Republic of Poland Rating Report

SCOPE A+ STABLE OUTLOOK

Credit strengths

- Strong economic growth
- Sound fiscal and monetary framework
- Resilient banking system
- Adequate external buffers

Credit weaknesses

- High reliance on capital inflows
- Growing budgetary pressures
- Political uncertainties
- Demographic headwinds

Rating rationale and Outlook:

Poland's A+ rating is underpinned by the country's resilient economy and close integration within the European Union (EU), high coherence and credibility of its monetary and fiscal frameworks, including a constitutional public-debt brake mechanism. The ratings are constrained by more subdued long-term growth prospects, given demographic headwinds, growing convergence of living standards with those in western economies, low savings and private investment which result in high dependence on foreign capital. Ongoing political and policy uncertainty related to the economic policy framework and growing long-term budgetary pressures weigh on the rating. The Stable Outlook reflects Scope's view that the risks for the ratings remain broadly balanced.

Figure 1: Sovereign scorecard results

Scope's sovereign risk categories	Poland	Peer comparison	
		Average	Slovakia
Domestic economic risk			
Public finance risk			
External economic risk			
Financial risk			
Political and institutional risk			
Qualitative adjustment (notches)	1		1
Final rating	A+		A+

AAA	AA	A	BBB	BB	B	CCC	CC	C

NB. The comparison is based on Scope's Core Variable Scorecard (CVS), which is determined by the relative rankings of key sovereign credit fundamentals. The CVS peer group average is shown together with one selected country chosen from the entire CVS peer group. The CVS rating can normally be adjusted by up to three notches depending on the size of relative credit strengths or weaknesses.

Positive rating-change drivers

- Improvement of growth potential
- Improving fiscal performance, leading to further declines in public debt
- Strengthened external balance sheet

Negative rating-change drivers

- Protracted period of slow growth
- Fiscal slippage, resulting in deteriorating debt sustainability
- Escalating political conflicts with the EU

Ratings & Outlook

Foreign currency

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

Local currency

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

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Bloomberg: SCOP

Domestic economic risk

Growth potential of the economy

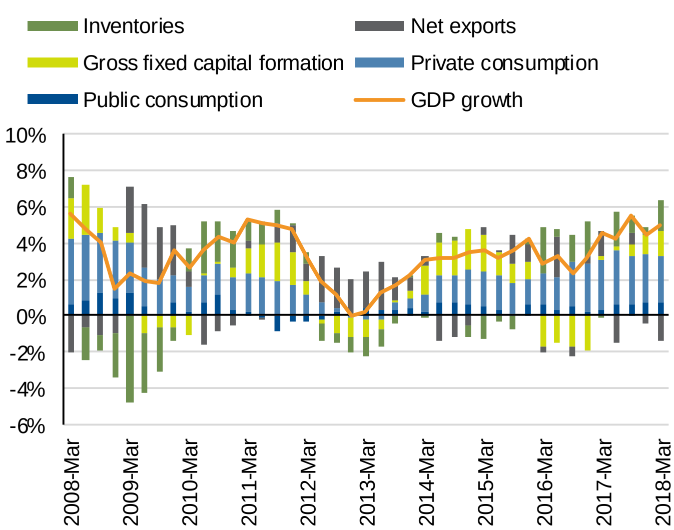
Strong private consumption growth in 2017

Poland belongs to the fastest-growing economies in the EU (average annual real GDP growth of 3.6% in 2007-2017) with very low economic and financial volatility. In 2017, Poland grew by 4.6%, predominantly driven by strong private consumption (as in the last few years), supported by a buoyant labour market, higher social transfers and record levels of consumer confidence. Public investment growth accelerated significantly in the second half of 2017 as the absorption of EU funds increased gradually. The pickup in public investment was driven by investments from local governments, which grew by 48.8% year-over-year in Q3 2017. In addition, exports were boosted by solid growth in the euro area, Poland's main export market.

Growth remains strong in 2018 2019

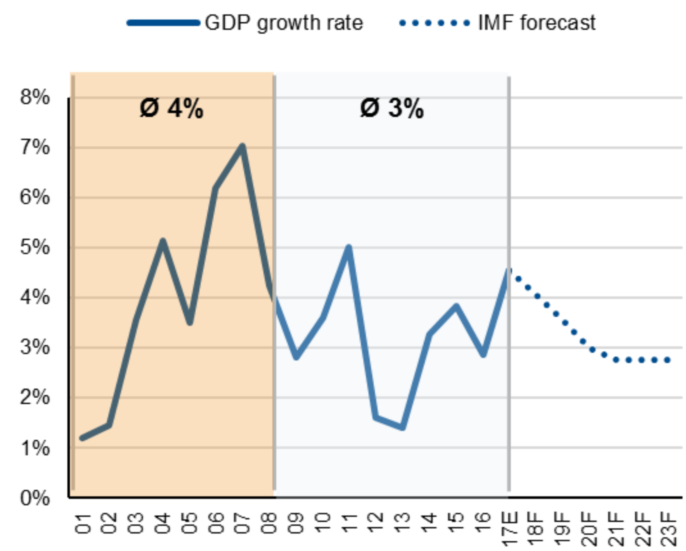
For 2018-2019, Scope expects GDP growth to remain strong, albeit gradually slowing to 4.1% this year, and 3.5% in 2019. Private consumption will be sustained by robust wage increases and low unemployment. The expected slowdown is mainly due to the negative contribution to growth from net exports, i.e. a worsening external balance. While export growth is likely to be moderate due to decreasing growth momentum in Europe, import growth will be sustained.

Figure 2: GDP growth by contributing component, % YoY



Source: Haver Analytics, Scope Ratings GmbH.

Figure 3: GDP growth, %



Source: Haver Analytics, IMF, Scope Ratings GmbH.

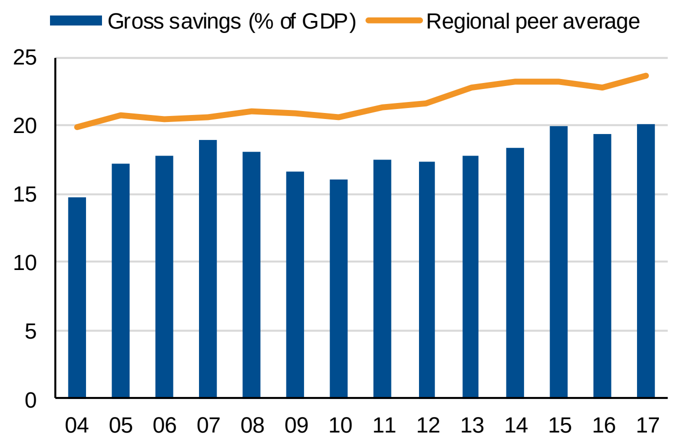
Investment has resumed since the second half of 2017

Investment growth in 2018-19 will continue to benefit from the high EU budget transfers that Poland secured in the 2014-20 budget framework. EU funds are often used as seed money in large projects to attract domestic investment. The faster drawing of EU funds, which is typical at the end of cohesion fund periods, strongly supported the resumption of investment growth since the second half of 2017, reflected in rising EU-financing contracts. As of the end of 2017, 55% of available EU funds for Poland in the current period to 2020 had been contracted, a similar ratio to that at the same point in the 2007-2013 financing phase. At the end of 2007-2013, Poland reached a final absorption rate of around 98%, the highest of any Eastern European country that has joined the EU since 2004 – signalling a potential pick-up going forward. Moreover, the current EU budget framework includes an additional three-year period (i.e. to 2023) in which countries can still draw funds, thereby increasing planning certainty, underpinned by a continuing low interest rate environment and a sound domestic banking sector.

