JCR

ISSUER REPORT

April 21, 2020

12061
Poland

Long-term Rating	A
Outlook*	Stable
Short-term Rating	-

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* Long-term Rating refers to Foreign Currency Long-term Issuer Rating in principle.

1. Overview

Poland is the largest economy in Central and Eastern Europe with a nominal GDP in excess of USD 580 billion and a population of 38 million in 2019. Following the economic transition and subsequent radical economic reforms, the country experienced significant economic deterioration in the early 1990s. Since then, it has transformed its economic structure mainly through economic and fiscal reforms and inflow of foreign direct investments (FDI) from the EU countries as well as utilization of EU funds. It joined NATO in 1999 and acceded to the EU in 2004. Even amid the economic stagnation in the EU countries during the global financial crisis and the European sovereign crisis, the Polish economy continued growing without interruption. The conservative Law and Justice (PiS) was re-elected in the parliamentary election in October 2019 and upholds a policy of inclusive economic growth with commitment to complying with both the EU and domestic fiscal rules. In response to the global coronavirus pandemic, the government together with the Central Bank took large scale economic measures to minimize the impact on the economy.

2. Sociopolitical Base and Economic Policy

Since the country's first free election held in 1991, the system of parliamentary democracy has been functioning as exemplified by a multi-party system and change of administration. In the process of its EU entry negotiation, Poland had to make a major review of its political, economic and fiscal systems. The systems in conformity with the EU standards have been put in place to ensure political and social stability. The then largest opposition party PiS won both the presidential election in May 2015 and the general election in October 2015. The party took power for the first time in eight years by winning a working majority in the upper and lower houses of parliament. The current prime minister is Mateusz Morawiecki, the former deputy prime minister and finance minister. In the latest general elections held in October 2019, PiS was re-elected on the back of high support in opinion poll.

PiS is originated from the anti-communist Solidarity trade union and is a conservative Christian democratic party. The party leader is Jaroslaw Kaczynski, who is the most influential person in politics. The party puts priority on enhancement of social welfare and intervention in national economy. In foreign policy, it looks to strengthen the relationships with the EU and the U.S., but currently takes a cautious stance toward introduction of the euro. Since taking office, the PiS government has pushed ahead with contentious amendments of the laws regarding the Supreme Court and public media. The European Commission (EC) found that the revision of the constitutional court law could threaten the rule of law and has been recommending the Polish government to take appropriate measures. In December 2017, the EC made a decision to trigger Article 7 of the Lisbon Treaty. The most serious sanction possible under Article 7 would be suspension of Poland's voting rights in EU institutions. Following decision made by European Court of Justice, the government partially scraped its judicial reform and avoided implementation of sanctions. Nonetheless, such sanctions would be hardly practicable because they require a unanimous vote and the Hungarian government has already indicated its opposition. The country had already established high-level political, social and economic

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systems in its EU accession process. Unless the issue leads up to a substantial reduction of EU funds, its impact is likely to be limited.

Under its economic and fiscal policies, the government puts priority on promotion of inclusive growth with commitment to keeping the fiscal deficit below 3% of GDP. The government has implemented various measures to increase social benefits and lower household burdens and has promoted to enhance active labor market. It has managed to contain the fiscal deficit by enhancing tax compliance and adhering to the expenditure rule. In the response to epidemic of coronavirus in Poland, the government in mid-March practically has closed the border and restricted the movement of people. As of April 10, Poland had 5,575 infected people and 174 deaths (Johns Hopkins University). In comparison with the country's population, the number of the infected people remains contained among European countries. The government unveiled the large scale economic measures equivalent to around 9% of GDP to support banks, companies and households.

3. Economic Base

Poland is a relatively advanced economy with its per capita GDP (ppp) in 2019 estimated to have excessed USD 33,000, which is slightly higher than the average of sovereigns rated in the A range by JCR. Its industrial structure is diversified, encompassing logistics hubs and outsourcing business lately in addition to the traditional manufacturing such as steel, car and electric appliances and wholesale/retail. Since the middle of the 1990s, the country has introduced FDI mainly from other European countries and deepened its economic relationship with those countries through international trade and finance. The outstanding balance of FDI at the end of 2019 was around 50% of GDP. Poland is firmly integrated into the EU's supply chain, with 80% of its exports bound for the EU member countries, including close to 30% bound for Germany alone. Since its accession to the EU, the country has been receiving a substantial amount of transfers from the EU funds and the government has been upgrading the social infrastructure by effectively using them. It was entitled to receive EUR65 billion or 21% of GDP (in 2007) between 2007 and 2013 and more than EUR76 billion or 18% of GDP (in 2014) between 2014 and 2020.

