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REPUBLIC OF POLAND	Assigned Ratings/Outlook: **A /stable**	Type: Monitoring, Unsolicited
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 12-08-2022 "Sovereign Ratings" "Rating Criteria and Definitions"

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Rating Action

Neuss, 12 August 2022

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, competitive and well-diversified economy boasting a strong recovery following the pandemic, thus continuing the convergence process towards EU income levels; downside risks to economic growth in the short term from pronounced uncertainty related to the war in Ukraine and high energy prices, compounded by having to source fossil fuel imports from alternative suppliers earlier than expected
2. Notwithstanding some degree of uncertainty over timely disbursements of the funds under NextGenerationEU, the medium-term growth outlook remains generally backed by the expectation of progressing implementation of reforms and initiatives as elaborated in last year's Recovery and Resilience Plan and subsequently in the current year's National Reform Plan
3. Generally high quality of the institutional framework, including advantages associated with being a member of the EU and NATO, somewhat balanced by recurring disharmony over specific EU guiding principles
4. Swift and stronger-than-expected improvement of fiscal metrics following the pandemic and the comparatively moderate public debt ratio leave considerable space to address challenges presented by adverse reverberations from Russia's aggression in Ukraine; structural measures are likely to weigh on the expenditure side in the medium-to-longer-term, but do not obstruct fiscal sustainability in our view; banking sector seems in largely resilient position although chiefly legal risks related to foreign exchange mortgage loans will still have to be monitored
5. Position as a large net external debtor has continued to improve, suggesting diminishing external vulnerabilities, also mitigated by the NIIP composition; recent widening of the current account deficit exaggerated by commodity price increases, but moderate deficit likely to prevail over the medium term amid expected strengthening of domestic demand

Reasons for the Rating Decision and Latest Developments[1]

Macroeconomic Performance

Poland's credit rating is underpinned by its well-diversified and competitive economy and its track record of brisk economic growth, making for a very strong macroeconomic profile. Due to its economic structure, the sovereign saw a comparatively mild contraction in the first year of the pandemic, and the subsequent recovery backed by fiscal support proved strong, ensuring that the country continues to converge towards EU levels in terms of GDP per capita. Our expectations are for continued healthy growth. Still, in light of the Russian war in Ukraine, there are considerable downside risks to near-term economic prospects linked to Poland's high dependency on fossil fuels and pressure to ensure its energy security, sharp commodity price increases, and prospectively modest economic activity in Poland's single most important trading partner, Germany. The medium-term outlook remains positive with a view to a number of planned reforms and initiatives likely to strengthen productivity and ultimately potential growth, with disbursement of the funds under the EU's Recovery and Resilience Facility (RRF) having become more likely recently, although ultimately depending on the European Commission (EC) assessment of meeting agreed targets. Further afield, unfavorable demographics may drag on economic growth, but the integration of Ukrainian refugees could alleviate labor market pressures.

Following a comparatively mild recession in the first year of the pandemic (2020: -2.2%, EU: -5.9%), Polish economic output saw a strong rebound in 2021, expanding by 5.9% (EU: 5.4%). With that, real GDP growth was markedly more pronounced than assumed in our last review, and the Polish economy exceeded its pre-pandemic level (Q4-19) as early as Q2-21. The biggest contribution to last year's annual GDP expansion stemmed from recovering private consumption (3.4 p.p.) amid easing of Covid-19 containment measures, followed by an almost equally strong contribution (3.3 p.p.) from exceptional stockbuilding. While public consumption and investment also added positively to GDP growth, net exports posed a drag (-1.5 p.p.), as imports rose significantly stronger than exports.

The vivid economic recovery continued at the beginning of the current year, with real GDP in Q1-22 growing by 2.5% q-o-q, again to a large extent driven by strong inventory build-up, as well as an exceptionally strong rise in investment, and leaving real GDP 8.4% above its pre-Covid-19 level (EU: +1.4%). In light of Russia's military aggression against Ukraine from February 2022 and the concomitant surging commodity prices, as well as regarding supply shortages compounded by zero-Covid-policies in China, near-term growth prospects have markedly deteriorated. Consumer confidence and business sentiment – especially export expectations - have worsened over the last few months, pointing to a possible significant growth slowdown for the second half of the year. Some of Poland's most important trade partners, such as Germany, seem set to experience a sharp growth slowdown as well.

