



# 2016 OUTLOOK: POLAND

## MACRO, RATES AND FX

December 2015

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# Executive summary (macro)

- Polish GDP growth was 3%-4% throughout 2015, roughly in line with our expectations. We expect a similar rate in 2016, driven by three engines: exports, investments and consumption. The most positive element in the economy in recent quarters was a significant improvement in the labour market, with continued job creation and a substantial fall in unemployment. As a shortage of labour (based on official data and anecdotal evidence from companies) now seems to be one of the main obstacles to growth, in this report we take a more in-depth look at the labour market (pages 8-9 and annex pages 33-40).
- Forecasting inflation has been difficult in recent quarters. Deflation, which was supposed to be temporary, has been with us for 18 months. Therefore, our second focus here is inflation. While the direct and indirect effects of supply shocks were, to a large extent, responsible for low inflation (not only in Poland), we find that inflation in non-tradable services is already in the 1.5-2.0 range. Therefore, it looks as if local demand has already started to put pressure on prices. If this continues, if there is not another global commodity shock, and if we see some pick up in tradables inflation (higher inflation in Europe, no zloty appreciation), in 2016 we should finally see prices rise. We see downside risk to that scenario in a possible decrease in energy/gas prices at the start of 2016. For more on inflation prospects please see pages 14-15.
- The outlook of relatively strong growth and rising inflation would not require an additional demand boost from monetary or fiscal policy. Nevertheless, it looks as if interest rates will fall next year (after the new Monetary Policy Council members take office in 1Q16) and the fiscal deficit will rise (we expect the new government to make amendments to budgets for both 2015 and 2016). These policies could give a short-term boost to domestic demand, but would imply greater imbalances in the medium term (current account deficit and inflation). Still, we would stress that the starting point is very favourable. Since the general election in late October, the market has focused on the possible shape of fiscal policy in the coming years. The new administration started with a bang, amending not only the budget for 2016, but also for 2015, in order to deliver at least some of its campaign proposals, and has proposed a change in the so-called spending rule. See pages 18-21 for more on these risks.

## Executive summary (markets)

- The change of Monetary Policy Council (MPC) members at the start of the year (eight out of nine in 1Q16) is a strong argument in favour of market expectations of additional monetary easing. The new administration has sent a clear message about its preferences as regards new members. We think that the sooner they deliver a rate cut the better, given the still very benign inflation outlook at the beginning of the year. Therefore we assume an additional 50bp by March (reference rate at 1%).
- As we argued in our previous reports, the combination of macro forecasts (as summarised above) and expansionary macroeconomic policy (rate cuts and a looser fiscal stance), together with a start of normalisation in the US, should favour a steeper yield curve in Poland. While we think there is still some room for the front-end of the curve to adjust downwards, we see the long-end of the yield curve higher in 2016 (10Y close to 3.5%). The steepening of the curve should be more visible in bonds than in swaps (because of the risk premium). As regards demand, we still see local banks and foreign investors as the main players on the Polish Treasuries market.
- In early 2015 the zloty appreciated vs. the euro on monetary policy divergence (easing in the Euro zone, end of cuts in Poland) and EUR/PLN tried to test 4.0. Concerns about Grexit and, in the following months, also about Emerging Markets, the looming Fed rate hike and uncertainty about Polish politics weighed on the zloty, pushing EUR/PLN well above our year-end target. In 2016 we think global factors will be supportive for the zloty. The Fed rate hike may be interpreted as a vote of confidence for the US and the global economy (if concerns about China do not strengthen) and more monetary easing could work in favour of the Polish currency. The question is to what extent local factors might offset this. Monetary easing by the new MPC would not be supportive for the zloty and GDP growth should stabilise, giving no support for an appreciation. The government looks determined to implement at least some of its pre-election promises quickly, increasing structural risk for Polish fiscal policy. A possibility of an FX mortgage loan conversion is an additional risk factor, as we have yet to see how this issue is settled. Overall, we see limited room for the zloty to strengthen and think it is likely to trade in a EURPLN range of at 4.15-4.35, but it could move above that if risks materialise.

## 2015 summary: our expectations vs. the outcome

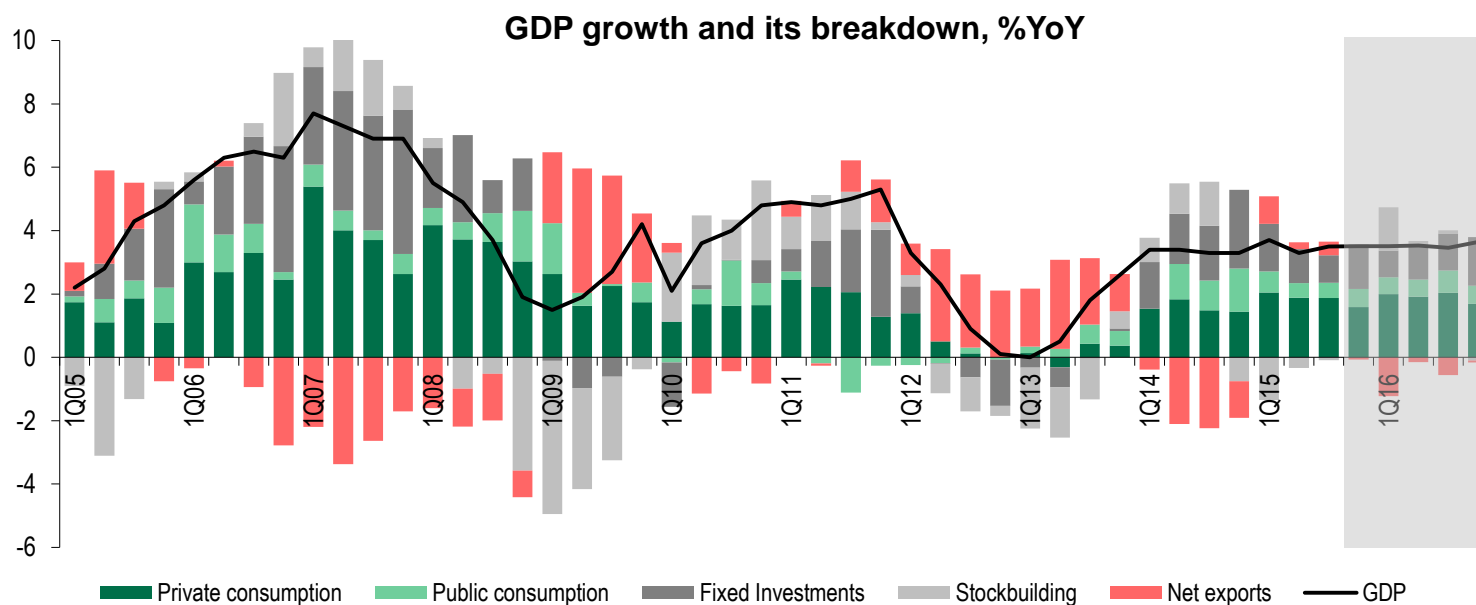
Indicator	Our view (12 months ago)	Outcome
<b>GDP</b>	A slowdown (if any) should be temporary with GDP growth reaching 3.2% in 2015.	Strong growth continued throughout 2015 and proved even higher than expected at the start of 2015.
<b>GDP breakdown</b>	Solid growth in exports (6%-7%) and a greater role for domestic demand (consumption +3.6%, investments +8.4%)	Strong exports (6%). Domestic demand contributed less than expected amid higher households' propensity to save and a bit lower investments
<b>Labour market</b>	Further labour market improvement, employment creation, falling unemployment and wages up 3%-4%.	Unemployment decreased even more than expected,. Nominal wage growth was in line with forecast.
<b>Inflation</b>	Inflation should not be a problem any time soon. CPI inflation below zero at least until mid-2015 (1% by year-end). Core CPI rising to 1%.	Deflation persisted for the whole year, mostly due to the slump in commodity prices (already felt at the start of the year). Core inflation was almost flat (0.2%-0.5% range).
<b>Monetary policy</b>	12M CPI significantly below target, putting pressure on the Monetary Policy Council (MPC) to cut rates 25bp.	Official rates were reduced by 50bp and in 2H15 the market started to price in further easing in 2016.
<b>Interest rate market</b>	Domestic fundamentals should contribute to higher yields. Front-end to perform better and curve to steepen as a result	Polish curve steepened, although the long end was slightly below our forecast and we did not expect the front-end rally that happened in 2H15.
<b>FX market</b>	EUR/PLN rate to decrease slightly in 2015 (mid-year c4.1, year-end c4.0). Volatile year for EUR/USD but an overall upward move.	EURPLN downward trend from 1H15 reversed in 2H15 (year-end weaker than we forecast). There was high volatility in EURUSD, but its overall direction in 2015 was the opposite of what we expected.

