

Rating Object	Rating Information	
REPUBLIC OF POLAND Long-term sovereign rating Foreign currency senior unsecured long-term debt Local currency senior unsecured long-term debt	Assigned Ratings/Outlook: A /positive	Type: Monitoring, Unsolicited with rated entity participation
	Initial Rating Publication Date: Rating Renewal: Rating Methodologies:	31-03-2017 21-02-2020 "Sovereign Ratings" "Rating Criteria and Definitions"

Rating Action

Neuss, 21 February 2020

Creditreform Rating has revised its outlook on the Republic of Poland to "positive" from "stable" and affirmed the unsolicited long-term sovereign rating of "A". Creditreform Rating has also affirmed Poland's unsolicited ratings for foreign and local currency senior unsecured long-term debt of "A".

Contents

Rating Action	1
Key Rating Drivers	1
Reasons for the Rating Decision ..	2
Macroeconomic Performance	2
Institutional Structure	6
Fiscal Sustainability	8
Foreign Exposure	10
Rating Outlook and Sensitivity ..	11
Ratings*	12
Economic Data	12
Appendix	12

Key Rating Drivers

1. Track record of strong and stable growth which has proven fairly resilient amidst a weakening external environment; we expect economic growth to decelerate but remain solid, primarily aided by private consumption, which should be boosted by labor market conditions and fiscal support
2. Strong macroeconomic fundamentals and significant competitiveness gains have led to continued income convergence; potential growth is likely to remain among the strongest in an EU comparison; however, marked demographic headwinds and less EU funding support pose some risks
3. While institutional conditions are still characterized by a generally high quality, discussions with the EU centered around diverging views on parts of its judicial system drag on; increasing risk of undermined checks and balances may create an unfavorable backdrop for policy predictability, but we believe Poland will seek further constructive engagement within the EU
4. Resilient growth and diminishing debt servicing costs will anchor a further declining public debt ratio; raft of expansionary measures geared towards social issues should be kept broadly in check by tax-rich growth and enhanced tax administration; risks stemming from high FX debt and fiscal pressure from age-related spending
5. We continue to see no serious external imbalances, as Poland should post moderate current account deficits going forward and risks emanating from Poland's highly negative NIIP are somewhat mitigated by its composition; declining net external debt as a share of GDP

Reasons for the Rating Decision

Our assessment of the Republic of Poland's high creditworthiness is underpinned by the sovereign's very strong macroeconomic performance, its fiscal strength and contained risks from the external sector, while we see some potential for improvement with regard to the institutional set-up.

The outlook on the Republic of Poland was revised to positive, reflecting our expectation that (i) Poland's public finances will remain sound and the public debt ratio will continue on its downward trajectory, despite the government's spending plans; (ii) its economy will further exhibit healthy growth without being characterized by detrimental macroeconomic imbalances; and (iii) growth rates significantly above those witnessed in the majority of other EU member states will provide for a continued convergence process.

Macroeconomic Performance

The sovereign's credit ratings continue to reflect the very strong characteristics of its macroeconomic performance profile, which builds on relatively high per capita incomes, pointing to a continued convergence process towards EU averages, and brisk and stable economic growth that is supported by benign labor market conditions and is underpinned by a highly diversified and competitive economy.

We view Poland's macroeconomic strength as buttressed by its relatively prosperous and diversified economy, as well as its high degree of competitiveness. Since becoming a member of the European Union, Poland has outpaced EU average economic growth by far (by 2.6 p.p. in 2004-18), leading to a continued economic convergence and significantly improved living standards, as measured by GDP per capita. Estimates by the IMF put the per capita income in Poland at USD 33,891 in 2019 (in PPP terms), equivalent to 76.1% of the weighted EU-28 average and up from USD 32,005 and 74.1% of the EU average in 2018. To put Poland's rapprochement with the EU into perspective, the country stood at a mere 50.2% at the time of its accession, which is tantamount to the second-fastest income convergence among CEE countries over that time period (25.9 p.p.). However, the economy's GDP p.c. still lies below the median of our A-rated universe (USD 37,582) and also below the income levels seen in other Central and Eastern European (CEE) economies. We reiterate our belief that income convergence will progress materially. At the same time, we deem income disparity as relatively low. Taking into account social transfers, Poland's Gini coefficient equates to 27.8 (EU-SILC survey), a marked drop from 2017 when it stood at 29.2, and comparing relatively low to the EU average (2018: 30.9).

