face of Covid-19 and Russia-Ukraine crises and is expected to display comparatively robust rates of economic growth over coming years as well as present comparatively strong longer-run economic growth potential.

Profitable, liquid and well-capitalised domestic banking system: Non-performing loan (NPL) ratios have edged under their pre-Covid levels. Tier 1 capital and liquidity coverage ratios have likewise significantly improved since the Covid-19 crisis. FX-related risk remains outstanding in the banking system, including as relates to resolution of Swiss franc mortgage loans.

Mixed dynamics in the external sector: Current-account dynamics had improved, although a 2020 surplus has reverted rapidly back to deficit amid strong domestic demand and surging global energy and commodity prices. Inward foreign direct investment (FDI) remains robust. The net international investment liability position has improved and gross external debt had partially de-levered. Foreign-exchange reserve levels have recently declined, and FX risks in government debt prevail.

Ratings challenges include: i) longer-standing trend of weakening of governance institutions, also affecting economic and institutional outlooks; ii) weakening of Poland's public finances since the Covid-19 crisis, combined with a recent sharp rise of inflation and interest rates; and iii) social and environmental transition risks.

Poland's sovereign rating drivers

Risk pillars		Quantitative scorecard		Reserve currency adjustment (notches)	Qualitative scorecard	Final rating
		Weight	Indicative rating		Notches	
Domestic Economic Risk		35%	aa-	Reserve currency adjustment (notches)	+1/3	A+
Public Finance Risk		25%	a+		0	
External Economic Risk		10%	bb		0	
Financial Stability Risk		10%	aaa		+1/3	
ESG Risk	Environmental Risk	5%	aa		-1/3	
	Social Risk	5%	bbb		-1/3	
	Governance Risk	10%	bbb-		-1/3	
Overall outcome		**a+**		**0**	**0**	

Note: The qualitative scorecard adjustments, capped at one notch per rating pillar, are weighted equally with an aggregate adjustment rounded to the nearest integer. The reserve currency adjustment applies to currencies in the IMF's SDR basket. For details, please see Scope's 'Sovereign Ratings' methodology. Source: Scope Ratings.

Outlook and rating triggers

The Negative Outlook represents our opinion that risks to the sovereign ratings are skewed to the downside.

Positive rating-change drivers

- Substantive easing of governance risks and of tensions with the EU
- Declining debt/GDP trajectory
- Improved external balance sheet

Negative rating-change drivers

- Inadequate resolution of governance risk
- Deterioration of debt sustainability
- External shock and/or further weakening of external-risk profile

Ratings and Outlook

Foreign currency

Long-term issuer rating	A+/Negative
Senior unsecured debt	A+/Negative
Short-term issuer rating	S-1+/Negative

Local currency

Long-term issuer rating	A+/Negative
Senior unsecured debt	A+/Negative
Short-term issuer rating	S-1+/Negative

