Republic of Poland
Rating Report

A
STABLE OUTLOOK

Credit strengths

- Strong macroeconomic fundamentals
- Robust growth potential
- Moderate public debt, cash cushion and deep capital markets
- Liquid, well-capitalised banking system

Credit challenges

- Weakening of governance institutions
- Marked deterioration in inflation outlook
- Economic and geopolitical risks associated with the Russia-Ukraine war
- Comparatively weak debt structure

Rating rationale:

Robust macroeconomic fundamentals: Poland's credit ratings are anchored by a large, diversified economy and strong macroeconomic fundamentals. The Polish economy proved comparatively resilient in the face of Covid-19 and cost-of-living economic crises to date and presents comparatively strong longer-run economic growth potential.

Moderate level of public debt: Poland's general government debt ratio stood at a moderate 49.1% of GDP as of the end of 2022, representing nevertheless a rise from the 45.7% ratio as of end-2019. We see the general government debt ratio dipping further to 48% this year before resuming a modest upside trajectory medium run, reaching around 51% by 2028.

Profitable, liquid and well-capitalised domestic banking system: Non-performing loan (NPL) ratios are below their pre-Covid crisis levels. Tier 1 capital and liquidity coverage ratios remain strong, having stabilised above pre-pandemic averages. FX-related risks remain outstanding in the domestic banking system, such as regarding legacy Swiss-franc mortgage loans.

Ratings challenges include: i) a longer-standing trend of weakening of governance institutions, furthermore raising uncertainties around European Union (EU) funding; ii) a marked deterioration of the outlook for underlying inflation; iii) economic and geopolitical risks following escalation of Russia's war in Ukraine; iv) a comparatively weaker structure of government debt and rises in government expenditure; and v) social and environmental risks.

Poland's sovereign rating drivers

Risk pillars		Quantitative		Reserve currency	Qualitative*	Final rating
		Weight	Indicative rating	Notches	Notches	
Domestic Economic Risk		35%	a-	PLN [+0]	+2/3	A
Public Finance Risk		20%	aa-		+1/3	
External Economic Risk		10%	b		+1/3	
Financial Stability Risk		10%	aaa		+2/3	
ESG Risk	Environmental Factors	5%	bbb-		0	
	Social Factors	7.5%	bb		0	
	Governance Factors	12.5%	bb+		-1/3	
Indicative outcome			**bbb+**		**+2**	
Additional considerations					**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 Stable Outlook reflects Scope's view that risks to the ratings are presently balanced over the forthcoming 12-18 months.

Positive rating-change drivers

- Reduced governance risk
- Budgetary performance improves
- External balance sheet strengths materially
- Social and environmental risks redressed

Negative rating-change drivers

- Governance risks continue or escalate
- Weakening of budget discipline
- External shock and/or weakening of the external-risk profile