The Polish economy exhibits a diversified economy, with the industrial sector accounting for nearly a quarter of total gross value added in Q3-19 (24.9% of GVA) as compared to 18.7% in the EU-28, followed by an equally high share of construction and primary sectors with 8.0 and 2.3% of GVA respectively. Meanwhile, we observe that services continue to gain importance, in particular wholesale/retail trade, transport and accommodation (Q3-19: 26.5%), which were able to expand their share by 1.2 p.p. over the last five years, next to higher value-added business services, with an increase from 7.6% of GVA in Q3-14 to 8.9% in last year's third quarter. In tandem with the GVA share, significantly rising services

exports also pay testament to the increasing relevance of services, as suggested by the increase of 157% in nominal terms (current prices) between 2009 and 2018 as compared to roughly 130% of total exports.

Moreover, we consider these vividly rising exports as illustrative of the high degree of competitiveness of the Polish economy. Perhaps even more impressively, Poland's global export market share has increased rapidly over recent years, posting at 1.31% in 2018, up from 1.26 and 1.04% in 2017 and 2013 respectively. On top of this, we take note of a sustained inflow of new foreign direct investments (FDI). The stock of inward FDI grew at an average quarterly rate of 4.4% y-o-y in the first three quarters of 2019, somewhat faster than in 2018. While the real effective exchange rate (CPI based) has been broadly stable over the past twelve months, external competitiveness was also supported by contained real unit labor costs (ULC). According to AMECO data, real ULC increased by a relatively moderate 1.1% in 2019 (2018: 2.1%), by and large comparable to real ULC developments witnessed in Poland's main trading partners such as Germany (1.5%), the Czech Republic (1.1%), and the UK (1.8%).

Although heightened uncertainty stemming from frequent regulatory and taxation changes appears to be a recurrent issue, burdening corporate business decisions, the overall favorable business environment also continues to give Poland a competitive edge, in particular as compared to other CEE economies. That being said, the business environment seems to have deteriorated since our last review, judging by the current World Bank's Doing Business assessment. Poland thus slipped by seven places to the 40th rank out of 190 economies in the 2020 edition of the Doing Business Report. Poland fares particularly weak with regard to the topics 'starting a business' and 'registering property' (ranks 128 and 92 respectively). Notwithstanding, Poland's overall performance is in line with the EU average (median rank 40), and the country also ranks higher than most other CEE economies – surpassed only by Slovenia and the Baltics. The same applies to the latest World Economic Forum's ranking, according to which Poland achieved a stable rank 37 out of 141 economies in the latest vintage of the Global Competitiveness Report (2018: 37th/140), ahead of several CEE states.

With a view to growth dynamics, we see that Poland's economic activity cooled over the course of last year. Following extraordinarily strong growth in 2017 and 2018 when total output expanded by 4.9 and 5.1% respectively, real GDP came in significantly lower in 2019, at 4.0% according to the flash estimate by Statistics Poland. That said, the Polish economy turned out fairly resilient amidst decelerating economic growth in the euro area and receding trade flows. Furthermore, last year's GDP growth matched Poland's post-EU accession average (2004-18: 4.0%) and Poland should have been able to continue its streak of being among the fastest growing economies in Europe, considering quarterly growth dynamics throughout 2019.