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Bloomberg: RESP SCOP

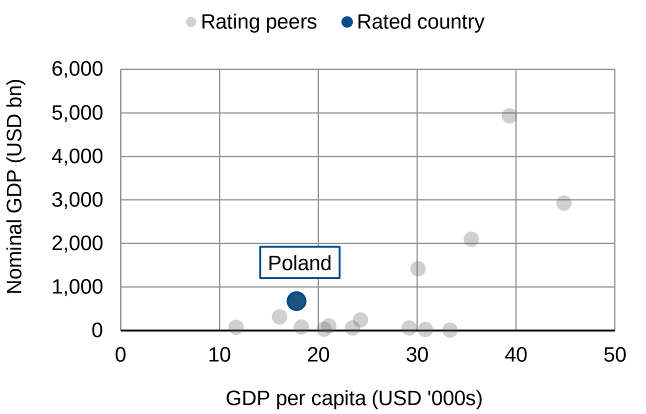
Domestic Economic Risks

- **Growth outlook:** After a comparatively moderate economic downturn of -2.2% in 2020, the Polish economy rebounded, with real growth of 5.9% in 2021. Growth momentum remained strong in 2022 Q1 (+9.2% YoY), deriving from strong household consumption growth and rising inventories, more than offsetting a negative net export contribution. We expect quarterly growth to have softened significantly, however, by Q2. Nevertheless, growth for 2022 as a whole ought to remain strong, of 4.9% (revised from 4.7% as of Jan-22 forecasts), anchored by favourable base effects, arrivals of Ukrainian workers expanding the labour force, supportive fiscal policies, as well as EU funding. We expect 3.1% growth during a 2023 election year. Medium-run potential growth is estimated of around 3% a year – higher than that of rating peer economies, even acknowledging working-age population decline averaging 0.8% per year over 2022-27.
- **Inflation and monetary policy:** Inflationary pressures have accelerated significantly over recent months, rising to 15.6% YoY in June (according to national CPI) – well above a central bank 1.5-3.5% target. This rise has been significantly driven by external factors, relating to energy and agricultural prices and global supply-chain disruption. However, core inflation has risen over the same period, reaching 9.2% YoY in June, pointing to accelerating domestic price pressures, under context of strong household demand and tight labour markets. The National Bank of Poland has increased its policy rate by a cumulative 590bps since October 2021, to 6.0% by June 2022. We expect further rate hikes, placing the policy rate at about 8.0% by end-2022, before reduction to 7.0% before end-2023.
- **Labour market:** Employment dynamics are strong, with the employment rate increasing to 71% by 2022 Q1, up 2.5pps compared with 2019 Q4 pre-crisis. The unemployment rate is low, at 2.7% as of May 2022, down from 3.4% on average over 2021. We see the unemployment rate averaging 2.7% over calendar-years 2022 and 2023. The arrival of Ukrainian refugees, having been granted access to the domestic labour market and social benefits, reflect an estimated added 350,000 workers for the workforce according to the OECD and ought to help alleviate labour shortages of some sectors. The tightness of the labour market has fuelled strong nominal wage growth, of an average of 12.3% YoY between January and May 2022.

Overview of Scope's qualitative assessments for Poland's *Domestic Economic Risks*

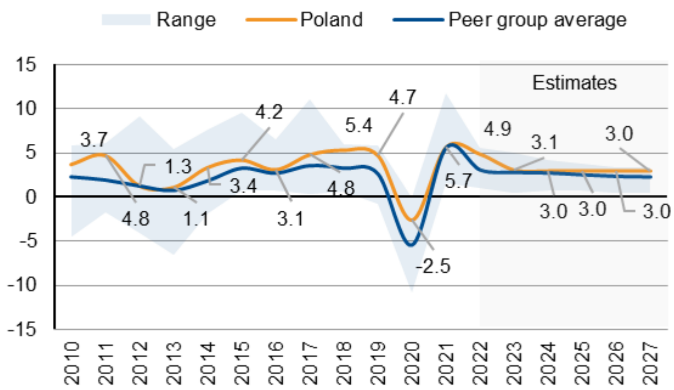
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aa-	Growth potential of the economy	Strong	+1/3	High growth potential; long-term growth prospects supported by EU programmes
	Monetary policy framework	Neutral	0	Credible and effective central bank, but compared against a strong peer group of euro-area countries with ECB access
	Macro-economic stability and sustainability	Neutral	0	Diversified economy and competitive export base; long-term sustainability of growth reliant upon foreign funding, external demand