# 2016 outlook: our views and risks

Indicator	Our view (in a nutshell)	Risks
<b>GDP</b>	Strong growth to continue in 3%-3.5% range throughout 2016. Any dip below 3% would be short-lived.	Most of the risks are external: growth in the Euro zone (Germany in particular), a spillover of pessimism from EMs to developed markets.
<b>GDP breakdown</b>	Consumption and investment growth rates similar to 2015 (3%, 6%, respectively). Any negative contribution from net exports should be moderate.	External negative risks for exports; Upside risk for private consumption, negative risks for investments (public in 1H16).
<b>Labour market</b>	Continuation of job creation, though labour shortages should be more and more visible. Rising wage pressure.	Limited growth in employment because of a lack of qualified labour. Growth slowdown and low inflation, resulting in limited pressure on wages.
<b>Inflation</b>	Upward trend to continue, but 12M CPI should remain way below target and slightly >1% at year end.	Continuing import of low inflation from abroad, supply-side shocks, effect of sector taxes.
<b>Monetary policy</b>	Adjustment in the main policy rate in 1Q16 (-50bp) when the new MPC arrives.	More easing in 2016 if inflation surprises to the downside and the MPC is extremely dovish.
<b>Fiscal policy</b>	Fiscal deficit slightly above 3% of GDP.	Higher deficit caused by increased spending.
<b>Interest rates</b>	Steeper curve: additional room for strengthening at the front-end thanks to monetary easing. Long end affected by local fundamentals (CPI/GDP). Rising yields in core markets and more fiscal risks.	Continuation of no-inflation (low growth) story in Europe keeping bund yields low and/or a more dovish Fed could mean no steepening in Poland. However, fiscal/political risk locally (with a possible impact on rating) may even force rates higher.
<b>FX market</b>	EURPLN range-trading without a clear trend, as positive global factors offset local risks (over-expansionary macro policy). USDPLN down (EURUSD upward move).	Risks for EURPLN connected with EM performance, as well as the issue of CHF loans. Risk for USDPLN: EURUSD at parity (or below)

# GDP growth stabilised at around 3.5%

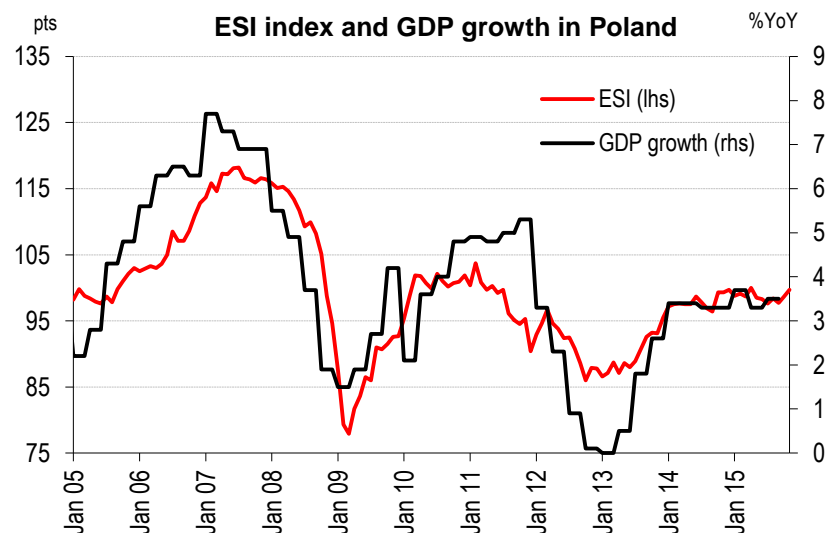
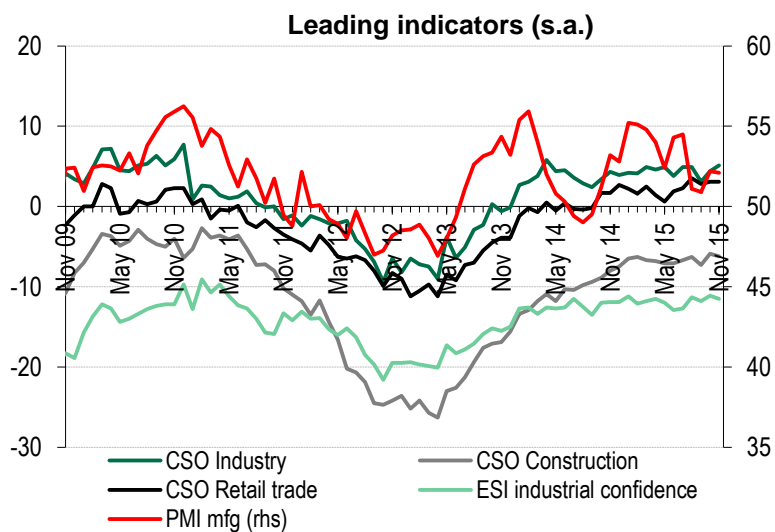
- Poland has entered an unprecedented period of stable GDP growth with seven quarters in a row of economic growth in a very narrow range at around 3.5% YoY.
- All three of the main engines of growth – private consumption, fixed investments and exports – are still working, although the composition of growth seems to be changing slightly. Fixed investments have slowed down, after very rapid expansion in 2014 and early 2015, and are unlikely to return to double-digit growth. Private consumption growth remains stable, with risks on the upside, as healthy wage growth, possible social transfers and low interest rates are likely to boost spending. Finally, export growth, which has slowed in the last few months, should revive, in our view, driven by accelerating growth in the Euro zone, Poland's main trading partner.
- We see a good chance of GDP growth remaining stable at close to 3.5% in the year ahead.



Sources: GUS, BZ WBK.

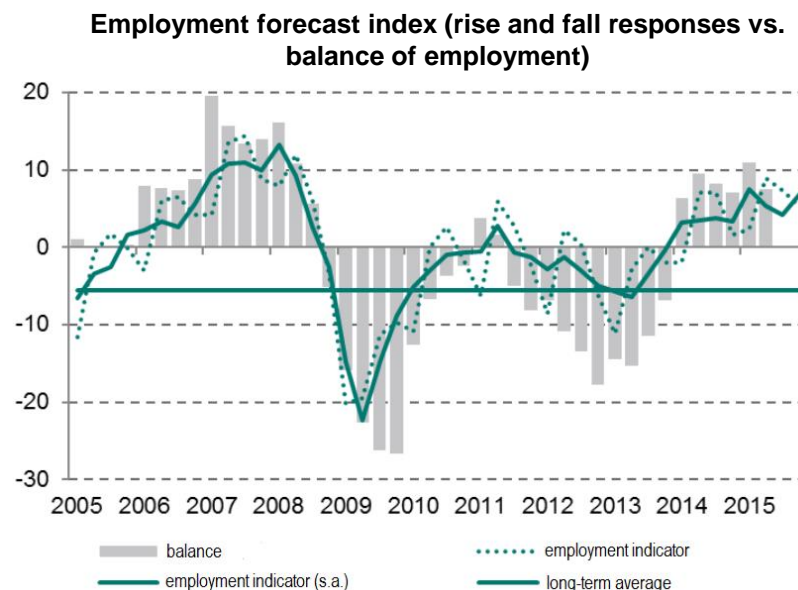
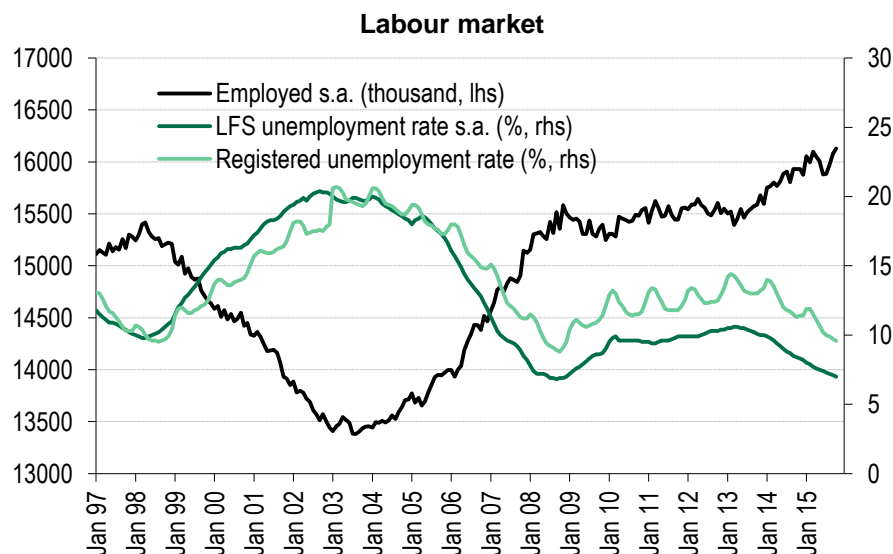
# Leading indicators show growth momentum continues

- Most leading indicators and business climate surveys weakened slightly and temporarily in the early part of 3Q15, but they remain at high levels, consistent with 3%+ economic growth. It is significant that the improvement of sentiment is broad-based and not limited to one or two sectors or branches.
- The PMI index was an outlier, falling significantly in August-September, but it recovered again in the fourth quarter, showing a significant pickup in new orders and production. We note that earlier in the recovery cycle (e.g. in 2013) the PMI was sending overly-optimistic signals about the improvement and it deteriorated significantly in late 2014, while GDP growth remained robust.