Although the weakening external environment, in particular in the euro area, had a tangible impact on Polish export growth, external trade made a positive contribution. Currently available data indicates that net exports contributed 0.4 p.p. to economic growth (2018: 0.0 p.p.). Quarterly Eurostat data signals that export growth volumes declined significantly up to Q3-19, with yearly export growth rates standing significantly below the levels seen in the

previous year. While still vividly growing services exports also lent some support, import growth slowed more sharply than export growth, partly due to the high import intensity of slowing exports and investments. Imports of goods and services grew by only 4.1 and 3.7% y-o-y in the second and third quarter of 2019 as compared to 8.9 and 7.9% in the year before.

Investment growth held up relatively well and had a meaningful impact on GDP growth. Based on preliminary 2019 data, gross fixed capital formation is estimated to have increased by 7.8%, somewhat slower than the previous year, when investment grew by 8.9%. Having said this, we observe a significant slowdown in investment activity in the second half of 2019, with total gross fixed capital formation growth dropping from 9.9 and 9.1% y-o-y in the first half of the year to 4.6% in Q3 (Q3-18: 11.9%), primarily related to the construction sector. Available data shows that total construction investment slightly decreased by 0.1% (unadjusted data), mainly due to a drop in the category 'other buildings and structures'. On the whole, gross fixed capital formation should have contributed 1.4 p.p. to overall growth. In this vein, preliminary estimates of gross capital formation's growth contribution (0.6 p.p.) hint at the change in inventories being the main culprit for the weaker outturn in 2019.

Meanwhile, private household spending remained the main engine of Poland's growth, driven by continued employment growth, rising disposable incomes, upbeat consumer confidence, and low funding costs which fueled consumer credit. Statistics Poland reckons that private consumption expanded by a brisk 3.9%, somewhat slower than in the preceding years when household spending increased by 4.5% (2017) and 4.3% (2018) respectively.

Looking ahead, we forecast Polish real GDP growth to ease to 3.4% in 2020, as export growth is set to decelerate further, while domestic demand is not likely to keep up the pace seen over 2017-19. While we expect that strong private consumption will extend into 2020, providing a marked uplift to Poland's economic growth, investment growth should slow down further, weakened by a lower utilization of EU funds and the muted outlook for export growth.

External demand is thus likely to remain sluggish, given the persistently high degree of economic and political uncertainty and only hesitant signs of stabilization in international trade policies. Polish export growth is also likely to come in a touch lower against the backdrop of lukewarm economic prospects in the euro area and in Germany as its key trading partner in particular. Hence, the growth contribution of net external trade should turn broadly neutral this year, as import growth is likely to gain some traction on the back of robust domestic demand.

We expect investment growth to normalize to more sustainable levels, thus remaining relatively solid. Firstly, public investment should rise at more moderate rates, now that the impact of local government elections in 2018 and parliamentary elections in 2019 fades out. We further assume a somewhat lower uptake of European Structural and Investment Funds (ESIF), also denting public investment growth and implying some adverse second-round effects on private investment activity. Private investment growth, in turn, is also set

to decrease, essentially in view of laggard external demand from the euro area. This appears to be affirmed by soft survey data, showing that export expectations in the industrial sector have declined since the beginning of 2018 and have dwindled to their lowest level since the third quarter back in 2013. New orders have also been on the retreat since the second half of 2018, but seem to have stabilized more recently. On the other hand, capacity utilization still posts well above its long-term average (2000-18: 75.4%), albeit down to 80.2% in Q1-20 after peaking at 83.4% in the second quarter of 2018. Moreover, financing conditions remain very favorable. On 05 February, the Monetary Policy Council of the National Bank of Poland (NBP) decided to keep its reference rate unchanged, standing at 1.5% since March 2015, and we believe NBP is likely to hike key interest rates in 2022 at the earliest. Low interest rates should also continue to be conducive to construction investment. Household demand for dwellings should thus remain strong. The number of dwellings for which permits have been granted or which have been registered with a construction project climbed to a new record-high in 2019, reaching 268,500, up from 257,600 in 2018.