Nominal GDP and GDP per capita, USD '000s



Source: IMF World Economic Outlook (WEO), Scope Ratings

Real GDP growth, %



Source: IMF WEO, Scope Ratings forecasts

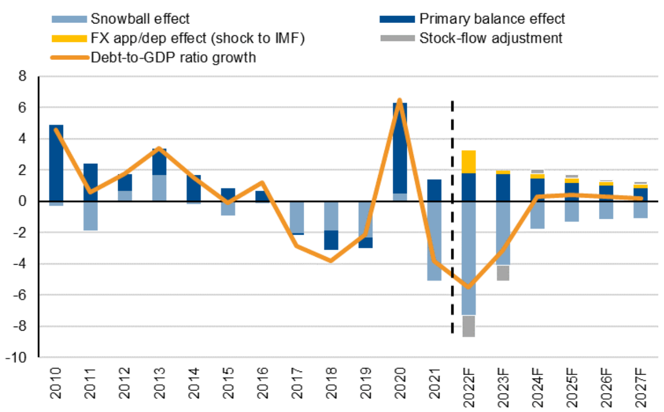
Public Finance Risks

- **Fiscal outlook:** Strong revenue growth resulting from economic recovery and phasing out of pandemic counter-crisis measures supported a significant reduction of the general government budget deficit to 1.9% of GDP in 2021, from 6.9% in 2020. This deficit is set to widen again this year, however, due to the worsening economic outlook, anti-inflationary budgetary measures, costs of accommodating refugees as well as a government objective of raising military expenditure to 3% of GDP next year (from 2%). We expect this deficit to rise to 3.2% of GDP this year, better than an updated government estimate of 4.3%, however. Thereafter, we see the deficit remaining around/above the Maastricht criterion in 2023 and 2024. The government budget balance ought to benefit from delayed approval and gradual release of Poland's Recovery and Resilience Facility funds, of EUR 35.4bn (or 4.5% of projected 2022-26 GDP).
- **Debt trajectory:** Poland's general government debt ratio stood at 53.8% of GDP as of end-2021, representing a decline from 2020 (of 3.3pps), albeit remaining well above the end-2019 debt ratio of 45.6%. We estimate this debt ratio to continue sharply declining, to 48.3% this year, aided by elevated inflation and still robust real growth, before concluding a forecast horizon to 2027 at 46.4% with the debt trajectory anchored by nominal economic growth but challenged by rising financing costs and continued primary fiscal deficits.
- **Debt profile & market access:** A comparatively short average maturity of Polish treasuries (4.7 years) and outstanding foreign-exchange risk, in view of 12.4% of GDP of foreign-exchange-denominated general government debt, reflecting 23% of outstanding public debt as of Q1 2022, represent credit-rating constraints. Foreign debt of Poland has dropped to 24.3% of aggregate debt by Q1 2022 from 34.7% as of end-2016. Government bond yields of Poland have risen markedly since start-2021. The yield on 10-year government bonds has risen to 6.5%, from 1.2% as of early 2021. Credit strengths of Poland associate with strong market access, a sizeable cash cushion and deep domestic capital markets. Rule-of-law contentions cast continued questions as regards EU balance of payments assistance under adverse economic scenarios that might require lender of last resort functionalities.

Overview of Scope's qualitative assessments for Poland's *Public Finance Risks*

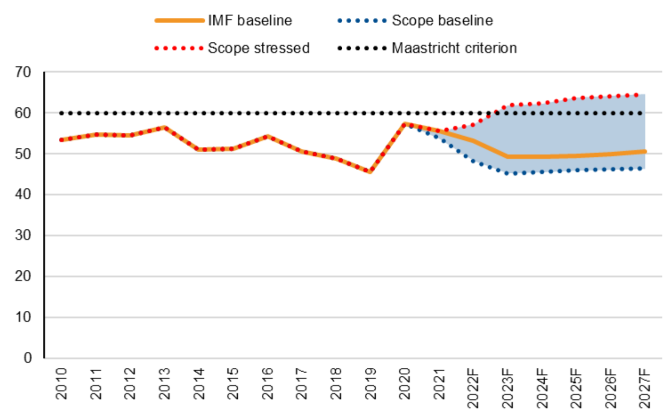
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a+	Fiscal policy framework	Neutral	0	Credible fiscal framework although suspended during Covid crisis; current overheating due partly to expansionary policies
	Debt sustainability	Neutral	0	Contingent liabilities and rising ageing-related costs coupled with substantive social spending programmes pose medium-run fiscal challenges; risk from substantive FX share of public debt
	Debt profile and market access	Neutral	0	Low, albeit rising, average maturity of treasuries; foreign-exchange risk; sharp rise of yields; moderate gross financing needs; significant cash cushion; deep domestic capital markets

