JCR

ISSUER REPORT

April 5, 2022

12061

Poland

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

* 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 660 billion and a population of 38 million in 2021. Following the economic transition and subsequent radical economic reforms, the country experienced a 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. Since taking office in 2015, the conservative Law and Justice Party (PiS), despite its ongoing dispute with the EU over the "rule of law," has a stable political base and upholds a policy of inclusive economic growth with commitment to complying with both the EU and domestic fiscal rules. The government has launched large-scale economic measures in response to the COVID-19 pandemic in an effort to achieve a quick economic recovery.

2. Sociopolitical Base and Economic Policy

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. PiS, then the country's largest opposition party, won both the presidential election in May 2015 and the general elections 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. In the latest general elections held in October 2019, PiS was re-elected on the back of high public support. The current prime minister is Mateusz Morawiecki, the former deputy prime minister and finance minister. Incumbent President Andrzej Duda, supported by PiS, was also re-elected in the presidential election in July 2020.

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 economic management. In foreign policy, it looks to strengthen the relationships with the EU and the United States, 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 Supreme Court law could threaten the rule of law and has been recommending the Polish government to take appropriate corrective measures. In the end of 2017, the EC decided to trigger Article 7 of the Lisbon Treaty. Following the advisory made by the European Court of Justice (ECJ), the government partially scrapped its judicial reforms in a bid to avoid enforcement of sanctions. Even when the EC should decide to invoke sanctions, they would be hardly practicable because they require a unanimous vote and the Hungarian government has already indicated its

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opposition. In conformity with the EU's 2021-2027 Multiannual Financial Framework and the EU Recovery and Resilience Fund, the EU member countries have agreed to imposition of sanctions such as a freezing of funds to the countries that do not comply with its “rule of law” principle at the end of 2020. Poland and Hungary had appealed to the ECJ, claiming that this violated EU treaties, but the ECJ eventually ruled that it was legal in February 2021. Considering Poland's high level of public support for the EU and geopolitical importance within the EU in the face of Russia, it is unlikely that sanctions will be imposed, and an agreement is likely to be reached. Poland has already implemented advanced political, social, and economic institutions in the process of joining the EU, and foreign direct investment has not been affected, reaching a record high in 2021. If this problem does not lead to a significant reduction in EU fund, JCR considers that the impact on the economy is expected to be limited, and we are closely watching the development.

Prior to the pandemic, the government’s priorities in economic and fiscal policies had been promotion of inclusive growth with commitment to keeping the fiscal deficit below 3% of GDP. It has implemented various measures to enhance social benefits, reduce household burdens and invigorate the labor market. On the fiscal front, it has been working to contain the fiscal deficit by enhancing tax compliance and adhering to the expenditure rule. After the onset of the pandemic, large-scale economic measures totaling about 15% of GDP have been launched to support businesses and households in order to mitigate the impact of the pandemic on the economy and achieve an early economic recovery. The package mainly consists of fiscal measures such as waiver of social security contributions and wage compensation, financial support to companies by the Polish Development Fund (Financial Shield), and guarantees for corporate loans through the BGK (national development bank). Loans provided under the Financial Shield are converted into subsidies when companies meet certain conditions such as maintenance of employment.

3. Economic Base

Poland has relatively developed economy, with per capita GDP (in ppp terms) in 2021 estimated to have exceeded USD35,000, 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 attracted FDI mainly from other European countries and deepened its economic relationship with those countries through international trade and finance. The outstanding balance of FDI on an IIP basis at the end of 2021 increased closely to 50% of GDP. Poland is firmly integrated into the EU's supply chain, with above 70% 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 subsidies from the EU funds and the government has been upgrading the social infrastructure by effectively using them. It was entitled to receive EUR65 billion (equivalent to 21% of 2007 GDP) between 2007 and 2013 and more than EUR82.2 billion (equivalent to 20% of 2014 GDP) between 2014 and 2020. It is to receive EUR75 billion (equivalent to 13% of 2020 GDP) between 2021 and 2027. In addition, it has been allocated up to EUR23.9 (in current prices) billion (equivalent to around 4% of 2020 GDP) in subsidies from the EU Recovery and Resilience Fund.

Meanwhile, Poland’s population began declining in the late 1990s, giving rise to concern over future supply of labor force as the economy kept expanding before the pandemic. In addition to an increased employment rate and a reduced unemployment rate, the inflow of foreign workers mainly from Ukraine has been helping to ease the labor shortage. After the pandemic, the government has restricted inflow of foreign workers, but is now moving to ease the restrictions. Electricity consumed in the country is mainly generated with the coal produced at home, but the government is planning to diversify power sources through a shift to renewable energies and construction of six nuclear power units. Other energy resources such as oil and natural gas are mostly imported from Russia. In February 2020, the government formulated Poland's Energy Policy for 2040, which calls for lowering the share of coal in power generation to below 56% by 2030, while increasing renewable energy to 21% of final energy consumption through an increased capacity of photovoltaic and offshore wind power. Also, six nuclear power units will be installed. Meanwhile, EU member countries have set

2050 target for carbon neutral, but Poland has not yet committed to this target.