Meanwhile, Poland's population began declining in the late 1990s, giving rise to concern over future supply of labor force reflecting the current economic expansion. In addition to an increase in employment rate and reduction of unemployment rate, more than one million (around 6% of total labor force) Ukrainians are estimated to stay in Poland as foreign workers, helping to ease the labor shortage. Electricity consumed in the country is mainly generated with the coal produced at home, but the government plans to diversify the sources to renewables and nuclear power. Other energy resources such as oil and natural gas are mainly imported from Russia.

4. Economic Trends

The economy has been growing uninterruptedly led by stable domestic demand with annual growth rates averaging close to 5% in the past three years. The economic growth decelerated to 4.1% (preliminary) in 2019 from 5.1% in 2018 on moderation of domestic demand and slowdown of exports. The domestic demand was supported by consumer spending brought by increased wages and employment and solid investment prompted by a massive inflow of EU funds. The country faces a labor shortage as the unemployment rate fell to record low level to 3.3% in 2019. However, the continued rise in employment rate and inflow of overseas workers may ease the shortage at least in the short term. Inflation remains contained as a rise of wages has been partly offset by improved productivity. In response to the coronavirus outbreak the Central Bank cut policy rate and the required reserve rate, and provides liquidity to banks and financial support to nonfinancial corporation through banks. The government practically closed the border and adopted measures to restrict the movement of people. It also adopted large scale economic measures to support for labor market and companies, as well as infrastructure investment. The increase in the number of infected people remains moderate, but the economy will fall temporally due mainly to the closure of the border and restriction of movement of peoples. If the situation will not prolong, the economy will likely to return to growth of around 3% on the back of stable domestic demand in 2021.

5. Financial System

The country's financial system stays stable. In the process of privatization in the 1990s, many major Polish banks excluding PKO BP, the country's largest bank, became subsidiaries of major European banks. Bank lending to the private sector remained moderate at around 50% of GDP at the end 2019, with lending growth mirroring the nominal GDP growth in recent years. The banks continued to register solid earnings in 2019. Bank's capital adequacy ratio rose to around 19.0% at the end of 2019 while the nonperforming loan ratio dropped further to around 6.5%. Banks have capacity to withstand the impact derived from economic slowdown.

President Andrzej Duda launched a plan to convert CHF mortgage loans to PLN at non-market exchange rates, which had been one of his election promises in 2015. However, the president had to make a major revision of his initial proposal in light of its significant impact on the financial system. Currently, borrowers are expected voluntary sue banks if there is defective contract. Despite the decisions made by European Court of Justice and domestic court, the decisions do not provide a clear judgment and so will not be a decisive solution for the arbitration of foreign currency-denominated mortgage loan contracts Therefore it will likely take quite long for rulings to be issued. The outstanding balance of CHF loans as of end 2019 continues to shrink to less than 10% of total bank loans. Moreover, the credit quality of those loans stays sound as the financial standing of FX borrowers is on average better than zloty ones. Not many borrowers are expected to sue against banks, but banks are forced to set aside provision in preparation for the risk. JCR will monitor the development.

6. External Position

The current account balance again returned to a surplus in 2019. With the trade balance being largely balanced, a structurally growing service balance surplus more than offsets a chronic primary income balance deficit. The country's external liquidity stayed solid as it enjoyed a net capital inflow amid a modest current account surplus and the continued inflow of EU funds. The country's transportation and business service exports have been growing markedly in recent years. The primary income balance is constantly in a deficit as the foreign owners of Polish firms receive a large share of the profits. A net capital balance inflow mainly originated from the EU funds amounted to about 2.0% of GDP in 2019.

The country's net external liabilities on the IIP basis and external debt shrank to 50% of GDP and 60% of GDP at the end of 2019, which were still relatively high as compared to those of other sovereign governments rated in the A range. The public and private sectors respectively accounted for 40% and 60% of the external debt. As for the debt owed by the private sector, intercompany loans made by more stable financing sources accounted for more than 40% of its total. The country's foreign exchange reserves increased to EUR 114.5 billion at the end of 2019, or equivalent to 5.1 times of its monthly goods and services imports and 2.3 times of its short-term external debt (excluding intercompany lending).

7. Fiscal Base

Poland was relieved of the EU's excessive deficit procedure in June 2015 for the first time since 2009. It has since been keeping its fiscal deficit below 3% of GDP. In the 2019 budget, the general government fiscal deficit (ESA 2010) had been estimated at 1.7% of GDP, citing a one-off bonus for pensioners, enlarged child benefits and reduction of the personal income tax rate pledged prior to the general election. However, the deficit actually proved to be smaller at around 1% of GDP thanks to increased tax revenues resulting from economic expansion and intensified tax compliance. The general government debt (ESA 2010) shrank to 46.0% of GDP at the end of 2019 from 48.8% a year earlier. The debt structure also improved, with the ratios of foreign currency-denominated debts (owed by the central government) and those held by nonresidents falling to 26% and 40%, respectively, at the end of 2019. Japan, Luxemburg and the Netherlands were the major nonresident creditors with a combined share totaling more than 50% (excluding omnibus accounts). Other creditors were geographically diversified. Average debt maturity is relatively longer with over five years.