Contributions to changes in debt levels, pps of GDP



Source: IMF WEO, Scope Ratings forecasts

Debt-to-GDP forecasts, % of GDP



Source: IMF WEO, Scope Ratings forecasts

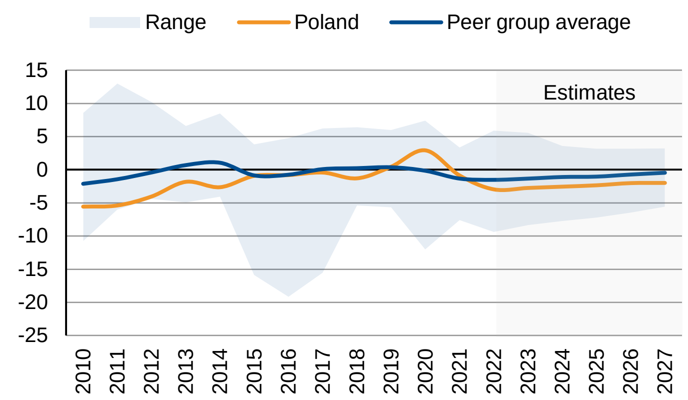
External Economic Risks

- **Current account:** Current-account dynamics had improved in run up to the Covid-19 crisis, from a current-account deficit of 6.9% of GDP in 2008 to a 0.5% of GDP surplus by 2019. Amid strengthening external-sector competitiveness, Poland's share of world exports increased from 0.6% in 2001 to 1.5% by 2021. During the Covid-19 crisis, the current-account balance temporarily reached surplus of 2.9% of GDP in 2020 but had reverted sharply to deficit by end-2021, under a context of rapid domestic demand recovery and surging energy and commodity prices. This current-account deficit widened to 3.6% of GDP in the 12 months to April 2022. The current-account balance is expected to remain in deficit near term, due to elevated global energy prices, disruptions of trade with Russia and Ukraine, which accounts for more than 3% of Polish exports, as well as weakening of demand from key European trading partners. Russia halted gas to Poland over a payment terms dispute (seeking payment in rouble), but Poland is receiving Russian gas transited from countries such as Italy, France and Germany.
- **External position:** Poland's external sector is bolstered by a capital-account surplus anchored by structural EU fund inflows, reflecting a strong quality of external financing, with FDI liabilities constituting a significant 51% of gross external liabilities as of Q1 2022. Inward FDI accelerated to 6.1% of GDP in the year to April 2022, from 2.8% in 2019 and 2.9% in 2020. The net international investment position (NIIP) strengthened to -39% of GDP by Q1 2022, from lows of -70% in Q3 2014; gross foreign debt had de-levered to 55.7% of GDP in Q1 2022, from Q4 2016 peaks of 76.3%.
- **Resilience to external shocks:** After declining sharply against euro during an immediate phase after Russia's further invasion of the Ukraine, the Polish zloty has stabilised since – although nevertheless 2.4% weaker against euro in 2022. Foreign-exchange reserves declined to USD 135.6bn in May 2022, from USD 148.5 at an August 2021 record peak, as the central bank sold foreign currencies at Russia-Ukraine crisis peaks earlier this year, with reserves representing currently an 81% coverage of external debt maturing under one year – off 2021 peaks of 91% coverage and modest compared to levels of Poland's 'a+' sovereign peers.

Overview of Scope's qualitative assessments for Poland's *External Economic Risks*

