Creditreform Sovereign Rating

Creditreform Rating

Rating Object	Rating Information	
REPUBLIC OF POLAND	Assigned Ratings/Outlook: **A /stable**	Type: Monitoring, Unsolicited with participation
Long-term sovereign rating Foreign currency senior unsecured long-term debt Local currency senior unsecured long-term debt	Initial Rating Publication Date: Rating Renewal: Rating Methodologies:	31-03-2017 21-07-2023 "Sovereign Ratings" "Rating Criteria and Definitions"

Rating Action

Neuss, 21 July 2023

Creditreform Rating has affirmed the unsolicited long-term sovereign rating of "A" for the Republic of Poland. Creditreform Rating has also affirmed Poland's unsolicited ratings for foreign and local currency senior unsecured long-term debt of "A". The outlook is stable.

Key Rating Drivers

1. Large and diversified economy boasting consecutive years of competitive gains and fast labor productivity growth, which has strengthened underlying growth and contributed to Poland's ongoing convergence process towards EU income levels; following the strong post-pandemic recovery, adverse economic repercussions from the war in Ukraine have led to a more volatile development, in an environment of accommodative fiscal and tighter monetary policies
2. Bolstered by initiatives and measures to foster the green and digital transformation and enhance social inclusion as set out in Poland's Recovery and Resilience Plan (RRP), we regard the medium-term growth outlook as positive, assuming an eventual release of NGEU funds in the near term, which is still pending due to controversy with the European Commission (EC) over rule-of-law-related issues; significant delays in NGEU disbursements would dampen the growth outlook
3. Generally high quality of the institutional framework, including the economic and security benefits linked to EU and NATO membership, while key metrics suggest a weakening tendency in governance over recent years; repeated tensions with the EC over EU rules could harbor some reputational risk, balancing the strengths of the institutional set-up to some extent; regarding the upcoming parliamentary election to be held this fall, the incumbent PiS is currently leading the polls, but might lose its majority
4. Fiscal sustainability risks remain limited in our view, although pressure on expenditure growth has increased more recently; we expect the sovereign's public debt ratio to edge up over the medium term, but to remain comparatively moderate; lower revenues due to last year's PIT reform and higher outlays driven by energy support measures, the interest rate bill, as well as social and defense spending, should keep the headline deficit elevated; the regulatory context (MREL) and recent legal decisions (foreign exchange-denominated mortgages) are likely to affect capital buffers and the profitability of the banking sector, but seem by and large manageable

Contents

Rating Action 1
Key Rating Drivers 1
Reasons for the Rating Decision and Latest Developments 2
Macroeconomic Performance 2
Institutional Structure 5
Fiscal Sustainability 7
Foreign Exposure 9
Rating Outlook and Sensitivity ...10
Analysts 11
Ratings* 11
ESG Factors 11
Economic Data 13
Appendix 13

5. Poland's negative net international investment position (NIIP), which is partly mitigated by the high stock of foreign direct investment, continues to improve, pointing to decreasing external vulnerabilities; the previous widening of the current account deficit, driven by deteriorating terms of trade, particularly for goods, is reversing; we expect the current account balance to post a small surplus this year and the NIIP to continue on its upward trajectory going forward

Reasons for the Rating Decision and Latest Developments[1]

Macroeconomic Performance

The sovereign boasts a very strong macroeconomic performance profile buttressed by its competitive and well-diversified economy, supporting our favorable credit assessment alongside ongoing income convergence towards the EU level. A swift and strong recovery from the pandemic was followed by weaker developments following Russia's invasion of Ukraine, with negative effects on private households partly softened by extensive fiscal support and resilient labor market developments. While there is significant progress in diversifying away from Russian energy imports, downside risks to the near-term economic outlook stem from Poland's still high reliance on fossil energy amid challenging energy market conditions, as well as more pronounced dampening effects from higher interest rates following the recent monetary policy tightening cycle. Crucial RRF-disbursements have been delayed; however, assuming an eventual unlocking in the near term, we continue to view the medium-term outlook as constructive, given initiated and planned reforms, and measures set to enhance productivity and ultimately potential growth. Beyond the medium-term horizon, and despite some possible respite from a more permanent integration of displaced persons from Ukraine, unfavorable demographic developments could weigh on economic growth.

Following an upward revision to 6.9% in 2021, Poland's real GDP growth moderated to a still strong 5.1% in 2022, posting quarter-on-quarter declines in last year's second and fourth quarters amid a weakening tendency linked to the negative economic effects of the war in Ukraine. Apart from the marked increase in inventories, which produced the largest positive contribution to last year's GDP growth outcome, private consumption and exports still added positively, albeit to a lesser extent than in the previous year. However, net exports continued to act as a drag on overall growth. The positive contribution of gross fixed capital formation increased compared to 2021.

Displaying an average real GDP growth rate of 3.8% over the ten years to 2022, Poland remains one of the fastest growing economies in the EU (2013-22: 1.6%), on the back of which its convergence towards the EU level in terms of GDP per head has been progressing. Although per capita income rose by roughly 13% to an estimated USD 43,480 in 2022 (IMF data, PPP terms), at 80% of the EU level in 2022, the Polish economy still has significant catching-up potential.

With regard to the current year's first quarter, Polish economic output surprised positively with a 3.8% quarter-on-quarter increase, chiefly driven by surging government consumption, and, to

[1] This rating update takes into account information available until 14 July 2023.

a lesser degree, by investment and inventories, whereas household expenditure dropped for a second consecutive quarter.

