Poland

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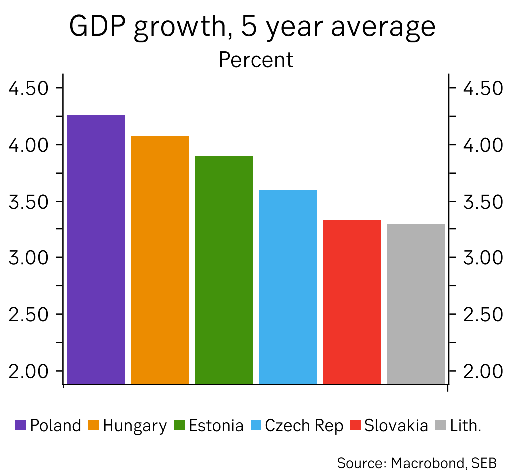
Growth is slowing but should remain strong. Expansionary fiscal policy has fueled domestic demand and has produced rising government deficits. Medium-term risks mainly relate to reduced access to EU funding and labour shortages that could weigh on economic growth and fiscal balances.

Country Risk Analysis

Recent economic developments

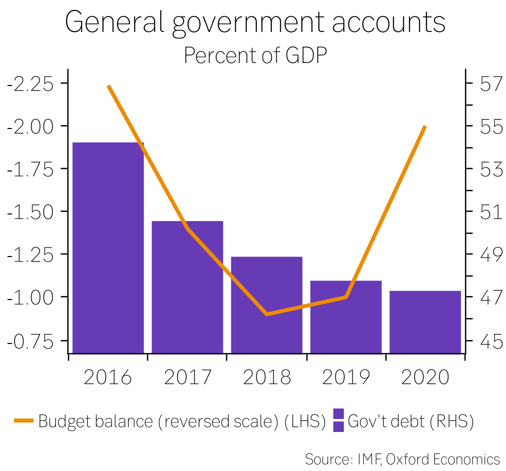
Growth is decelerating but remains high by European standards. The Polish economy has grown uninterrupted since 1992, at an average rate of 4.2%. This track record of balanced economic growth outshines European peers. Last year, real GDP growth cooled slightly with the first estimates putting growth at 4% lifted by strong domestic demand. This would be stronger than expected by most analysts at the beginning of last year. Being a slightly more closed economy (despite exports gradually growing more important) than European peers has made the economy more resilient to the weaker global environment. At the same time, a booming labour market and rising social transfers have been supporting household spending. In addition, investment has been recovering.



High economic activity led to heated labour market and higher inflation. With the economy still operating above its potential according to most estimates, and the population shrinking , demand for labour has driven the unemployment rate to new record lows. This in turn has fuelled wage increases which together with higher food prices pushed inflation to 2.5% yoy recently. The rate of inflation is expected to head higher in 2020 as minimum wage increases and higher domestic energy prices boost overall prices.

External position is sound. Following a small deficit in 2018, we expect that the current account balances moved roughly into balance in 2019. For 2020, a small deficit, which has been the norm for Poland, is forecasted. Deficits are normally financed by foreign direct investment (FDI) and transfers from the EU. FX reserves rose during the year to about USD 128 bn, equivalent to 5-6 months' of prospective imports. This is adequate given the flexible exchange rate but barely moderate given relatively high external debt service levels. External debt estimated at 59% of GDP in 2019 is slightly higher than most country risk class peers despite having declined in the past two years. Most of the debt is held by the private sector. A mitigating factor may be that a high share of the private debt is intercompany-related.

Economic policies



Expansionary policy produces rising deficits. Fiscal policy has been in expansionary mode since 2018. Thanks to strong improvements in tax collection, lauded by the IMF as structural in their nature, the budget deficit was contained initially. A new stimulus package introduced in 2019, however, is expected to have pushed the general government deficit to 1.7% of GDP. A key component in the stimulus package, which partly extends into 2020, is an expansion of the so called 500+ child-raising benefit to include all children. Our baseline forecast points to a further increase in the underlying deficit in 2020 although one-off effects, including those related to new changes to the pension system, may keep the headline budget deficit unchanged.

