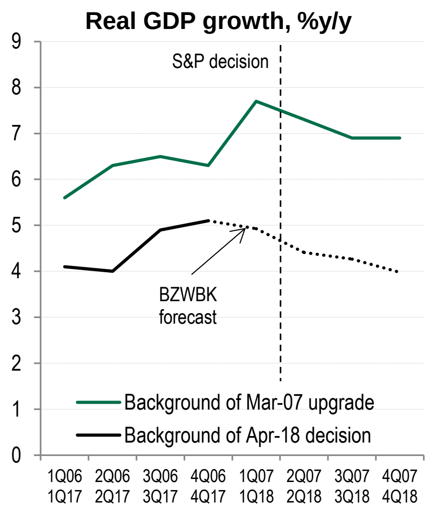
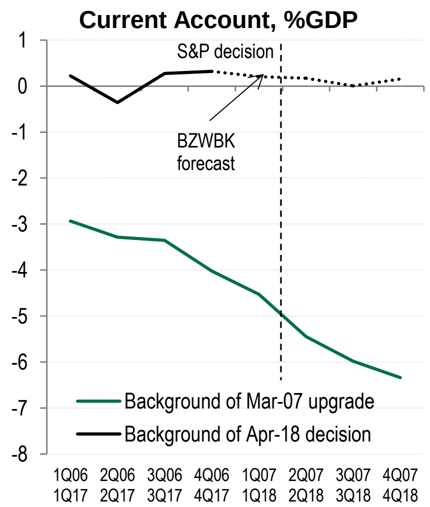
ECONOMIC COMMENT

11 April 2018

Weighing S&P's options ahead of Poland's review

S&P's rating review for Poland is scheduled on April 13. The current assessment is BBB+ with a stable outlook – the lowest score among the three main rating agencies. Moody's did not change its rating or outlook when it recently had an opportunity, on March 23. Having considered important data and remarks from officials that came in the meantime and making a comparison with the case from 2007 when S&P upgraded Poland from BBB+ to A-, we conclude that a rating upgrade now is highly unlikely. There are some arguments for improvement of Poland's rating outlook, however, so a no-change outcome is, in our view, less certain in this respect. What we view as quite possible is a positive rephrasing of the statement to take account of the positive macro and fiscal changes. This would unlock the possibility of a positive outlook designation in October.





S&P is scheduled to review Poland on April 13. It currently rates Poland at BBB+ with a stable outlook. Moody's was scheduled to review Poland on March 23, just three weeks earlier, but did not issue a full report. Instead, some comments appeared the following week, explaining no revision of its A2 with a stable outlook. Will S&P follow suit? The answer is not straightforward. In the meantime, there have been several new pieces of information affecting the creditworthiness of Poland. Also, S&P theoretically may feel pressured to raise its assessment, having been the only agency to downgrade Poland after the 2015 general elections won by PiS. Also, it assigns the lowest score for Poland out of the three main rating agencies (one notch below Fitch, two notches below Moody's).

Since the scheduled date of the Moody's rating review we got:

Full FY2017 data - The GG deficit for 2017 fell from 2.3% of GDP to 1.5% – the lowest level since comparable data have been available (1995). In our view, in 2018 it will rise to c2% of GDP, but should not raise concerns among investors. The GG debt fell to 50.6% of GDP in 2017 from 54.1% in 2016. This could make a case for a rating upgrade as long as this trend is viewed as permanent and not due to cyclical factors (note that S&P sees debt at 48.6% in 2020, according to its Dec-17 forecast update).

Conciliatory remarks and actions from Polish high officials to end the spat with the EU over the rule of law – PM Mateusz Morawiecki sees a high probability of reaching an agreement with the European Commission. PiS Leader Jarosław Kaczyński confirmed a willingness to reach an agreement with the EU, assessing such a probability at 80%. The ruling Law and Justice (PiS) party recently proposed amendments to judicial laws addressing some of the EC's recommendations. The head of the EC was positive regarding the proposals.

We note, however, that while the agency downgraded Poland in January 2016 on institutional concerns, its recent opinions have focused on net government debt levels, its response to aging populations, and long-term potential growth.

Poland achieved significant progress in 2017 with respect to fiscal parameters, but so did many other countries, as the favorable global macro environment supported higher revenues (economic rebound) and low financing costs (low-rate environment, disappearing inflation).