# Strong demand for labour; unemployment nears all-time low

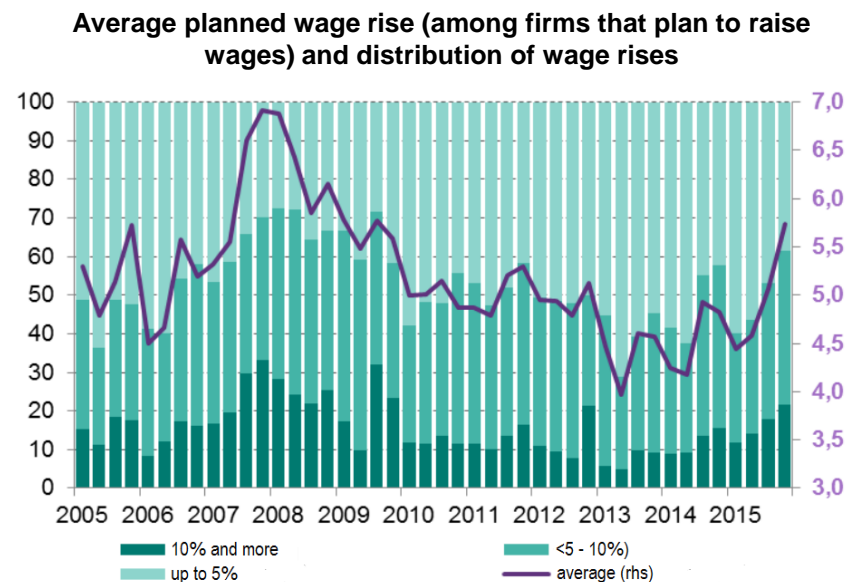
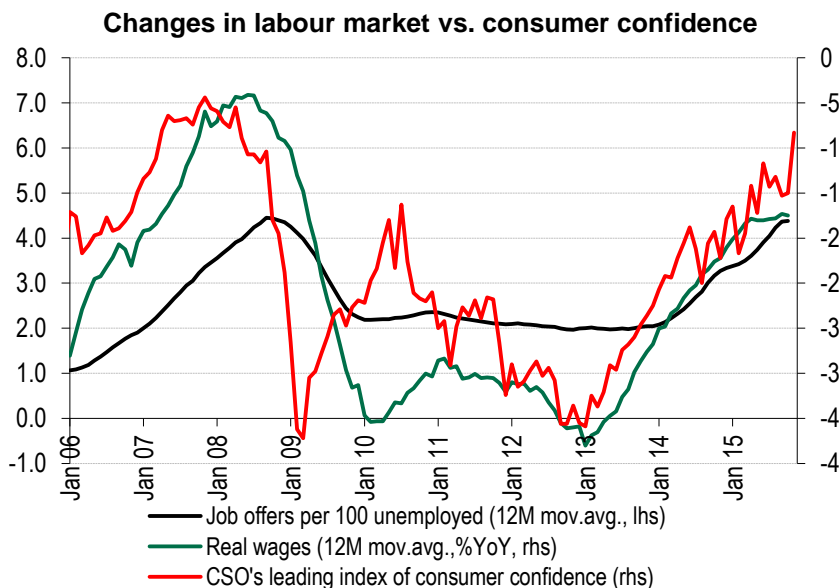
- The labour market has improved steadily for the second straight year. The number of people employed has reached an all-time high of more than 16 million and demand for labour, after slowing temporarily in mid-2015, remains robust, with companies still planning to hire new workers.
- The seasonally-adjusted unemployment rate is falling fast. According to the Labour Force Survey (LFS) it fell to 7.0% in October, its lowest since December 2008. We think it could reach its previous all-time low of 6.8% by the end of this year.
- Employment growth is likely to continue in the coming quarters, but may slow due to: (1) a growing scarcity of skilled workers, and (2) rising productivity (as a result of high investment growth in the last two years).
- A labour shortage may constrict Poland's GDP growth in the coming years. Please see Annex pages 33-40 for a more detailed discussion of the labour market and demographic challenges ahead.





# Wage pressure may grow

- Despite solid demand for labour, nominal wage growth has remained moderate at a stable 3.3%-3.5%YoY on average in the last few quarters, in both corporate sector and in the overall economy. Real wage growth has accelerated more significantly, and was above 5% YoY in the first half of 2015, amid deepening deflation.
- The wage pressure is still not significant, but there are signals that tensions may grow if economic growth continues and companies keep hiring. The number of new job offers is at its highest level ever recorded (higher than in 2007/08), and the ratio of job offers to the number of unemployed is rising. If this trend continues, it is likely to trigger growing wage pressure, amid an increasing shortage of labour. The National Bank of Poland (NBP) warned of this in its recent report on the economic climate, in which it said the ratio of firms planning to raise wages had increased, along with the ratio of those entrepreneurs expecting a hike to be higher than 5%.

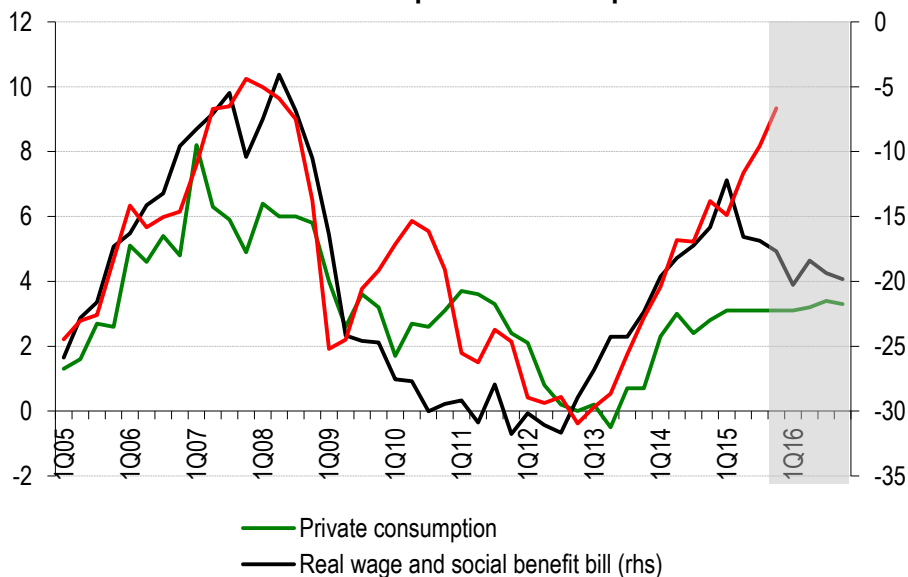


Sources: GUS, NBP, BZ WBK.

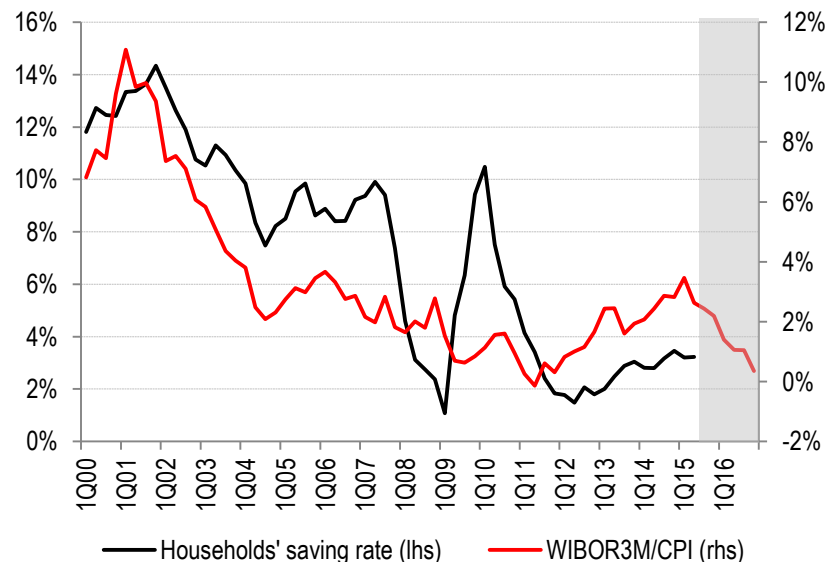
# Consumption should remain strong

- The positive trends in the labour market are triggering a significant improvement in consumer sentiment: recent surveys show Poles have not been so optimistic since the 2007 credit boom. However, the pace of private consumption growth remains moderate (c.3% YoY) as the household savings rate has been rising gradually.
- We expect private consumption growth to remain stable, or even accelerate slightly in 2016, as labour income should continue to grow at a decent pace. Families should also receive a boost from the government's "500+" programme of child benefits, which – if implemented in its recently-proposed form – adds c2% annually to households' disposable income.
- The household savings rate seems to be correlated to real interest rates, so, if rates drop significantly after the MPC trims base rates and inflation rises, the savings rate may decline as well, which would be positive for consumption.