High inflation rates continue to pose a burden on private consumption, and whilst the HICP monthly annual rate is on the retreat, it remained in double-digit territory this May (12.5%, EU: 7.1%), having averaged 13.2% in 2022. The core rate (excluding energy, food, alcohol and tobacco) has come down to 10.4% as of May-23. Significant government support to alleviate adverse effects emanating from the war in Ukraine, alongside higher social spending, cushions the blow to private households to some extent and is flanked by tax relief specifically for low-income earners. A VAT rate of zero on food is to remain in place until the end of 2023, among other measures. Overall in 2023, the fiscal support measures in response to high energy prices, as well as wage growth in a still tight labor market, should support household balance sheets, although real wages ultimately fell last year. As from Jan-23, the minimum salary increased to PLN 3,490, and as from July was raised to PLN 3,600.

Given its decreases around the turn of the year (2022/23), we expect private consumption to post a decline overall in 2023. That said, receding, though still high, inflation rates are likely to give way to modest real wage increases, which—in tandem with relatively robust labor market developments and ongoing support from government measures, including the positive effects on disposable income from the tax reform in force since last year—should set the stage for a recovery, resulting in rising household spending in 2024.

Labor market developments of late include a record-low unemployment rate and continued — albeit decelerating — employment growth, partly aided by integration of a large number of displaced people from Ukraine into the domestic labor market. According to OECD estimates, refugees from Ukraine had increased the labor supply by 2.1% by the end of 2022. Poland's unemployment rate averaged only 2.9% in 2022 (Eurostat, LFS-adj.), constituting the second-lowest rate in the EU (EU: 6.2%). More recently, drawing on monthly figures, the rate had dropped even further, standing at 2.7% in May-23. Employment had increased at a slower rate last year (2022: 0.4%), comparing unfavorably against developments in the EU as a whole (2022: 1.5%).

A shortage of workers remains a structural bottleneck for the Polish economy, as also underscored by a recent EC survey (Q2-23) among enterprises in the industrial sector. Tying in with structural developments, we observe that Poland has narrowed the gap to the EU when it comes to the participation rate. As of Q1-23, the respective metric had climbed to 74.0% of Poland's total population, as compared to 75.0% in the EU, still exhibiting the lowest level of the Visegrad Four. While Poland is seen as performing relatively well in terms of equal opportunities and fair working conditions when set against Central and Eastern European (CEE) peers, individuals' level of digital skills remains an area that leaves scope to improve. Some gauges of social protection and inclusion similarly point to potential to catch up.

In terms of investment, a high interest rate environment by more recent historical standards in the wake of the NBP's monetary policy tightening could hinder private sector gross fixed capital formation in the near term, while the RRP-related initiated and envisaged measures generally back positive expectations as regards public investment. In fact, the year 2022 saw a significant leap in general government investment by 14.3%.

We do flag, however, that due to continued controversy with the EC over matters predominantly relating to rule of law (see below), no payment request has yet been made for disbursement of RRF funds, which are linked to a positive assessment by the EC as regards fulfilment of agreed

targets and milestones. Apart from changes to Poland's controversial disciplinary regime for judges, with regard to which remedial action is ongoing, key deliverables under the RRP in the near-term include a strategic review of long-term care and limiting the segmentation in the labor market.

Aside from the allocated RRF funding of about EUR 35.4bn over the period until and including 2026, which would consist of EUR 23.0bn in grants and EUR 11.5bn in loans, Poland is set to remain the largest recipient of EU funds with regard to the Multiannual Financial Framework 2021-2027, generally having access to cohesion funds in the amount of EUR 88.3bn. Grants through REPowerEU, for which Poland has so far not submitted an RRP amendment, could amount to EUR 2.76bn.

Whilst a first payment request for RRF disbursement is pending, implementation of RRP measures is underway. Despite some downside risks regarding the absorption of EU funds, with the upcoming parliamentary election potentially further delaying the implementation of investment projects, we ultimately expect these to be unlocked, paving the way for marked enhancements in terms of digitization, upskilling of labor, and the decarbonization of the economy. According to EC estimates, NGEU, the bulk of which consists of the RRF, could increase Poland's GDP by 1.1% to 1.8% by 2026 and add about 105 thousand jobs over this period.

With regard to the external environment facing Poland at the current stage, cumulative effects of more restrictive monetary policy are likely to increasingly weigh on the economic performance of major European trading partners going forward, whilst receding inflation - on average from a lower level than registered in Poland - may give private households elsewhere more scope for consumption. We expect net exports to contribute positively to this year's economic output, partly due to domestic demand-driven, weakening imports, with the effect becoming markedly smaller in 2024 amid the assumed recovery of private consumption in particular.

Overall, we forecast Poland's real GDP to rise by about 1.0% this year and accelerate to about 2.8% in 2024 amid strengthening domestic demand. The medium-term outlook remains ultimately positive, on the back of assumed further progress in rolling out RRP measures and the assumed near-term unlocking of RRF funds, although this will have to be monitored vigilantly. Adding to the underlying resilience of the economy, private sector indebtedness compares as relatively moderate in the EU context and has decreased more markedly recently, improving the chances to better withstand economic shocks.