Long-term challenges prevail

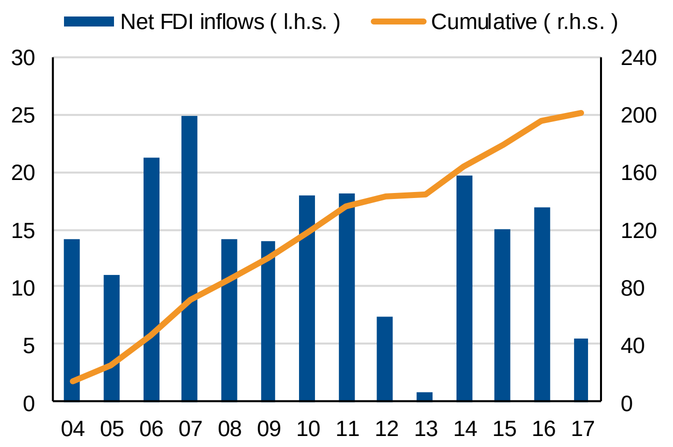
Scope notes that Polish growth rates are gradually declining (Figure 3), reflecting diminishing sources of past growth and a longer-term transition to slower growth rates as living standards converge towards those of western EU countries. While the short-to-medium-term growth outlook remains favourable, Poland's long-term economic growth prospects face considerable challenges, primarily demographic headwinds in the form of an expected decline in the working age population, underlining the need for increasing labour market participation and a better skilled workforce. The working-age population has been falling by 1% annually since 2012, resulting in steadily rising skilled labour shortages. The labour force participation rate has remained at a low 56% since 2012. As a positive development, Scope notes, however, that despite the reduction in the statutory retirement age (a flagship programme of the government), the effective retirement age has risen in recent years. However, as sources of strong past growth gradually diminish, Poland faces the challenge of becoming more innovative and positioning itself more favourably in global value chains.

Figure 4: Gross savings as a % of GDP



Source: Haver Analytics, Scope Ratings GmbH.

Figure 5: Net FDI inflows, 2004-2017 (in USD bn)



Source: Haver Analytics, National Bank of Poland, Scope Ratings GmbH.

Strong reliance on foreign capital for investment

Moreover, it is Scope's view that the low level of national savings is a further constraint on Poland's long-term growth prospects. Low national savings and weak business investment are typical in economies in Central and Eastern Europe (CEE). Poland's savings and investment rates have been lower than the average of its regional peer group[1] (Figure 4). In principle, this reflects the low investment rate of the Polish non-financial corporate sector on an aggregate level. Small- and medium-sized enterprises in Poland represent 99.8% of non-financial business investment and are typically labour-intensive, rather than capital-intensive.

However, Scope notes that the investment rate in the industry sector, as measured by gross fixed capital formation, was around 6% of GDP, which is high in an European context. Thus far, Poland has been successful in drawing strong foreign direct investment (FDI) and EU structural fund inflows. Consequently, despite low domestic savings, Poland has benefitted from a transfer of external savings to sustain robust domestic growth. Despite the substantial rise in Polish real wages, they remain considerably lower than in other EU countries. The resulting price competitiveness of Polish companies, in combination with a large domestic market, the country's strategic location in the centre of the CEE region, strong economic and financial links within the EU, including close integration in the German supply chain, all combine to continue to attract foreign direct investments (Figure 5).

[1] The regional peer group for Poland includes: Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Romania, the Slovak Republic and Slovenia.

Economic policy framework

Poland's low growth volatility and economic resilience is underpinned by the strong credibility of its structural and monetary policy frameworks, including effective policies in stemming macroeconomic imbalances and aiding crisis prevention, as demonstrated by the fact that Poland was the only country in the EU that did not go into recession during the global financial crisis.

Some policies have not been conducive to growth… Other measures have improved the country's social prospects

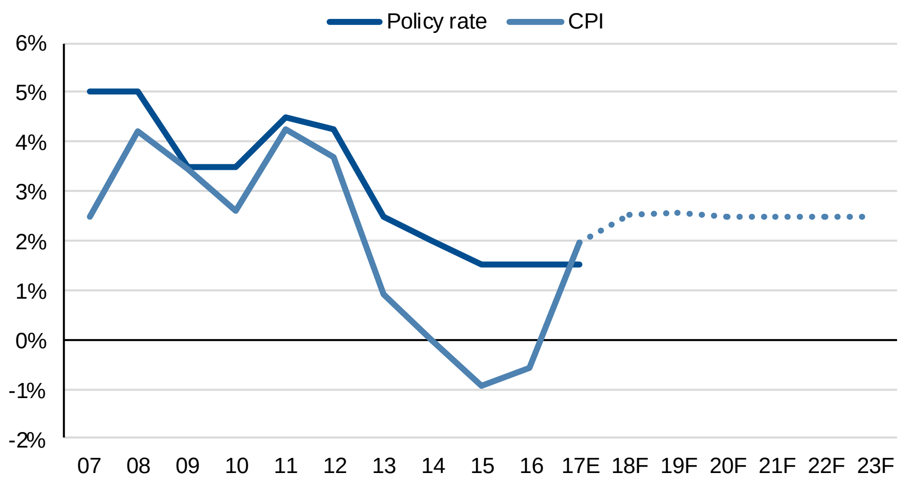
The government is committed to implementing structural reforms to boost productivity, private investment and labour force participation, which should help increase potential GDP growth and support the convergence process with EU living standards. The government's Plan for Responsible Development has identified low savings rates, productivity growth, and labour force participation rates as the main economic challenges. However, recent policies are likely to undermine the Plan's objectives in the short term. For example, a child benefit, (Family 500 plus programme), has led to increased female withdrawal from the labour force while the number of births increased by 5% in 2017. While some policies, such as lowering the retirement age, have not been conducive to growth, it is Scope's view that other measures have been undertaken to improve the country's economic and social prospects by reducing poverty levels and improving tax collection.

Poland's attractiveness for FDI is underpinned by its economic policy framework, setting various incentives. For example, the 'Programme for supporting investments of major importance to the Polish economy for years 2011-2023' includes the provision of government grants to investors in priority sectors (automotive and biotechnology), helping FDI to reach high returns. Nevertheless, the regulatory framework and other barriers to expansion place burdens on investment activity, reducing potential increases in productivity. In this regard Scope notes higher than usual uncertainty caused by abrupt regulatory changes. The government is committed to implementing reforms to increase the efficiency of the public administration, including procedures for public procurement, spatial planning, and building permits, all of which are key for the country's investment climate and regional development.

National footprint of economy has become more pronounced

In keeping with government strategy, state-owned and state-controlled companies are continuing to gain in importance. The government's strategy also aims at lowering dependence on foreign capital. As a result, the privatisation of state property has been discontinued, despite it having generated an average of 0.8% of GDP in revenues over 2000-15. Instead, the government supports a more active role for state-controlled companies in the banking and energy sectors and has created a new development fund to facilitate investment in high-tech sectors.

Figure 6: Consumer Price Index (CPI) YoY change, and policy rate (%)



Source: Haver Analytics, IMF, Scope Ratings.

Despite robust wage growth, inflation has remained low

Increasing bottlenecks in the form of labour shortages have been compensated for with large inflows of migrant workers from Ukraine, helping to contain wage pressures and inflation (Figure 6). Despite robust wage growth, headline inflation has remained below the central bank's target since 2012, and core inflation is even lower, at below 1%. It is Scope's view that the central bank is likely to keep the policy interest rate unchanged at 1.5%, where it's been since March 2015. Monetary Policy Committee members stress that interest rates can stay at current levels as falling unemployment has not yet led to higher inflation. However, wage growth suggests substantial tightening in the labour market and higher wages are likely to feed into higher core inflation during 2019, making interest rate hikes more likely.