Household spending is set to remain robust and materially drive Poland's economic expansion going forward, as illustrated by sentiment data provided by the European Commission. Consumer confidence has thus plateaued at historically high levels, albeit more recent survey data has come in at a softer patch. In the same vein, we view consumers' expectations of their financial situation over the next twelve months as still supportive of vivid consumer expenditure growth. Upbeat consumer sentiment arises from persistently favorable labor market developments. Coupled with rising public sector wages, minimum wage hikes, and fiscal measures including higher government outlays for pensioners, families, and disadvantaged groups (see below) this should cater for robust household spending growth.

While we expect private consumption to remain the main driver of Poland's output expansion, its growth rate is set to slacken to some degree, as the increasingly tight labor market appears to have passed its cyclical peak. Labor market conditions, however, remain very benign. According to Eurostat LFS data, the unemployment rate continued its downward trend and stood at 3.4% in 2019, a decrease of 0.5 p.p. compared to the previous year, and the lowest reading in the historical series. In addition, Poland's unemployment rate is the third lowest in the EU-28 (average 2019: 6.8%), and compares favorably with other CEE economies. Also, the labor participation rate increased further last year, rising from 70.5% in the third quarter of 2018 to 70.8% in Q3-19. Still, the gap towards the European average is considerable (EU-28: 74.0%), largely driven by the low participation among the elderly. The Polish participation rate of people in the age of 55-64y is increasing only very gradually (Q3-19: 50.9%) and ranks among the lowest in the EU-28 (63.0%).

Nevertheless, employment growth is gradually abating, becoming increasingly less supportive to growth as supply-side constraints are beginning to bite, but also due to slowly abating labor demand on the back of easing economic activity. Judging by national accounts data, employment growth (domestic concept) weakened, recording negative yearly growth rates throughout 2019. Another indication that the labor market may be shifting into a lower gear is the number of vacancies, which is gradually receding after having

peaked in Q2-18. Concurrently, labor shortages are still pervasive, with the share of corporate respondents citing labor as a main limiting factor to their business remaining among the highest in the EU at the end of 2019, albeit less so than a year before.

The income situation of private households is set to improve as a result of the favorable labor market conditions and higher disposable income. As shown by Statistics Poland data, wage growth continues to be brisk, with the average gross monthly wage posting rates of at least 7.1% y-o-y since Q2-18 (Q3-19: 7.6%). It has to be emphasized that wage pressure would be significantly higher without the continued inflow of labor from abroad, especially from Ukraine. Furthermore, disposable income is boosted by numerous government measures, inter alia the extension of the Family 500 Plus program, a PIT rate cut, an income tax exemption for people under 26y, and the continuation of the Pension Plus Program. What is more, households will benefit from minimum wage increases; as of the first semester of 2020, the monthly minimum wage stands at EUR 610.79, 16.8% above the previous year's level (Eurostat data). Having said this, rising HICP inflation will likely act as a drag on real disposable income, while Polish households appear to have become more inclined to save more recently. We note that the propensity to save may be facilitated by the newly introduced voluntary occupational pension saving scheme (Employee Capital Plan, PPK) going forward.

As mentioned in our last review, marked demographic headwinds, and very likely less EU funding support, pose some risks to Polish economic growth further afield. To be sure, potential growth should remain among the strongest in an EU comparison for now, with the EU Commission forecasting potential output growth to equate to approx. 4.0% in 2019-21. Nevertheless, the rapidly ageing population and lower ESI funds are likely to put medium- to long-term growth on a descending path.

Institutional Structure

Poland's credit ratings continue to be backed by a generally high quality of the sovereign's institutional set-up, while our reservations concerning the evolving judicial system are somewhat balanced by benefits associated with EU membership.