**Real wage and social benefit bill and consumer confidence vs. private consumption**



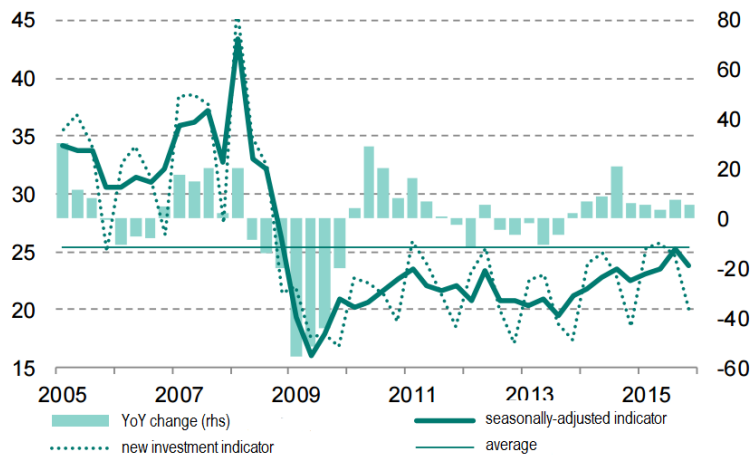
**Household savings rate vs. real interest rate**



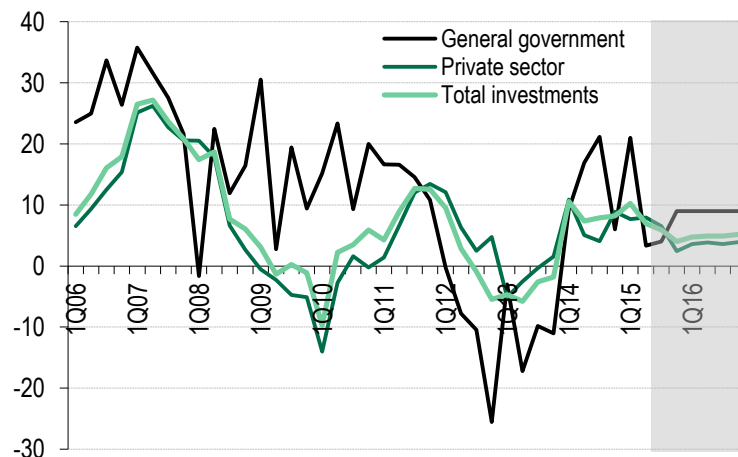
# Investments should increase, but more moderately

- Investment growth slowed to 4.6% YoY in 3Q15 after surprisingly strong and persistent growth in the preceding quarters (average of 9.9% YoY in 1Q14-1Q15).
- Investment outlays by the biggest companies (about 50% of the private sector) climbed 16% YoY in 3Q15. Data on investment loans also record solid growth. This, in our view, suggests that private sector demand for investment remained strong. In contrast, public investment slowed considerably in 2Q15 (it rose c2.5%YoY in real terms) and local government investment declined 15% YoY in 3Q15 (local governments account for about 50% of the public sector). EU funding flows also weakened in 2Q and 3Q.
- We conclude that the deceleration in investment in 3Q was due to lower public investment, while private sector momentum remained strong. We remain quite optimistic about private investment in 2016: entrepreneurs are in buoyant mood and plan to invest, capacity utilization is above average and credit criteria are still loose. Public investment may take time to emerge from the current soft patch, but the new EU financial framework and government plan should be supportive.

**New investment indicator – percent of companies planning new investment in one quarter ahead**

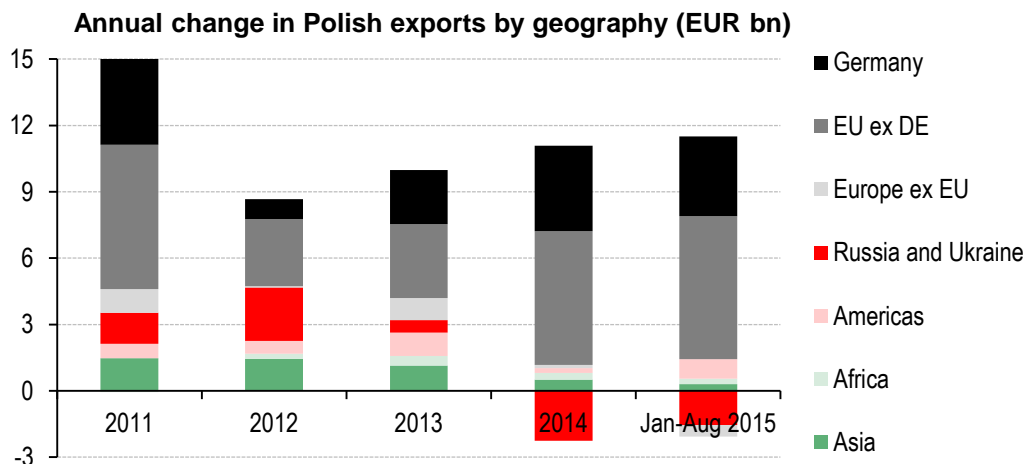


**Public and private investment growth, %YoY**



# Strong export performance should continue

- Economic recovery is under way in the Euro zone and we expect it to last in 2016 and to continue to fuel Polish export growth. Data for the first half of the year showed a noticeable revival in exports to Poland's major trading partners in the EU. However, recent signals from Germany (weaker data, Volkswagen scandal) imply some downside risk for German growth and, thus, for Polish exports.
- Trade with Russia tumbled 30% YoY in 1H15. However, its impact on the Polish economy was limited thanks to the recovery in Western Europe. Exports to Ukraine, after dropping by more than 30% in late 2014, have started recovering but are still 8% below last year. In general, exports growth this year has been driven by demand from the EU, accompanied by stable sales outside the EU. The Russian gap was offset by a rise in sales to non-European countries, but the weakness of Emerging Market economies suggests this trend is unlikely to strengthen.
- Elevated global risk aversion has kept the PLN exchange rate at a competitive level and even a moderate appreciation is unlikely to undermine export expansion. In general, we expect exports to grow by c9% YoY, mostly thanks to demand from the Euro zone/European Union, which should counter weaker tendencies in other countries.



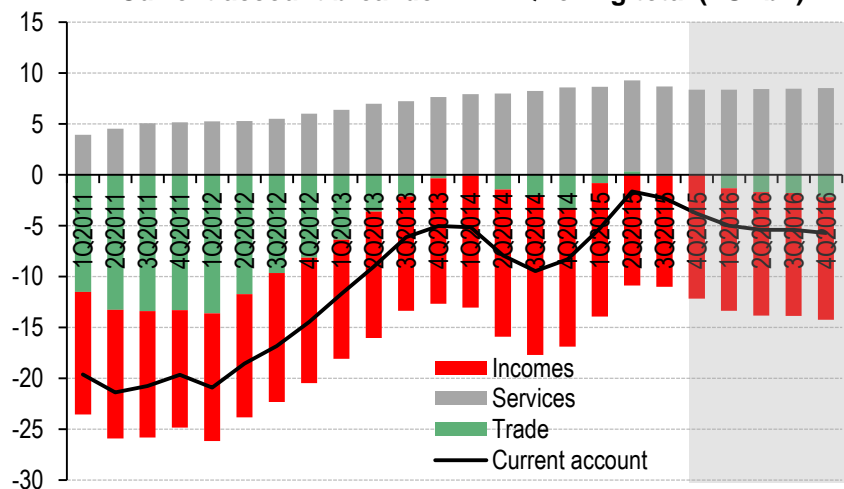
**GDP forecast for Poland's main trading partners**

Country	GDP growth – our forecast (consensus)	
	2015	2016
Germany	1.5 (1.6)	2.3 (1.8)
United Kingdom	2.4 (2.4)	2.6 (2.3)
Czech Republic	(4.2)	(2.7)
France	1.2 (1.1)	1.6 (1.4)
Italy	0.8 (0.8)	1.7 (1.2)
Netherlands	(1.9)	(1.8)