Macroeconomic stability and sustainability

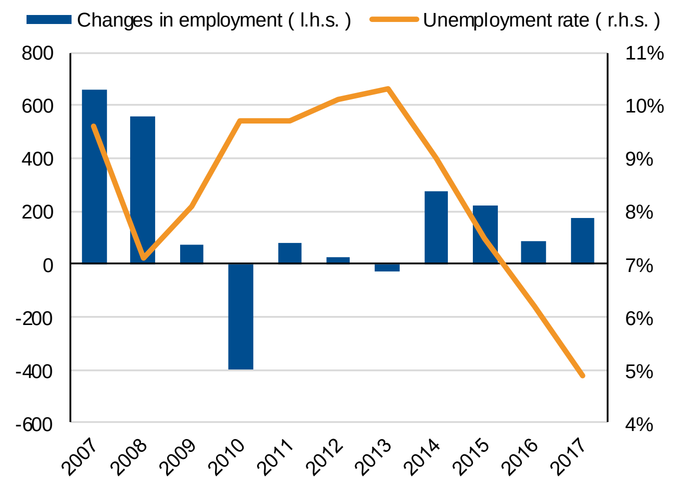
Poland is one of the most balanced economies in the EU

According to the results of the latest European Commission risk assessment[2], Poland is one of the most balanced economies in the EU. Private- and public-sector debt is among the lowest in the EU and financial sector liabilities are growing at a moderate pace. The rise in home prices is also slower than in most of the euro area as well as in Central and Eastern European countries. At the same time, the scale of both the decline in unemployment rates and the increase in economic activity in Poland markedly exceeds the EU average.

While living standards are converging towards those in western EU countries, Poland is not constrained by macro-economic imbalances arising from a lack of diversification, structural income inequalities, or social considerations. According to the European Commission Country Report on Poland for 2018, the country is making good progress in reaching the national targets set by the Europe 2020 strategy in the following areas: greenhouse gas emissions, poverty, energy efficiency, tertiary education, reducing early school leaving and the employment rate. Progress is limited in R&D investment and in renewable energy.

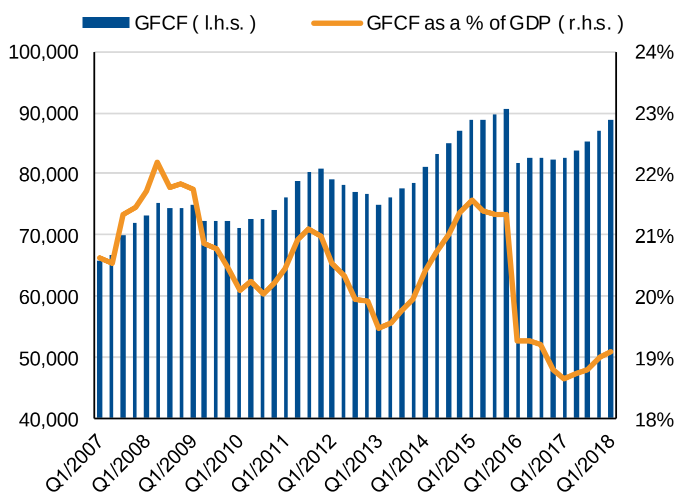
[2] European Commission's Alert Mechanism Report published at the end of 2017

Figure 7: Employment ('000s) and unemployment as a % of labour force



Source: Eurostat, Scope Ratings GmbH.

Figure 8: Gross fixed capital formation (PLN '000)



Source: Haver Analytics, Statistics Poland, Scope Ratings GmbH.

Poland needs to adapt to lower EU transfers based on the future EU budget framework

It is Scope's view that Poland will need to adopt policies conducive to sustainable long-term growth in view of notably lower EU transfers from the EU budget framework covering the 2021-27 period. The European Commission has proposed cuts to both its cohesion and agriculture programmes, reducing spending in these areas by 11% and 18% respectively. This would result in a loss to Poland of around 15% of earmarked EU funds but the remaining funds would remain at a high level, in line with previous expectations when the current EU budget framework was determined, including allocations of more than EUR 100bn to Poland, equivalent to 2.5% of GDP. While Poland made significant progress in the previous budget framework, including major infrastructure upgrades and large investments in machinery and equipment in the agricultural sector, the effects of lower EU transfers would not be immediate, as the 2014-20 EU budget cycle allows for an additional three-year period in which countries can still draw funds; providing additional planning certainty for Poland.

Public finance risk

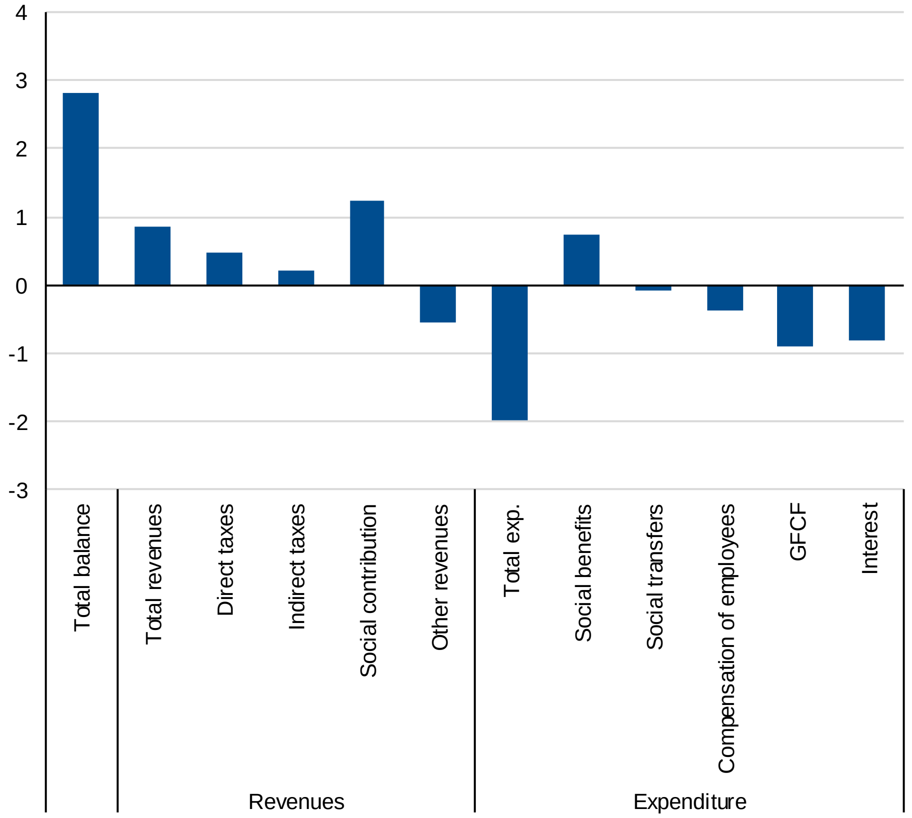
Fiscal policy framework

Comprehensive EU fiscal framework, underpinned by constitutionally anchored debt brake mechanism

Poland benefits from its EU membership and the EU's fiscal policy framework. Under this framework, a sovereign is bound by strict deficit and debt boundaries of 3% and 60% of GDP respectively, may be subject to the Excessive Deficit Procedure and is expected to be heading towards country-specific structural fiscal benchmarks. Moreover, Poland has additional strong fiscal safeguards anchored in its national law. Two prudent debt-to-GDP thresholds of 55% and 60% automatically trigger corrective fiscal policy actions when breached. In Scope's opinion, Poland's EU membership and national framework create a credible public finance framework[3].

[3] Scope has a positive view on Poland's constitutional ban on incurring loans and granting guarantees that could cause public debt to exceed 60% of GDP. Poland's Public Finance Act includes a stabilising expenditure rule that incorporates a correction mechanism for adjusting the growth of expenditures should the public-debt-to-GDP ratio exceed 43% and 48% thresholds. There are also additional prudential procedures which would be followed in the event of public debt-to-GDP breaching a 55% limit.