In our view, the country draws extensive benefits from its EU membership, including adoption of common rules and standards as well as significant trade and financial integration. The EU is Poland's key source of foreign direct investment, which increased sharply following its accession. Moreover, a significant share of the Polish population is domiciled in another EU member state, with over one million Poles having migrated to the United Kingdom. The negotiations between the UK and the EU on the free movement of workers will thus be extremely important for Poland. Equally important are the EU payments and Interreg programs under ESIF. According to EU cohesion data as of 13 February, Poland is the largest beneficiary, with a funding of roughly EUR 105bn, corresponding to 16.3% of total EU financing in 2014-20.

At the same time, the latest vintage of the World Bank's Worldwide Governance Indicators (WGI), our preferred measures of good governance, suggests that institutional conditions have somewhat deteriorated since our last review. That being said, we view the overall

institutional quality as generally high, although the sovereign continues to receive persistently lower scores than the EU average and the median of our A-rated universe on all indicators except control of corruption. On the WGI control of corruption, Poland is ranked at 54 out of 209 economies worldwide, whereas the 'A' median lies at rank 59. On the other hand, the sovereign is considerably less aligned with the A median and the EU-28 average when it comes to the quality of policy formulation and implementation, with Poland standing at rank 53 (A median: 44, EU: 39). While government effectiveness and control of corruption have remained broadly stable over the last couple of years, we observe that scores of the WGIs rule of law and voice and accountability (rank 58) have further weakened. Rule of law is particularly noteworthy here, on which the sovereign is placed at rank 70, significantly above the EU median (rank 38).

The deteriorating perception of the quality of property rights, contract enforcement, the courts, and of the freedom of expression and media reflects the increasing risk of eroding checks and balances, which may create an unfavorable backdrop for the sovereign's policy predictability. The European Commission has thus repeatedly expressed its concerns about judicial independence in Poland, and views the reforms of the Polish court system as a potential threat to the EU's fundamental values. After having referred Poland to the European Court of Justice (ECJ) on this matter, ECJ eventually made its final judgement on the Polish Supreme Court Act in June 2019, ruling that the lowering the retirement age of judges of the Supreme Court is contrary to EU law, and breaches the principle of the irremovability of judges and thus that of judicial independence.

As we understand, controversial discussions between the Polish government and the Commission about judicial independence in Poland are ongoing. While we believe that Poland will seek further constructive engagement within the EU, the newly formed government and its close President Duda are likely to maintain their at times divergent views in the dispute over judicial reform.

This may be all the more true, as the national conservatives (PiS) remain the strongest political force in Poland. In October 2019, elections for the lower house (Sejm) and the Senate were held. PiS was able to maintain its dominant position in the Sejm, taking almost 44% of the votes and gaining 6 p.p. as compared to the general election in 2015. The strongest opposition alliance, the liberal-conservative Civic Coalition (KO; includes PO, .N and smaller parties), received around 27% of the public vote. By contrast, PiS lost its absolute majority in the Senate with 48 out of 100 seats, while the Civic Coalition is almost on a par with the ruling PiS party (43 seats). As a corollary, PiS will no longer be able to pass legislation as swiftly and without contradiction through the two houses as was the case in the previous legislative period.

Indeed, Poland's government appears to be continuing to pursue a tough course in the conflict over judicial reforms, although facing opposition from KO at the beginning of the year. Still, a controversial bill was passed by Sejm this January and signed by President Duda in early February, imposing disciplinary restrictions on judges should they engage in political activities or question the authority of judges appointed by the reformed National Judicial Council.

Further tensions between EU stakeholders and the Polish government as regards Poland's judicial system cannot be ruled out. Over the course of the ongoing negotiations of the next Multiannual Financing Framework 2021-27, the European Parliament and some EU member states have declared their intention to make access to EU funding conditional on respecting fundamental EU values such as judicial independence. The financial fallout implied by lower EU payments to the Republic of Poland would be significant (see above). However, as such decisions would require unanimous support, this seems rather unlikely against the background that Hungary has already indicated to veto an Article 7 procedure in the past.