Government debt broadly stable. Despite expansionary fiscal policies, government debt is expected to have remained broadly stable at about 48% of GDP in 2019. Debt affordability is well in line with peers. On the other hand, the share of foreign currency debt is on the high side making debt affordability sensitive to a depreciation of the exchange rate.

Banking sector poses limited risks. The size of the banking sector in terms of assets/GDP is smaller than peers such as Hungary and the Czech Republic. A recent ruling by the Court of Justice of the European Union on outstanding FX indexed loans contracts in Poland has been interpreted differently by various observers. It appears, however, as if market perceptions of the risk that banks will be forced to convert old FX loans appear to have risen. This being said, any outcome of possible litigations against banks lies several years down the road.

Political situation

PiS second term unlikely to lead to major policy shifts. The ruling Law and Justice party (PiS) showed that the 2015 elections was not a one-off by coming out the winner in the October 2019 elections too. They managed to retain a single majority in the Lower house but by missing a super-majority in the Senate they will probably not be able to implement previously aired plans of constitutional change.

The government's main thrust of economic policies is expected to remain largely unchanged. This includes moving towards increased state intervention which often tends to be at odds with country risk. Presidential elections are due in May 2020.

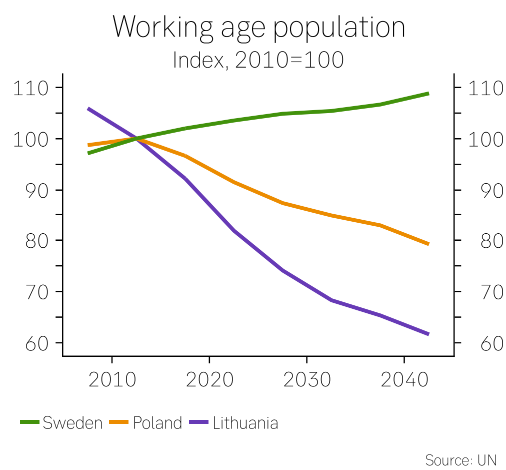
Strong institutional quality may be at risk. One aspect of the increased state intervention has been the changes to the judicial system, generally viewed as in the direction of less independence for the judiciary. The changes has led to conflicts with the EU Commission which has been arguing that measures are threatening to infringe on the separation of powers. As a consequence, the Commission initiated a disciplinary procedure against the government in late 2017. The process is likely to be a lengthy one.

Outlook

Economic slowdown on the cards. Growth should continue to decelerate in the near-term, mainly due to lower export demand from European markets, but also due to lower investments. Still , Oxford Economics (our house forecasters) expect real GDP to expand by 3.1% in 2020 underpinned by continued strong household spending. The government is slightly more optimistic basing this year's budget on the assumption of real GDP growth of 3.7%. The central bank expects 3.6%.

Lower EU funding ahead. In the past few years, funds from the EU have financed 15-20% of investments in Poland. Now that the peak of the 2014-2020 EU budget period disbursements has been reached, and with a smaller EU budget in the Union's next Multiannual Financial Framework spanning 2021-2027, less funds will be available for members. In addition, given Poland's income convergence, and given that new funding may be linked to some form of new rule-of-law mechanism, the country will to an increasing extent have to fund investments by more costly private financing. This could weigh on economic growth over the medium term.

Challenging demography likely to weigh on medium-term growth. Over the longer-term, activity should largely follow the euro area business cycle but is likely to be lower than in the past decade. The key factor that will limit potential GDP growth is the declining population. Most projections indicate that the decline in the working age population which started in 2011 will be among the worst in the OECD in the coming decades. This is likely to weigh on growth and to slow the convergence in GDP per capita. In addition, there has been a steady decline in labour productivity over the past few years. Although there should be scope to raise the activity rate and although improved family benefits could have a positive effect on birth rates, the only factor that really can compensate for the demographic decline is a massive immigration.