Ratings and 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: RESP SCOP

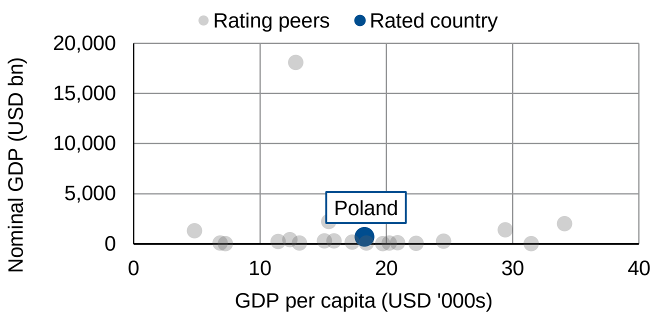
Domestic Economic Risks

- **Growth outlook:** The Polish economy experienced robust economic growth of 5.1% in 2022, anchored by strong household consumption and build-up in inventories. Nevertheless, economic momentum decelerated markedly as the year progressed, as subdued consumer and business confidence, tighter funding conditions and inflation weighed on private demand, resulting in a 2.3% QoQ decline in GDP during the last quarter of the year. Output rebounded 3.8% QoQ in Q1 2023, although this was largely due to improvements in net foreign trade amid easing supply-chain bottlenecks, subdued domestic demand and declining global commodity prices. In annual terms, growth is expected to decelerate to 2% this year, reflecting dampening effects of inflation on real incomes and elevated nominal interest rates on private demand. It should pick up to 2.8% next year, and edge up to potential, estimated around 3.0% annually, over the subsequent years. These forecasts acknowledge working-age population decline averaging 0.9% per annum over 2023-28 according to UN projections.
- **Inflation and monetary policy:** Price pressures remain very elevated, with consumer-price-index (CPI) inflation standing at 13.0% YoY as of May 2023, having eased from February 2023 peaks of 18.4% primarily owing to declines in energy prices and comparatively more favourable base effects. However, core inflation (excluding food and energy prices) remains near multi-decade highs, at 12.2% in April, reflecting high underlying price pressures, under a context of tight labour markets and still-strong household demand, the latter benefitting from budgetary support. The National Bank of Poland hiked its policy rate to 6.75% by September 2022, before pausing the hike cycle.
- **Labour market:** Labour-market dynamics have stayed strong so far despite the cooling of economic momentum, as reflected in elevated employment (of those aged 15-64), at 71.8% as of Q4 2022, and an unemployment rate still near historic lows, at 2.7% as of April 2023. Unemployment is seen averaging 2.7% in 2023-24. Since escalation of the war in Ukraine, the relocation of Ukrainian refugees is estimated to have raised labour supply in Poland by 2.1% by the end of 2022, helping to ease to a degree the tightness in labour markets, with the number of job vacancies declining over recent months. Nevertheless, the vacancy rate remains elevated, reflecting labour shortages. Nominal wage growth is strong, despite having eased somewhat during recent months (+12.1% YoY as of April), risking making high inflation more endurant.

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

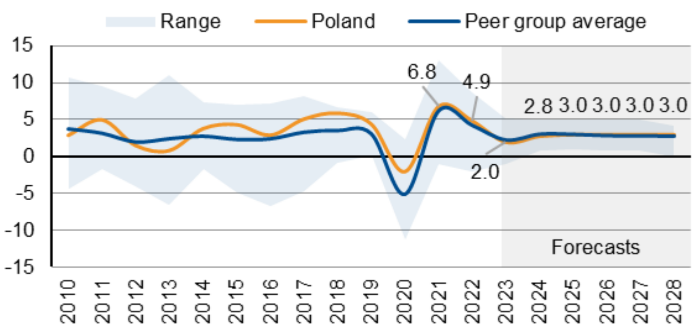
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a-	Growth potential of the economy	Strong	+1/3	Robust growth potential; long-term growth prospects supported by EU funding
	Monetary policy framework	Neutral	0	Elevated although declining inflation; negative real policy rates of the central bank
	Macro-economic stability and sustainability	Strong	+1/3	Large, diversified economy and competitive export base; long-run sustainability of growth reliant on foreign funding, external demand