Fiscal Sustainability

Poland's public finances remain a key rating strength and have continued to improve since our last review, featuring comparatively modest debt levels, a declining public debt ratio, and contained debt servicing costs, somewhat balanced by a high though gradually waning exposure towards risks stemming from foreign currency denominated debt.

To be sure, we expect the headline deficit to widen again in 2019 and 2020 after having declined from 1.5 to 0.2% of GDP in 2017-18. General government expenditure should increase markedly given the rising public wage bill as well as extensive tax and social policy measures introduced in the run-up to the general elections in October and amended by the government at the end of last year.

The fiscal package mainly consists of social transfers and tax measures geared towards families with children and pensioners – tying in with the government agenda of supporting inclusive growth. First and foremost, this includes the extension of the child benefit program (Family 500+), which was introduced in 2016 and is paid independent of households' income as of July 2019, with the fiscal impact thus to be fully felt this year (PLN 39.2bn). Furthermore, the disbursement of a 13th month pension payment will lead to a significant increase in pension expenses. The same applies to the indexation of pensions to 103.56%, with a minimum guaranteed increase of PLN 70, while the minimum pension will be ramped up to PLN 1,200 – increasing outlays by approx. PLN 9.2bn in 2020. Rising wages for civil servants and the increase in long-term care allowance, as well as initiatives such as the 'Dobry start', 'Za życiem', 'Mama4+' and 'Senior+' programs can also be expected to significantly weigh on the budget. By the same token, government revenues will be reduced by cutting the lower threshold in the first tax bracket from 18 to 17%, and abolished personal income taxes for major income categories for persons under 26y.

Additional revenues will be generated by the extension of already implemented and newly introduced measures largely geared towards raising the VAT intake and enhancing tax compliance. Thus, the split payment mechanism and the bank risk analysis system to eschew tax fraud, as well as the implementation of an IT clearing system (STIR) and the introduction of online and virtual cash registers should all have beneficial effects on general government revenue. Moreover, excise duties on alcoholic beverages and tobacco products are to be hiked by 10% and social security contributions are planned to be increased by scrapping the yearly cap and closing regulatory gaps related to the application of non-standard labor contracts. What is more, the Polish government can expect a material one-

off payment in 2020, associated with the liquidation of the second pillar pension funds (OFEs). While the respective assets may be transferred to the first or third pillar, assets shifted to the third pillar will be subject to a conversion fee. The government expects a comparatively high transformation rate and thus revenues of PLN 12.6bn in 2020 (and another PLN 5.4bn in 2021).

On the whole, we see the headline deficit rise to 0.9 and 1.3% of GDP in 2019 and 2020 respectively. Resilient economic growth and the favorable labor market conditions are likely to cushion the effects of a rising public wage bill and expansionary tax and social measures, but increasingly less so going forward; in line with our expectation, economic activity and employment growth are gradually losing momentum.

We note that our 2019 forecast is more favorable than the Convergence Program scenario, as tax revenue appears to have come in significantly higher than previously budgeted. As signaled by quarterly data on the general government level for the first three quarters of 2019 (Eurostat), revenues have indeed been growing vividly. Whilst compensation of employees and social benefits rose by 6.3 and 12.3% y-o-y respectively, the intake of taxes on income surpassed the previous year's level by 13.8%; VAT revenues increased by 9.7%. Monthly data on the Ministry of Finance's (MoF) estimated budget execution underscores our expectations, showing that by November 2019, corporate income taxes surpassed the budget plan by 6.3% and non-tax revenues by 14.2%. Indeed, the MoF announced that the revenue from the state budget may exceed the budget plan by more than PLN 14bn more recently, mainly due to higher income taxes and non-tax revenues.

Hence, we think that fiscal risks are somewhat mitigated by the fact that the Polish government's assumptions and related estimates on the budget and debt developments have tended to be rather cautious, being outperformed by the actual outturn over the recent past. However, not only the aforementioned one-off is clouded by uncertainty, but also yields from newly implemented measures targeted towards combating the grey economy and improving tax administration. It thus remains to be seen to what extent the government will be able to capitalize on assets transferred to the third pillar.

