Republic of Poland
Rating Report

A+ NEGATIVE OUTLOOK

Credit strengths

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

Credit challenges

- Weakening of governance institutions
- Marked deterioration of inflation outlook
- Economic and geopolitical risks associated with 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 has proven comparatively resilient thus far in the face of Covid-19 and cost-of-living economic crises and presents comparatively strong longer-run economic growth potential.

Moderate level of public debt: Poland's general government debt ratio stood at a moderate 53.8% of GDP as of end-2021, representing nevertheless a rise from a 45.6% ratio as of Q4 2019. Scope sees the general government debt ratio declining to 47.5% in 2023, before resuming a gradual upside trajectory during subsequent years, concluding a forecast horizon to 2027 around 50.1%.

Profitable, liquid and well-capitalised domestic banking system: Non-performing loan (NPL) ratios have edged below their pre-Covid crisis levels. Tier 1 capital and liquidity coverage ratios have furthermore improved since the Covid-19 crisis. FX-related risk remains outstanding in the banking system, such as with respect to legacy Swiss-franc mortgage loans.

Ratings challenges include: i) a longer-standing trend of weakening of governance institutions, raising uncertainty around predictability of European Union (EU) funding as well as of contingent EU support under adverse economic scenarios; ii) a marked deterioration of the inflation outlook; iii) economic and geopolitical risks associated with escalation of the Russia-Ukraine war; iv) a comparatively weaker structure of government debt and rises of 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%	bbb-		-1/3	
Indicative outcome			**a-**		**+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 Negative Outlook represents Scope's opinion that risks to the sovereign ratings remain skewed to the downside.

Positive rating-change drivers

- Reduced governance risk
- Budgetary performance improves
- External balance sheet strengths materially

Negative rating-change drivers

- Governance risks continue or escalate
- Weakening of budget discipline
- External shock and/or 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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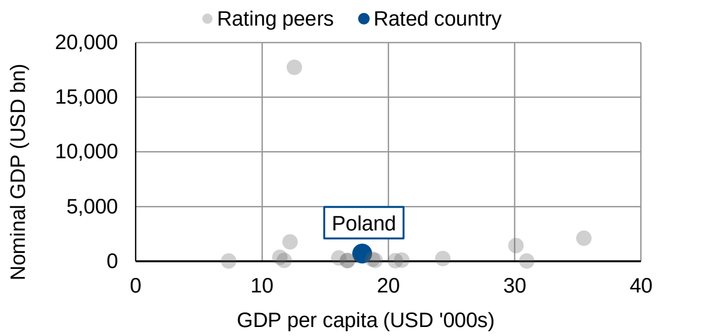
Domestic Economic Risks

- **Growth outlook:** After a strong post-pandemic crisis rebound, anchored by strong growth of household consumption and inventories, bringing quarterly output to around 11pps above end-2019 levels by Q1 2022, economic momentum weakened significantly during the second quarter of this year, with QoQ growth of -2.3% caused by a contraction of investment and in inventories. After picking up in Q3 (+1.0% QoQ), we anticipate slowdown of economic growth over coming quarters, due to the aggregate impact of rising consumer prices on eroding real income, weighing on private domestic demand, as well as from weakening of the growth outlooks among core trading partners. In annual terms, real growth is expected to remain strong this year, at 5.7%, before slowing to 1.5% by 2023, and edging up to potential, estimated at around 3.0% annually, over subsequent years. These forecasts acknowledge working-age population decline averaging 1% per annum over 2023-27 according to UN projections.
- **Inflation and monetary policy:** Price pressures have risen to multi-decade highs, with consumer-price-index (CPI) inflation standing at 17.4% YoY in November (slightly down on October peaks of 17.9%). High global energy and raw materials prices and very strong domestic (and thus import) demand have fuelled said rise. A marked increase in core inflation (11.0%) points to high underlying price pressures, under a context of tight labour markets and still-strong household demand, the latter benefitting from fiscal support. The National Bank of Poland has hiked its policy rate since October 2021, to 6.75% by September 2022. After a pause of the hike cycle since October, we see the central bank potentially resuming rate hike(s) during 2023 as a response to inflation and market dynamics.
- **Labour market:** Labour-market dynamics have stayed strong so far despite cooling of economic momentum, as reflected in elevated employment (of those aged 15-64), at 71.2% as of Q3 2022, and an unemployment rate still near historic lows, at 3% as of October. From escalation of the war in Ukraine to August, around 400,000 Ukrainian refugees have located work in Poland since escalation of the war, in part explaining a degree of easing of labour-market tightness, with the number of job vacancies declining over recent months. Nevertheless, the job vacancy rate remains elevated, reflecting persistent labour shortages. There has been a significant rise in nominal wages (+13% YoY in October), threatening to make current high inflation more endurant.