Apart from that, Poland's increasing share in the global export market over the last few years pays testament to advancing competitiveness, which is also reflected in a more pronounced decline in real unit labor costs in 2022 vs. 2021 and 2017 compared to its main European trading partners and the EU overall, despite rising labor costs. This was aided by a depreciation of the zloty and improving labor productivity. Picking up on productivity developments, we note that, while remaining well below EU levels, Poland compares favorably against most main CEE peers with regard to nominal labor productivity per person, whereas there remain some gaps to bridge from the per-hour-worked perspective.

In a bid to strengthen Poland's non-cost competitiveness, part of the RRP aims at promoting the business environment. A more recent measure in this context saw the launch of a package of simplifications concerning VAT, inter alia by reducing formalities in international trade and standardizing the procedure for issuing binding information, entering into force from Jul-23. Judging by international rankings such as the IMD Competitiveness Yearbook, Poland moves in

the lower third among the fellow EU members, occupying rank 43 out of 64 countries considered in the 2023 report recently published. That said, this corresponds to a marked improvement compared to the preceding year (2022: rank 50 out of 63 countries).

In the same vein, there remains considerable scope for the improvement of digital skills and the integration of digital technology, as suggested by the EC's Digital Economy and Society Index (DESI). In the most recent respective ranking (2022), Poland is seen as moving around one of the lower places. When it comes to the UN Global Innovation Index, which compares a total of 132 countries, Poland ranks 38th, trailing most EU members in this respect.

Deficiencies regarding the business environment are part of the reason for comparatively weak private investment, which as a share of GDP has trended downward over recent years, increasing the gap to the EU average. In 2022, Poland's respective ratio stood at 12.6%, vis-à-vis 19.6% in the EU as a whole (AMECO data). To be sure, there also remains scope to improve public investment management in order to enhance the efficiency of public infrastructure investment, as also hinted at by the IMF in a recent assessment (Oct-22). While the ratio of public investment-to-GDP decreased somewhat to 4.0% in 2022, the government expects it to reach an average of 4.2%-4.3% in the years 2024-2026 (Convergence Program 2023, CP23).

Poland's estimated potential growth was the highest among CEE peers over the ten-year period to 2022, averaging 3.5%, compared to 1.3% for the EU overall. Current EC estimates regarding potential growth in 2023 and 2024 (3.7% and 3.4%, respectively) continue to see the Polish economy ahead of its main peers, for which there might be some downside risks linked to potentially protracted delays in RRF disbursement. The government is somewhat more cautious in this regard, assuming potential growth rates of 3.2% in 2023, roughly 3.0% in 24-25 and 2.7% in 2026, with an expected decline in labor assumed to negatively affect potential growth further out, whereas accumulation of productive capital and the increase in efficiency of production factors (TFP) are assumed to increase.

Institutional Structure

Poland's generally high-quality institutional framework is underpinned by considerable advantages linked to EU membership, such as access to the large Single Market, common standards, as well as deep and broad capital markets. NATO membership significantly enhances the sovereign's security infrastructure. The institutional set-up is further strengthened by very sound monetary and financial supervisory frameworks, with related functions performed by the NBP and the Polish Financial Supervision Authority (KNF) in a credible and accountable manner. These general strengths remain somewhat balanced by a rather fragmented system of fiscal oversight by EU standards, as well as recurrent and sometimes protracted dissonance over EU guiding principles—in particular rule of law and the supremacy of EU law over national law more generally. Further developments on these matters will have to be monitored vigilantly, as we see some reputational risks to the sovereign if they continue over an extended period. A parliamentary election is to be held this fall, with the incumbent right-leaning PiS currently ahead in polls, while having lost some support compared to the 2019 election.

The Worldwide Governance Indicators (WGI) compiled by the World Bank back the assessment of a generally high-quality institutional framework overall, although Poland continues to trail the EU-27 median as well as the median of the A-rated peers in our rating universe with regard to the four WGI dimensions on which we put particularly high emphasis. These are 'voice and accountability' (relative rank of 76 out of 209 economies), 'government effectiveness' (77), 'rule of

law' (73,) and 'control of corruption' (63). Moreover, and while awaiting the WGI update for the reference year 2022, we note that across those four pillars, Poland saw its relative ranks deteriorate in the most recent reference year (2021), enhancing the impression of a weakening tendency since the middle of the last decade.

As regards recently contested matters of rule of law, the EC, in its newly published annual assessment report (Jul-23), stresses ongoing serious concerns over the independence of the Polish judiciary, among others relating to the National Council for the Judiciary. The report also mentions lack of progress on separating the function of the Minister of Justice from that of the Prosecutor General. Room to improve equally persists as regards the combat of corruption, particularly pertaining the effective enforcement of high-level anti-corruption policies.

On the ongoing issue over the situation of judges affected by decisions of the Disciplinary Chamber of the Supreme Court, the European Court of Justice (ECJ) ruled in June 2023 that the justice reform of December 2019 amending national rules relating to the organization of the ordinary courts, the administrative courts, and the Supreme Court, breached EU law. Following some amending procedures in 2022, the Sejm passed a bill in January 2023 to undertake further reforms concerning this disciplinary regime, which is, however, currently pending at the Constitutional Tribunal.

Further to recurring tensions with the Commission over some guiding principles of the EU, we are aware that the EC had launched an infringement procedure against Poland this June for violating EU law with a new law establishing a special committee for the Examination of Russian influence on the internal security of Poland. With the law having been turned down by a majority in the Senate, a final decision on whether it will enter into force seems pending.