Irrespective of more expansionary fiscal policies, we expect to see the public debt ratio following its downward trajectory. General government debt fell below 50% of GDP in 2018, amounting to 48.9% of GDP (2017: 50.6%), and will presumably decrease further in the coming years, largely driven by solid economic growth, rising inflation and declining interest payments. Whereas the debt-to-GDP ratio continued its decline in 2019 (Q3-19: 47.4% of GDP), we point out that gross government debt has tended to grow in nominal terms over the past few years.

Although the share of State Treasury debt denominated in foreign currencies has dropped since our last review, we still have to flag it as high. According to the MoF, FX debt amounted to 26.4% in December 2019, down from 29.3% at the end of 2018. As we understand, Poland's medium-term debt strategy foresees a further reduction to 20.4% by 2023. In any case, we believe that refinancing risks are limited, underlined by the high debt affordability. Poland's 10-year bond yields fell to 2.266% at the end of January 2020 (weekly quotations,

24-01-20), roughly 55bp lower than a year before. In addition, interest payments have continued to follow their downward path, dwindling to as low as 3.2% of general government revenues, down from 3.6% in Q3-18 (Q3-16: 4.3%).

Meanwhile, the Polish banking sector remains in good shape and entails no fiscal sustainability risks at this stage. Compared to the EU median (~177% of GDP), Poland exhibits a rather small banking sector, which accounted for roughly 91% of GDP in Q2-19. According to EBA data, the share of non-performing loans declined further from 5.3% in Q3-18 to 4.8% in the third quarter of 2019 – still around 2 p.p. above the EU average (2.9%), but broadly in line with other CEE countries (median: 4.7%). Capital buffers, as measured by a CET 1 ratio of 15.7% in Q3-19 remain comfortable (EU average: 14.6%), albeit having declined from 16.3% a year before.

Having said this, residential real estate should be monitored carefully going forward. House prices have been gaining traction over the last four years and showed annual growth rates of more than 8% in the first three quarters of 2019 (Q3-19: 9.0%); 3-y growth rates even surpassed the 20% threshold in the second quarter. Affordability metrics obtained from the OECD, however, do not yet raise concerns – with the price-to-income ratio posting approx. 8% below its longer-term average (2010-19) – and we do not see signs of excessive credit growth.

Foreign Exposure

External vulnerabilities are rather limited. The country's net international investment position (NIIP) has improved steadily, and we continue to see no looming external imbalances in the near to medium term.

In fact, we expect that the current account shifted back into positive territory last year, amid a challenging external environment, mainly driven by the strong positive position in the trade balance. In 2018, the current account had turned negative on the heels of the first surplus in decades, falling from 0.1 to -1.0% of GDP. Over the course of 2019, the current account has resumed its longer-term upward trajectory, posting a surplus equaling 0.2% of GDP in Q3-19 (rolling four-quarter sum). This was chiefly a result of a significantly improved goods balance which narrowed from -1.0% of GDP in Q4-18 to -0.1% of GDP in this year's third quarter and came on the back of a softening export growth which nevertheless exceeded even weaker import growth (see above). Furthermore, the strong services surplus held up and reached 4.5% of GDP, to our knowledge the highest reading on record, while the large primary income deficit, which mirrors high dividends flowing to foreign direct investors abroad, was broadly stable (3.8% of GDP).

In line with the preliminary estimate of net external trade for the whole year 2019 and backed by monthly balance of payment data up to November 2019, according to which the current account totaled roughly PLN 14.1bn (rolling 12-month sum), the current account should have ended up in surplus at the end of last year. Based on our expectation of subdued external demand and strengthening import growth, whereas the large primary income deficit is likely to persist, Poland should post moderate current account deficits going forward.