Poland's comparatively high dependence on fossil fuels in its energy mix, which accounted for 86% of its energy supply in 2020 (EC data), as well as its heavy reliance on imports in this regard, generally leaves it susceptible to disruptions in this area. Judging by the European Commission's

[1] This rating update takes into account information available until 05 August 2022.

recently presented vulnerability matrix (May-22), the sovereign counts among the more vulnerable EU economies by comparison in terms of total energy intensity and energy weight in the HICP basket, as well as in terms of direct goods exports to Russia, Ukraine and Belarus. Although its share has somewhat declined over recent years, Russia was still the origin of about 55% of Polish natural gas imports and more than two-thirds of Polish crude oil and coal imports in 2020 (Eurostat).

Halted Russian gas exports to Poland in April 2022 underscored risks surrounding the supplier mix. This said, we understand that relatively high levels of gas storage at this point in time should help to contain immediate adverse effects from lacking gas deliveries. Moreover, Polish plans to fall back on gas supplies especially from Norway and the US seem well advanced, although there remain uncertainties over the scope and timing of the delivery.

Consumer sentiment deteriorated in the context of significant upward pressure especially on energy and food prices, with households' assessment of their financial situation and intentions of major purchases having taken a hit, posing downside risks to private consumption. Polish consumer prices have soared to 14.2% in June (HICP), additionally burdened by a depreciation of the zloty and weighing on consumer sentiment, along with higher mortgage payments as monetary policy is tightened, lifting bank lending rates.

At the same time, Poland's strong labor market and vivid wage growth should continue to bolster household expenditure, flanked by government support packages to cushion the impact of higher energy prices ('Anti-inflationary shield') and higher demand due to the presence of a large number of displaced people from Ukraine finding shelter in Poland. According to the UN, about 1.26mn refugees from Ukraine were registered for protection schemes as of 02-Aug-22 (UNHCR data). Moreover, tax relief to private households (personal income tax, PIT) entailed by the latest changes to the 'Polish Deal', in force since July 2022 ('Polish Deal 2.0'), will add to this.

Already in a favorable position prior to the outbreak of the coronavirus and in the face of record-low unemployment rates, the labor market proved largely resilient in 2021, with employment increasing by 1.5%, thus surpassing its 2019 level (Eurostat data, domestic concept). Unemployment averaged 3.4% last year, less than half the rate recorded in the EU-27 (7.0%). In monthly terms, the unemployment rate dropped to 2.7% as of May-22. Authorities' most recent anti-inflationary shield extension was to remain in place until the end of October 2022, but may be extended again depending on further developments of commodity prices.

Given the large number of refugees from Ukraine, many of whom will be able to work in the country, we expect employment to increase further in the short term. However, as it is difficult to estimate how many of the displaced Ukrainian citizens will choose to return to their home country at some point in time, the medium-term outlook for employment is subject to a high level of uncertainty.

That said, already prior to Russia's attack on Ukraine, Poland's labor participation rate had continued to rise, pointing to some success of efforts to encourage more people to work. Looking at other structural aspects regarding the labor market and referring to some challenges highlighted by the EC's Social Scoreboard, enhancing the digital skills of employees is a work in progress, as is the improvement of childcare options.

Wage dynamics have accelerated recently, with average monthly gross wages and salaries rising by 9.6% in 2021 and edging up to 9.7% y-o-y in Q1-22 (Statistics Poland), gathering pace in light of substantial price pressures and a tight labor market. Compared to the first half of 2021, the

minimum wage was 7.5% higher in HY1-22 (Eurostat). As a less accommodative monetary policy stance should work its way through the economy, and as labor supply is increased by the influx of people from Ukraine, wage growth could moderate in 2023.

After its exceptionally strong expansion in this year's first quarter, gross fixed capital formation is likely to see some backlash in the second quarter. Investment activity related to initiatives and measures envisaged in the national RRP, which is based on expected grants in the amount of EUR 23.9bn and loans to the tune of EUR 11.5bn, should generally support gross fixed capital formation going forward. Poland's recovery plan was eventually greenlighted by the EC in June 2022 (see below). Moreover, measures concerning business activity taxation introduced with the Polish Deal from January 2022 would provide a more supportive basis for business investment.

However, we also expect dampening effects from the higher monetary policy rates from the second half of the year. Less favorable financing conditions in the face of a more restrictive monetary policy and supply bottlenecks could in particular hamper construction investment. In addition, the war-related uncertainty could lead to investment projects being postponed.

Given the challenging external environment in the face of adverse effects associated with the war in Ukraine, Polish exports look set to weaken substantially this year, having dropped in Q1-22 compared to the preceding quarter. Net exports are likely to drag on GDP growth in 2022, while we currently assume a positive effect in the following year. Redirecting some trade links and economic agents adapting to new energy regimes should eventually give rise to an export recovery in 2023.