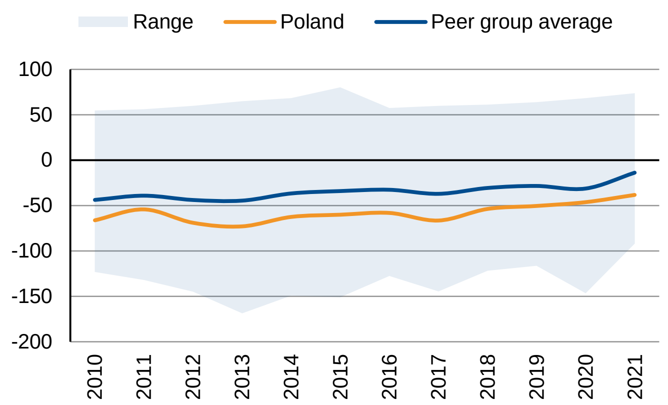
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bb	Current account resilience	Strong	+1/3	Recent deterioration of the current account, returning to deficit, but strong financing resilience via EU funding and foreign direct investment
	External debt structure	Neutral	0	Poland's external debt stock has been reduced over past years
	Resilience to short-term shocks	Weak	-1/3	Moderate foreign-exchange reserves compared to a strong peer group, including many reserve-currency countries

Current account balance, % of GDP



Source: IMF WEO, Scope Ratings GmbH

NIIP, % of GDP



Source: IMF, Scope Ratings GmbH

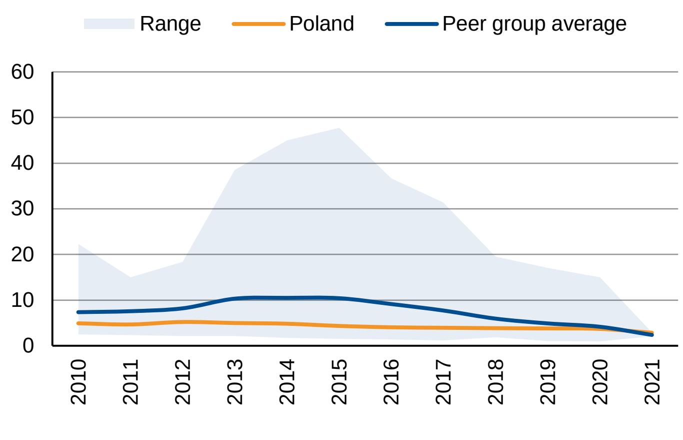
Financial Stability Risks

- **Banking sector:** A stable banking system, with resilient asset quality through the pandemic crisis allowing for gradual removal of Covid-crisis regulatory relief. NPLs had declined to 4.4% of aggregate loans by 2022 Q1, below their pre-Covid level (4.8% end-2019). Tier 1 capital and liquidity coverage ratios declined from early 2021 peaks, to 15.9% of risk-weighted assets and 160.1% of total net cash flow amounts, respectively, by Q1 2022, as a consequence of sharply rising yields on debt instruments measured at fair value through other comprehensive income (mostly government-issued bonds) and due to phasing out of liquidity support, but remained circa end-2019 pre-crisis levels. Profitability was strong, as reflected in a 15.2% return on equity as of Q1 2022. Direct exposure of the Polish banking sector to assets in Russia, Belarus and Ukraine is marginal, of PLN 2.3bn at end-2021, or less than 0.1% of total assets. Main challenges include resolution of CHF-denominated housing loans, which could require large additional loan-loss provisioning.
- **Private debt:** While speedy removal of monetary stimulus discourages excesses as far as fresh borrowing, some borrowers could face payment difficulties as interest rates rise rapidly, although lowered debt service ratios since 2013 provide the private sector with a degree of cushion. Despite monetary tightening, credit growth to the private sector has accelerated over recent months, to levels above pre-pandemic averages, of 6.8% YoY in May. Aggregate non-financial private debt stood around a moderate 75.8% of GDP as of end-2021.
- **Financial imbalances:** Robust housing-market conditions represent one risk area to monitor closely. Legal risk from FX loans represents another to Poland's banking system, with 14% of banking-system loans to households (although down from 42% as of early 2009) and 14% of banking-system deposits from domestic residents (compared with 9% a decade before) denominated in foreign currency. However, the severity of risk from EUR 20bn of Swiss franc-denominated mortgages to banks has moderated, as key legal guidance suggests a reduced likelihood of the most adverse court outcomes with legal costs likely to be spread out over time, while profitability of banks has improved.