On a more positive note, legislative work carried out in 2022 aimed at further increasing the effectiveness of the national system for counteracting money laundering and financing of terrorism resulted in the Financial Information System Act which became effective in Feb-23, inter alia implementing EU provisions regarding the creation of a centralized automated mechanism enabling timely identification of holders of payment accounts, bank accounts, and safe deposit boxes.

When it comes to greening the economy, indicators such as the Eco-innovation index, which sees Poland in second-to-last position in 2022, hint at some catching-up potential. Poland's overall share of renewable energy has trended upwards over recent years, but ranges in the lower third of the EU countries (2021: 15.6%, Eurostat data). Moreover, Poland displays one of the highest levels of GHG emissions per capita (2021: 10.7 tons of CO_2 equivalent).

Against this backdrop, and bearing in mind an energy mix dominated by fossil fuels and high reliance on Russian energy imports until early 2023, there remain challenges to tackle. We are aware of plans to increase natural gas consumption, while energy efficiency measures are enhanced among broad-based efforts to reduce the overall consumption of energy. Key energy infrastructure projects such as the interconnectors with Lithuania and Slovakia, and the Baltic Pipe have been completed and are operational, replacing imports from Russia. Moreover, there are plans for floating storage in the Baltic Sea in 2026. The 2023 draft update of the National energy and climate plan (NECP) is pending.

Fiscal Sustainability

We continue to regard fiscal sustainability risks as limited in light of a comparatively moderate public debt ratio in the European context and a track record of prudent fiscal planning. In the near term, we expect headline deficits to persist on the back of temporary energy support, as well as more permanent social and defense spending, with the latter two items also weighing on medium-term fiscal prospects. Regulatory and legal risks linked to MREL and foreign-exchange-denominated housing loans appear to be largely manageable from the current perspective. Higher debt servicing costs amid tighter financial market conditions do not, in our view, alter an ultimately positive assessment of debt affordability, which—alongside recently improved tax compliance and very sound debt management—adds to risk-mitigating factors, notwithstanding elevated FX debt. We will continue to monitor the development of the recent increase in contingent liabilities as well as the visibility of off-budget funds and any budgetary effects of the pre-electoral campaign in the run-up to the general elections.

Following a marked decrease to -1.8% of GDP in 2021, Poland's general government deficit increased to -3.7% of GDP last year on the back of spending related to shielding measures to alleviate adverse effects from higher energy and food prices on the private sector, a continuation of social programs to support families, as well as due to lower tax revenue amid a tax reform lowering personal income tax included in last year's 'Polish Deal'. According to Eurostat data, tax revenue fell by 2.2 p.p. in relation to GDP in 2022. Government support under the inflation shield was estimated to amount to about 2.4% of GDP in 2022 (CP23). In addition, government spending to accommodate displaced people from Ukraine came to roughly 0.4% of GDP.

Overall, total government expenditure rose by 15.5% compared to 2021, considerably stronger than in the preceding year (+2.9%), and stronger than total revenue in 2022, which mounted by 10.2%. Social benefits other than social transfers in kind were a key driver of overall government outlays, rising by 11.9%, while public wages saw another strong increase by 9.3% last year. Revenue intake via taxes on income, wealth etc. climbed by 7.1%, driven by CIT, while tax revenue from production and imports increased by 5.5%. Continued growth in employment had net social contributions soar by 14.5%.

Public finances in the current year will continue to be burdened by increasing debt servicing costs (see below) and the provided energy support. Among others, the reduced VAT rate on food, in place since Feb-22, is to remain at zero until the end of 2023, which could come at a cost of approximately PLN 11bn in 2023. The associated net budgetary impact of shielding measures in 2023 is estimated to amount to roughly 1.9% of GDP (CP23), although this will be financed partly by a mechanism capping profits of electricity and gas companies.

Apart from this, the expected slower economic pace will likely weigh on tax revenue, alongside the permanently lower PIT intake following the abovementioned reform. Pension indexation is driving up age-related costs. Potentially adding to the fiscal burden, the Jul-23 amendment to the Budget Act for 2023 passed by the Sejm includes a downward revision to the revenue target and an upward revision to envisaged expenditure for 2023, while aiming not to exceed a state budget deficit of PLN 92bn. The amendment includes an increase in funds for local government units and one-off payments for certain public employees.

We are aware that the anti-inflationary shield may also affect the estimate of the VAT gap for the period 2022 and 2023. In this context, it is noteworthy that Poland was one of two EU members to increase the VAT total tax liability (VTTL) in 2020. Continuing its improving trend, Poland's estimated VAT gap decreased further to 11.3% of VTTL in 2020 (2019: 12.7%, EC data), partly

owing to the increasing value of electronic transactions in the wake of the pandemic. To be sure, at this level, Poland's VAT gap still compares unfavorably with the EU-27 as a whole (2020: 9.1%).

Drawing on monthly budget implementation data as regards the state level, we note that in the period Jan-May-23 state budget expenditures were higher by 19.9% (PLN 39.3bn). Compared with the envisaged budget deficit in the initial budget law for 2023, the state deficit seemed on a more favorable course over the first five months of 2023, amounting to about PLN 20.85bn (cash basis). Bearing in mind that 2023 is an election year, however, government spending seems subject to upside risks.