4. Economic Trends

The Polish economy had kept growing uninterruptedly until 2019 led by stable domestic demand with annual growth rates averaging close to 5% between 2017 and 2019. The economic growth decelerated in 2019 but remained high at 4.7% on robust consumer spending brought by increased wages and employment and solid investment prompted by a massive inflow of EU funds. The country faced a labor shortage with the unemployment rate falling to a record low of 3.3% in 2019. However, inflation remained contained as a rise of wages had been partly offset by improved productivity. The economic growth rate in 2020 only fell by 2.5%, mainly due to the effect of economic stimulus measures amid the pandemic. Due to the impact of the restrictive measures, real GDP contracted 8.2% year-on-year in the second quarter of 2020. The economic activity resumed thereafter along with the relaxation of the restrictive measures and real GDP had reached pre-pandemic level in the first half of 2021. The economy in 2021 was estimated to grow around 5% due to the reopening of economic activity and the continued economic measures, although monetary policy was tightened from October 2021 in response to rising inflation. As for developments in the labor market, an increase of unemployment remains curbed due to the employment support measures taken by the government.

Geopolitical risks are rising due to the Russian military invasion of Ukraine. While the future outlook remains uncertain, sanctions against Russia are likely to be prolonged. While the impact on exports and imports from Russia is limited due to the diversification of import/export destinations, the economic deterioration in the EU, its largest trading partner, is expected to have a material impact. While this will put downward pressure on the economy in the first half of 2022, the economy is expected to continue growing around 4 % in 2022 as a whole stemming from strong domestic demand, and large inflows of EU funds and Reconstruction funds.

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. The bank lending to the private sector remained not so high at slightly ca. 45% of GDP at the end 2021. In the first pandemic year the banking sector registered financial loss by absorbing the higher credit costs resulting from the economic downturn and costs of legacy risk (with one-off in a bank preparing to offer voluntary conversion of FX loans to zloty). Their nonperforming loans ratio slightly rose to 7.0% at the end of 2020 from 6.7% a year earlier. A moratorium on loan repayments has been in place as part of anti-pandemic support measures. The outstanding balance of loans under moratorium fell to below 0.5% of the total loans as of June 2021 from the peak of around 10% in the middle of 2020. Some of these loans may become nonperforming after the end of the moratorium period, but JCR holds that banks will be able to absorb any additional credit costs with their profit. Bank profits of 2021 increased substantially due to a reduction in credit costs with keeping high capital adequacy ratio. As far as the conversion of housing loans from Swiss francs to local currency is concerned, borrowers will be able to sue banks individually due to potential deficiencies in the contracts or negotiate with banks. Although it has shrunk to around 7% of total loans outstanding and its quality of its assets is relatively sound, the banking sector is building up its reserves in preparation for more lawsuits. JCR considers that impact on the earnings on banks is limited.

6. External Resilience to External Shocks

Poland's current account balance ended in a surplus equivalent to 2.9% of GDP in 2020. The surplus expanded significantly from a year earlier because a trade surplus increased as imports decreased more than exports on bleak demand at home. The country's external liquidity stayed solid as it enjoyed a net capital inflow amid an increased current account surplus and the continued inflow of EU funds. The primary income balance remains in chronic deficit as the foreign owners of Polish firms receive a large share of their profit. On the other hand, the country's transportation and business service exports have been growing markedly in recent years, with its increasing service balance surplus more than offsetting a primary income balance deficit. The current account balance for 2021 posted a marginal deficit due mainly to increased prices of imported fuels, with the limited impact of supply constraints. External liquidity remains robust, with net inflows continuing due to an inflows from EU funds. The country's net external liabilities on an IIP basis and gross external debt shrank to around 40% and 60% of GDP, respectively, at the end of 2021. The country's foreign exchange reserves increased to EUR 128.1billion at the end of 2021 or equivalent to 5.9 times of its monthly goods and services imports and over 2.6 times of its short-term external debt (excluding intercompany loans).