Overview of Scope's qualitative assessments for Poland's *Financial Stability Risks*

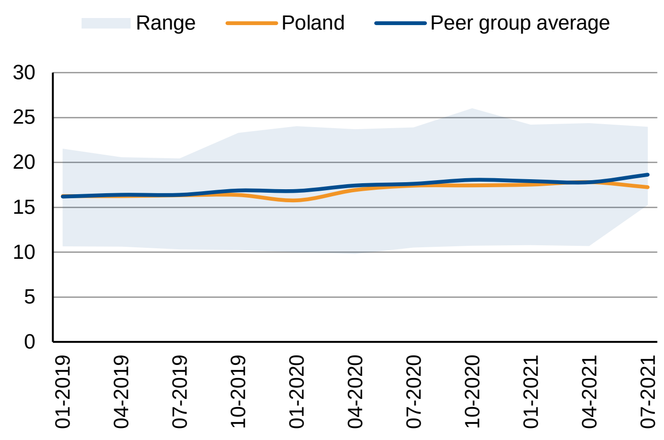
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Banking sector performance	Neutral	0	Profitable, liquid and well-capitalised banking system. NPLs declining. FX risks, including from the resolution of Swiss franc mortgages.
	Banking sector oversight	Neutral	0	Effective financial-sector oversight
	Financial imbalances	Strong	+1/3	Low private-sector debt level; pick-up of credit growth and housing risks

Non-performing loans, % of total loans



Source: World Bank, Scope Ratings GmbH

Tier 1 ratio, % of risk-weighted assets



Source: IMF, Scope Ratings GmbH

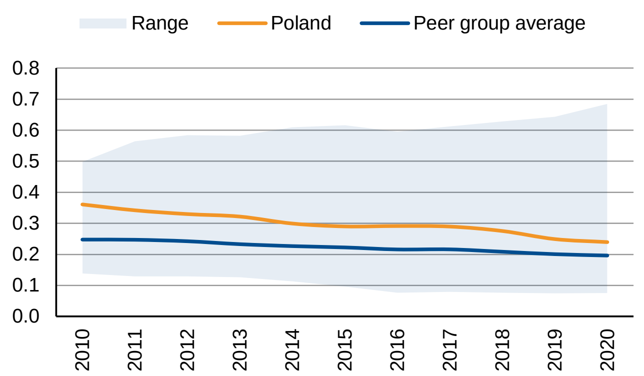
ESG Risks

- **Environment:** Poland's energy mix is heavily reliant on fossil fuels, with coal accounting for around 40% of final energy consumption. Dependence on Russian energy imports is elevated, representing more than a third of gross energy available. This dependence has declined in recent years, however, allowing Poland to find other suppliers after Russia halted natural-gas exports to Poland in April 2022. Poland adopted an energy policy strategy in 2021 pledging to significantly curtail coal-fired power by the 2040s, with a main contribution to coal-based emissions emanating from its power sector. Poland participates under the European Emissions Trading System, creating incentives to reduce emissions. Poland's energy transition strategy targets 30% reductions of emissions by 2030 as relative to 1990 levels.
- **Social:** The working-age population is seen declining around 0.8% annually over 2022-27, causing a steadily rising skilled-labour shortage. However, over three million Ukrainian refugee arrivals have contained societal wage pressures and temporarily eased adverse demographics. The population of Warsaw has grown by 15%; in Kraków, by 23%; in Gdańsk, by 34%. While the net present value of expected pensions spending changes is benign at -2.3% of GDP over 2021-50 (under IMF projections), the net present value of health care spending changes is more material of 34.8% of GDP over the same period. Poland exhibits weak social and transport infrastructure relative to peer economies and low digitalisation.
- **Governance:** On 22 December 2021, the European Commission opened latest infringement proceedings with association to a breach of the primacy of EU law. Dialogue with EU institutions has, however, improved during recent months and the European Commission, under pressure, conditionally approved Poland's EUR 35.4bn Recovery and Resilience Plan. However, the European Parliament and an association of judges of Poland consider reforms tabled by the government as falling short of compliance with decisions of EU courts. Separately, Poland came to agreement with the Czech Republic around a Turów mine dispute, agreeing to a settlement payment. Performance of Poland on World Bank Worldwide Governance Indicators has weakened since 2014 (the year prior to Law and Justice Party entering government). Next parliamentary elections are to be held not later than November 2023.