At this stage, we expect Poland's general government deficit to come in at approximately 5.2% of GDP in 2023 and to decrease to about 3.5% of GDP in 2024 amid waning energy-related government support and some reacceleration of GDP growth next year. Uncertainty linked to the war in Ukraine and potential further adverse economic repercussions, possibly also resulting from geostrategic decisions, remains high. Regarding the medium-term outlook, public finances should benefit from accelerating economic growth, whereas the abovementioned permanent PIT changes and increased defense expenditure are creating structural expenditure pressures.

The Polish RRP includes reforms to modernize and simplify the management of public finances with a new medium-term budgetary framework (by Q1-25). We note that fiscal oversight is reliant on a system of fiscal institutions, with the Supreme Audit Office (NIK) playing a central role. While the Polish development bank (BGK) has played a larger role in managing off-budgetary expenditure of late, e.g. via the Entrepreneurship Support Program and the Liquidity Guarantee Fund, we understand that there is commitment to increase transparency regarding off-budget funds.

The sovereign's debt-to-GDP ratio fell markedly in 2022, boosted by strong nominal growth, but at 49.1% of GDP remains above its pre-pandemic level (2019: 45.7% of GDP). To be sure, Poland's public debt ratio continues to range well below the EU level (2022: 84.0%). As of Q1-23, general government debt stood at roughly PLN 1,531.8bn, or 48.1% of GDP. Against the backdrop of our underlying assumptions for the development of the sovereign's headline deficit and economic activity, we expect the debt-to-GDP ratio to edge up to about 50.2% this year and further to 52.2% in 2024, driven partly by pre-financing of defense investment and rising interest outlays.

Risks to fiscal sustainability remain limited in our view, notwithstanding the assumed upward trajectory of the public debt ratio in the near to medium term. A recent history of outperforming fiscal forecasts, a diversified and rather stable investor base, and the recently increasing average maturity of the debt portfolio contribute to mitigating fiscal risks, apart from exhibiting a comparatively moderate debt level and high level of official reserves, which amount to about EUR 166.8bn or 25.4% of 2022 GDP as of 30 June 2023 (NBP data).

As illustrated by Ministry of Finance data, the average maturity of total debt was 5.17 years at the end of Jun-23 (end of 2022: 4.84 years), the longest since 2017. According to its strategy 2023-2026, the government aims to keep the average maturity close to 5 years, with possible temporary deviations due to market or budgetary circumstances, while it projects it to be in the range of 4.89-5.49 years by 2026. The share of debt denominated in foreign exchange is to be maintained below 25%. As of Q1-23, the respective share stood at an elevated 24.2%, with the euro accounting for the bulk thereof (21.0 p.p.).

Contingent liabilities of the state have been on the rise lately, amounting to 14.9% of GDP in 2022, up from 13.7% of GDP in 2021 (CP23), including guarantees securing financial liabilities of

gas sellers and the Armed Forces Support Fund for defense needs. The vast majority of debt covered by guarantees granted by the State Treasury is already included in general government debt.

Poland's banking sector appears solid when looking at capitalization levels and declining shares of non-performing loans, although the latter compare as high among the EU members. Drawing on the most recent EBA data, referring to Q1-23, the CET1 ratio of Polish banks increased somewhat to 17.5% (EBA data), exceeding the EU average (15.8%), whilst their NPL ratio remained at 4.4% (EBA data, EU: 1.8%). Stage 2 loans decreased to 10.2% (EBA data, Q1-22: 12.6%), compared to 9.1% in the EU.

While there are risks related to the recent ruling of ECJ regarding FX mortgage loans (mainly in CHF), which strengthened consumer rights by allowing borrowers to claim compensation under certain conditions, many banks have taken provisions to cover such risks, likely affecting their profitability. KNF estimated that, based on the ruling, the banking sector could be faced with costs of roughly PLN 100bn. Apart from such legal risks, we would reiterate that, measured against their total assets, Polish banks hold a relatively high share of domestic government bonds by European comparison (13.7% as of end Q1-23, ECB data), underscoring potential risks of a negative sovereign-bank loop in case of abruptly deteriorating capital market conditions for government bond prices.

In the face of tighter monetary policy, the yield on Polish 10-year government bonds had peaked in Oct-22 (8.76%, weekly data), but amid slowing economic growth and emerging expectations of a turn in the monetary policy cycle, the respective yield trended down, standing at 5.80% as of 07-Jul-23. In 2022, interest payments surged by 64.7%, reaching a still relatively moderate 1.6% of GDP or 3.9% of total revenue. Having further increased its main policy rate by 25 bp to 6.75% in Sep-22, NBP has since maintained its reference rate at this level, and seems to signal rate cuts in the course of the year, provided that confidence in firmly falling inflation rates remains high and inflation rates drop into single-digit territory in the immediate future.

In light of higher consumer prices and tighter monetary policy, lending to private households has been on the decline, with outstanding bank loans to private households posting negative annual rates of change since Jun-22 (Apr-23: -2,9%, ECB data), mainly due to loans for house purchase. In parallel, house prices started to fall in Q1-23, with their annual rate of change declining to 5.8% (Q1-22: 13.6%, Eurostat data). From Jul-23, housing demand will be supported by government subsidies ('Safe Credit 2%'), and it could prospectively benefit from monetary policy rate cuts. Outstanding loans to NFCs, meanwhile, have continued to increase lately in y-o-y terms (Apr-23: 5.4%).