Nominal GDP and GDP per capita, USD



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

Real GDP growth, %



Source: IMF WEO, Scope Ratings forecasts

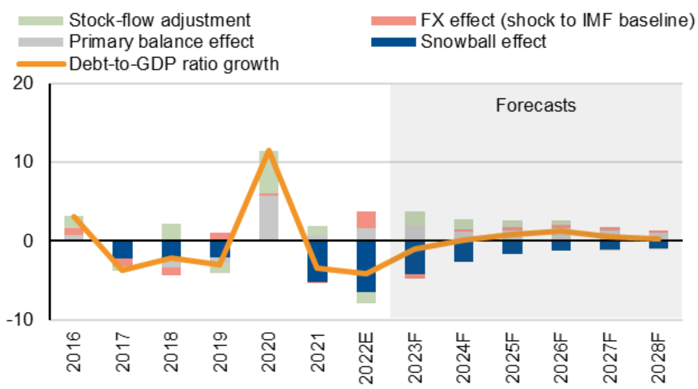
Public Finance Risks

- **Fiscal outlook:** After receding to 1.8% of GDP in 2021, the general government budget deficit widened to 3.7% of GDP last year, reflecting the impact of spending measures aimed at alleviating the effects of higher energy prices on the private sector, as well as expenditure associated with support for recent arrivals from Ukraine, outweighing the favourable revenue boost from strong nominal economic growth. Further spending pressures, related to growing personnel, pensions and welfare costs under a context of persistently elevated inflation, rising interest payments, as well as hikes in military expenditure (expected to reach 4% of GDP this year, from around 2.4% in 2022) weigh on the medium-run budgetary outlook. We expect the headline general government deficit to weaken modestly to 3.6% of GDP this year, before 2.8% of GDP in 2024 and averaging around 3.3% of GDP a year during 2025-28.
- **Debt trajectory:** Poland's general government debt-to-GDP ratio declined to 49.1% in 2022, from 53.6% the previous year-end, thanks to strong nominal economic growth and despite a higher fiscal deficit last year. The debt ratio is seen dipping further to 48.1% this year, before resuming a gradually rising trend medium run, concluding a forecast horizon to 2028 around 51.3% (5.6pps above end-2019 levels), due to the combined effects of sustained primary fiscal deficits and rising interest payments.
- **Debt profile & market access:** A comparatively short average maturity of Polish State Treasury debt (5.3 years) and outstanding foreign-exchange risks, given 23.3% of outstanding treasury debt being foreign-exchange-denominated (although this share was 36.7% as of early 2016), represent credit-rating constraints. Foreign debt of Poland has similarly dropped to 23.3% of aggregate debt by Q1 2023, from 34.4% as of 2016. Similar to for regional peers, government bond yields for Poland rose significantly last year before stabilising over recent months with the yield on 10-year zloty bonds averaging 6.1% since the beginning of this year (after moderating from October-2022 highs of 8.8%, nevertheless still well above lows of 1.5% as of July 2021). Credit strengths associate with a comfortable cash cushion (PLN 115.5bn on budgetary accounts at end-April 2023) and deep domestic capital markets. Rule-of-law contentions cast some uncertainties around EU balance of payments assistance potentially required under adverse economic scenarios.

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

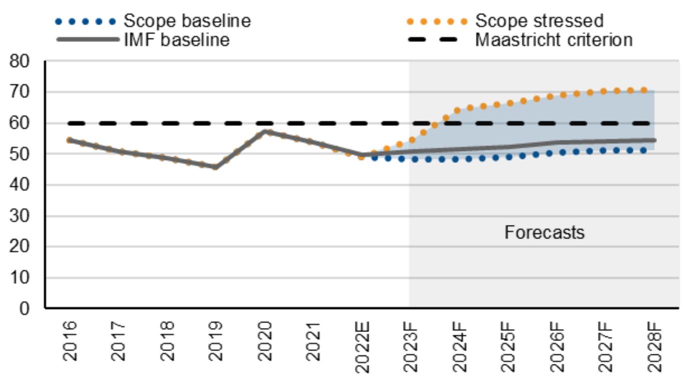
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aa-	Fiscal policy framework	Neutral	0	Fiscal dynamics are hindered by spending demands amid a present cost-of-living crisis, as well as due to significant social spending
	Debt sustainability	Strong	+1/3	Comparatively moderate debt levels and more benign longer-term ageing-related spending pressures; only small increase expected in public indebtedness over the forecast horizon
	Debt profile and market access	Neutral	0	Moderate average maturity of treasuries; foreign-exchange risks; moderate gross financing requirements; 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