When S&P previously upgraded Poland from BBB+/stable to A-/stable on March 29, 2007, Poland was at the peak of its business cycle, growing at an average rate of 6.5% y/y between 1Q06 and 1Q07. More recently, the 1Q17-1Q18 average is 4.6%. At the time, the C/A balance was at an average of -3.6% of GDP; currently, it stands at +0.2% GDP. The GG deficit improved

ECONOMIC ANALYSIS DEPARTMENT:

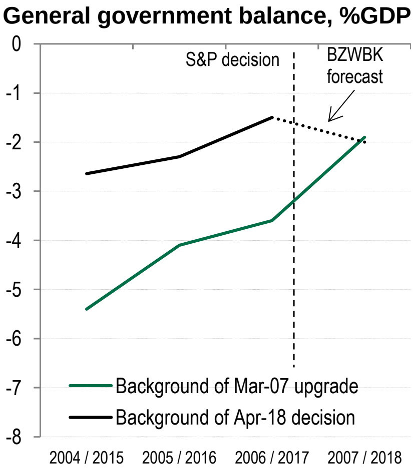
al. Jana Pawła II 17, 00-854, Warszawa fax +48 22 586 83 40

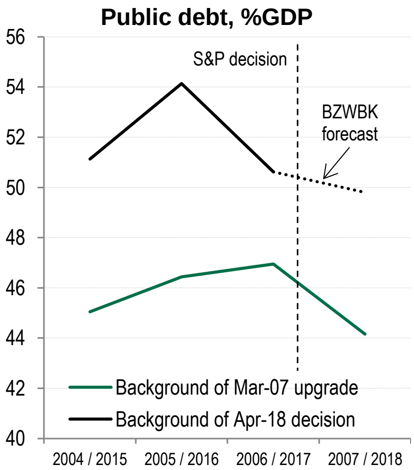
email: ekonomia@bzwbk.pl Web site: http://www.bzwbk.pl

Piotr Bielski	+48 22 534 18 87
Marcin Luziński	+48 22 534 18 85
Grzegorz Ogonek	+48 22 534 19 23
Konrad Soszyński	+48 22 534 18 86
Marcin Sulewski	+48 22 534 18 84

TREASURY SERVICES:

Poznań	+48 61 856 5814/30
Warszawa	+48 22 586 8320/38
Wrocław	+48 71 369 9400





between 2004 and 2007 from -5.4% of GDP to -1.9%, whereas it fell from -2.6% in 2015 to a record-low -1.5% in 2017, but could grow to -2% in 2018. At the time of the upgrade, public debt was at 44.2% of GDP; in 2018, it is expected at 49.8%. This comparison does not provide a clear-cut conclusion about an upgrade, as the current debt level is significantly higher. On the other hand, countries with S&P's BBB+ and those with A- are not clustered on a debt-to-GDP basis. In the BBB+ club, Poland has a debt ratio lower than Mexico, but higher than Thailand and Peru. Compared to A- countries, a club Poland could potentially join, it has lower debt than Malaysia, but not Latvia or Botswana.

It sounds like a story tilting towards a rating upgrade now. However, on July 31, 2017, S&P issued a report regarding the possible reduction of EU funds entering CEE countries and what that could mean for their ratings. In its view, there could be a decline of EU flows to the region due to Brexit, current political disputes between the EU and CEE countries, and the likely shift of priorities in the next EU fiscal framework. S&P concluded that the potential limitation of EU transfers, institutional risks, and demographic problems may place a cap on economic growth for CEE countries and prevent a rating upgrade. This report is one of the factors that keeps us from forecasting such a move by the rating agency in near future.

That being said, after the report was issued, S&P improved the outlook on its rating for Hungary from stable to positive (Hungary showed significant economic growth acceleration, but so did Poland – and to an even larger extent – which did not receive the same treatment from S&P). We see the probability for an outlook change to positive as non-negligible, but this is not our base-case scenario. In our view, there is a chance Poland might also see such a change this Friday, but this is quite uncertain. We expect S&P to eventually assign a positive outlook to its BBB+ rating on Poland, possibly in October when the agency has scheduled Poland for its next review. What we view as quite possible in April is a positive rephrasing of the statement to take account of the positive macro and fiscal changes. This would unlock the possibility of assigning a positive outlook in October.

Additional information is available on request. Please contact Bank Zachodni WBK S.A. Financial Management Division, Economic Analysis Department, al. Jana P awła II 17, 00-854, Warsaw, Poland, phone +48 22 534 18 87, email ekonomia@bzwbk.pl, http://www.bzwbk.pl.