Overview of Scope's qualitative assessments for Poland's *ESG Risks*

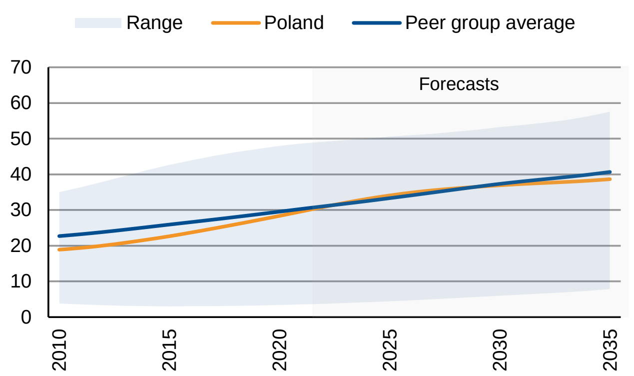
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bbb+	Environmental risks	Weak	-1/3	Structural challenges relating to transition risk to the green economy due to phasing out coal dependency
	Social risks	Weak	-1/3	Adverse demographics result in declining working-age population; significant health care spending changes; below-average skills of the workforce; inadequate social and transport infrastructure
	Institutional and political risks	Weak	-1/3	Ongoing institutional challenges and tensions with the EU; polarised domestic political conditions

CO_2 emissions per GDP, $mtCO_2e$



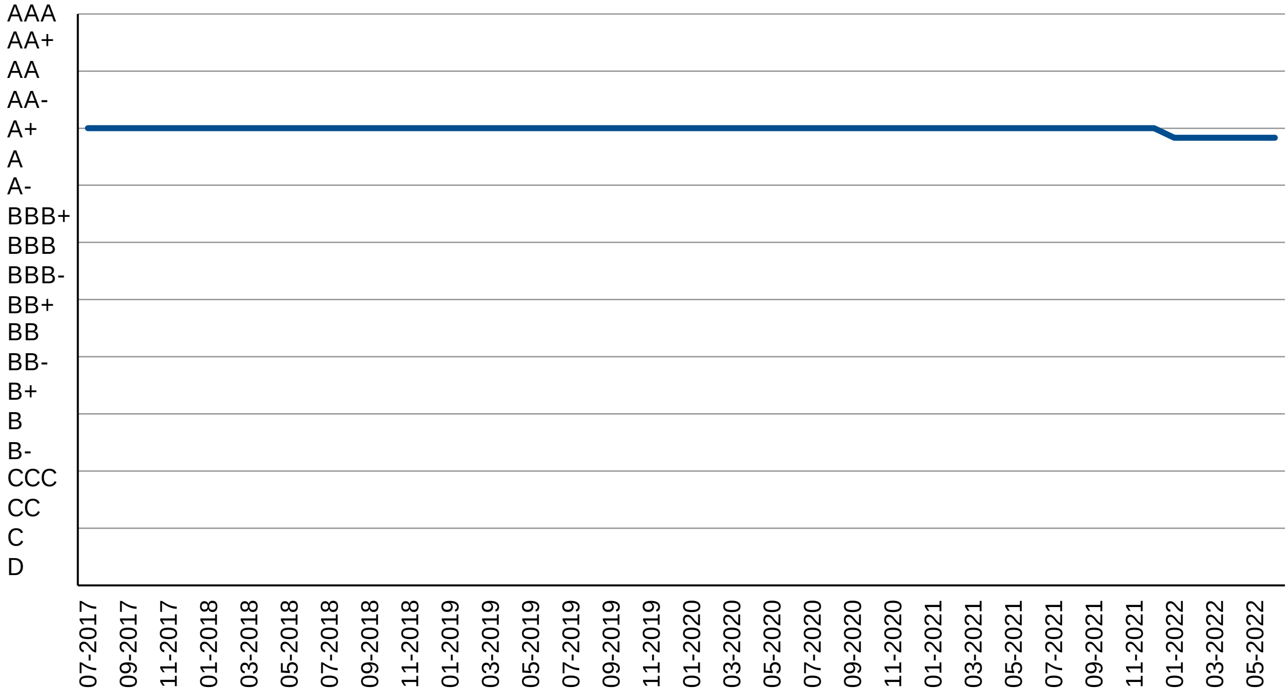
Source: European Commission, Scope Ratings GmbH