Figure 9: Changes in Poland's general government balance and its components, as % of GDP, differences between averages 2015-19F and 2010-14



Source: Haver Analytics, AMECO, Scope Ratings.

Sustained fiscal improvements

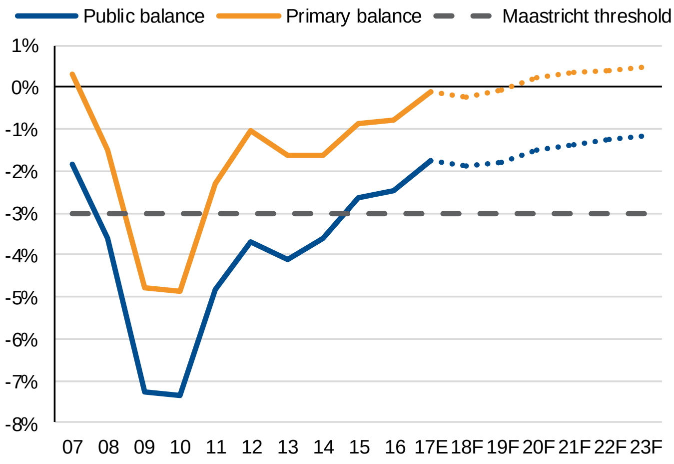
Following the 2010-14 period, when Poland was still subject to the Excessive Deficit Procedure[4], the forecasted improvement in the general government balance is equivalent to 2.8% of GDP in the 2015-19 period (Figure 9).

Long-term budgetary pressures are rising

The general government deficit more than halved to 1.7% of GDP in 2017 from 3.6% of GDP in 2014, while the primary deficit decreased from 1.7% of GDP to 0.1%, reflecting strong economic growth and strengthened tax compliance. Expenditures between 2014 and 2017 have risen in nominal terms (by PLN 90bn), yet the ratio of expenditures to GDP fell by 1%. Scope notes increasing long-term budgetary pressures due to heightened social spending, particularly higher pensions and child benefits. Moreover, the long-term costs of the reversal of the 2013 lifting of the retirement age need to be funded on a regular, less cyclical basis. Previously announced tax cuts, such as cuts to the VAT rate, are being postponed indefinitely. This year's fiscal stance is roughly neutral and the general government deficit is expected to widen slightly to 1.9% of GDP in 2018.

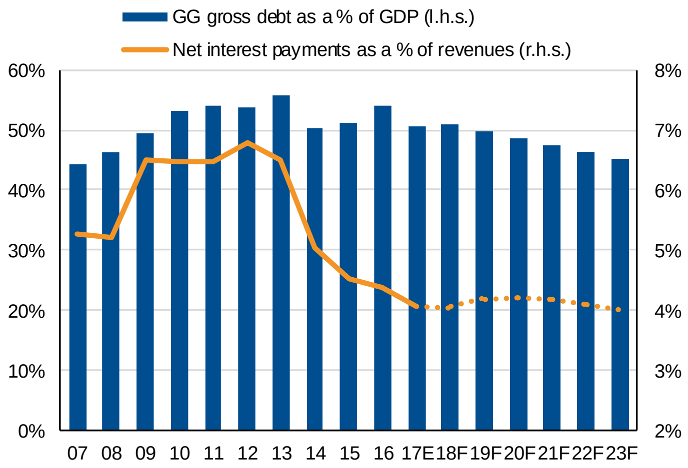
[4] Poland was subject to the EU Excessive Deficit Procedure from 2009-15; the Excessive Deficit Procedure – also called the 'corrective arm' of the Stability and Growth Pact – is triggered for a member state whenever the general government deficit is in excess of a 3% of GDP threshold, which cannot be treated as exceptional, or if the general government gross debt-to-GDP ratio exceeds a 60% of GDP threshold and is not diminishing at a satisfactory pace. Poland's deficit in 2008 amounted to 3.9% of GDP, while gross debt remained well below the 60% of GDP threshold – at 47.1%.
https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact/corrective-arm-excessive-deficit-procedure/closed-excessive-deficit-procedures/poland_en

Figure 10: Fiscal developments, % of GDP



Source: Haver Analytics, IMF, Scope Ratings GmbH.

Figure 11: Debt and interest burden



Source: Haver Analytics, IMF, Scope Ratings GmbH.

Moderate debt level and lowered interest payments result in larger fiscal space

Going forward, Poland's primary balance is expected to gradually increase and remain slightly in surplus over the long term (Figure 10), while the general government deficit will remain below the Maastricht threshold of 3% of GDP. In addition, favourable financing costs have notably reduced Poland's interest payments burden over the last five years (Figure 11), providing more fiscal space for the government. Poland's general government debt decreased by PLN 3bn, in nominal terms, to PLN 1,003bn in 2017, equivalent to around 50.6% of GDP (down from 54.2% of GDP in 2016). According to the domestic definition[5], public debt declined by 3.4 percentage points to 48.5% of GDP in 2017.

Debt sustainability

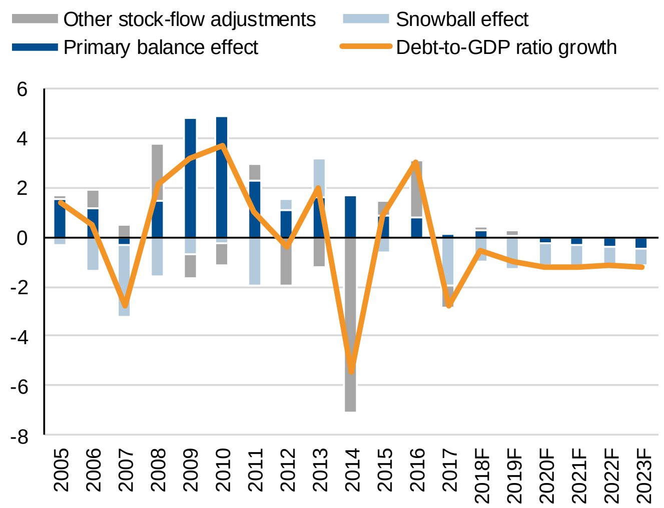
Robust debt-reducing trend

Poland benefits from moderate public debt levels, robust economic growth, low financing costs and contingent liabilities, and a small primary surplus, resulting in a sustained trend in debt reduction overall (Figure 12). Consequently, the IMF forecasts that the Polish debt-to-GDP ratio will decline to 45% in 2023.

Scope's public debt sustainability analysis, based on IMF forecasts and scenarios with growth, interest-rate and primary-balance shocks, confirms that Poland's debt is on a sound trajectory with a further gradual decline expected. Scope assesses Poland's public debt dynamics as adequate because of their relative robustness across several scenarios over the projection period to 2023 (Figure 13). Hypothetical stressed scenarios were reviewed, such as a protracted growth slowdown or banking sector stress in the euro area, Brexit-related risks as well as increased volatility in international financial markets with negative spillovers via trade, financial and confidence channels, weighing on GDP growth. Furthermore, external risks were reviewed, as these could threaten Poland's public debt dynamics, given its sizeable external financing needs, leading to higher financing costs. In scenarios in which Polish debt-to-GDP ratios breach the constitutionally-anchored threshold of 60% of GDP, budgetary correction mechanisms in line with the constitutional public debt brake mechanism would be applied, enforcing fiscal consolidation and reducing the primary deficit at an early stage.