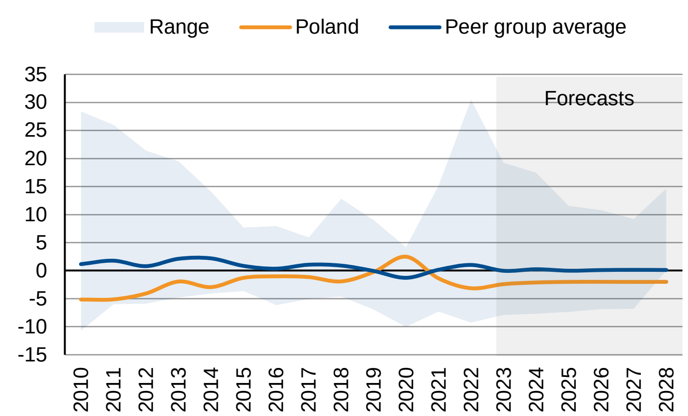
External Economic Risks

- **Current account:** Poland's external balance had improved during the run up to the Covid-19 crisis, from a current-account deficit of 6.7% of GDP in 2008 reaching a more modest 0.2% of GDP deficit by 2019, in part reflecting strengthening external-sector competitiveness. After reaching a temporary surplus of 2.5% of GDP in 2020, the current-account balance reverted to a 1.4% of GDP deficit by 2021. The deficit widened to 3% of GDP last year under a context of higher nominal energy and commodity imports, and disruptions of trade with Russia, Belarus and Ukraine (which had amounted to about 5.6% of Polish exports of goods as of 2021, before escalation of the Ukraine war), and despite robust services exports performance and recent easing of some supply-chain disruptions. Moving ahead, the IMF expects the current account to only gradually recover – concluding a forecast horizon to 2028 around -2% of GDP.
- **External position:** Poland's external sector is bolstered by structural capital-account surpluses anchored by EU fund inflows, reflecting a strong quality of underlying external financing, given foreign direct investment (FDI) liabilities constituting around half of gross external liabilities. Inward FDI amounted to 4% of GDP in the year to March 2023, up from 3.1% in 2020 and 2.9% in 2019. The net international investment position strengthened to -34% of GDP by end-2022, from lows of -69% in 2014. Gross foreign debt stood at 53% of GDP as of end-2022, reduced from 2016 peaks of 76%. The composition of foreign debt is furthermore favourable, being primarily comprised of long-term liabilities (amounting to over 80% of total debt).
- **Resilience to short-term external shocks:** After declining sharply against the euro initially after Russia's further invasion of Ukraine, zloty has rallied since late last year in line with improvements in the external balance. Foreign-exchange reserves strengthened to around USD 155bn by April 2023, after weakening last year from foreign-currency sales in defence of the currency as well as shifts in the value of dollar against other reserve currencies. Forex reserves presently represent 95% coverage of short-term external debt (the latter on a remaining-maturity basis), still off 2021 peaks of nearly 100% coverage and representing a comparatively modest coverage compared with that of regional peer economies.

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

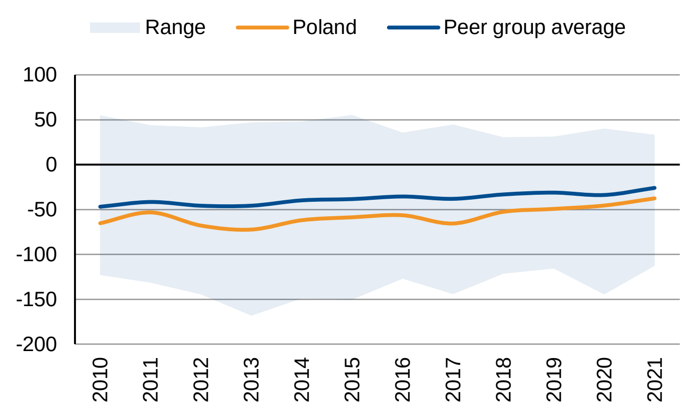
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
b	Current account resilience	Strong	+1/3	Recent strengthening of the current account, but strong (historical) financing resilience via EU funding and foreign direct investment
	External debt structure	Strong	+1/3	Poland's external debt stock has been reduced over the past years and is characterised by a low share of short-term liabilities, and significant share of intercompany lending
	Resilience to short-term external shocks	Weak	-1/3	Moderate foreign-exchange reserves compared with that of regional peers; strong peer group composed of many reserve-currency economies