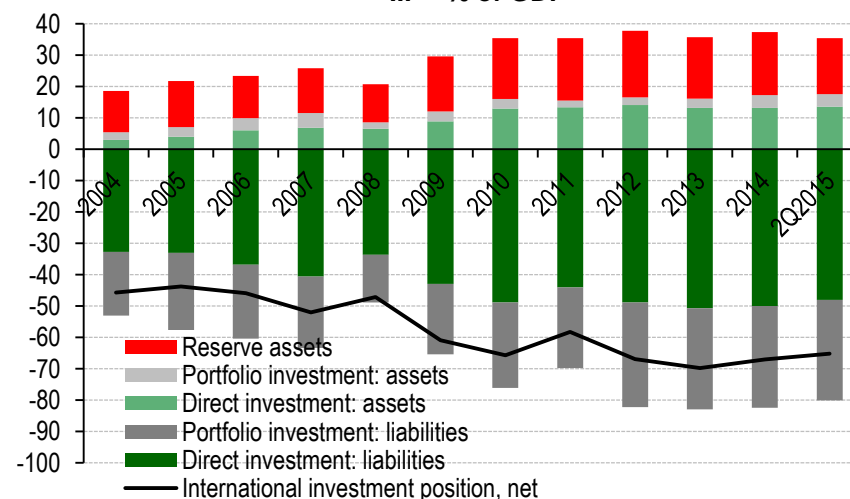
# C/A deficit to widen on deteriorating trade balance

- Poland's current account gap fell almost to zero at the start of 2015, but after a few quarters the trend started to reverse. Accelerating domestic demand will most likely now drive import growth higher (to c.10% YoY), putting it ahead of export growth and leading to a deterioration of the trade balance. Still, for most of 2015 exports and imports were roughly balanced so the starting point is solid.
- Services are likely to continue to generate a hefty surplus (or even extend it), in our view, driven by stronger demand from abroad and the strong competitiveness of Polish firms. We expect the financial account to show a small improvement thanks to larger inflows of EU funds (especially in 2H16) and lower outflows from the banking sector (due to the bank tax and lower dividends).
- We expect the current account deficit to widen to 1.4% of GDP in 2016E from 0.9% of GDP in 2015E. This will slightly undermine Poland's already high international investment position. By sectors, a decline in savings by the public sector should be offset to by higher savings in the private sector. We should also remember that under the European Commission's economic imbalances procedures, Poland was one of the few countries not required to take action.

Current account breakdown – 4Q rolling total (EURbn)



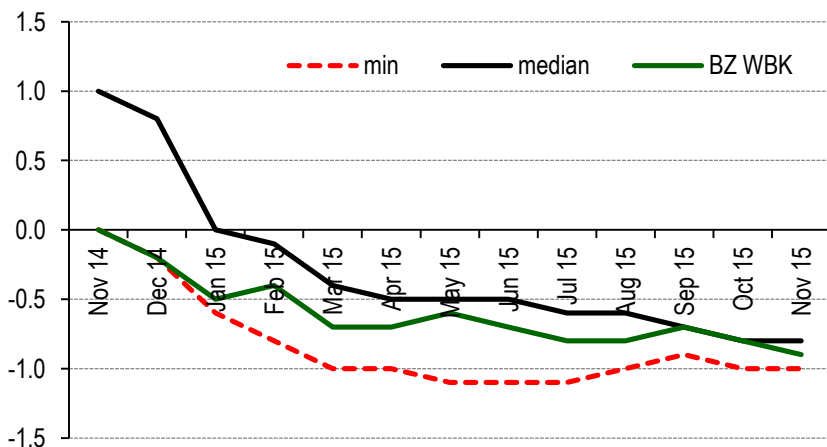
IIP - % of GDP



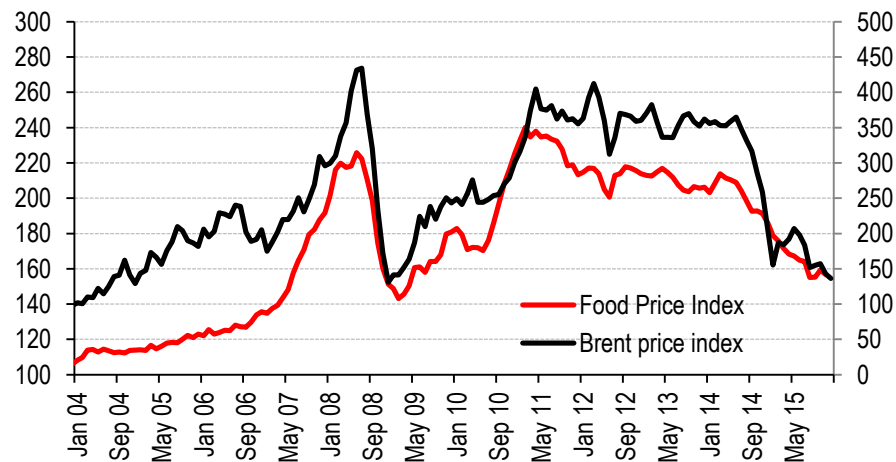
# Deflation lasted for the whole of 2015

- Last year when we titled this section *Inflation? What inflation?*, we did not expect deflation to continue until 2016. 12-month change to the CPI in 2015 was lower than we forecast, at an average of -0.9% vs. our expectations of 0.0% (at the time of our last annual report). As shown below, over-estimation of 2015 inflation was a common mistake and forecasts came down rapidly. This was particularly acute at the start of the year, due to strong global supply shocks (slumps in fuel and food prices), which brought down the non-core elements of the CPI basket. Prices in this category fell by 2.6% YoY vs. our estimate of -1.4%.
- Core inflation also proved lower than we expected at 0.3% vs. our forecast of 1.0%. This was primarily due to developments in prices of goods (tradables), which were kept low by the deflationary global environment, despite quite high domestic demand. At the same time, growth of non-tradables (services) prices was much higher (see breakdown on next page).

2015 CPI forecasts by Bloomberg

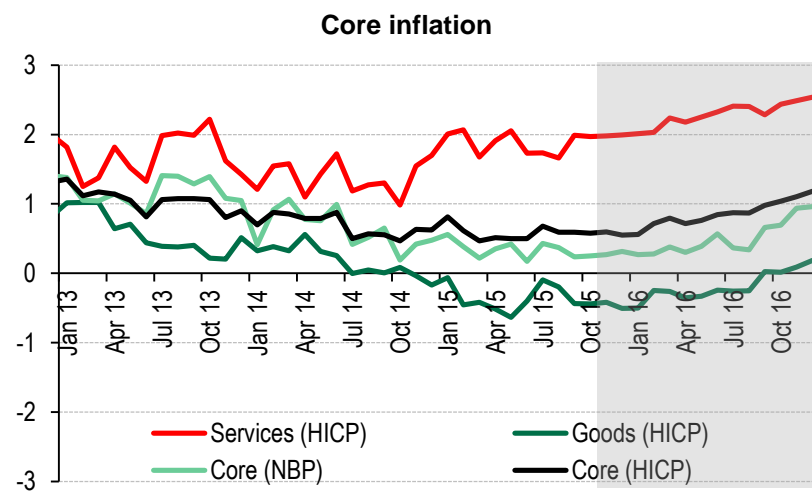
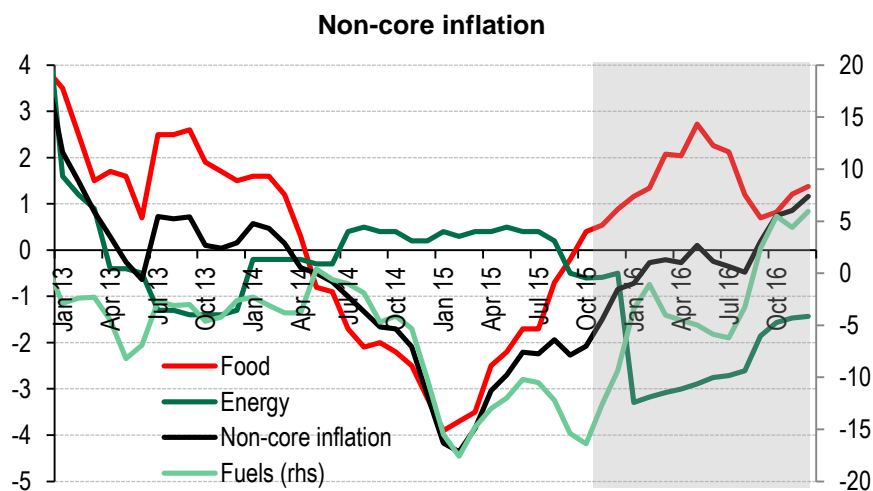


Prices of food and crude oil (2002-2004=100)



# Inflation should resume in 2016, but at a low level

- We expect food prices to climb throughout 2016. We have already seen a rebound, driven by the low base effect and the impact of the summer drought, which pushed fruit, vegetable and sugar prices up. Trends in other food categories remain weak and we expect them to strengthen slightly. In-mid 2016 the annual rate of food inflation should ease because of the higher base effect (drought in 2015), of course assuming a normal year in terms of crop production.
- There is not much space for another downward shock in fuel prices and we expect a small rebound based on higher crude. However, local energy and gas prices for households are likely to decrease at the start of 2016.
- As regards core inflation, we expect services prices to keep accelerating on the back of stronger private consumption and higher labour costs. Core goods prices should also rebound, although slowly. The upside risk is connected with a pass-through from a weaker zloty and/or a supermarket tax.
- To sum up, we are expecting non-core inflation to accelerate from -c0.8% YoY in Dec 2015 to c1.2% YoY in Dec 2016 and core inflation from c0.3% in Dec 2015 to c1.0% in Dec 2016. Our estimate of headline CPI sits at 1.0% YoY in Dec 2016 and 0.3% YoY on average in 2016.