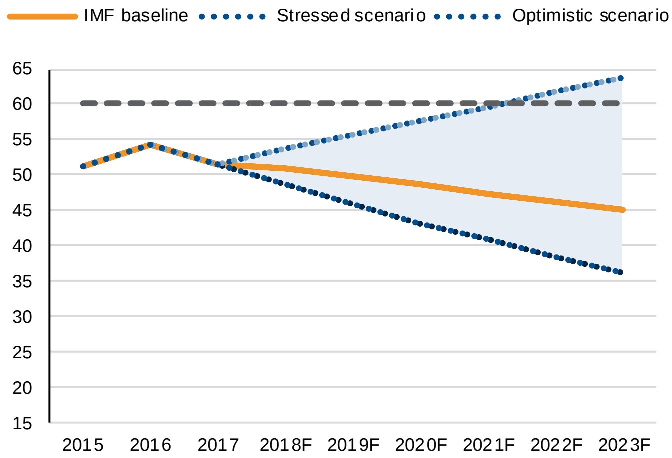
[5] The main differences between the domestic and international definition of government debt are related to the scope of the public sector (mainly the inclusion of the National Road Fund in general government debt).

Figure 12: Contribution to gov. debt changes, % of GDP



Source: IMF, Scope Ratings GmbH.

Figure 13: Government debt, % of GDP[6]



Source: IMF, Scope Ratings GmbH.

Scenario	Time Period	Real GDP growth (%)	Primary bal. (% of GDP)	Real eff. int. rate (%)	Debt end period (% of GDP)
History	2013-2017	3.2	-1.0	2.8	51.4
IMF Baseline	2018-2023	3.1	0.2	1.3	45.0
Optimistic Scenario		4.8	0.7	1.0	36.2
Stressed Scenario		1.6	-1.5	2.7	63.7

Source: IMF World Economic Outlook April 2018, Scope Ratings

Market access and funding sources

Strategic debt management targets are being met

Targets for public debt management set out in the Polish debt management strategy framework[7] are approved annually by parliament and have been regularly met. The financing of the state budget borrowing requirements was predominantly realised in domestic currency (84.3%) in the period from January-May 2018. The average maturity of domestic state treasury debt decreased to 4.45 years by the end of June 2018, down from 4.49 years at the end of 2017. The overall average time to maturity was 5.04 years at the end of June 2018 and the share of foreign-currency-denominated debt in state treasury debt decreased to 31.3% in Q1 2018 from 34.7% in Q4 2016.

In the third quarter of 2018, between two and three auctions of Treasury Bonds are planned with a total placement between PLN 8bn and PLN 18bn[8]. Treasury Bonds are largely bought by domestic banks, reflecting higher domestic demand for short-term government bonds in view of bank tax regulation and strong deposit growth.

After the second quarter of 2018, 60% of this year's state budget borrowing requirements have already been financed. In recent months, government bond yields in Poland have

[6] The general government gross debt-to-GDP ratio at the end of 2017 amounted to 50.6% of GDP, well below the Maastricht criterion of 60% of GDP.

[7] For 2018 to 2021 the strategy envisages that: i) the domestic market will remain the main source of finance for state budget borrowing requirements; ii) the average time to maturity of domestic debt must be maintained at a level of no less than four years, with the aim of achieving an ultimate level of 4.5 years; iii) the overall average time to maturity should be close to five years, and; iv) the state debt share of foreign-currency-denominated debt should be reduced to below 30%, with the effective share of EUR debt in foreign currency debt at a minimum of 70% with possible temporary deviations in the event of unfavourable market conditions.

[8] See *State budget borrowing requirements' financing plan and its background,* July 2018 https://www.finanse.mf.gov.pl/documents/766655/50940ecb-db1a-4361-92d0-db291b1ab9d1

been relatively stable, despite a significant growth of yields in developed markets, reflecting Poland's regional safe-haven status.

External economic risk

Current account vulnerabilities

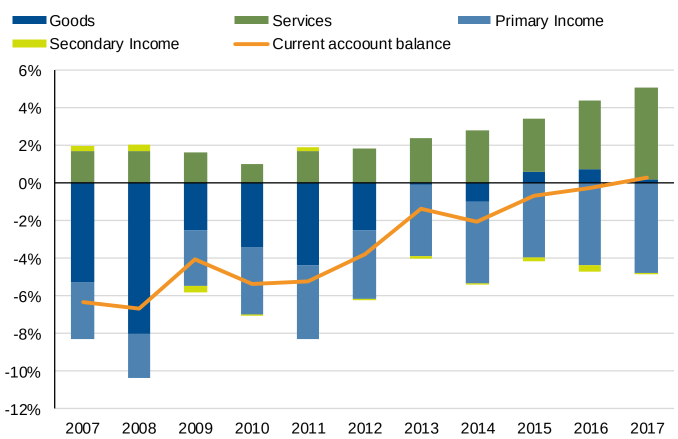
Scope views Polish current account vulnerabilities as moderate. Polish current accounts have been almost in balance from 2015 to 2017, despite strong private consumption growth. Moreover, the high quality of funding sources for previous current account deficits were largely the result of long-term foreign direct investment capital inflows, intra-company loans and EU structural funds. As a consequence, Poland is less exposed to capital flight during periods of financial market turbulence.

First current account surplus in history reached in 2017

In 2017, the current account swung into surplus for the first time in history. This was due to a high trade surplus in the second half of 2017, coupled with a primary income deficit reflecting income related to FDI. Another factor helping to keep the trade balance positive was a rising surplus in the trade of services. At the same time, the recovery in Polish goods exports in the second half of 2017 was accompanied by the faster growth of goods imports, which translated into a lower balance in goods trade.

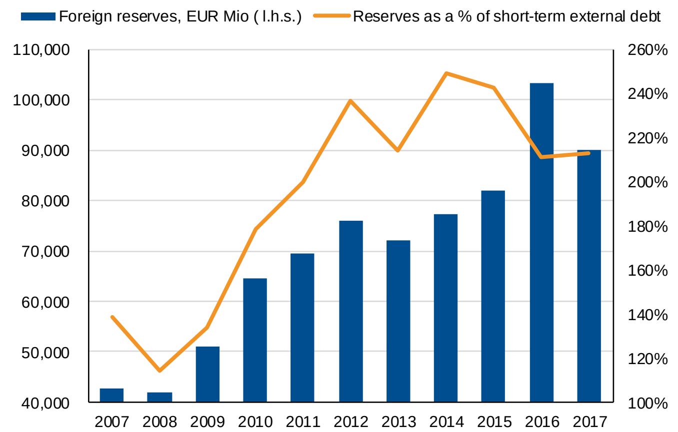
According to preliminary data, the current account balance was negative in Q1 2018, amounting to -0.2% of GDP in terms of a four-quarter rolling sum. Over the medium term, Scope expects Poland's export sector to support economic growth, underpinned by improving competitiveness and reflected in Poland's gains in export market shares, particularly in business services (Figure 14).

Figure 14: Current account balance and its components, % of GDP



Source: Haver Analytics, IMF, Scope Ratings GmbH.

Figure 15: Reserves to short-term external debt, excluding intercompany lending



Source: Haver Analytics, National Bank of Poland, Scope Ratings GmbH.

External debt sustainability

Improving external robustness

External economic risks are currently at historically low levels. Poland's negative net international investment position is typical of catching-up economies, as they tend to import more capital from abroad. Scope sees Poland's foreign liabilities favourably, as approximately half of Poland's foreign liabilities are foreign direct investments. Moreover, almost a third is related to stable non-debt instruments, including, among others, equity and the reinvestment of profits. Poland's net external debt, has systematically declined in recent years.

Vulnerability to short-term external shocks

Limited vulnerability to short-term shocks

Poland's external robustness has strengthened, supporting the country's ability to continue servicing foreign currency debt in the event of short-lived external market shutdowns. Sufficient internal foreign currency resources have boosted resilience to market volatility, as reflected by improving reserve adequacy. Poland's official reserves remain broadly adequate, covering nearly five months of imports or 214% of short-term external debt (excluding inter-company lending) at the end of March 2018. Thanks to strengthened external robustness, Poland ended the Flexible Credit Line IMF arrangement in November 2017. This precautionary buffer against potential external shocks had been approved in the amount of EUR 20.6bn in 2009, when Poland's reserve adequacy was critical.