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

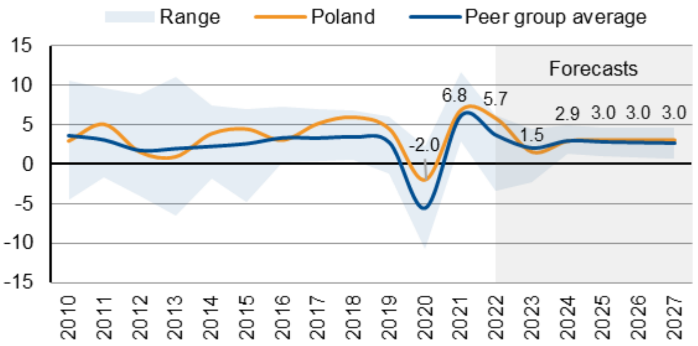
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a-	Growth potential of the economy	Strong	+1/3	Robust growth potential; long-term growth prospects supported by EU programmes
	Monetary policy framework	Neutral	0	Very high inflation and negative real rates of the central 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

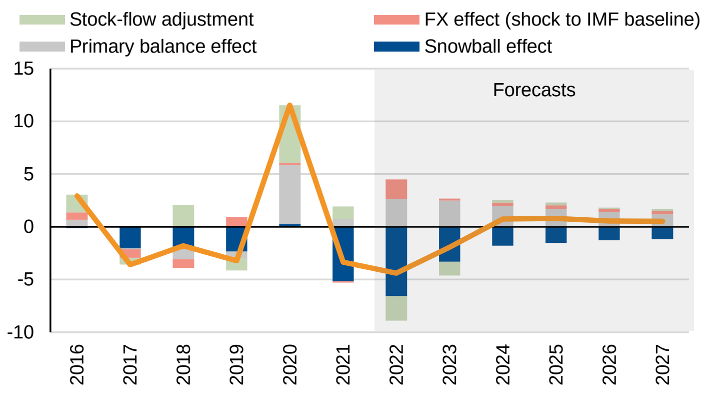
Public Finance Risks

- **Fiscal outlook:** After receding to 1.8% of GDP in 2021, on the back of strong revenue growth and reduced pandemic-related expenditure, the general government budget deficit is set to widen this year, to an estimated 3.9% of GDP. This weakening primarily reflects roll-out of spending measures aimed at alleviation of the impact of higher energy prices on the private sector, as well as expenditure associated with support for recent arrivals from Ukraine. Further spending pressures, related to growing personnel, pensions and welfare costs under a context of elevated inflation, rising interest payments, as well as increase of military expenditure (expected to reach at least 3% of GDP in 2023, from 2.2% as of 2022) weigh on the medium-run budgetary outlook. We expect the headline general government deficit to remain at 3.9% of GDP next year, before averaging 3.2% over 2024-27.
- **Debt trajectory:** Poland's general government debt-to-GDP ratio is seen declining from 53.8% in 2021 to 49.4% this year, and 47.5% by 2023, supported by strong nominal economic growth. The debt ratio is seen, however, resuming a gradual upside trend during subsequent years, concluding a forecast horizon to 2027 around 50% (4.5pps above end-2019 levels), due to combined impact of primary fiscal deficits and rising interest payments.
- **Debt profile & market access:** A comparatively short average maturity of Polish State Treasury debt (4.9 years) and outstanding foreign-exchange risk, given 23.4% of outstanding State Treasury debt being foreign-exchange-denominated (although this share was 36.7% as of early 2016), represent credit-ratings constraints. Foreign debt of Poland has likewise dropped to 24.4% of aggregate debt by Q2 2022, from 34.7% as of end-2016. Similar to regional peers, government bond yields have risen significantly during the past year, with the yield for 10-year government bonds standing at 6.4% (after moderating from October highs of 8.8%), still well above lows of 1.5% as of July 2021. Credit strengths associate with a sizeable cash cushion and deep domestic capital markets. Rule-of-law contentions cast questions as regards EU balance of payments assistance under adverse economic scenarios that might require lender of last resort functions.