As regards the EU mobility package's effects on Poland's crucial transport sector, we will continue to monitor developments around a proposal of a number of Eastern European EU members including Poland, who in March 2022 called on the EC to temporarily suspend provisions regarding the return of trucks to their countries of registration and cabotage operations.

Overall, we expect real GDP to grow strongly by about 5.0% this year, although mainly due to the significant carry-over effect from 2021 and the strong growth outcome in Q1-22, whereas the quarterly profile for the remainder of the year and the first part of the coming year is likely to remain subdued, despite cushioning fiscal measures. For 2023, we thus anticipate a marked slowdown of average annual GDP growth, to about 1.8%.

Uncertainty around the forecast remains very pronounced against the backdrop of the geopolitical development and its repercussions on the private sector, while the net effect of tighter monetary policy on the one hand and expansionary fiscal policy on the other seems not clear. While vaccination against Covid-19 has progressed, Poland remains among the EU countries with a relatively low vaccine uptake. Thus, although currently appearing to be more remote, downside risks to GDP growth via new infection waves cannot be entirely dismissed.

Growth prospects over the medium term remain generally supported by the implementation of the RRP, although recent disharmony between Poland and the EC over matters of rule of law, which had resulted in some delay in the EC's RRP assessment, may point to some uncertainty over timely disbursement with a view to meeting agreed targets and milestones. Previously contested by Poland and Hungary, the European Court of Justice dismissed these legal challenges in Feb-22, thus enabling the linking of receipt of the RRF funds to adherence to the rule of law as stipulated by the EC. Other than that, while there will be a decreasing influx of EU funding related to the Multiannual Financial Framework (MFF) 2014-20, cohesion policy funds under the

new MFF 2021-27 are set to provide roughly EUR 78.9bn (including Just Transition) over the coming years.

According to the Polish authorities, the RRP could lift GDP by at least 1.9% by 2040. The EC expects the plan to increase the Polish GDP by between 1.1% and 1.8% by 2026. Roughly two-fifths of the available funding is to go towards climate objectives (see below) and about one-fifth (21.3%) will be used to drive the digitalization, including initiatives such as 'Cyber Poland 2025' involving e.g. full digitalization of public services and high-speed internet connection. On the back of effective implementation of the envisaged reforms and investments, there seems to be some upward potential regarding the EC's current projections for Polish potential growth (3.6% for 2022 and 3.4% for 2023, AMECO). To be sure, underlying demographics continue to present risks to the medium-to-longer-term growth outlook, while lasting positive effects from the influx of refugees from Ukraine might improve prospects to some extent.

Poland's efforts towards strengthening and upgrading employees' digital skills and improving training bode well for productivity prospects, providing a firmer ground for the economy to move on from competitive advantages via costs alone. Notwithstanding progress in many categories, Poland was ranked 24th among the 27 EU member states with regard to the EC's Digital Economy and Society Index 2022, signaling vast room to improve.

In light of envisaged initiatives to foster skills, innovation and ultimately productivity, TFP growth could thus be the main contributor to enhancing potential growth going forward, along with capital accumulation. Gross domestic expenditure on R&D in percent of GDP has been on an upward trend over recent years, reaching 1.4% in 2020, although it continues to trail the respective share of Visegrad peers such as Hungary and Czech Republic (2020: HU: 1.6%, CZ: 2.0%, EU: 2.3% of GDP).

Poland may be about to lose some ground in terms of cost competitiveness, judging by real unit labor cost developments in 2021 vs. 2012 compared to the EU as a whole and to some of the main European trade partners. However, as Poland continues to gradually converge towards EU income levels (2021: GDP p.c. at 78% of the EU average, IMF data, PPP terms), a higher wage level has to be seen as part of the process, partly reflecting advancements already made towards higher value-added and/or more specialized jobs, and shortages of skilled labor in some of these areas. In order to tackle the latter, higher wages constitute to some degree a necessity to attract and retain talent. To what extent refugees from Ukraine will change these dynamics, or if at all, will have to be seen. On the other hand, we would still flag potentially mounting risks to cost competitiveness if strong wage growth continues to exceed productivity growth for a protracted period.

That said, it has to be stressed that Poland's global export market share has continued to trend up over recent years, at 1.49% in 2021 moving well above the five-year average from 2015-19 (1.23%), albeit edging down slightly compared to the exceptional year 2020. Its market share regarding services exports has continuously risen since 2016, reaching 1.37% last year and pointing towards competitive gains.