Current-account balance, % of GDP



Source: IMF WEO, Scope Ratings

Net international investment position (NIIP), % of GDP



Source: IMF, Scope Ratings

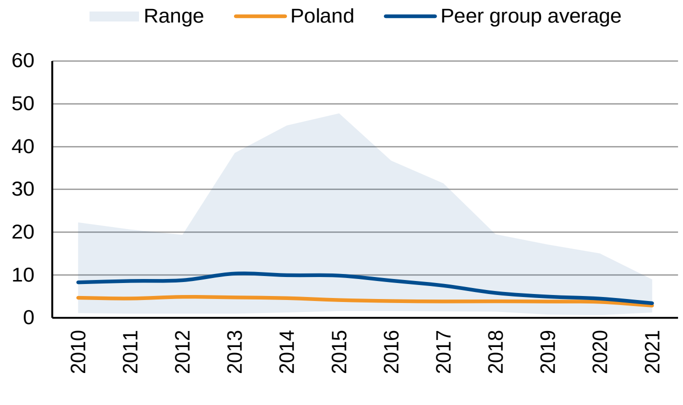
Financial Stability Risks

- **Banking sector:** The resilience of the Polish banking sector is underpinned by sound capitalisation and profitability metrics, with strong aggregate tier-1 capital and return on equity ratios of 16.6% and 9.0% respectively as of Q4 2022. The NPL ratio declined to 4.2% of gross loans by Q4 2022, below end-2019 levels. A sharp rise in lending rates ought to support interest margins over the coming years, although headwinds related to an increase in credit risk and the potential prolongation of the moratorium for mortgage loan repayments over 2023 may weigh on banking-sector profitability near term. Main challenges include the resolution of CHF-denominated housing loans, totalling about EUR 10.8bn, which could require large additional loan-loss provisioning. In September 2022, Getin Noble Bank, the nation's tenth largest lender (assets of EUR 9.1bn) entered resolution proceedings, requiring the contribution from the Polish resolution authority of EUR 1.4bn, in part due to losses from heavy exposures to franc loans.
- **Private debt:** Aggregate non-financial private debt is low, at 67% of GDP as of end-2022, under half the average for the euro area (162%). Higher mortgage lending rates and tighter lending standards cut household credit growth, as reflected in a decline in loans to households in recent months (-5.0% YoY in April 2023). Polish households are exposed to interest-rate risks in view of significant variable-rate mortgages outstanding (around 90% of overall mortgages). This vulnerability is, however, mitigated by moderate levels of household debt, favourable debt-servicing ratios, as well as the government mortgage payment holiday and borrower support fund.
- **Financial imbalances:** Housing-price growth has decelerated markedly over the recent months, to 4.9% YoY by Q1 2023 (from 17.4% YoY in Q1 2022), in line with higher borrowing rates and soft economic growth. In February 2022, the European Systemic Risk Board indicated it perceived limited evidence of overvaluation in the housing market, and assessed the current policy stance as appropriate and sufficient to address outstanding risks. Nevertheless, legal risks from foreign-currency loans are a vulnerability, with financial regulator KNF warning in October 2022 that the banking sector could face a PLN 100bn (EUR 22bn) charge in the case of an adverse ruling from the Court of Justice of the European Union, although provisions of PLN 37bn have already been created.

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

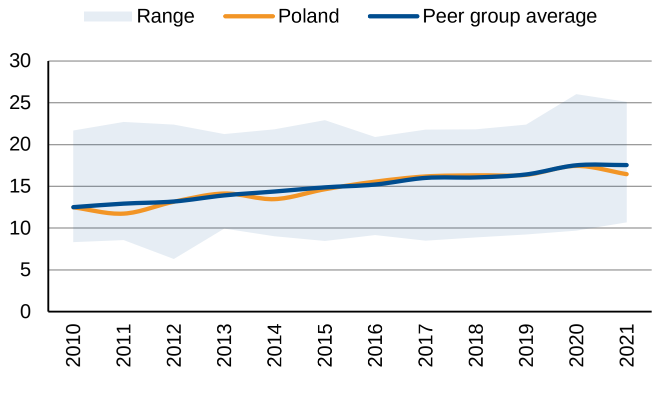
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Banking sector performance	Strong	+1/3	Profitable, liquid and well-capitalised banking system. FX risks, including from the resolution of Swiss franc mortgages.
	Banking sector oversight	Neutral	0	Effective financial-sector oversight
	Financial imbalances	Strong	+1/3	Low private-sector debt level; high variable-rate mortgages outstanding but risks mitigated by moderate household debt levels and payment holiday

