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Research Report on Poland

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Summary

Poland's economy remains solid, growing at a constant pace and, proving resilience to external adverse factors. Real GDP continues to grow with a positive trend, unemployment has been steadily declining and net exports have been increasing.

The banking sector is well capitalized and profitable, but bank assets have a sizable share of unhedged Swiss-franc denominated loans. Additionally, long periods of low inflation raise risks over the long-term state of the economy.

Victory of the conservative Law and Justice (PiS) party may lead to significant changes of economic policies. Finally, potential spillovers from Russia-Ukraine geopolitical crisis and the amount of debt held by foreign investors expose the country to external risks.

Main Economic Indicators of Poland

Macro indicators	2012	2013	2014
Gross pub. debt, bill PLN	878	926	867
Nominal GDP, bill PLN	1616	1663	1729
Real GDP growth, %	4,8	1,7	3,4
Gross gov. debt/GDP,%	54,4	55,7	50,1
Deficit (surplus)/GDP,%	-3,7	-4,0	-3,2
Inflation rate,%	2,4	0,7	-1,0
Curr. Account balance/GDP,%	-3,4	-1,3	-1,2

Development indicators	2014
Inequality adj. HDI	0,8
GDP per capita (Thou. of USD)	25,2

Default indicator	30.10.2015
5-Year CDS spread (Bp)	74
10Y Gov Bond Yield, %	2,7

Sources: RAEX (Europe) calculations based on data from the World Bank, IMF, Bloomberg

Government debt increased marginally but remains moderate. At the end of 2014, government debt to GDP stood at 50,1%, 5 p.p. lower than in 2013. After the one-off reduction in debt in early 2014 caused by the new pension reform, it has continuously increased (see graph 1). However the Agency projects it to remain moderate at 51,1% of GDP by end-2015.

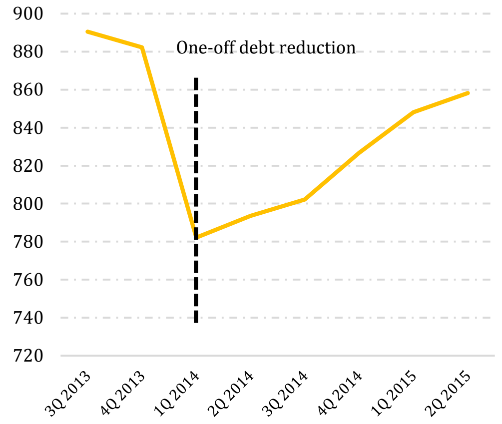
Short-term debt was unchanged in Q1 2015 and remained well covered by the amount of FX reserves.

Recently elected government may add pressure on contingent liabilities. The 2014 pension reform, increased the pressure on the government's future fiscal balances by transferring more than 50% of the assets in privately run funds to the state's Social Security Institution (ZUS). As mentioned on our previous report[1], such transfer of assets, combined with aging population and low fertility rates, present a challenge to the Polish authorities with respect to accumulating contingent liabilities in the long run.

The victory of PiS in recent parliamentary elections might lead to higher pressure on the fiscal balance and contingent liabilities. The party has pledged to reduce the retirement age, cut taxes to SMEs, impose higher taxes on banks and other financial institutions and introduce child and

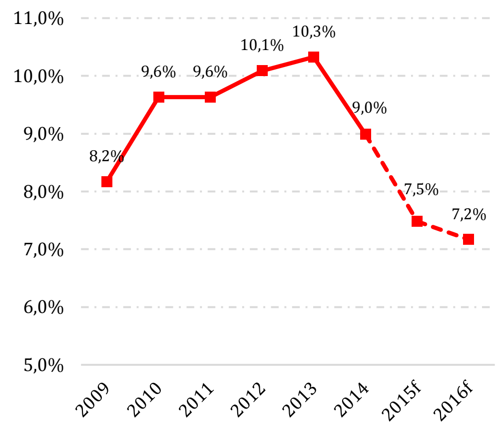
[1] Research report on Poland from 30th of April, 2015 (http://raexpert.eu/reports/Research_report_Poland_30.04.2015.pdf).

Graph 1: Public debt (Bill. of PLN)



Source: RAEX (Europe) calculations based on data from the Ministry of Finance of the Republic of Poland

Graph 2: Unemployment rate



Source: RAEX (Europe) calculations based on data from the IMF

family benefits. These proposals, along with the current fiscal stance are likely to have negative prospects on public finances.

The economy continues to grow consistently in real terms. The Polish economy grew at a rate of 3,6% in Q1 2015 as compared to a 3,4% increase in 2014. This robust growth has been mainly supported by increasing domestic private consumption, thanks in part to low inflation and wage growth. Steady investment expansion has been the result of recent growth in private credit. In addition, a recent pick-up in net exports and continuously declining unemployment rates (see graph 2) have also propelled GDP growth.

Continued negative inflation could adversely impact the economy. Subdued inflation may exert pressure on the fiscal budget in the long term. Lower prices combined with rigid wages could widen the deficit and raise debt levels.

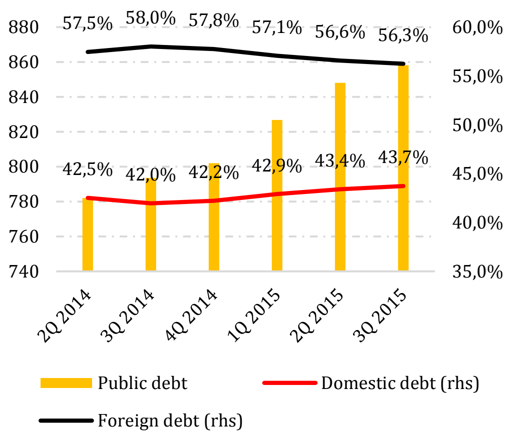
As mentioned above, periods of low inflation and deflation have contributed to elevated disposable income. However, prolonged periods of stagnant prices could hamper private investment. As a result, unemployment would grow leading to stagnant wages. This would ultimately affect household debt repayment capacity and lead to declining consumption.

Banking system remains sound and private credit is recovering. The banking system remains resilient to external shocks and continues to be profitable (ROA was 1,1% in Q1 2015) with sound capitalization (capital adequacy ratio of 9,25 in 2014). Additionally, private credit has started to recover since the end of 2014. Especially, the growth of loans to the non-financial sector was very high despite the slowdown of credit in 2014.

Exposure of many financial institutions to CHF (which appreciated earlier this year against the PLN) denominated loans have not yet impacted heavily on the financial sector. The high amount of bank buffers has helped to mitigate this risk so far.

External factors still present certain downside risks. FX debt as a percentage of total debt shrunk by 10% and the amount of debt held by non-residents decreased to 56% of total government debt (see graph 3) during H1 2015. However both indicators remain rather high. In addition, current account levels, albeit declining, remained negative in 2014 (-1,2% of GDP). The combination of the aforementioned factors raises concerns over the susceptibility of the country in case of renewed global market volatility.

Graph 3: Domestic and Foreign debt



Source: RAEX (Europe) calculations based on data from the Ministry of Finance of the Republic of Poland

Furthermore, Poland is a key link in the global supply chain of intermediary products. The country has strong trade ties with other EU countries where the overall economic performance has been sluggish. Additionally, continued tensions in Russia and Ukraine elevate the risks of potential negative spillover effects, including sharp fall in Polish exports to both countries.