In terms of non-cost competitiveness, Poland's business environment continues to face some challenges, among other things due to partially arduous administrative procedures. Drawing on the 2021 IMD competitiveness ranking, Poland occupies one of the lowest ranks among the EU countries, hinting at some potential to catch up.

Institutional Structure

The sovereign features a generally high-quality institutional framework, including the benefits in terms of access to a large market and funding attached to EU membership, as well as strategic security associated with NATO membership. The institutional set-up is further enhanced by the monetary policy frameworks ensuring credible and accountable policy-making through the National Bank of Poland (NBP), as well as by financial supervisory functions through the Polish Financial Supervision Authority (KNF). These general strengths are somewhat balanced by the continued absence of a fiscal council and recurring, temporarily more intense, disharmony over EU guiding principles, in particular over adherence to EU rule of law, and more generally over the supremacy of EU law versus national law. While there is the impression of some rapprochement in this matter of late, we will continue to monitor further developments closely.

Our preferred metrics when it comes to indicators gauging the quality of the institutional framework, the World Bank's set of Worldwide Governance Indicators (WGIs), by and large back our assessment of a generally high-quality institutional set-up in Poland. However, drawing on four dimensions we consider key, i.e. 'rule of law', 'government effectiveness', 'control of corruption' and 'voice and accountability', we have to highlight that the sovereign continues to trail the median of its A-rated peers in our rating universe, as well as the EU-27 median, with regard to these four pillars.

Moreover, we note that 2020 saw mixed developments as regards these dimensions. The perception of government effectiveness deteriorated markedly, with Poland slipping 12 ranks to a relative rank 71 out of 209 economies (EU median rank: 39). In terms of the extent to which citizens are able to participate in selecting their government and express themselves freely (voice and accountability), Poland edged down by 5 ranks, to 70 out of 208. That said, Poland's relative position when it comes to control of corruption was perceived as stable (rank 57/209), whereas its relative rank regarding rule of law improved somewhat, to 65 out of 209 economies considered, although still trailing its ranking prior to the sharp deterioration in the reference year 2017.

We continue to closely monitor long-standing points of contention between the EC and Poland as regards compliance with EU guiding principles, and especially regarding rule of law, recalling that the EC had opened Article 7 proceedings against Poland in December 2017 in this respect. Last year saw intensified controversy between the EC and the sovereign over the independence of Poland's judiciary, with one main point of contention constituting the controversial Disciplinary Chamber of Poland's Supreme Court, which the EC assessed as breaching EU law and which led to the EC imposing a fine of EUR 1mn per day. European Commission fines reportedly added up to about EUR 237mn by mid-July. Moreover, in December 2021 the EC launched infringement proceedings against Poland, as the Polish Constitutional Tribunal in rulings in July and October 2021 had taken the view that provisions of the European treaties were incompatible with the Polish constitution.

Having said that, we are aware that the EC finally greenlighted Poland's RRP in June 2022, highlighting among other things that in it Polish authorities expressed a commitment to abolish the controversial Disciplinary Chamber of the Supreme Court and, more generally, to reform the disciplinary regime regarding judges. We understand that the Polish president signed into law a bill making some changes to the contested disciplinary chamber on 13 June 2022, with the law entering into force on 15 July 2022.

Regarding the framework around the identification, prevention and combat of money laundering and financing of terrorism, we are aware that there remains some room to improve, as set out by the Moneyval Report published in Dec-21, while the transposition of the 5th Anti-Money-Laundering Directive is still being assessed by the EC.

Looking at domestic politics, parliamentary elections are not scheduled until autumn 2023, although a snap election cannot be ruled out completely with regard to some infighting within the government coalition in the recent past that had led to a re-composition of the governing alliance led by PiS. According to current polls, PiS remains in the lead, but has lost about eight percentage points in support since Oct-19.

When it comes to developments around the envisaged shift towards a greener economy, Poland continues to face some challenges, being among the EU countries with the highest greenhouse gas emissions per head (2020: 10.0 tons of CO_2 equivalent, EU: 7.5, Eurostat). Room to catch up is also illustrated by the EC's Eco-innovation index (2021) with regard to which Poland ranks second-to-last among the EU member states. While still comparing relatively low against the EU level, there are advancements as regards the overall share of energy from renewable sources, which climbed to 16.1% in 2020 (2010: 9.3%, Eurostat), with challenges to tackle in particular regarding transport and heating/cooling.