Non-performing loans, % of total loans



Source: IMF, Scope Ratings

Tier 1 ratio, % of risk-weighted assets



Source: IMF, Scope Ratings

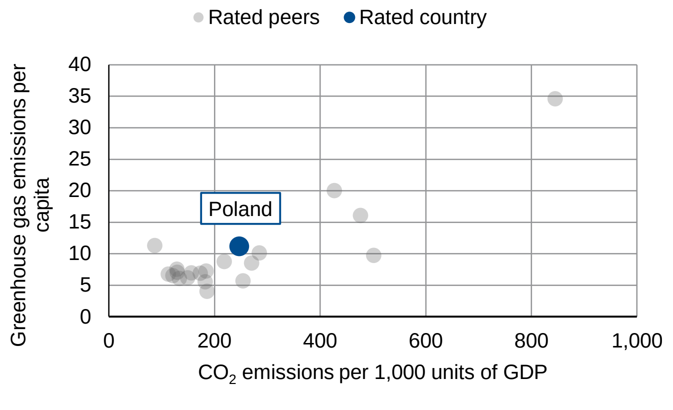
ESG Risks

- **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 has been elevated, having represented more than a third of gross energy available. However, this dependence has declined during recent years, allowing Poland to locate other suppliers after Russia halted natural-gas exports to Poland in April 2022. Poland adopted an energy strategy in 2021 pledging to significantly cut coal-fired power by the 2040s, with a main contribution to coal-based emissions stemming from its power sector. Poland participates under the European Emissions Trading System, creating incentives to cut emissions. The country's energy transition strategy targets 30% reductions of emissions by 2030 relative to 1990 levels.
- **Social:** The working-age population is seen declining around 0.9% annually over 2023-28, causing a steadily growing skilled-labour shortage, although demographic pressures eased temporarily with large refugee arrivals from Ukraine since Russia's full-scale invasion (around 1mn presently). While the net present value of expected pensions spending changes is benign at -5.5% of GDP over 2022-50 (IMF projections), the net present value of health-care spending changes is more material for Poland at 33.8% of GDP over the same period.
- **Governance:** On 15 February 2023, the European Commission (EC) decided to refer Poland to the Court of Justice of the European Union for violations of EU law by the Constitutional Tribunal relating to a breach of the primacy of EU law. On a separate matter, in February 2023, the Polish parliament voted on a bill aiming to address some of the conditions as defined by the EC to unlock funding allocated under the Recovery and Resilience Plan, such as amendments of disciplinary procedures against the nation's judges. The legislation's promulgation has, however, been suspended following Polish president Andrzej Duda's decision to postpone approval and refer the bill to the Constitutional Tribunal for adjudication. Performance of Poland on World Bank Worldwide Governance Indicators has weakened since 2014. Next parliamentary elections are to be held no later than November 2023.

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

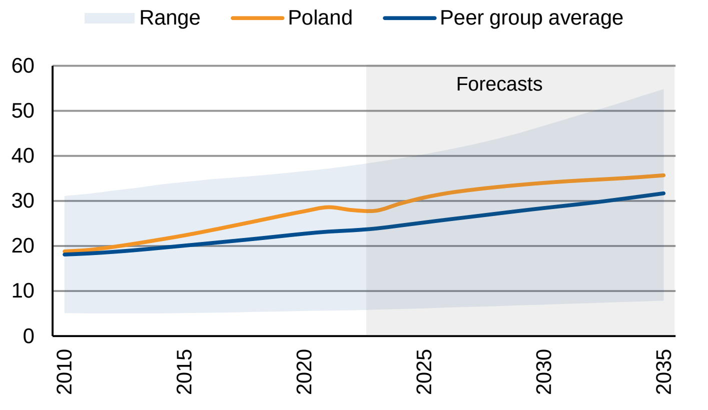
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bb+	Environmental factors	Neutral	0	Structural challenges relating to transition risk to the green economy due to having to phase out coal dependency
	Social factors	Neutral	0	Adverse demographics result in declining working-age population but demographic boost from recent arrivals from Ukraine; below-average skills of the labour force; comparatively low poverty and strong labour market
	Governance factors	Weak	-1/3	Institutional challenges; polarised domestic political conditions