# New MPC: More interest rate cuts are possible

- We believe that, given the balance of risks for GDP and CPI in the following quarters, a rate cut is not needed. However, the clear message from Law and Justice party (PiS) officials about preferences as regards new Monetary Policy Council members, and a clear PiS victory in the election, means the reference rate will most likely be cut.
- Five new members of the MPC will be nominated before its February 2-3 meeting. Together with current members designated by PiS, this will give PiS a majority. Theoretically, a cut is more likely in March as the MPC will see new projections for GDP and the CPI. The projection is unlikely to be hawkish enough to prevent a cut (especially given past forecasting errors on inflation).
- From the point of view of new members, monetary easing would be better sooner rather than later, we think. The longer they wait, the more they can be accused of a pro-cyclical move. We see a cut of 50bp by March 2016.

MPC member:	Designated by (recommended by):	Date of selection	Term of office (six years) expires:
Andrzej Bratkowski	Sejm (PO)	8 Jan 2010	20 Jan 2016
Elżbieta Chojna-Duch	Sejm (PSL)	8 Jan 2010	20 Jan 2016
Jerzy Haunser	Senate (PO)	13 Jan 2010	24 Jan 2016
Andrzej Rzońca	Senate (PO)	13 Jan 2010	24 Jan 2016
Jan Winiecki	Senate (PO)	13 Jan 2010	24 Jan 2016
Anna Zielińska-Głębocka	Sejm (PO)	9 Feb 2010	9 Feb 2016
Adam Glapiński	President (PiS)	16 Feb 2010	19 Feb 2016
Andrzej Kaźmierczak	President (PiS)	16 Feb 2010	19 Feb 2016
<b>Marek Belka, NBP Governor</b>	<b>President / Sejm (PO)</b>	<b>10 Jun 2010</b>	<b>10 Jun 2016</b>
Jerzy Osiatyński	President (PO)	20 Dec 2013	20 Dec 2019
The governor of the Polish Financial Supervision Authority (KNF), appointed by the prime minister	Date of appointment:	Term of office (five years) expires:	
Andrzej Jakubiak	12 October 2011	12 October 2016	

*Please note that the date when the term expires is not exactly six years after selection*

**FIVE NEW MEMBERS JOIN BEFORE THE MPC'S FEBRUARY MEETING**

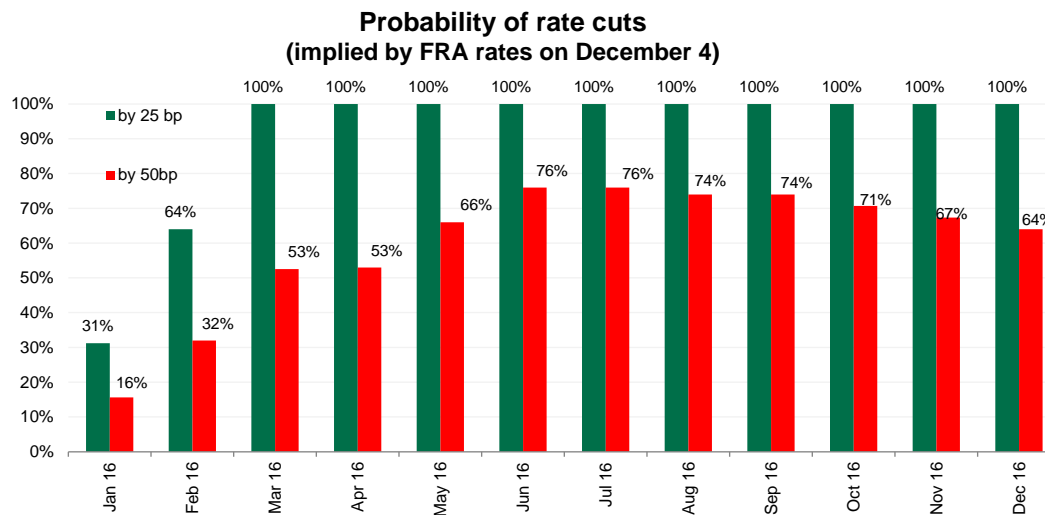
**THREE MORE NEW MEMBERS JOIN BEFORE THE MARCH MEETING**

**DEPUTY NBP GOVERNOR ALSO LEAVES IN 2016 (SEPTEMBER 7)**



# Is the money market pricing in enough easing in 2016?

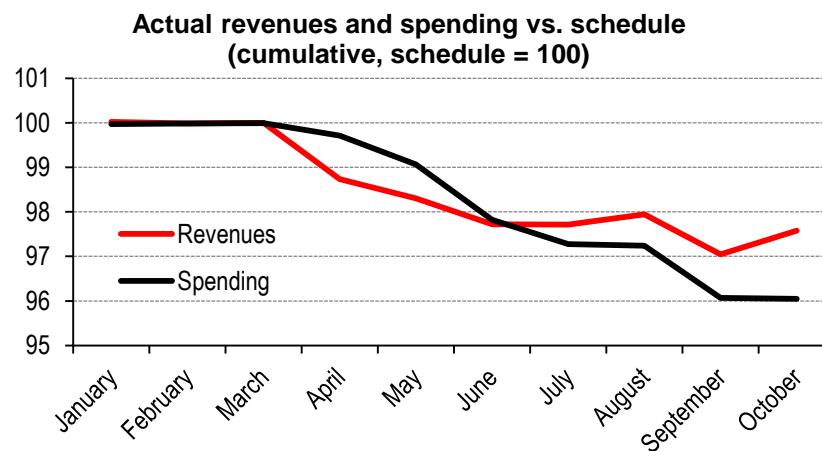
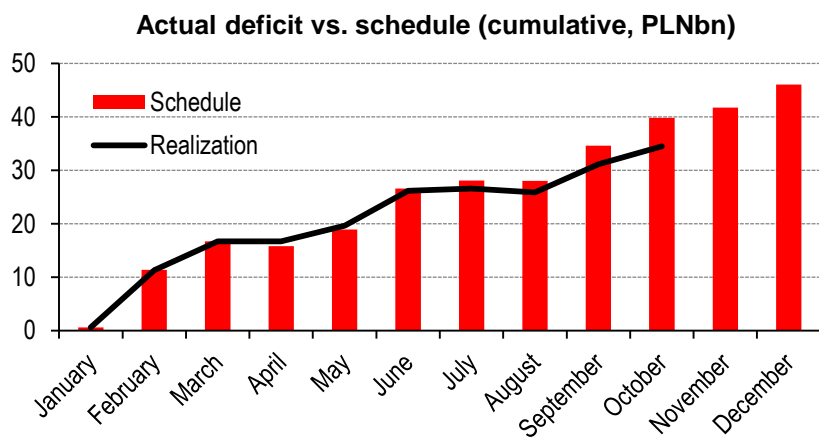
- In 2015, money market rates decreased markedly as the MPC cut the NBP rate by 50bp in March 2015. WIBOR rates stabilised in 2H15, following the MPC's declaration that monetary policy would remain unchanged until the end of the current Council's term. Interestingly, market speculation about possible rate cuts in Poland intensified at the start of October as representatives of the new administration suggested there was room for further monetary easing.
- As shown in the chart below, the FRA market is now fully pricing in a 25bp cut in three months' time and it sees over 50% odds of a 50bp reduction in that time frame. What is more, in the market's view, rates will now remain low for a longer period (FRA21x24 at 1.50%).
- We think the new MPC will cut rates by 50bp in 1Q16. While WIBORs should remain stable in the last month of 2015 as the turn of the year might be expensive on the money market, we expect them to decline at the beginning of 2016 and then stabilise. We expect 3M WIBOR to be 1.73% at the end of 2015E and 1.27% at the end of 2016E.



Sources: Reuters, BZ WBK.

# 2015 budget: moving the goal posts

- Since the parliamentary election, most market participants have focused on changes to the 2016 budget. Key questions are: Which proposals are to be implemented first? What is the cost and how will they be financed? Will revenue estimates be changed? Given the context of these challenges (details on the next page), we were surprised by the Finance Ministry announcing an urgent amendment of the 2015 budget because of a c.PLN4bn overshoot of the deficit.
- After 10 months the budget deficit stood at 75% of the full year target and was below schedule. Although tax revenues were less than planned (80% of the total projected for October for a shortfall versus the original schedule of PLN6bn), spending was as much as PLN10bn lower than planned.
- What the new government wanted to achieve, in our opinion, was an artificially low starting point, so that the 2016 budget draft would look comparatively better.
- Also, the previous cabinet assumed a substantial inflow of non-tax revenues in the last months of the year, due to payment for LTE frequencies (PLN9bn). If this revenue is rescheduled for 2016 (to finance next year's spending), the spending cutback in 2015 would need to be larger to avoid a budget amendment. In any case, small scale of deficit increase shows that an amendment is not really needed.