Further out, Poland's ageing population will likely exert pressure on fiscal metrics via age-related costs. Programs such as the Employee Capital Plans (PKK), a universal and long-term savings system for employees co-financed by employers and the government, constitute steps to alleviate such pressure to some extent. At the end of 2022, about 2.52mn employees were participating in the instrument (CP23).

Foreign Exposure

We continue to view Poland's external vulnerabilities as limited. Whilst the sovereign boasts sizable international reserves, Poland's negative NIIP has continued to shrink. The composition of the NIIP continues to involve mitigating elements such as a pronounced stock of net foreign direct investment.

On the back of deteriorating terms of trade, the current account deficit rose markedly in 2022, while the service surplus even increased. We assume a decreasing current account deficit in the near term and the NIIP to continue on its upward trajectory going forward.

Poland's current account deficit widened to -3.0% of GDP last year, primarily due to the increasing goods deficit (2022: -3.7% of GDP) amid soaring import prices, whereas the surplus in the services account mounted to a new high of 5.6% of GDP, boosted in particular by transport, travel and other business services. More recently, retreating energy prices contributed to some reversal of last year's movements, with the current account deficit shrinking to 1.2% of GDP in Q1-23, measured as a four-quarter average. The reversal was driven by the goods balance, with the respective deficit narrowing to -2.1% of GDP. Going forward, we expect the current account to conclude 2023 with a small surplus, with a deteriorating tendency in 2024 amid higher imports boosted by spending on defense and an assumed higher inflow of EU funding.

Meanwhile, Poland's NIIP improved further to -33.8% of GDP in 2022, continuing an uninterrupted positive trend since 2017. With the net foreign direct investment position (2022: -34.4% of GDP) dominating the overall position on the back of a constantly increasing stock of direct investment in Poland, the composition supports the assessment of limited external risks despite a pronounced net debtor position. When eventually unlocked, RRF grants should support the improving tendency of the NIIP. As of Q1-23, the position improved further to -31.6% of GDP (Eurostat data).

Rating Outlook and Sensitivity

Our rating outlook for the Republic of Poland's long-term credit ratings is stable. Downside risks regarding its macroeconomic performance in connection with the war in Ukraine, and potential further delays in RRF-disbursements, are by and large balanced by limited risks to fiscal sustainability and the improving external position, as well as by overall sound economic fundamentals.

We could consider a negative rating action if the macroeconomic outlook worsens significantly, with negative implications for Poland's convergence process towards EU income per capita, possibly amidst further delayed disbursement of RRF-funding, weak economic activity in Poland's main trading partners, and/or a further escalation of the war in Ukraine. Downward pressure on the rating or the outlook could also arise from further deteriorating public finances and an entrenched increase in the public debt ratio, possibly as part of the above described scenarios, including protracted tensions between the EC and the Polish authorities.

Conversely, we could raise the sovereign's rating or the outlook if, amid timely unlocking of RRF-funds and limited disruptive effects linked to the Russian war against Ukraine and related geopolitical tensions, the medium-term growth outlook becomes markedly stronger, raising expectations of an accelerated convergence towards EU income levels, and positive implications for debt-to-GDP. A higher degree of policy predictability following repeated dissonance over EU guiding principles would seem conducive to such a scenario materializing.

Analysts

Primary Analyst
Fabienne Riefer
Senior Analyst Public Finance
f.riefer@creditreform-rating.de
+49 2131 109 1462

Chairperson
Dr Benjamin Mohr
Head of Public Finance
b.mohr@creditreform-rating.de
+49 2131 109 5172

Ratings*

Long-term sovereign rating	A /stable
Foreign currency senior unsecured long-term debt	A /stable
Local currency senior unsecured long-term debt	A /stable

*) Unsolicited

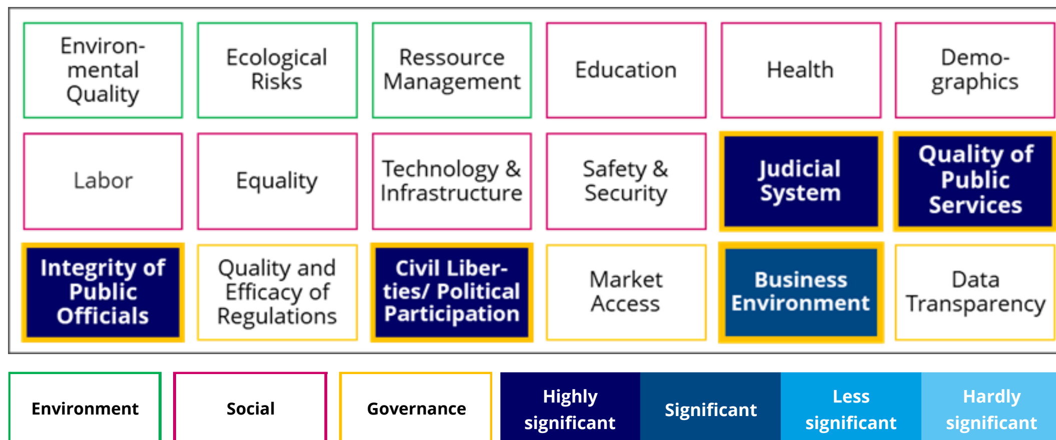
ESG Factors

Creditreform Rating has signed the ESG in credit risk and ratings statement formulated within the framework of the UN Principles for Responsible Investment (UN PRI). The rating agency is thus committed to taking environmental and social factors as well as aspects of corporate governance into account in a targeted manner when assessing creditworthiness.