In this context, we highlight ongoing reforms to implement low-and zero-carbon solutions in public transport, such as modernizing bus fleets in the cities, as well as improving and modernizing railway structure, comprising an estimated 478km of railway lines by 2026 (National Reform Program 2022, NRP22). Moreover, offshore windfarms in the Baltic Sea are to be financed, prospectively aiding to reduce dependency on fossil fuels. In general, Poland's RRP is geared towards lifting the share of renewable energy sources in its energy mix.

Fiscal Sustainability

Risks to fiscal sustainability overall seem limited given the moderate public debt ratio - which, despite the temporary pandemic-related increase, remains low from a European perspective - and a track record of prudent fiscal planning. Last year's stronger-than-expected improvement in fiscal metrics will likely be reversed by higher spending and lower expected revenue from measures introduced to combat negative reverberations from hostilities in Ukraine this year. Apart from downside risks due to the significant uncertainty surrounding developments linked to the war in Ukraine, and despite a credible commitment to fiscal discipline, medium-term prospects for public finances in our view have deteriorated somewhat, largely on the back of more permanently higher social and defense spending. While adding to spending pressure in the short term, fiscal prospects related to the currently high number of refugees from Ukraine are not clear-cut at this stage. We continue to monitor risks related to pending legal decisions on the handling of FX denominated mortgage loans to private households. Although refinancing costs on the capital market are rising amid the current global monetary policy tightening cycle, we do not think that debt affordability gives rise to concern at present.

Following the pandemic-induced strong increase in Poland's general government deficit to 6.9% of GDP in 2020 (average 2015-19: -1.5% of GDP), the forceful economic rebound since then had the headline deficit shrink to 1.9% of GDP last year. The outcome was considerably better than estimated in our last review and well below the deficit recorded in the EU as whole (-4.7% of GDP), in our view underscoring sound fiscal planning on the part of the Polish authorities.

The comparatively favorable fiscal outcome was largely the result of strongly recovering tax revenue amid vivid economic expansion. Tax receipts from income and wealth, as well as from production and imports, saw double-digit annual percentage increases last year (2021: 18.5% and 22.3%, respectively), helping to lift total general government revenue by 14.9% (2020: 2.7%). At the same time, total government outlays increased by 2.8% last year (2020: 17.7%), amid diminishing expenditure to contain the pandemic. Compensation of government employees, on the other hand, saw an even stronger increase than in the first year of the pandemic (2021: 8.7%, 2020: 7.6%). An exceptional 14th pension benefit also contributed to further increasing government expenditure last year.

In 2022, personal income tax revenue is expected to come in lower on the back of the most recent changes to PIT, in force from this July, which aim to offer some relief in particular to families with children. Moreover, lower VAT rates and excise duties under the anti-inflationary shield will weigh on the overall tax revenue. That said, at least with regard to the first five months of 2022, the state budget was in surplus to the tune of PLN 12.1bn, with tax revenue 18.1% higher than in the same period in 2021 (cash basis, Ministry of Finance data).

While 2022 will most likely see lower spending on Covid-19 containment measures, the cost related to cushioning the wide-ranging adverse effects from Russia's aggression against Ukraine are likely to push up the headline deficit. Apart from the actions taken to soften the effect from surging commodity prices, this also includes cost for the accommodation of people fleeing from Ukraine. We gather that, including recent tax measures, estimated fiscal support amounts to about 2.9% of GDP in the current year, of which 1.5 p.p. are attributable to the anti-inflationary shield, 1.0 p.p. to the Polish Deal, and 0.4 p.p. to support for refugees. Recent hints that the anti-inflationary shield may be extended beyond the end of October 2022 highlight significant uncertainty over this and next year's fiscal outcome. Moreover, as also illustrated by the most recent changes to the Polish Deal, amendments to agreed legislation could be made at relatively short notice.

At this juncture, we expect the Polish headline deficit to rise to about 4.0% this year. Bearing in mind that parliamentary elections are scheduled for 2023, there might be incentives to further boost government spending, adding to already elevated uncertainty over public finances against the current geopolitical backdrop. This might also entail the risk of monetary policy hikes having to go further than currently expected. We nevertheless anticipate the headline deficit to decrease, to about 3.3% of GDP in 2023, reflecting continued economic expansion and the expiration of some support measures.