# 2016 budget: first campaign promises to be delivered

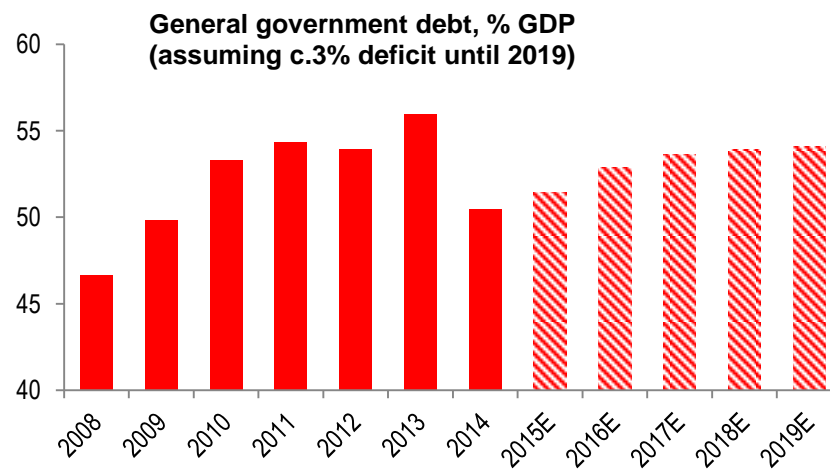
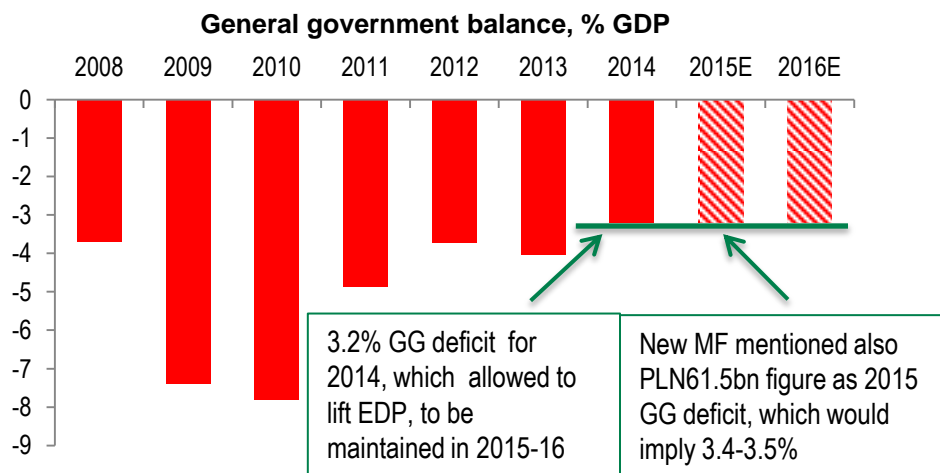
- The three main PiS proposals included: 1. child benefits, 2. higher tax-free income, and 3. a lower retirement age.
- The element certain to be included in the 2016 draft budget amendment is spending on child benefits. The annual cost is more than PLN20bn (if introduced without an income threshold for the second and subsequent children), though it will be introduced gradually at a budgetary cost for 2016 of cPLN15bn. The project is to be financed with sector taxes (a tax on the financial sector of cPLN6-7bn and a tax on supermarkets of cPLN3bn), a slight increase in income from dividends (PLN1-2bn), improved tax collection (PLN2-3bn) and a higher deficit (PLN1-2bn).
- Bills to implement the other two proposals have already been sent to parliament by the president. They assume implementation starting at the beginning of 2016, but it is very likely to be postponed till 2017, in our view. Even the extra non-tax revenue moved from 2015 (LTE PLN9bn) would not be enough to cover the gap (as shown below). Still, there is a chance the proposals could cost less as changes might be introduced in the parliamentary phase. For example some officials have suggested an income cap for child allowance, lower and/or diversified tax-free income (depending on annual income) and a minimum number of years of work to qualify for earlier retirement.

## Possible changes in fiscal policy

HOW TO FINANCE CHILDREN ALLOWANCE? 2016 COST of PLN15bn (full-year cost c.PLN21bn)	
1. Tax on assets of banks and insurance companies	cPLN6-7bn (probably effective from Feb. 2016)
2. Introduction of large shops tax	cPLN3bn (project still under discussion, details to be announced soon)
3. Better VAT tax collection	PLN2-3bn (in year one, more expected in following years -- see below)
4. Higher deficit (PLN1-2bn) and higher dividends (PLN1-2bn):	PLN3bn
OTHER PROPOSALS OF THE NEW GOVERNMENT (EXTRA SPENDING / REVENUES)	
1. Increase in tax-free income from PLN3091 to PLN8000	c. PLN15.6bn (costs divided c50/50 between central and local budgets)
2. Return to lower retirement age (60 for women and 65 for men)	PLN5.5bn (in the first year and more in following years)
3. Free drugs for elderly	PLN0.25bn
4. Higher non-tax revenues from 2015 budget (LTE frequencies)	+PLN9bn
5. More efficient tax collection	+PLN19bn VAT +PLN4.5n CIT +PLN8bn excise (medium-term targets)

# Fiscal policy in the medium term: more structural risk

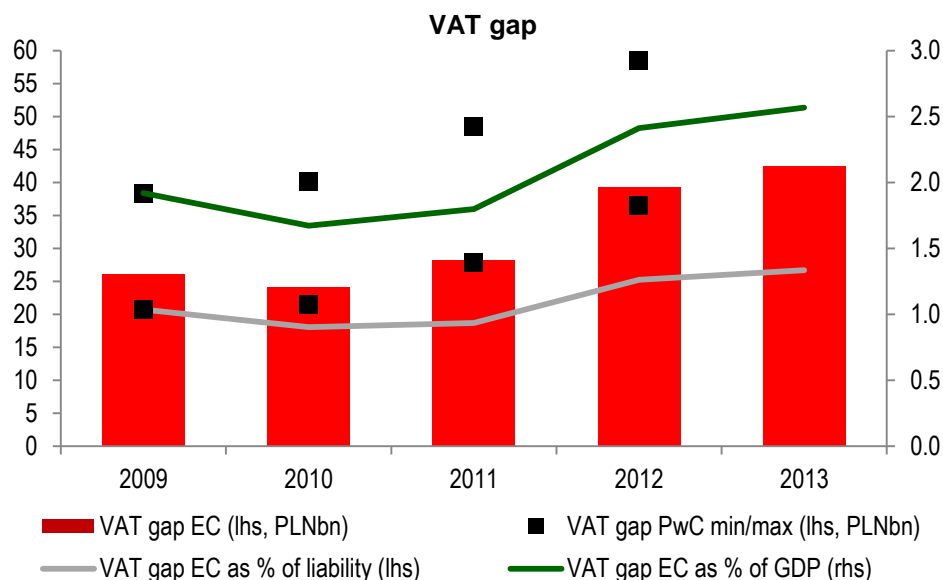
- The new cabinet underscored the importance of public finance stability and keeping the budget deficit in check (c3% of GDP). At the same time, however, amendments to the 2015-16 budgets imply a fiscal deficit above this threshold. The government is planning to increase spending substantially when the economic cycle is well advanced, which implies a higher structural deficit. Moreover, it creates more fiscal structural risks by proposing a change in the so-called 'spending rule' (changing inflation formula to CPI target and allowing for temporary increase in spending if financed by one-off revenues).
- On the revenue side, it is expected to be covered (at least partly) by temporary revenues (payment for LTE frequencies), which are not likely to be repeated in following years. This implies risk for the following years, as an extra boost in spending is not likely to be reversed. The most significant revenue item (except sector taxes) for the new government is its assumption about more efficient tax collection. No doubt it is required, as the gap in revenues is significant, according to independent reports (details on the next page), but it remains to be seen to what extent (and when) targets will be achieved.
- The most risky proposal of the government from the point of view of medium-term growth and a negative effect on public finances is the lowering the retirement age.



Sources: GUS, Eurostat, BZ WBK.