While there is no universal and commonly agreed typology or definition of environment, social, and governance (ESG) criteria, Creditreform Rating views ESG factors as an essential yardstick for assessing the sustainability of a state. Creditreform Rating thus takes account of ESG factors in its decision-making process before arriving at a sovereign credit rating. In the following, we explain how and to what degree any of the key drivers behind the credit rating or the related outlook is associated with what we understand to be an ESG factor, and outline why these ESG factors were material to the credit rating or rating outlook.

For further information on the conceptual approach pertaining to ESG factors in public finance and the relevance of ESG factors to sovereign credit ratings and to Creditreform Rating credit ratings more generally, we refer to the basic documentation, which lays down key principles of the impact of ESG factors on credit ratings.

ESG Factor Box



The governance dimension plays a pivotal role in forming our opinion on the creditworthiness of the sovereign. As the World Bank's Worldwide Governance Indicators Rule of Law, Government Effectiveness, Voice and Accountability, and Control of corruption have a material impact on Creditreform Rating's assessment of the sovereign's institutional set-up, which we regard as a key rating driver, we consider the ESG factors 'Judicial System and Property Rights', 'Quality of Public Services and Policies', 'Civil Liberties and Political Participation', and 'Integrity of Public Officials' as highly significant to the credit rating.

Since indicators relating to the assessment of an economy's competitive stance by e.g. the World Bank, the World Economic Forum, the European Commission, and IMD Business School and the World Intellectual Property Organization (UN) add further input to our rating or adjustments thereof, we judge the ESG factor 'Business Environment' as significant.

While Covid-19 may exert adverse effects on several components in our ESG factor framework in the medium to long term, it has not been visible in the relevant metrics we consider in the context of ESG factors – though it has a significant bearing on public finances. To be sure, we will follow ESG dynamics closely in this regard.

Economic Data

[in %, otherwise noted]	2017	2018	2019	2020	2021	2022e	2023e
Macroeconomic Performance							
Real GDP growth	5.1	5.9	4.5	-2.0	6.9	5.1	1.0
GDP per capita (PPP, USD)	30,055	32,604	34,669	34,425	38,555	43,480	45,343
Credit to the private sector/GDP	57.1	55.4	55.0	53.6	51.2	44.8	n/a
Unemployment rate	5.0	3.9	3.3	3.2	3.4	2.9	n/a
Real unit labor costs (index 2015=100)	102.5	103.4	104.3	107.5	102.6	99.6	99.9
World Competitiveness Ranking (rank)	38	34	38	39	47	50	43
Life expectancy at birth (years)	77.8	77.7	78.0	76.5	75.5	n/a	n/a
Institutional Structure							
WGI Rule of Law (score)	0.4	0.4	0.4	0.5	0.4	n/a	n/a
WGI Control of Corruption (score)	0.7	0.7	0.6	0.6	0.6	n/a	n/a
WGI Voice and Accountability (score)	0.8	0.7	0.7	0.6	0.6	n/a	n/a
WGI Government Effectiveness (score)	0.6	0.6	0.5	0.4	0.3	n/a	n/a
HICP inflation rate, y-o-y change	1.6	1.2	2.1	3.7	5.2	13.2	12.0
GHG emissions (tons of CO2 equivalent p.c.)	10.9	10.9	10.3	9.8	10.7	n/a	n/a
Default history (years since default)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Fiscal Sustainability							
Fiscal balance/GDP	-1.5	-0.2	-0.7	-6.9	-1.8	-3.7	-5.2
General government gross debt/GDP	50.8	48.7	45.7	57.2	53.6	49.1	50.2
Interest/revenue	3.9	3.5	3.3	3.2	2.6	3.9	n/a
Debt/revenue	127.2	118.2	111.1	138.4	126.8	123.4	n/a
Total residual maturity of debt securities (years)	4.9	4.8	4.8	4.5	4.4	4.3	n/a
Foreign exposure							
Current account balance/GDP	-1.1	-1.9	-0.2	2.5	-1.4	-3.0	n/a
International reserves/imports	48.4	43.5	48.4	58.9	48.5	43.9	n/a
NIIP/GDP	-60.3	-54.7	-48.8	-43.9	-39.4	-33.7	n/a
External debt/GDP	67.3	64.2	58.9	60.7	56.4	53.0	n/a

Sources: IMF, World Bank, Eurostat, AMECO, ECB, Statistics Poland, own estimates

Appendix

Rating History

Event	Publication Date	Rating /Outlook
Initial Rating	31.03.2017	A /stable
Monitoring	02.03.2018	A /stable
Monitoring	01.03.2019	A /stable
Monitoring	21.02.2020	A /positive
Monitoring	21.08.2020	A /stable
Monitoring	13.08.2021	A /stable
Monitoring	12.08.2022	A /stable
Monitoring	21.07.2023	A /stable

Regulatory Requirements

In 2011 Creditreform Rating AG (CRAG) was registered within the European Union according to EU Regulation 1060/2009 (CRA-Regulation). Based on the registration Creditreform Rating AG is allowed to issue credit ratings within the EU and is bound to comply with the provisions of the CRA-Regulation. The rating was not endorsed by Creditreform Rating AG from a third country as defined in Article 4 (3) of the CRA-Regulation.