Emissions per GDP and per capita, $mtCO_2e$



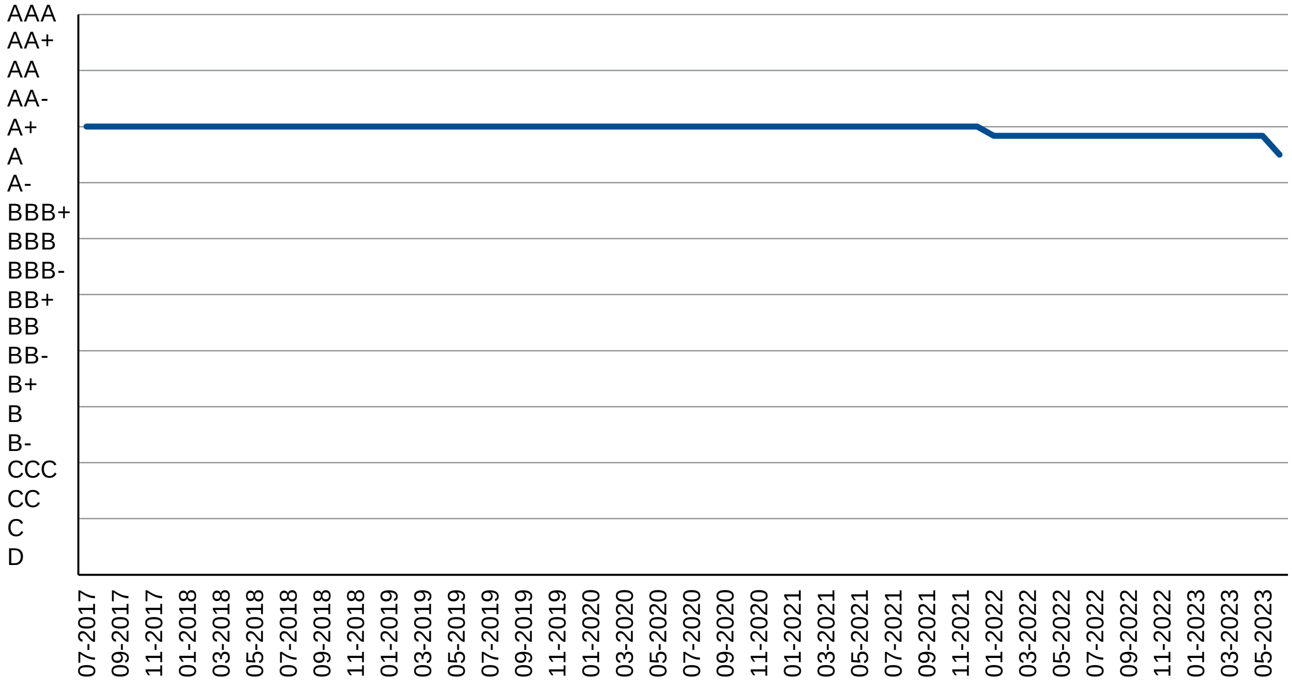
Source: European Commission, Scope Ratings

Old age dependency ratio, %



Source: United Nations, Scope Ratings

Appendix I. Rating history (foreign-currency long-term debt)



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, including a methodological reserve-currency adjustment.

Peer group*
Bulgaria
China
Croatia
Cyprus
Hungary
Italy
Latvia
Portugal
Romania
Slovakia
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 30 – with the governance indicator reflecting a composite of six indicators) used in Scope's quantitative model, the Core Variable Scorecard, in line with Scope's Sovereign Rating Methodology. The metrics and sources for the data presented here ensure comparability across global peers and may therefore differ from national and other selective international statistics.

Pillar	Core variable	Source	2018	2019	2020	2021	2022
Domestic Economic	**GDP per capita, USD '000s**	IMF	15.5	15.7	15.8	18.0	18.3
	Nominal GDP, USD bn	IMF	588.8	596.0	599.5	679.5	688.3
	Real growth, %	National statistics	5.9	4.4	-2.0	6.9	5.1
	CPI inflation, %	National statistics	1.6	2.3	3.4	5.1	14.4
	Unemployment rate, %	National statistics	3.9	3.3	3.2	3.4	2.9
Public Finance	**Public debt, % of GDP**	National statistics	48.8	45.7	57.2	53.6	49.1
	Net interest payment, % of revenue	IMF	3.5	3.3	3.2	2.6	3.5
	Primary balance, % of GDP	AMECO	1.2	0.6	-5.6	-0.7	-2.2
External Economic	**Current-account balance, % of GDP**	National statistics	-1.9	-0.2	2.5	-1.4	-3.0
	Total reserves (incl. gold), months of imports of goods & services	WB	4.1	4.5	5.6	4.7	-
	NIIP, % of GDP	IMF	-52.5	-49.3	-45.6	-37.7	-34.3
Financial Stability	**NPL ratio, % of total loans**	IMF	3.9	3.8	3.7	2.9	-
	Tier 1 ratio, % of risk-weighted assets	IMF	16.1	16.2	15.8	17.5	15.8
	Credit to private sector, % of GDP	WB	52.4	50.8	49.8	-	-
ESG	**CO_2 per EUR 1,000 of GDP, $mtCO_2e$**	EC	274.3	247.6	241.0	247.1	-
	Income share of bottom 50%, %	WID	19.6	19.5	19.5	19.5	-
	Labour-force participation rate, %	WB	70.4	70.9	-	-	-
	Old-age dependency ratio, %	UN	25.6	26.7	27.7	28.6	28.0
	Composite governance indicators*	WB	0.6	0.6	0.6	0.5	-

*Average of the six World Bank Worldwide Governance Indicators.

Appendix IV. Economic development and default indicators

IMF Development Classification	Emerging Market and Developing Economies
5y USD CDS spread (bps) as of 1 June 2023	87.3

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