Financial stability risk

Financial sector performance

Banks' profitability improved in 2017, ending a downward trend from previous years due to new taxation on financial sector assets and higher contributions to bank guarantee and relief funds. The total profit earned by the banking sector was close to 2016 levels when banks reported one-off revenue from the sale of a stake in Visa Europe Limited. Scope views the capital position of the banking system as good with low leverage. In 2017, banks continued to increase their regulatory capital, maintaining a high average level of 18%.

Banks remain profitable and well-capitalised

The quality of banks' loan portfolios was stable in 2017, with non-performing loan ratios declining to 7% in 2017. The portfolio of foreign currency mortgage loans remains a potential vulnerability for the banking sector. However, the quality of the portfolio remains solid, despite significant foreign exchange shocks in the past. Moreover, the high share of deposits, especially household deposits, in banks' liabilities, and a simultaneous decrease in wholesale funding, supports the stable funding of banks and the mitigation of liquidity risks. Banks are meeting their supervisory liquidity ratios.

Financial sector oversight and governance

Banks have successfully absorbed new bank tax

The bank resolution framework, in accordance with the European Bank Recovery and Resolution Directive, took effect in early October 2016, supporting the mitigation of systemic risks. Banks have successfully absorbed the new bank asset tax, inducing them to significantly increase holdings of government bonds, which are excluded from the banking sector tax base.

Parliament abandoned plans to impose an immediate and mandatory conversion of foreign currency mortgages for Polish banks. These now represent less than 10% of total private credit and 5% of GDP. The original proposal for a mandatory conversion of foreign currency mortgages has been replaced with a scheme requiring banks to repay 'excessive' spreads charged unfairly to mortgage borrowers. The potential cost here is estimated at PLN 4bn-9bn and is much lower than the potential PLN 67bn cost of mandatory conversion, which would have been equivalent to 3.7% of GDP in 2015 or six times annual banking sector profits. The Financial Stability Committee recently recommended a new rule to raise to 150% from 100% the risk weight of Polish bank exposure to foreign currency mortgages used for calculating capital adequacy, aimed at providing an incentive for banks to convert their foreign currency mortgages into PLN voluntarily over time.

Macro-financial vulnerabilities and fragility

No major vulnerabilities

Scope views the Polish financial system as stable, supported by a domestic economic environment that exhibits no major vulnerabilities. The levels and growth rates of debt held by non-financial enterprises and households remains moderate and does not create imbalances in the economy or the financial system. Scope does not see signs of an excessive easing of banks' lending policies, and the credit cycle in Poland indicates that the risks of excessive lending are low. Credit growth in 2017 was slightly lower than nominal GDP growth. As a result, the countercyclical buffer was retained at 0%. The domestic residential real estate market is in an expansion phase, but strong growth here has not yet generated heightened price tensions as rising demand is satisfied by adequate levels of supply.

Institutional and political risk

Perceived willingness to pay

Poland joined the EU in 2004 and has fully adopted the EU's regulatory framework, providing an anchor for institutional stability and predictability. Poland's willingness to pay has been demonstrated, e.g. in its treatment of the Flexible Credit Line under the IMF arrangement at a time when external vulnerabilities were more pronounced. Poland used the credit line only as a precautionary measure while committing to improve its foreign exchange reserves adequacy and fiscal policy[9]. In fact, the credit line was not actually drawn upon. In Scope's view, Poland is as likely as any EU member to honour debt obligations in full and on time. Scope does not consider that the ongoing dispute between the European Commission and the incumbent Polish government over the reform of the judiciary system will affect Poland's willingness to pay debt obligations.

Recent events and policy decisions

The centre-right single-party majority government (PiS, Law and Justice Party) has been in office since November 2015 and has fulfilled several campaign promises, including the introduction of new child benefits and a reduction in the retirement age to 60 years for women and 65 for men, both have been gradually introduced at the end of 2017.

Recent policy events have been negative

Scope believes that the ongoing political and policy uncertainty is set to continue. Judges loyal to the government have controversially been appointed to Poland's constitutional court and other courts are set to follow suit. Tensions with the EU over the 'Rule of Law' procedure initiated by the European Commission are ongoing, and the risk of sanctioning mechanisms (which would result in a reduction in EU voting rights and/or sanctions) has not dissipated. Nevertheless, Scope does not expect tensions with the EU and recent policy initiatives to have a material negative effect on Poland's robust economic performance.

In April 2018, the presidential bill concerning the Supreme Court came into force. Under the new law, the retirement age for judges was cut to 65 years, allowing a number of judges to be removed before their terms would normally have expired. Scope will closely monitor the current situation, particularly focusing on whether the Polish authorities will further escalate the situation over the Supreme Court, which would weigh on relations with the European Commission.

Future private investment will largely depend on the macroeconomic outlook for Poland and on the stability and quality of law and institutions, including the policy and regulatory environment. The rule of law, including the independence of the judiciary and legal certainty, is also of key importance.

[9] The IMF Flexible Credit Line is designed for crisis prevention purposes and provides countries with the flexibility to draw on the credit line whenever needed over the time of the arrangement. Disbursements are neither phased nor conditional on compliance with policy targets as is the case for traditional IMF-supported programmes. The credit line can only be granted to countries with strong fundamentals and policies. The Flexible Credit Line is a renewable credit line, which can be approved for either one or two years. There is no cap on access to Fund resources under the Flexible Credit Line, and access is determined on a case-by-case basis. http://www.imf.org/en/News/Articles/2017/11/02/pr17418-poland-ends-the-two-year-flexible-credit-line-arrangement-with-the-imf

Geopolitical risk

Poland has been a member of NATO since 1999 and is not directly engaged in any conflict. The ongoing war on the eastern border between Ukraine and Russia has not directly affected Poland. Thus, in Scope's opinion, Poland is as likely as its European partners to be affected by geopolitical threats.

Methodology

The methodology applicable for this rating and/or rating outlook, Public Finance Sovereign Ratings, is available at www.scoperatings.com.

Historical default rates from Scope Ratings can be viewed in Scope's rating performance report at https://www.scoperatings.com/#governance-and-policies/regulatory-ESMA. Please also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA) at http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope's definition of default and definitions of rating notations can be found in Scope's public credit rating methodologies at www.scoperatings.com.

The rating outlook indicates the most likely direction of the rating if the rating were to change within the next 12 to 18 months. A rating change is not automatically ensured, however.

I. Appendix: CVS and QS results

Sovereign rating scorecards

Scope's Core Variable Scorecard (CVS), which is based on the relative rankings of key sovereign credit fundamentals, provides an indicative 'A' ('a') rating range for the Republic of Poland. This indicative rating range can be adjusted by up to three notches on the Qualitative Scorecard (QS) depending on the size of relative credit strengths or weaknesses versus peers based on analysts' qualitative findings.

For the Republic of Poland, the following relative credit strengths have been identified: i) growth potential of the economy; ii) fiscal policy framework; and iii) market access and funding sources. Relative credit weaknesses are: i) vulnerability to external short-term shocks; and ii) poor recent events and poor policy decisions. The combined relative credit strengths and weaknesses generate a positive one-notch adjustment and indicate a sovereign rating of A+ for the Republic of Poland. A rating committee has discussed and confirmed these results.

Rating overview

CVS category rating range	a
QS adjustment	A+
Final rating	A+

In order to calculate the rating score within the CVS, Scope uses a minimum-maximum algorithm to determine a rating score for each of the 24 indicators. Scope calculates the minimum and maximum of each rating indicator and places each sovereign within this range. Sovereigns with the strongest results for each rating indicator receive the highest rating score; sovereigns with the weakest results receive the lowest rating score. The score result translates into an indicative rating range that is always presented in lower case.