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

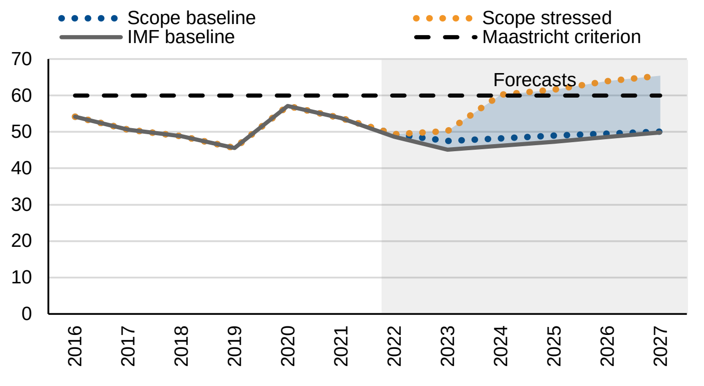
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aa+	Fiscal policy framework	Neutral	0	Fiscal dynamics are hindered by spending demands amid a present cost-of-living crisis, as well as social spending
	Debt sustainability	Strong	+1/3	Comparatively moderate debt levels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

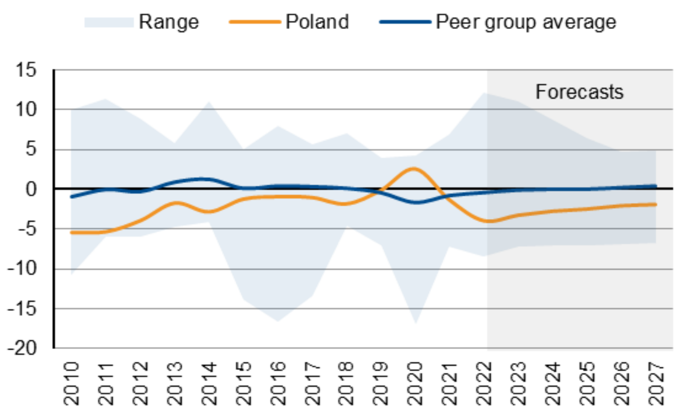
External Economic Risks

- **Current account:** Poland's external balance had improved during run up to the Covid-19 crisis, from a current-account deficit of 6.7% of GDP in 2008 to a 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. This deficit widened during recent months, reaching 3.7% of GDP in the year to September 2022 under a context of higher nominal energy and commodity imports, and disruptions of trade with Russia, Belarus, and Ukraine (which had amounted to around 5.6% of exports of goods in 2021, before escalation of the 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 2027 around -2% of GDP.
- **External position:** Poland's external sector is bolstered by structural capital-account surpluses anchored by EU fund flows, reflecting a strong quality of external financing, with foreign direct investment (FDI) liabilities constituting around half of gross external liabilities. Inward FDI amounted to 5.3% of GDP in the year to September 2022, up from 2.9% in 2019 and 3.1% in 2020. The net international investment position strengthened to -35% of GDP by Q2 2022, from lows of -69% in 2014. Gross foreign debt stood at 55% of GDP in Q2 2022, reduced from 2016 peaks of 76%. The composition of foreign debt is favourable, being primarily comprised of long-term liabilities (more than 80% of the aggregate).
- **Resilience to short-term external shocks:** After declining sharply against euro during an initial phase after Russia's further invasion of Ukraine, zloty has stabilised since, although nevertheless remaining 2% weaker against euro compared with end-2021 levels. Foreign-exchange reserves stood around USD 142bn as of November 2022, weaker compared with August 2021 records of USD 149bn, after foreign-currency sales earlier this year in defending the currency as well as shifts in the value of dollar against other reserve currencies. Forex reserves currently represent an 85% coverage of short-term external debt (on remaining-maturity basis), off 2021 peaks of 91% coverage and representing a comparatively modest coverage ratio compared with that of regional peer countries.