This sovereign rating is an unsolicited credit rating. The Ministry of Finance (MoF) participated in the credit rating process as it provided additional data and information and commented on a draft version of the report. Thus, this report represents an updated version, which was augmented in response to the factual remarks of the MoF during their review. However, the rating outcome as well as the related outlook remained unchanged.

Unsolicited Credit Rating	
With Rated Entity or Related Third Party Participation	YES
With Access to Internal Documents	NO
With Access to Management	NO

The rating was conducted on the basis of CRAG's "Sovereign Ratings" methodology (v1.2, July 2016) in conjunction with its basic document "Rating Criteria and Definitions" (v1.3, January 2018). CRAG ensures that methodologies, models and key rating assumptions for determining sovereign credit ratings are properly maintained, up-to-date, and subject to a comprehensive review on a periodic basis. A complete description of CRAG´s rating methodologies and basic document "Rating Criteria and Definitions" is published on our website.

To prepare this credit rating, CRAG has used the following substantially material sources: International Monetary Fund, World Bank, Organization for Economic Co-operation and Development, Eurostat, European Commission, European Banking Authority, European Central Bank, World Economic Forum, IMD Business School, UNCTAD, National Bank of Poland, Republic of Poland - Ministry of Finance, Statistics Poland, KNF.

A Rating Committee was called consisting of highly qualified analysts of CRAG. The quality and extent of information available on the rated entity was considered satisfactory. The analysts and committee members declared that the rules of the Code of Conduct were complied with. No conflicts of interest were identified during the rating process that might influence the analyses and judgements of the rating analysts involved or any other natural person whose services are placed at the disposal or under the control of Creditreform Rating AG and who are directly involved in credit rating activities or approving credit ratings and rating outlooks. The analysts presented the results of the quantitative and qualitative analyses and provided the Committee with a recommendation for the rating decision. After the discussion of the relevant quantitative and qualitative risk factors, the Rating Committee arrived at a unanimous rating decision. The weighting of all risk factors is described in CRAG´s "Sovereign Ratings" methodology. The main arguments that were raised in the discussion are summarized in the "Reasons for the Rating Decision".

As regards the rating outlook, the time horizon is provided during which a change in the credit rating is expected. This information is available within the credit rating report. There are no other attributes and limitations of the credit rating or rating outlook other than displayed on the CRAG website. In the event of providing ancillary services to the rated entity, CRAG will disclose all ancillary services in the credit rating report.

The date at which the credit rating was released for distribution for the first time and when it was last updated including any rating outlooks is indicated clearly and prominently in the rating report; the first release is indicated as "initial rating"; other updates are indicated as an "update", "upgrade or downgrade", "not rated", "affirmed", "selective default" or "default".

In accordance with Article 11 (2) EU-Regulation (EC) No 1060/2009 registered or certified credit rating agency shall make available in a central repository established by ESMA information on its historical performance data, including the ratings transition frequency, and information about credit ratings issued in the past and on their changes. Requested data are available on the ESMA website: https://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml.

An explanatory statement of the meaning of each rating category and the definition of default are available in the credit rating methodologies disclosed on the website.

Disclaimer

Any rating issued by Creditreform Rating AG is subject to the Creditreform Rating AG Code of Conduct which has been published on the web pages of Creditreform Rating AG. In this Code of Conduct, Creditreform Rating AG commits itself – systematically and with due diligence – to establish its independent and objective opinion as to the sustainability, risks and opportunities concerning the entity or the issue under review.

When assessing the creditworthiness of sovereign issuers, Creditreform Rating AG relies on publicly available data and information from international data sources, governments and national statistics. Creditreform Rating AG assumes no responsibility for the true and fair representation of the original information.

Future events are uncertain, and forecasts are necessarily based on assessments and assumptions. Hence, this rating is no statement of fact, but an opinion. Nor should these ratings be construed as recommendations for investors, buyers or sellers. They should only be used by market participants (entrepreneurs, bankers, investors etc.) as one factor among others when arriving at investment decisions. Ratings are not meant to be used as substitutes for one's own research, inquiries and assessments. Thus, no express or implied warranty as to the accuracy, timeliness or completeness for any purpose of any such rating, opinion or information is given by Creditreform Rating AG in any form or manner whatsoever. Furthermore, Creditreform Rating AG cannot be held liable for the consequences of decisions made on the basis of any of their ratings.

This report is protected by copyright. Any commercial use is prohibited without prior written permission from Creditreform Rating AG. Only the full report may be published in order to prevent distortion of the report's overall assessment. Excerpts may only be used with the express consent of Creditreform Rating AG. Publication of the report without the consent of Creditreform Rating AG is prohibited. Only ratings published on the Creditreform Rating AG web pages remain valid.

Creditreform Rating AG

Creditreform Rating AG
Europadamm 2-6
D - 41460 Neuss

Phone +49 (0) 2131 / 109-626
Fax +49 (0) 2131 / 109-627
E-Mail info@creditreform-rating.de
Internet www.creditreform-rating.de

CEO: Dr. Michael Munsch
Chairman of the Board: Michael Bruns
HRB 10522, Amtsgericht Neuss