The changes to PIT implemented in Jul-22 and, more generally, recently implemented fiscal policies somewhat skewed towards social benefits to families with children as well as pensioners (Convergence Program 2022, CP22), tend to leave medium-term prospects for public finances somewhat less favorable, while acknowledging that the measures may be conducive to enhancing the social fabric. Defense spending is to amount to at least 2.2% of GDP in 2022 and will be increased to 3% of GDP from 2023 (Homeland Defense Act). We are also aware that redirecting receipts from the sale of CO2 emission rights to the Energy Transformation Fund away from the state budget should lead to upward pressure on the deficit in the medium term.

However, we would highlight as positive that commitment to fiscal discipline ultimately remains in place, as also suggested by respective initiatives elaborated in the RRP and NRP22, such as the planned reform of the fiscal framework by Q1-25, including a reform of the budget system.

The scope of the Stabilizing Expenditure Rule was already extended last year, in a bid to increase the transparency and efficiency of public finance management (NRP22).

In light of the strong economic recovery and lower-than-expected fiscal deficit last year, Poland's public debt ratio dropped markedly in 2021, by 3.3 p.p. to 53.8% of GDP, continuing to represent a relatively moderate level as compared to fellow EU members (EU 2021: 88.1% of GDP). In Q1-22, debt-to-GDP fell further, to 52.1% (Eurostat, preliminary data). Against the backdrop of our expectations for the public deficit this year and next, as well as an assumed moderation of inflation rates in 2023, we currently expect the public debt ratio to drop to about 50.7% in 2022 and to decrease to 49.6% next year.

Overall, we continue to see limited risks to fiscal sustainability, assuming that the public debt ratio stays below 60% of GDP over the next few years. While interest payments fell by a further 4.6% last year, pushing the interest-to-GDP ratio down to 1.1% (interest-to-revenue: 2.6%), refinancing costs are set to increase due to more restrictive global monetary policy and associated borrowing conditions on financial markets. Also worth recalling, at 26.7% as of May-22, the share of floating rate instruments in the state treasury debt portfolio appears relatively high, underscoring exposure to interest rate risk. Nevertheless, debt servicing should remain well-manageable.

The NBP began raising its reference rate from October 2021 in ten consecutive hikes, from 0.10% at the time to 6.50% in July-22, with the last step being a 50-basis-point increase, in order to help bring the inflation rate close to its target of 2.5% (+/- 1 p.p.). Further rate increases remain possible, although stabilizing inflation rates could prompt the NBP to pause. Asset purchases under the Asset Purchase Program were discontinued in November 2021. We also understand that the NBP did not intervene in the foreign exchange market in 2021, although the option generally remains available.

Since our last review, the zloty has on trend slightly depreciated against the euro, witnessing a temporary sharp loss against the euro following Russia's invasion in Ukraine. The depreciating trend has run counter to some degree to a reduction of the share of foreign-exchange-denominated sovereign debt observed over recent years. Polish authorities maintain the aim to keep the foreign-exchange-denominated share of the sovereign debt portfolio below 25%, as also echoed in the 'Polish Deal'. As of May-22, the respective share of state treasury debt stood at 22.1%, still moving on a rather elevated level.

The Polish banking sector proved resilient over the course of the pandemic, partly backed by safety nets through government-guaranteed loans. Drawing on EBA data, current metrics of capitalization and asset quality point to an overall solid position. At 15.9% as of Q1-22, the sector's CET1 ratio remains somewhat above the EU level (15.2%), having decreased from an intermediate peak of 17.5% in Q3-20. After edging up over the most acute course of the pandemic, the NPL ratio has dropped to 4.4% in Q1-22, resuming a downward trend observed over recent years. Nevertheless, at this level it remains well above that of the EU as a whole (1.9%) and well above that of its Visegrad peers. Banking profitability seems to have recovered from the pandemic-induced dip, looking at return on assets, which has bounced back to relatively favorable levels by European comparison (Q1-22: 1.4%, EU: 0.4%).

Direct exposure of Polish banks to assets in Russia, Ukraine and Belarus appears limited, coming to PLN 2.8bn or about 0.1% of GDP at the end of Dec-21 (net, on and off balance sheet, NBP). Risks to the banking sector mainly relate to the outcome of legal decisions regarding foreign-

exchange denominated housing loans, although decreasingly so, as there has been further progress to tackle this issue, not least through a settlement framework proposed by KNF. We understand that more than 80,000 lawsuits were lodged in connection with this issue, and according to NBP about 20,000 settlements were reached more recently. With a view to the exchange risk, a pronounced zloty depreciation could render banks' provisions insufficient. What is more, in order to support borrowers of FX-denominated loans, banks have to make higher contributions to the BFG fund, likely eating into their profitability this year.