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

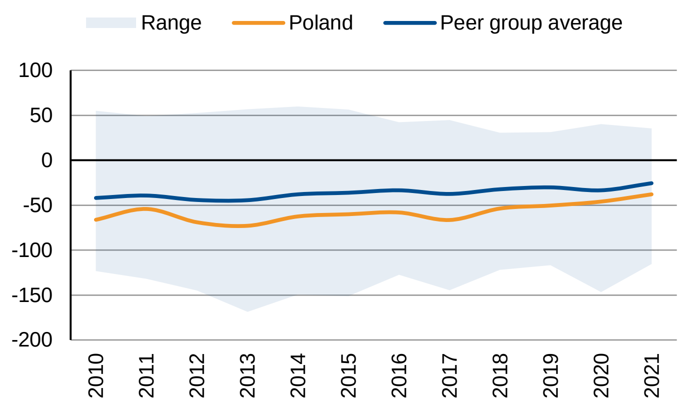
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
b	Current account resilience	Strong	+1/3	Recent deterioration of the current account, but strong (historical) financing resilience via EU funding and foreign direct investment
	External debt structure	Strong	+1/3	Poland's external debt stock has been reduced over 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: National Bank of Poland, IMF forecasts, Scope Ratings

Net international investment position (NIIP), % of GDP



Source: IMF, Scope Ratings

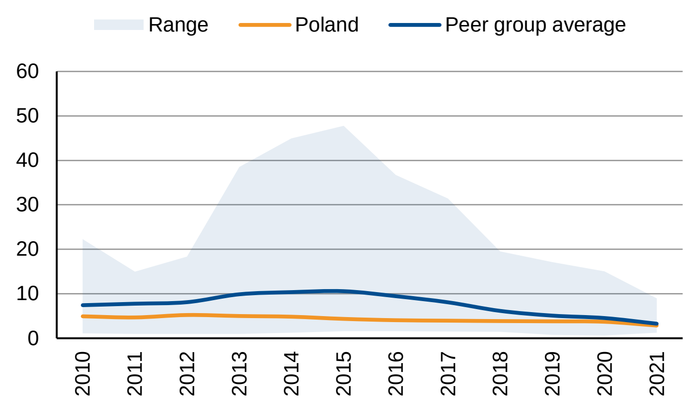
Financial Stability Risks

- **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 16.0% and 11.5% as of Q2 2022. After rising moderately during the pandemic crisis, the NPL ratio resumed a pre-crisis declining trajectory, reaching 4.3% of gross loans by Q2, below its end-2019 levels. While a sharp rise in lending rates ought to support interest margins over coming years, implementation of a moratorium for mortgage loan repayments until end-2023 will reduce banking-sector profitability near term. Main challenges reflect resolution of CHF-denominated housing loans, which could require large additional loan-loss provisioning. In September 2022, Getin Noble Bank, the nation's tenth largest lender (with assets of EUR 9.1bn) entered restructuring proceedings, requiring public cash injections of EUR 1.4bn, in part due to losses resulting from heavy exposures to Swiss franc loans (which accounted for more than a quarter of its portfolio).
- **Private debt:** Aggregate non-financial private debt is low, at 72% of GDP as of Q2 2022, below half the average for the euro area (167%). Higher mortgage rates and tighter lending standards cut household credit growth, as reflected in a decline of household lending as of Q3 2022 (-2.3% YoY). Polish households are exposed to interest-rate risks in view of significant variable-rate mortgages outstanding (97% of aggregate mortgages at end-2021). This vulnerability is, however, mitigated by moderate household debt levels, favourable debt-servicing ratios, as well as the government mortgage payment holiday, expected to last until end-2023.
- **Financial imbalances:** Housing price growth stood at an elevated 16.4% YoY as of Q2 2022. In February 2022, the European Systemic Risk Board indicated it perceived limited evidence of overvaluation in the housing market, however, and assessed the current policy stance as appropriate and sufficient to address outstanding risks. However, legal risks from foreign-currency loans remain a vulnerability, with financial regulator KNF warning in October this year that the banking sector could face a EUR 20bn charge in case of an adverse ruling from the Court of Justice of the European Union.

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

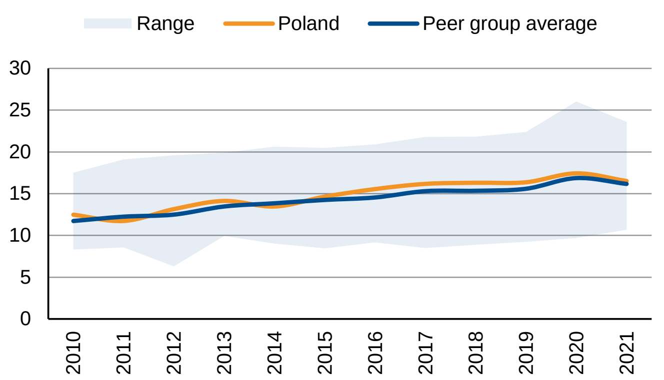
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Banking sector performance	Strong	+1/3	Profitable, liquid and well-capitalised banking system. FX risks, including from resolution of Swiss franc mortgages.
	Banking sector oversight	Neutral	0	Effective financial-sector 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