Meanwhile, risks emanating from Poland's highly negative NIIP are subsiding and are also mitigated by its composition. After the NIIP had already improved significantly from -61.2 to -55.8% of GDP in 2017-18, this trend was sustained in 2019, with the NIIP increasing to -51.5% of GDP in Q3-19. The improvement in the Polish NIIP was partly due to a significant build-up of reserve assets, which shot up by 16.5% y-o-y in nominal terms, or from 20.0 to 21.7% of GDP in the year to Q3-19. In addition, we do not consider its economy as seriously vulnerable to a sudden capital outflow, as net FDI stood at -35.8% of GDP, accounting for a large share of the NIIP. We also note positively that the share of sovereign external debt declined from to approx. 44% of overall general government debt in Q3-19 (Q3-18: 47%) and net external debt continues to follow its downward trajectory, currently standing at 22.5% of GDP (Q3-18: 27.6%).

Rating Outlook and Sensitivity

Our Rating outlook on Poland's sovereign ratings is positive, as we assume that the risk situation underlying the key factors affecting sovereign credit risk – including macroeconomic performance, institutional structure, fiscal sustainability, and foreign exposure – is likely to improve over the next 12-24 months.

We could raise our sovereign rating if the public debt ratio continues on its presumed downward trajectory, irrespective of the government's ambitious spending plans, and if medium-term growth evolves in line with our expectations, remaining healthy while avoiding an overheating, thus creating the favorable backdrop for a closer convergence with EU levels in terms of incomes and productivity. Also, the implementation of reforms addressing structural bottlenecks such as Poland's demographic transition could result in a rating uplift. At the same time, we view the absence of a further deterioration in perceived governance quality as a prerequisite for a positive rating action.

The positive outlook indicates that we consider a downgrade as rather unlikely. Nevertheless, downward pressure on the outlook or rating could arise if medium-term growth falls short of our expectations and income convergence towards EU levels does not progress. This may be the case if trade tensions escalate further and hopes for a stabilization of global trade prove premature, if excessive wage growth not aligned with labor productivity results in a material deterioration of the economy's cost competitiveness, or if the institutional quality weakens further.

Primary Analyst
Wolfgang Lauer
Sovereign Credit Analyst
w.lauer@creditreform-rating.de
+49 2131 109 3865

Chair Person
Benjamin Mohr
Head of Sovereign Ratings
b.mohr@creditreform-rating.de
+49 2131 109 5172

Ratings*

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

*) Unsolicited

Economic Data

[in %, otherwise noted]	2014	2015	2016	2017	2018	2019e	2020e
Real GDP growth	3.3	3.8	3.1	4.9	5.1	4.0	3.4
GDP per capita (PPP, USD)	25,411	26,670	27,799	29,717	32,005	33,891	35,651
HICP inflation rate, y-o-y change	0.1	-0.7	-0.2	1.6	1.2	2.1	2.7
Default history (years since default)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Life expectancy at birth (years)	77.8	77.5	78.0	77.8	77.7	n.a.	n.a.
Fiscal balance/GDP	-3.6	-2.6	-2.4	-1.5	-0.2	-0.9	-1.3
Current account balance/GDP	-2.1	-0.6	-0.5	0.1	-1.0	n.a.	n.a.
External debt/GDP	72.7	71.8	76.4	67.0	64.0	n.a.	n.a.

Source: International Monetary Fund, Statistics Poland, Eurostat, 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

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.

This sovereign rating is an unsolicited credit rating. The Ministry of Finance (MoF) participated in the credit rating process as MoF 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 MoF during their review. However, the rating outcome as well as the related outlook remained unchanged.

The rating was conducted on the basis of CRAG's "Sovereign Ratings" methodology in conjunction with its basic document "Rating Criteria and Definitions". 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 the following internet page: www.creditreform-rating.de/en/regulatory-requirements/.

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

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 case 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. Neither 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

Hellersbergstrasse 11
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: Prof. Dr. Helmut Rödl
HRB 10522, Amtsgericht Neuss