Within the QS assessment, analysts conduct a comprehensive review of the qualitative factors. This includes but is not limited to an economic scenario analysis, a review of debt sustainability, fiscal and financial performance, and policy implementation assessments.

There are three assessments per category for a total of 15. For each assessment, the analyst examines the relative position of a given sovereign within its peer group. For this purpose, additional comparative analysis beyond the variables included in the CVS is conducted. These assessments are then aggregated using the same weighting system as in the CVS.

The result is the implied QS notch adjustment, which is the basis for the analysts' recommendation to the rating committee.

Foreign- versus local-currency ratings

The Republic of Poland's public debt is predominately issued in domestic currency while a third of public debt is in foreign currency, mainly in euros. Poland has an established history of open capital accounts and local-currency debt issuance, which does not provide for a rating bias in favour of either local-currency or foreign-currency debt. Consequently, Scope sees no reason to believe that Poland would differentiate between any of its contractual debt obligations based on currency denomination. Furthermore, the recent history of sovereign defaults does not provide a strong justification for a rating bias in favour of either local-currency or foreign-currency debt.

II. Appendix: CVS and QS results

CVS

Rating indicator	Category weight
Domestic economic risk	35%
Economic growth	
Real GDP growth	
Real GDP volatility	
GDP per capita	
Inflation rate	
Labour & population	
Unemployment rate	
Population growth	
Public finance risk	30%
Fiscal balance	
GG public balance	
GG primary balance	
GG gross financing needs	
Public debt	
GG net debt	
Interest payments	
External economic risk	15%
International position	
International investment position	
Importance of currency	
Current-account financing	
Current-account balance	
T-W effective exchange rate	
Total external debt	
Institutional and political risk	10%
Control of corruption	
Voice & accountability	
Rule of law	
Financial risk	10%
Non-performing loans	
Liquid assets	
Credit-to-GDP gap	
Indicative rating range	**a**
QS adjustment	**A+**
Final rating	**A+**

QS

Maximum adjustment = 3 notches

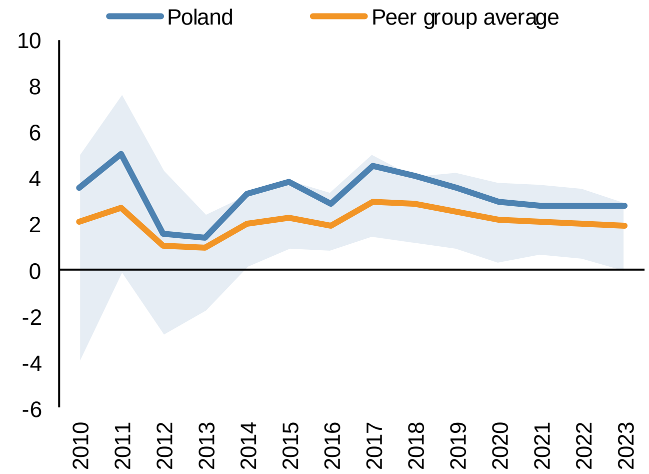
	+2 notch	+1 notch	0 notch	-1 notch	-2 notch
Growth potential of the economy	○ Excellent outlook, strong growth potential	◉ Strong outlook, good growth potential	○ Neutral	○ Weak outlook, growth potential under trend	○ Very weak outlook, growth potential wel under trend or negative
Economic policy framework	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate
Macro-economic stability and sustainability	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate
Fiscal policy framework	○ Exceptionally strong performance	◉ Strong performance	○ Neutral	○ Weak performance	○ Problematic performance
Debt sustainability	○ Exceptionally strong sustainability	○ Strong sustainability	◉ Neutral	○ Weak sustainability	○ Not sustainable
Market access and funding sources	○ Excellent access	◉ Very good access	○ Neutral	○ Poor access	○ Very weak access
Current account vulnerability	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate
External debt sustainability	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate
Vulnerability to short-term external shocks	○ Excellent resilience	○ Good resilience	○ Neutral	◉ Vulnerable to shock	○ Strongly vulnerable to shocks
Perceived willingness to pay	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate
Recent events and policy decisions	○ Excellent	○ Good	○ Neutral	◉ Poor	○ Inadequate
Geopolitical risk	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate
Banking sector performance	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate
Banking sector oversight and governance	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate
Financial imbalances and financial fragility	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate

*** Implied QS notch adjustment = (QS notch adjustment for domestic economic risk)*0.35 + (QS notch adjustment for public finance risk)*0.30 + (QS notch adjustment for external economic risk)*0.15 + (QS notch adjustment for institutional and political risk)*0.10 + (QS notch adjustment for financial stability risk)*0.10**

Source: Scope Ratings GmbH.

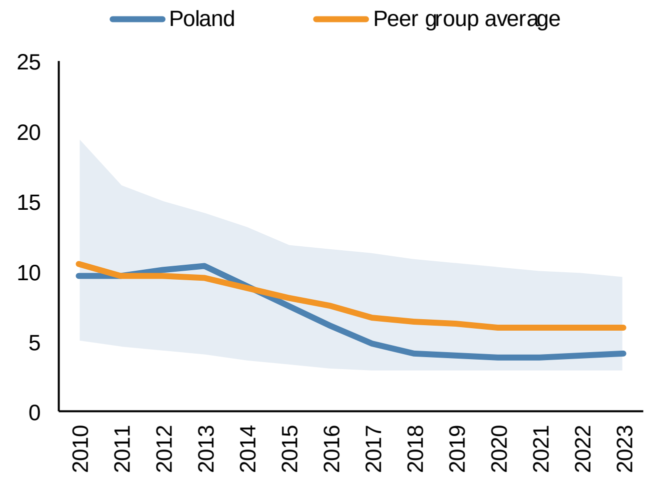
III. Appendix: Peer comparison

Figure 16: Real GDP growth



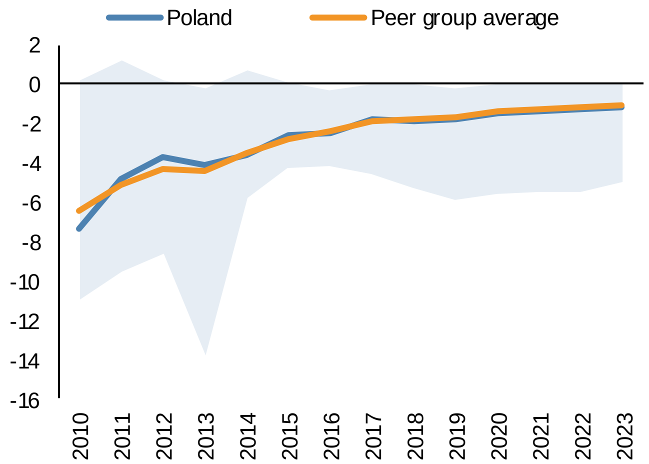
Source: IMF, Calculations Scope Ratings GmbH

Figure 17: Unemployment rate, % labour force



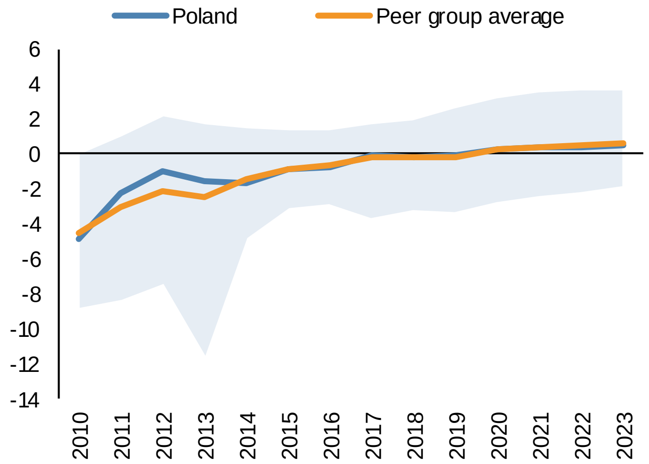
Source: IMF, Calculations Scope Ratings GmbH