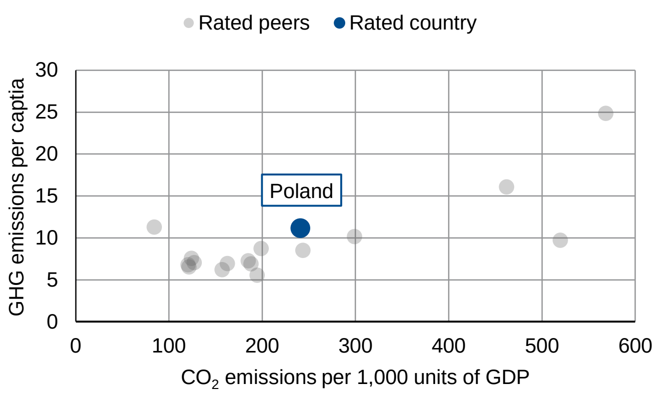
ESG Risks

- **Environment:** Poland's energy mix is heavily reliant upon 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. This dependence has declined in recent years, however, allowing Poland to locate other suppliers after Russia halted its natural-gas exports to Poland during April this year. Poland adopted an energy strategy in 2021 pledging to significantly curtail coal-fired power by the 2040s, with a main contribution to coal-based emissions from its power sector. Poland participates under the European Emissions Trading System, creating incentives to reduce 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 1% annually over 2023-27, causing a steadily growing skilled-labour shortage, although demographic pressures have eased temporarily with large Ukrainian refugee arrivals since Russia's full-scale invasion (around one million have registered). 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 for Poland at 34.8% of GDP during the same period.
- **Governance:** On 22 December 2021, the European Commission (EC) opened latest infringement proceedings in association with a breach of the primacy of EU law. Despite some improvements during past months, as reflected in a conditional approval of Poland's Recovery and Resilience Plan (RRP) in June, although dialogue with EU institutions is still ongoing, with disbursement of EU funds totalling over EUR 100bn under the RRP and the EU 2021-27 Cohesion Funds on hold, in view of requirement for implementation of rule of law-associated reforms requested by the EC. The operational arrangements were adopted by the EC on 25 November 2022 and now they are being signed both by Poland and the EC. Performance of Poland on World Bank Worldwide Governance Indicators has weakened since 2014. Next parliamentary elections are to be held not later than November 2023.

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

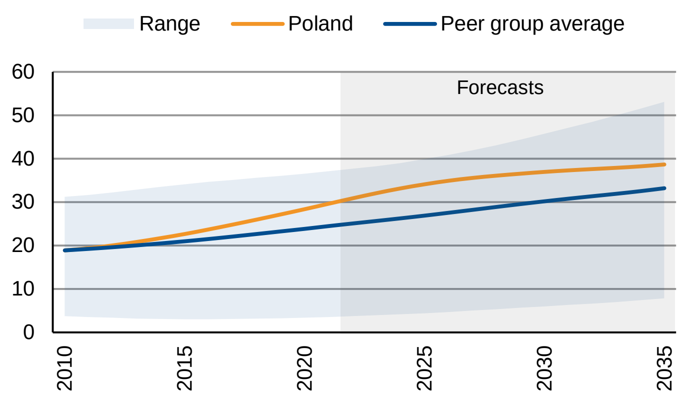
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bbb-	Environmental factors	Neutral	0	Structural challenges relating to transition risk to the green economy due to having to phase out coal dependency
	Social factors	Neutral	0	Adverse demographics result in declining working-age population but new 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, $mtCO_2e$