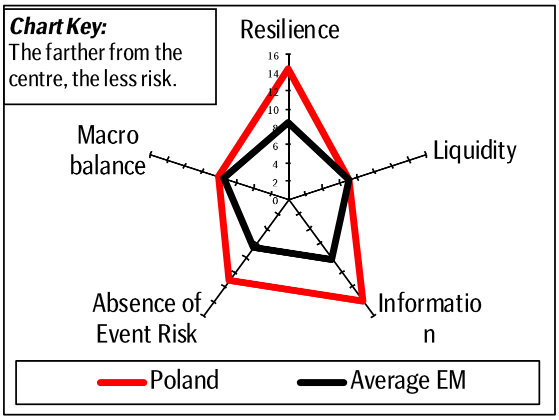


Public finances vulnerable to cyclical downturn. Recent years' improvements to public finances have been important in reducing country risk. We expect this positive trend to continue. Recent government policies, however, have introduced a new risk to this scenario. The higher share of social spending that the government has locked in will leave very little space to adjust spending when a downturn hits the economy. At the same time, most observers see limited scope for further improvements on the revenue side following the past years' improved tax collection.

Risks to competitiveness from higher wages. Poland has enjoyed strong international competitiveness over the past few years and has been able to gain export market shares in its most important markets. The election campaign promise to raise minimum wages by more than 75% by 2023 putting them at about 60% of the average wage level in the economy (the highest among OECD countries) risks turning these fortunes. The authorities desire to move towards an economic model less reliant on low labour costs might be positive in principle but the suggested pace and modality is fraught with some risk.

Poland: Risk Profile

Key figures	**2020**
Population (mn.)	38,4
GDP/capita (USD)	16 194
GDP (% chg)	3,1
CPI Inflation (%)	3,2
Current Account Balance (% of GDF	-0,3
Reserves/imports (months)	5
Budget balance (% of GDP)	-1,8
Government debt (% of GDP)	47,3



External ratings:
Fitch: A- / Stable
Moody's: A2 / Stable
S&P: A-/ Stable

Peers:
Czech Rep.
Lithuania
Slovakia

Graph: The pentagon shows Poland's risk profile to be generally stronger than the average of all emerging market countries .

Poland: Key Economic Indicators

Macroeconomic	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**
GDP real (% chg)	3,8	3,1	4,9	5,1	4,0	3,1	2,6	2,0
GDP (bn USD)	476,8	471,3	527,7	585,6	588,7	614,1	660,2	720,9
GDP/capita (USD)	12 553	12 412	13 894	15 420	15 511	16 194	17 420	19 043
Investments/GDP (%)	16	16	15	14	14	15	16	16
Trade/GDP (%)	80	83	86	86	92	100	102	100
Money & Prices								
CPI inflation (%)	-0,9	-0,6	2,0	1,8	2,2	3,2	2,6	2,5
Money, M2 (% chg)	8,6	9,8	5,7	7,2	6,1	5,0	4,8	4,5
Interest rates (%)	1,5	1,5	1,5	1,5	1,5	1,6	1,9	2,3
Exchange Rate (USD)	3,8	3,9	3,8	3,6	3,6	3,4	3,3	3,3
Government Finances								
Budget balance/GDP (%)	-3,0	-2,2	-1,4	-0,4	-1,7	-1,8	-1,9	-2,0
Govt debt/GDP (%)	51,3	51,1	54,1	48,9	48,0	47,3	47,1	47,0
Balance of Payments (USD bn)								
Current account	-2,7	-2,5	0,5	1,5	-5,1	-2,1	-2,2	-2,3
(% of GDP)	-0,6	-0,5	0,1	0,3	-0,9	-0,3	-0,3	-0,3
Export of goods	191,1	196,5	228,2	250,3	270,0	303,8	330,9	352,5
Imports of goods	188,6	193,2	226,6	254,0	274,3	311,8	342,0	366,0
Other current acct flows	-5,2	-5,8	-1,0	5,2	-0,8	6,0	8,9	11,2
Net FDI	10,2	4,7	6,3	14,7	13,1	14,3	15,1	15,8
Debt service requirement	-70,7	-74,4	-78,3	-82,4	-86,8	-91,4	-96,2	-101,2
Net other capital flows	61,8	82,6	74,3	69,3	88,9	84,3	90,6	96,3
Chg in intl reserves	-1,3	10,4	2,8	3,1	10,2	5,2	7,3	8,6
External Debt & Liquidity (USD bn)								
Reserves	93,6	104,0	106,9	110,0	120,2	125,4	132,6	141,2
months of imports	6,0	5,8	5,5	5,0	4,8	4,6	4,4	4,3
Gross external debt (% of GDP)	69,5	72,2	72,6	61,5	58,7	58,7	56,9	54,2
Gross External Debt	331,1	340,1	383,0	359,9	345,4	360,6	375,9	391,1
o/w short term debt	39,9	47,8	48,9	50,5	52,7	54,7	56,9	59,3