Figure 18: General government balance, % of GDP



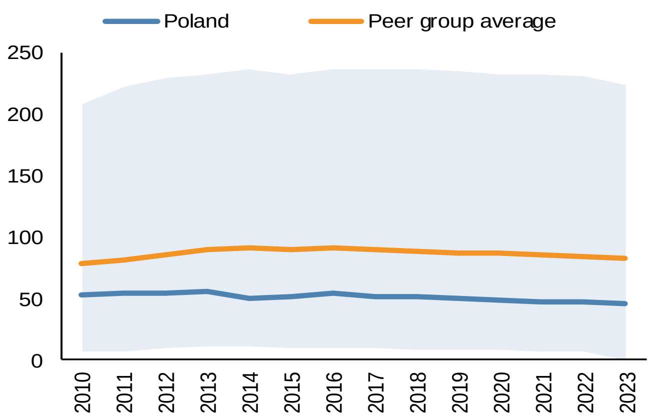
Source: IMF, Calculations Scope Ratings GmbH

Figure 19: General government primary balance, % of GDP



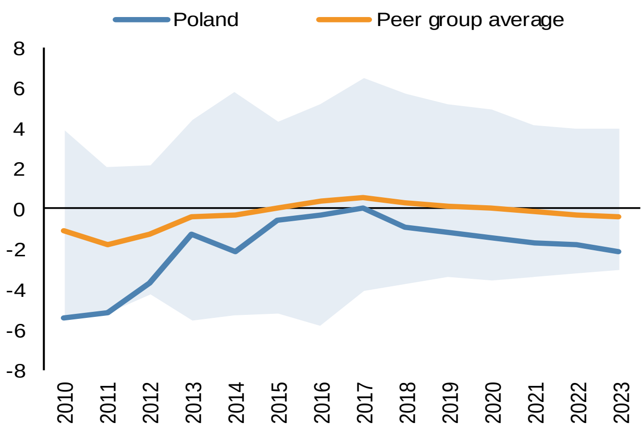
Source: IMF, Calculations Scope Ratings GmbH

Figure 20: General government gross debt, % of GDP



Source: IMF, Calculations Scope Ratings GmbH

Figure 21: Current account balance, % of GDP



Source: IMF, Calculations Scope Ratings GmbH

IV. Appendix: Statistical table

	2013	2014	2015	2016	2017	2018E	2019F
Economic performance							
Nominal GDP (PLN bn)	1.656,9	1.719,8	1.799,4	1.858,6	1.982,3	2.085,0	2.208,3
Population ('000s)	38.063,0	38.018,0	38.006,0	37.967,0	37.973,0	37.961,0	37.943,0
GDP per capita PPP (USD)	24.719,3	25.602,4	26.594,8	27.383,3	29.291,4	-	-
GDP per capita (PLN)	43.530,9	45.235,8	47.345,4	48.953,7	52.202,4	54.926,0	58.199,2
Real GDP, % change	1,4	3,3	3,8	3,0	4,6	4,1	3,5
GDP growth volatility (10-year rolling SD)	1,8	1,8	1,8	1,6	1,2	1,2	1,2
CPI, % change	0,9	0,0	-0,9	-0,6	2,0	2,5	2,5
Unemployment rate (%)	10,3	9,0	7,5	6,2	4,9	4,1	4,0
Investment (% of GDP)	19,0	20,4	20,5	19,6	20,0	21,1	21,6
Gross national savings (% of GDP)	17,7	18,3	19,9	19,3	20,0	20,2	20,4
Public finances							
Net lending/borrowing (% of GDP)	-4,1	-3,6	-2,6	-2,5	-1,7	-1,9	-1,8
Primary net lending/borrowing (% of GDP)	-1,6	-1,7	-0,9	-0,8	-0,1	-0,2	-0,1
Revenue (% of GDP)	38,5	38,7	38,9	38,7	39,8	40,8	41,1
Expenditure (% of GDP)	42,6	42,3	41,6	41,2	41,5	42,7	42,8
Net interest payments (% of GDP)	2,5	1,9	1,8	1,7	1,6	1,7	1,7
Net interest payments (% of revenue)	6,5	5,0	4,5	4,4	4,1	4,1	4,2
Gross debt (% of GDP)	55,7	50,2	51,1	54,2	50,6	50,8	49,8
Net debt (% of GDP)	50,9	44,5	46,4	48,1	46,7	46,1	45,1
Gross debt (% of revenue)	144,7	129,9	131,3	139,9	129,2	124,6	121,3
External vulnerability							
Gross external debt (% of GDP)	70,5	71,2	70,4	75,1	67,9	-	-
Net external debt (% of GDP)	36,1	36,4	34,7	32,1	29,7	-	-
Current-account balance (% of GDP)	-1,3	-2,1	-0,6	-0,3	0,2	-0,9	-1,2
Trade balance (% of GDP)	-	-0,8	0,5	0,7	0,1	-0,4	-0,6
Net direct investment (% of GDP)	-0,8	-2,4	-2,1	-1,2	-0,7	-	-
Official forex reserves (EOP, EUR mn)	72.153,6	77.408,4	81.867,7	103.455,7	90.167,6	-	-
REER, % change	0,2	0,9	-2,3	-3,5	2,4	-	-
Nominal exchange rate (EOP, PLN/EUR)	4,1	4,3	4,3	4,4	4,2	-	-
Financial stability							
Non-performing loans (% of total loans)	6,0	5,4	5,0	4,7	4,7	-	-
Tier 1 ratio (%)	14,0	13,7	14,5	15,4	16,3	-	-
Consolidated private debt (% of GDP)	75,4	78,1	78,9	81,6	76,5	-	-
Domestic credit-to-GDP gap (%)	-5,0	-4,9	-6,1	-3,8	-10,0	-	-

Source: IMF, ECB, EC, National Bank of Poland, Ministry of Finance of Republic of Poland, Haver Analytics, Statistics Poland Scope Ratings GmbH.

V. Regulatory disclosures

This credit rating and/or rating outlook is issued by Scope Ratings GmbH.

Rating prepared by Jakob Suwalski, Associate Director

Person responsible for approval of the rating: Dr Giacomo Barisone, Managing Director

The ratings/outlook were first assigned by Scope as subscription rating in January 2003. The subscription ratings/outlooks were last updated on 28.07.2017. The senior unsecured debt ratings as well as the short-term issuer ratings were last assigned by Scope on 28.07.2017.

Solicitation, key sources and quality of information

The rating was initiated by Scope and was not requested by the rated entity or its agents. The rated entity and/or its agents did not participate in the ratings process. Scope had no access to accounts, management and/or other relevant internal documents for the rated entity or related third party.

The following substantially material sources of information were used to prepare the credit rating: public domain and third parties. Key sources of information for the rating include: Ministry of Finance of Poland, National Bank of Poland, Statistics Poland, BIS, European Commission, European Central Bank, Statistical Office of the European Communities (Eurostat), IMF, OECD, IMF, OECD, Haver Analytics and the World Bank.

Scope considers the quality of information available to Scope on the rated entity or instrument to be satisfactory. The information and data supporting Scope's ratings originate from sources Scope considers to be reliable and accurate. Scope does not, however, independently verify the reliability and accuracy of the information and data.

Prior to the issuance of rating action, the rated entity was given the opportunity to review the rating and/or outlook and the principal grounds upon which the credit rating and/or outlook is based. Following that review, the rating was not amended before being issued.

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