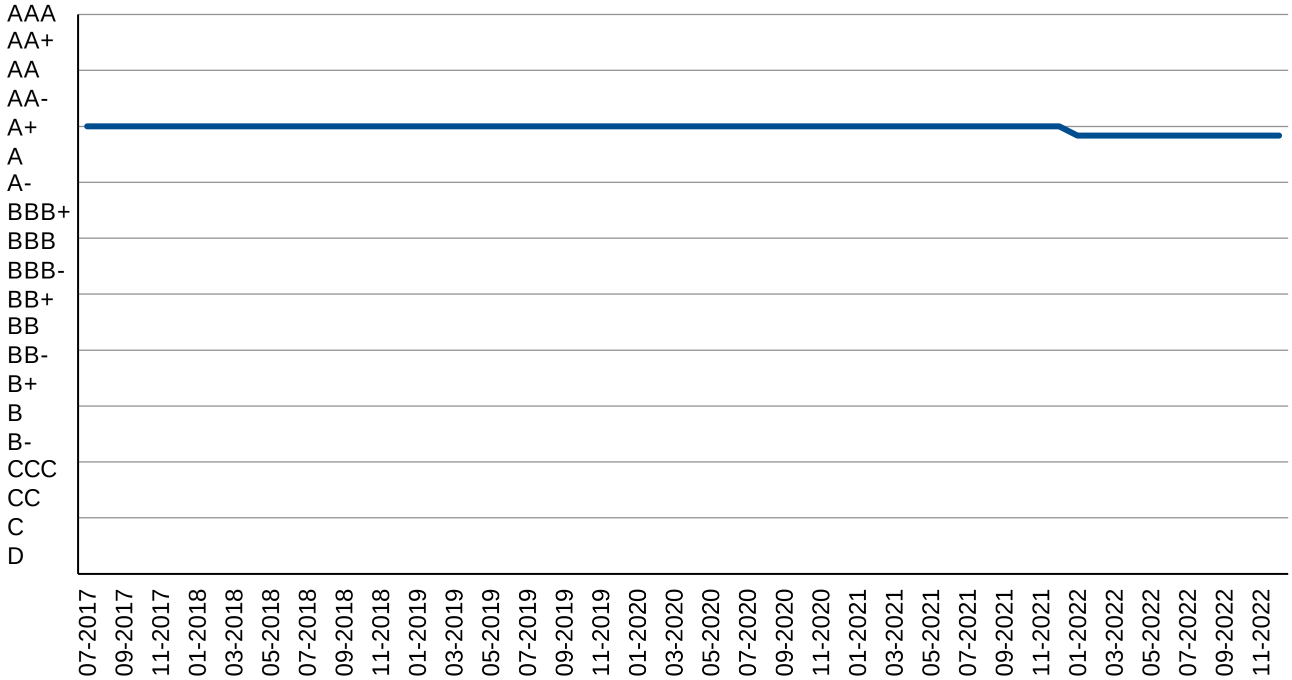
Source: European Commission, Scope Ratings

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
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	2017	2018	2019	2020	2021
Domestic Economic	**GDP per capita, USD '000s**	IMF	13,869	15,468	15,727	15,802	17,946
	Nominal GDP, USD bn	IMF	526.6	587.4	597.2	599.8	679.1
	Real growth, %	Poland Central Statistical Office	5.1	5.9	4.4	-2.0	6.8
	CPI inflation, %	Eurostat	2.0	1.6	2.3	3.4	5.1
	Unemployment rate, %	WB	4.9	3.9	3.3	3.2	3.4
Public Finance	**Public debt, % of GDP**	IMF	50.6	48.8	45.6	57.1	53.8
	Interest payment, % of revenue	IMF	3.9	3.5	3.3	3.2	2.6
	Primary balance, % of GDP	IMF	0.1	1.2	0.6	-5.6	-0.7
External Economic	**Current account balance, % of GDP**	National Bank of Poland	-1.1	-1.9	-0.2	2.5	-1.4
	Total reserves, months of imports	IMF	4.5	4.1	4.5	5.6	4.7
	NIIP, % of GDP	IMF	-66.4	-53.7	-50.4	-46.0	-38.0
Financial Stability	**NPL ratio, % of total loans**	IMF	3.9	3.9	3.8	3.7	2.9
	Tier 1 ratio, % of risk-weighted assets	IMF	15.9	16.1	16.2	15.8	17.5
	Credit to private sector, % of GDP	WB	52.5	52.5	50.7	50.0	-
ESG	**CO_2 per EUR 1,000 of GDP, mtCO_2e**	EC	289.4	274.3	247.6	241.0	247.1
	Income share of bottom 50%, %	WID	20.0	19.6	19.5	19.5	19.5
	Labour-force participation rate, %	WB	69.9	70.4	70.9	-	-
	Old-age dependency ratio, %	UN	24.8	26.0	27.2	28.4	29.6
	Composite governance indicators*	WB	0.7	0.6	0.6	0.6	-

* 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 9 December 2022	131.0

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