Source: OEF (Oxford Economic Forecasting), IMF and SEB estimates

Rating history					
Fitch (eoy)	A-	A-	A-	A-	A-
Moody's	A2	A2	A2	A2	A2
S&P (eoy)	A-	BBB+	BBB+	A-	A-

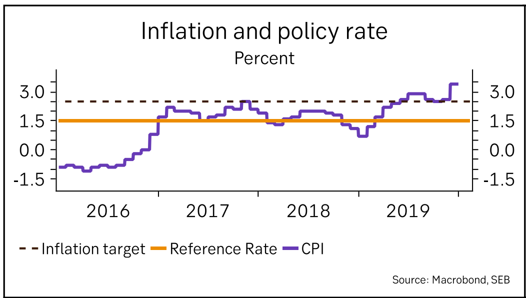
Type of government: Democratic: Coalition of centre-right Civic Platform and centrist Polish Peasant Party

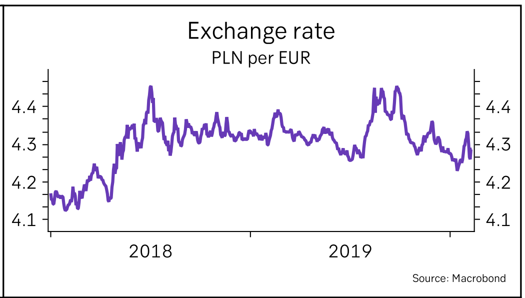
Next elections: Parliamentary 2023, presidential elections 2020

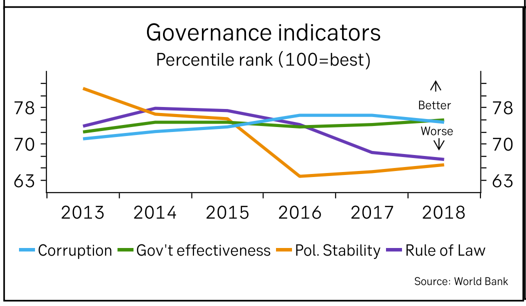
Other:

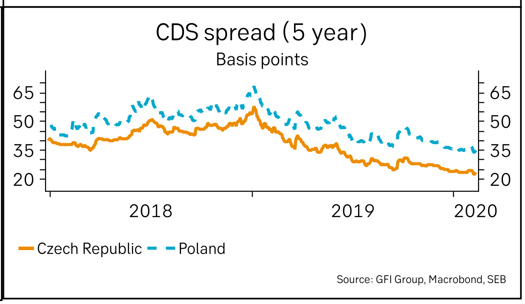
Latest PC deal: 1994, London and Paris Club

Recent IMF programs: FCL of about EUR 8.2 bn cancelled in Nov. 2017









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