The 2020 budget plan estimated a general government fiscal deficit at 1.2% of GDP, envisaging a balanced state budget for the first time since 1990. The implementation of large scale economic measures equivalent to around 9 % of GDP will inevitably force the government to review the budget and widen the fiscal deficit. While actual spending measures is estimated at around 3% of GDP, revenues are likely to fall stemming from economic deterioration. All these considered, JCR holds that total fiscal impact will be around 5% of GDP. Nonetheless, the government is equipped with the sufficient fiscal space to absorb the impacts and will maintain the debt to GDP ratio equivalent to those of other A range sovereigns rated by JCR.

8. Outlook and Overall Assessment

The ratings mainly reflect the country's diversified and stable economic base, prudent fiscal management and solid external liquidity. On the other hand, the ratings remain constrained by its still large net external liabilities in GDP terms regardless of the recent improvement. The outlook of the ratings is Stable. PiS, which was re-elected in the parliamentary election in October 2019, upholds a policy of inclusive economic growth with commitment to keeping the fiscal deficit below 3% of GDP by capitalizing on its stable political base. While the government has implemented various measures to expand social welfare, it has so far managed to contain the fiscal deficit thanks to increased tax revenues brought by economic expansion and enhanced tax compliance, and adhering to the expenditure rule. The general government debt kept shrinking in terms of nominal GDP. Despite of the state balanced budget adopted in 2020, the large scale economic measures to combat with novel coronavirus will force the government to review the budget. Nonetheless, the government still has sufficient fiscal space to implement the measures.

Further reduction of net external liabilities and external debts in terms of GDP will be positive for the ratings. On the other hand, the ratings will be negatively affected if the following factors have material impacts on economy and public finance; deterioration of external environment mainly pandemic of the novel coronavirus and EU economies: intensification of labor shortage: and substantial reduction of EU fund triggered by EU sanction.

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Selected economic and fiscal indicators

		2015	2016	2017	2018	2019
Nominal GDP	USD billions	464.0	472.0	526.4	585.7	589.9
Population	millions	38.4	38.4	38.4	38.4	38.4
Per capita GDP in PPP	USD	26,820	27,720	29,950	31,380	33,440
Real GDP growth rate	%	3.8	3.1	4.9	5.1	4.1
Consumer price inflation(Eurostat)	%	-0.7	-0.2	1.6	1.2	2.1
Unemployment rate(Eurostat)	%	7.5	6.2	4.9	3.9	3.3
General government revenues/GDP	%	39.1	38.7	39.8	41.4	41.3
General government expenditures/GDP	%	41.7	41.1	41.2	41.6	42.5
General government balance/GDP	%	-2.6	-2.4	-1.5	-0.2	-1.2
General government debts/GDP	%	51.3	54.3	50.6	48.8	46.0
Current account balance/GDP	%	-0.6	-0.5	0.1	-1.0	0.5
External debts/GDP	%	70.4	75.3	68.4	63.4	59.2
Net international investment position	%	61.0	62.5	62.3	55.3	50.5
External debts/Export G&S	%	142.5	144.5	126.0	114.1	105.9
Foreign exchange reserves/Monthly import G&S	Times	5.2	6.3	4.8	4.7	5.1
Foreign exchange reserves/Short-term external debts	Times	2.6	2.2	2.2	2.3	2.3

(Notes)
1 Figures for general government balance and debt in 2019 are estimated by JCR
(Sources)
Eurostat, Statistics Poland, Ministry of Finance, and National Bank of Poland

Ratings

(billions of yen)

	Rating	Outlook*	Amount	Rate (%)	Issue Date	Maturity Date	Release
No. 15 Yen Bonds	A	-	10	0.91	2013.11.15	2020.11.13	2020.03.24
No. 4 Yen Bonds	A	-	50	2.24	2005.11.18	2021.02.18	2020.03.24
No. 6 Yen Bonds	A	-	60	2.62	2006.11.14	2026.11.13	2020.03.24
No. 13 Yen Bonds	A	-	10	2.50	2012.11.08	2027.11.08	2020.03.24
No. 7 Yen Bonds	A	-	50	2.81	2007.11.16	2037.11.16	2020.03.24
Foreign Currency Long-term Issuer Rating	A	Stable	-	-	-	-	2020.03.24
Local Currency Long-term Issuer Rating	A+	Stable	-	-	-	-	2020.03.24

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History of Long-term Issuer Rating (Foreign Currency Long-term Issuer Rating or its equivalent)

Date	Rating	Outlook*	Issuer
2002. 05. 31	BBB+	-	Poland
2003. 05. 08	A-	Stable	Poland
2008. 02. 26	A-	Positive	Poland
2008. 12. 16	A-	Stable	Poland
2013. 03. 01	A	Stable	Poland

*Outlook for Foreign Currency long-term issuer rating, or direction in case of Credit Monitor

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