In addition to this, given the comparatively rapid monetary tightening and prospects of further rate hikes, challenges could arise for private households to service their debt. According to NBP, the share of loans in the mortgage portfolios subject to fixed or periodically fixed interest rates was only at 3% at the end of 2021. Bearing in mind that a relatively high share of public debt is held by the domestic banking sector (Q1-22: 46.9%, Ministry of Finance), we see some reason to monitor valuation effects, i.e. bond price volatility.

While house prices have continued to rise vividly, climbing by 13.6% y-o-y and by 35.5% in a 3-year comparison in Q1-22 (Eurostat), we would expect a dampening effect from recent monetary policy on mortgage borrowing, as well as from stricter lending conditions applied by banks. Arguably, initial effects are visible in a slowdown to 2.9% of the annual increase in outstanding mortgage loans to private households (May-22; May-21: 3.9% y-o-y). However, demand for housing will likely remain supported by the high number of refugees from Ukraine, maintaining some upward pressure on house prices.

Contingent liabilities of the state have increased this year on the back of guarantees issued in connection with the intended protection of consumers of gaseous fuels. State Treasury guarantees to gas sellers total PLN 30bn. In addition to further guarantees such as towards the Armed Forces Support Fund, Polish authorities estimate that from 13.7% of GDP in 2021 contingent liabilities could increase by 2.4 p.p. to a relatively high 16.1% of GDP in 2022 (CP22).

Foreign Exposure

We continue to view external vulnerabilities as limited. Poland's status as net external debtor has diminished further, judging by its shrinking negative net international investment position (NIIP). Owing to large commodity price increases dragging the goods trade balance into a deficit, the current account seems set to post a pronounced negative balance this year, which could reverse somewhat in 2023 amid an assumed moderation of import prices. We highlight as positive the continued increase of the surplus in the service balance over the last few years.

Poland's negative NIIP in percent of GDP has continued to decline over recent years. In 2021, the position shrank to -39.9% of GDP, narrowing by more than 20 p.p. since 2016 (-61.5% of GDP). In terms of its composition, an increasingly high net direct investment position on the back of inward direct investment mitigates external risks associated with a Poland's net external debtor position. As of Q1-22, the NIIP has continued its positive development, standing at -39.2% of GDP.

Meanwhile, the current account balance swung back into a deficit to the tune of 0.7% of GDP last year (2020: +2.9% of GDP, avg. 2015-19: -0.6% of GDP), primarily as the trade in goods balance closed the year with a slight deficit, given recovering domestic demand and mounting import prices. The surplus in the service balance slightly expanded compared to the preceding

year, continuing a positive trend reflecting further advancements in terms of competitiveness and sophistication of services.

Looking at Q1-22, the service balance remained on this path, whereas the overall current account position overall became significantly more negative (-2.8% of GDP, four-quarter moving sum) as soaring import prices pushed the goods balance into a larger deficit. We expect commodity price developments to remain a dominant factor for this year's external developments, with a more pronounced current account deficit as our baseline scenario. Assuming lower commodity prices for the coming year, we expect to see at least some reversal in 2023.

Rating Outlook and Sensitivity

Our rating outlook on Poland's long-term credit ratings is stable. We consider current downside risks due to the attack on Ukraine to the otherwise strong macroeconomic performance profile as balanced by largely contained risks to fiscal sustainability and an improving external position, whilst we continue to take a somewhat cautious view on policy predictability given recent developments in the relationship with the EC.

We could lower the outlook or the sovereign's ratings if macroeconomic prospects deteriorate significantly stronger than currently expected, potentially exacerbated by delays in the disbursement of RRF funds in case of resurfacing controversy over EU guiding principles, in turn likely weighing on the convergence progress. Downward pressure could also arise if, contrary to what we expect, deteriorating public finances become more entrenched over the medium term, with negative consequences for the public debt ratio. Adverse macroeconomic developments as described above and/or a significant escalation of geopolitical tensions could be among possible triggers for such a scenario.

Conversely, a positive rating action could be prompted by a significantly higher-than-expected medium-term economic growth, possibly implying limited reverberations from the war in Ukraine and a timely disbursement of EU funds, which should also be reflected in firmly improving fiscal metrics. Reassurance over policy predictability following a phase of intensified controversy over EU guiding principles would seem conducive to such a scenario.

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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

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.