7. Fiscal Base

Prior to the outbreak of the pandemic, the country had made good progress on fiscal consolidation thanks to increased tax revenues resulting from economic expansion and intensified tax compliance and adherence to the expenditure rule. The general government fiscal deficit (ESA 2010) had been kept below 3% of GDP from 2015 to 2019, and the general government debt at the end of 2019 reduced significantly to 45.6% of GDP. The fiscal deficit in 2020 deteriorated to 7.1% of GDP on the implementation of economic measures and the slowdown in tax revenues caused by the economic contraction, while the government debt at the end of 2020 surged to 57.4% of GDP. The government forced to apply escape clause of expenditure rule. In 2021, the fiscal deficit is expected to narrow to below 4% of GDP and the outstanding government debt slightly reduced in terms of GDP on increased tax revenues from the economic recovery. Under the 2022 budget, the government introduced inflation shield measure and modest economic measures (Polish Deal), but the fiscal deficit and government debt are likely to improve further due to increased tax revenues from the economic recovery. Considering the solid commitment, including the obligation to control debt by law, and the track record, the government was planned to activate expenditure rule and make fiscal consolidation from 2023. However, given the impact of Russian invasion of Ukraine, the government is to take the decision as regards the fiscal framework in 2023 after the EC Spring fiscal guidelines.

The State Treasury debt (national definition) structure also improved, with the ratios of foreign currency-denominated debts and those held by nonresidents falling to around 20% and 30%, respectively, at the end of 2021. Japan, the Netherlands and Luxemburg were the major nonresident creditors on the domestic Treasury Securities market with a combined share in excess of 60% (excluding omnibus accounts). Other creditors were geographically diversified. Average debt maturity was relatively longer at nearly 5 years.

8. Outlook and Overall Assessment

The ratings mainly reflect the country's diversified and stable economic base, prudent fiscal management and solid external liquidity. The outlook of the ratings is Stable. The fiscal deficit has widened significantly since the introduction of economic measures to mitigate the impact of the COVID-19 pandemic and economic contraction. However, real GDP has already recovered to pre-pandemic levels in the first half of 2021 on the progress in reopening of economic activities. Continued geopolitical risk of Russia's invasion of Ukraine among European countries is likely to weigh on the economic recovery. However, the economic structure is becoming more resilient to shocks, and public finances have the fiscal capacity to implement additional measures from government fiscal consolidation in the past.

The levels of the country's net external liabilities and gross external debt in GDP terms, which had been constraining factors for the ratings, have steadily decreased in recent years. Meanwhile, the implementation of the economic package to mitigate the impact of the pandemic has resulted in deterioration of the government debt in terms of GDP. Shrining the government debt to GDP ratio to the level close to pre-pandemic level will be a positive factor for the ratings. On the other hand, the ratings will come under downward pressure if a prolonged pandemic, a substantial reduction of EU fund allocations resulting from sanctions, and worsening geopolitical risks resulted from Russian invasion have material impacts on the economy and public finance.

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Selected economic and fiscal indicators

		2017	2018	2019	2020	2021E
Nominal GDP	USD billions	527	587	597	597	660
Population	millions	38	38	38	38	38
Per capita GDP in PPP	USD	30,080	32,020	34,300	34,500	37,540
Real GDP growth rate	%	4.8	5.4	4.7	-2.5	5.7
Consumer price inflation(Eurostat)	%	1.6	1.2	2.1	3.7	5.2
Unemployment rate(Eurostat)	%	4.9	3.9	3.3	3.2	3.5
General government revenues/GDP	%	39.8	41.3	41.0	41.5	41.8
General government expenditures/GDP	%	41.3	41.5	41.8	48.7	45.3
General government balance/GDP	%	-1.5	-0.2	-0.7	-7.1	-3.5
General government debts/GDP	%	50.6	48.8	45.6	57.4	55.8
Current account balance/GDP	%	-0.3	-1.3	0.5	2.9	-0.9
External debts/GDP	%	68.4	63.6	59.3	58.4	55.4
Net international investment position	%	62.4	55.4	50.3	42.9	38.7
External debts/Export G&S	%	126.0	115.2	107.1	104.0	92.0
Foreign exchange reserves/Monthly import G&S	Times	4.6	4.5	4.6	5.2	4.8
Foreign exchange reserves/Short-term external debts	Times	2.1	2.2	2.1	2.3	2.6

(Note) Figures of public finance and external indicator for 2021 are estimated by JCR
(Sources)Eurostat, Statistics Poland, Ministry of Finance, and National Bank of Poland

Ratings

	Rating	Outlook*	Amount (millions)	Currency	Rate (%)	Issue Date	Maturity Date	Release
Foreign Currency Long-term Issuer Rating	A	Stable	-	-	-	-	-	2022.03.14
Local Currency Long-term Issuer Rating	A+	Stable	-	-	-	-	-	2022.03.14
No.6 Yen Bonds	A	-	60,000	JPY	2.62	2006.11.14	2026.11.13	2022.03.14
No.13Yen Bonds	A	-	10,000	JPY	2.50	2012.11.08	2027.11.08	2022.03.14
No.7 Yen Bonds	A	-	50,000	JPY	2.81	2007.11.16	2037.11.16	2022.03.14

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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