Old age dependency ratio, %



Source: United Nations, Scope Ratings GmbH

Appendix I. Rating history



NB. Positive/Negative Outlooks are treated with a +/-0.33-notch adjustment. Credit Watch positive/negative with a +/-0.67-notch adjustment.

Appendix II. Rating peers

Rating peers are related to sovereigns with an indicative rating in the same rating category or in adjacent categories per Scope's Core Variable Scorecard embedding a methodological reserve-currency adjustment.

Peer group*
Bulgaria
Cyprus
France
Italy
Japan
Latvia
Lithuania
Malta
Portugal
Slovakia
Slovenia
Spain

Publicly rated sovereigns only; the full sample may be larger.

Appendix III. Statistical table for selected CVS indicators

This table presents a selection of the indicators (24 out of 29 – with the governance indicator reflecting a composite of six indicators) used in Scope's quantitative model, the Core Variable Scorecard.

	2016	2017	2018	2019	2020	2021E	2022F	2023F
Domestic Economic Risk								
GDP per capita, USD '000s	12.4	13.9	15.5	15.7	15.7	17.8	18.5	20.0
Nominal GDP, USD bn	472.3	526.6	587.4	597.2	599.9	678.8	699.6	755.6
Real growth, %[1]	3.1	4.8	5.4	4.7	-2.2	5.9	4.9	3.1
CPI inflation, %[1]	-0.6	2.0	1.6	2.3	3.4	5.1	13.9	9.5
Unemployment rate, %[1]	6.3	5.0	3.9	3.3	3.2	3.4	2.7	2.7
Public Finance Risk								
Public debt, % of GDP[1]	54.2	50.6	48.8	45.6	57.1	53.8	48.3	45.2
Interest payment, % of government revenue	4.4	3.9	3.5	3.3	3.2	2.7	3.3	3.5
Primary balance, % of GDP[1]	-0.7	0.1	1.2	0.6	-5.6	-0.8	-1.8	-1.7
External Economic Risk								
Current account balance, % of GDP	-0.8	-0.4	-1.3	0.5	2.9	-0.9	-2.9	-2.7
Total reserves, months of imports	5.3	4.5	4.1	4.5	5.6	-	-	-
NIIP, % of GDP	-58.1	-66.4	-53.7	-50.4	-46.2	-38.3	-	-
Financial Stability Risk								
NPL ratio, % of total loans	4.0	3.9	3.9	3.8	3.7	2.9	-	-
Tier 1 ratio, % of risk-weighted assets	15.6	16.2	16.3	16.4	17.4	16.4	-	-
Credit to private sector, % of GDP	54.4	52.5	52.5	50.7	50.0	-	-	-
ESG Risk								
CO_2 per EUR 1,000 of GDP, $mtCO_2e$	291.1	289.4	275.0	248.9	239.1	-	-	-
Income quintile share ratio (S80/S20), x	4.9	4.6	4.7	-	-	-	-	-
Labour-force participation rate, %	69.1	69.9	70.4	70.9	-	-	-	-
Old-age dependency ratio, %	23.7	24.8	26.0	27.2	28.4	29.6	30.9	32.1
Composite governance indicator[2]	0.7	0.7	0.6	0.6	0.6	-	-	-

[1] Forecasted values are produced by Scope
[2] Average of the six World Bank Worldwide Governance Indicators
Source: European Commission, IMF WEO, World Bank, Scope Ratings GmbH

Appendix IV. Economic development and default indicators

IMF Development Classification	Advanced economy
5y USD CDS spread (bps) as of 30 June 2022	110.2

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