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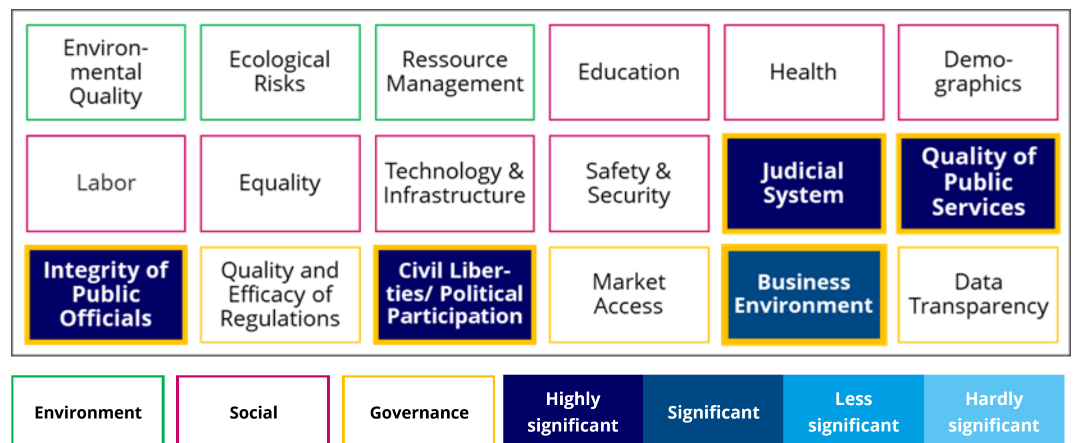
ESG Factor Box



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 competitive stance of the sovereign such as the World Bank's Ease of Doing Business index and the World Economic Forum's Global Competitiveness Indicator add further input to our rating or adjustments thereof, we judge the ESG factor 'Business Environment' as significant.

While Covid-19 may have significant 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 concerning economic prospects and public finances. To be sure, we will follow ESG dynamics closely in this regard.

Economic Data

[in %, otherwise noted]	2016	2017	2018	2019	2020	2021	2022e
Macroeconomic Performance							
Real GDP growth	3.1	4.8	5.4	4.7	-2.2	5.9	5.0
GDP per capita (PPP, USD)	28,321	30,162	32,532	34,689	34,226	37,786	41,685
Credit to the private sector/GDP	57.0	56.9	55.5	54.9	53.6	51.4	n/a
Unemployment rate	6.3	5.0	3.9	3.3	3.2	3.4	n/a
Real unit labor costs (index 2015=100)	102.1	102.5	104.5	103.7	107.3	102.0	n/a
World Competitiveness Ranking (rank)	33	38	34	38	39	47	50
Life expectancy at birth (years)	78.0	77.8	77.7	78.0	76.5	75.6	n/a
Institutional Structure							
WGI Rule of Law (score)	0.6	0.4	0.4	0.4	0.5	n/a	n/a
WGI Control of Corruption (score)	0.8	0.7	0.7	0.6	0.7	n/a	n/a
WGI Voice and Accountability (score)	0.8	0.8	0.7	0.7	0.6	n/a	n/a
WGI Government Effectiveness (score)	0.7	0.6	0.6	0.5	0.4	n/a	n/a
HICP inflation rate, y-o-y change	-0.2	1.6	1.2	2.1	3.7	5.2	14.0
GHG emissions (tons of CO2 equivalent p.c.)	10.6	11.0	11.0	10.4	10.0	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	-2.4	-1.5	-0.2	-0.7	-6.9	-1.9	-4.0
General government gross debt/GDP	54.2	50.6	48.8	45.6	57.1	53.8	50.7
Interest/revenue	4.4	3.9	3.5	3.3	3.2	2.6	n/a
Debt/revenue	140.0	127.2	118.2	111.1	138.4	127.1	n/a
Total residual maturity of debt securities (years)	4.9	4.9	4.8	4.8	4.5	4.4	n/a
Foreign exposure							
Current account balance/GDP	-0.8	-0.3	-1.3	0.5	2.9	-0.7	n/a
International reserves/imports	0.6	0.5	0.4	0.5	0.6	0.5	n/a
NIIP/GDP	-61.5	-61.2	-55.9	-49.8	-44.3	-39.9	n/a
External debt/GDP	76.3	67.0	64.2	58.8	60.3	56.5	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

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. Neither the rated sovereign nor a related third party participated in the credit rating process. Creditreform Rating AG had no access to the accounts, representatives or other relevant internal documents for the rated entity or a related third party. Between the disclosure of the credit rating to the rated entity and the public disclosure no amendments were made to the credit rating.

Unsolicited Credit Rating	
With Rated Entity or Related Third Party Participation	NO
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, European Center for Disease Prevention and Control (ECDC), Blavatnik School of Government, 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 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.

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