# There is scope for tax collection to be more effective

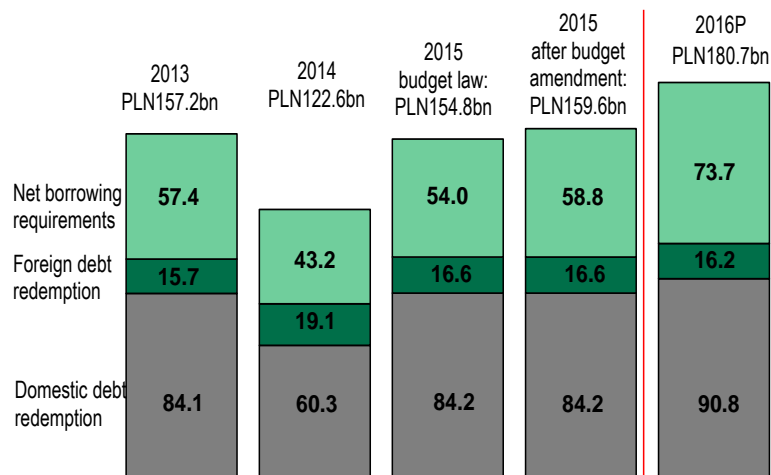
- According to the 2015 [report](#) by the European Commission, which quantifies and analyses the VAT gap in the EU, in 2013 Poland was in the upper quintile of the EU-26 member states with the gap at 27% of total VAT liabilities (an estimate of revenue loss due to fraud, tax evasion, bankruptcies, and financial insolvencies, as well as miscalculations). This is almost double the median result within the EU. What is more, the gap increased by an additional 2pp compared to 2012 (and c20% in 2009-11). In nominal terms, it exceeded €10bn in 2013. As pointed out in the report, Poland has continued to struggle with its capacity to collect VAT at a pace compatible with the pace of economic growth.
- Another [report](#) (only in Polish) on this issue was published by PwC in 2013. The latest estimate of VAT gap (minimum and maximum figures) presented in the report was for 2012. It is interesting that the nominal figures of the gap from the report by the Commission are close to the minimum figure calculated by PwC.



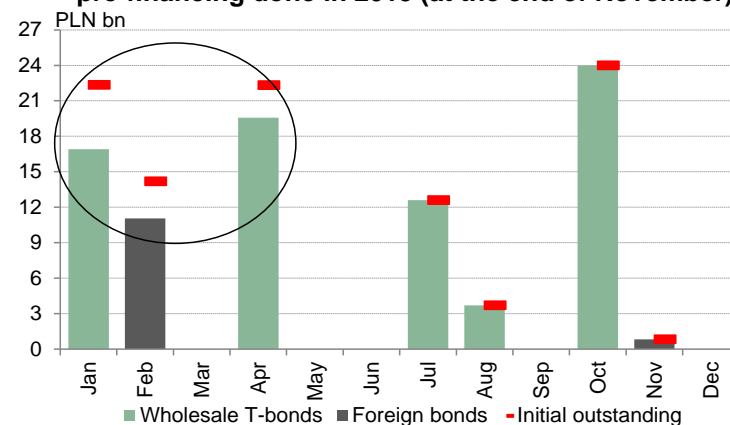
# Higher debt supply in 2016

- As a result of 2015 budget amendment (deficit up PLN4bn) net borrowing needs increased to PLN58.8bn (from PLN54bn assumed in the 2015 Budget Act) but they were already covered by October 2015.
- We do not expect 2016 net and gross borrowing to change significantly from the preliminary assumptions of PLN73.7bn and cPLN180bn, respectively. The increase compared with 2015 would be mainly due to higher deficit and a significant increase in debt redemptions (see chart). The pre-financing of 2016 financing needs started mainly through switch and buy-back tenders and drawing credit facilities from international financial institutions. In our view, the financial resources on budgetary accounts at the end of 2015 will be higher than the PLN7bn assumed in the previous government's 2016 budget draft (like the previous year). This means that, together with the pre-financing auction (including switching auctions), the Ministry of Finance should cover more than a quarter of its 2016 gross borrowing needs (PLN180bn) by the end of 2015.

**Gross borrowing requirements**



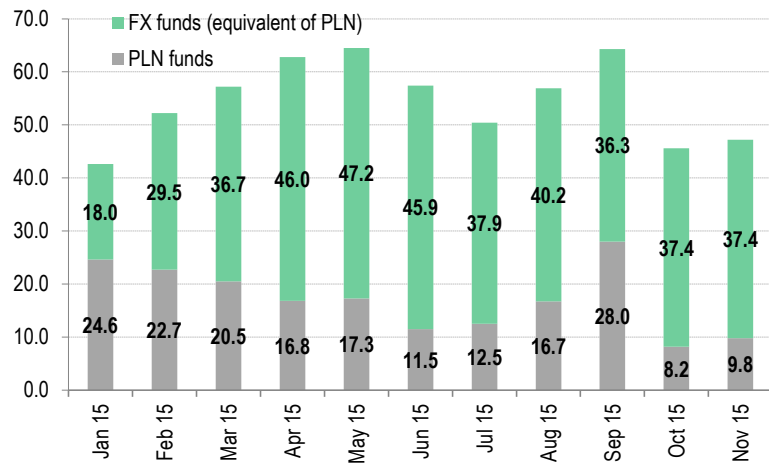
**Treasury security redemptions in 2016, including pre-financing done in 2015 (at the end of November)**



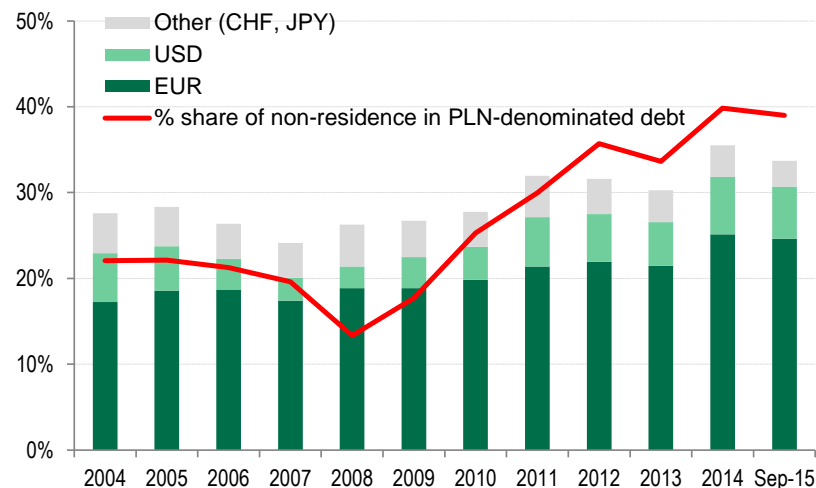
# Less foreign financing in 2016?

- According to the new minister of finance, Paweł Szaląmacha, Poland should continue to reduce the share of FX-denominated debt (mainly in EUR and USD) in total public debt. At the same time, he did not exclude a possibility of expanding the list of currencies in which it is issuing bonds on the international markets. Actually, the previous government also had a target of 30% of FX debt in total debt, but was rather flexible in achieving it (above this level in 2014-15). We think the new administration may treat it more seriously. As regards, next year's needs of FX financing, the Ministry of Finance already secured the US dollars to cover all FX needs in non-euro currencies (swap deals in September/October 2015). Moreover, foreign currencies in the budgetary account stood at the equivalent of more than PLN30bn at the end of November (see chart below). This clearly suggest that the ministry secured all the 2016 FX needs worth of €3.9bn, not to mention the Eurobond buy-back auction results (€0.73bn).
- We think that in 2016, as in previous years, PLN-denominated securities will play the main role. At the same time issuance on international markets will depend on market conditions. It seems that the Euro zone and Japanese markets should be attractive as regards issuing plans for 2016, taking into account low interest rates and market liquidity.

**Funds in PLN and in foreign currency on budgetary accounts**  
(funds financing the borrowing needs, end of month, PLN bn)



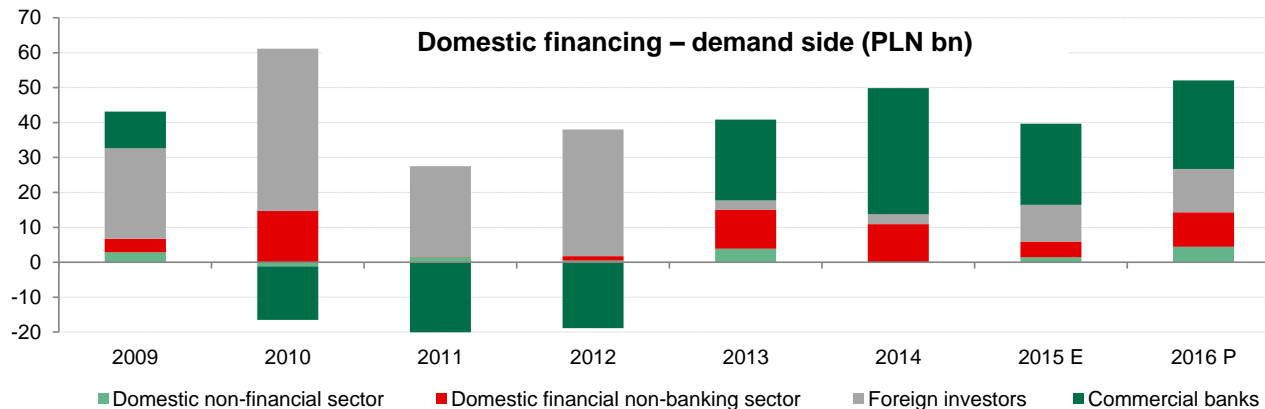
**Structure of FX-denominated debt (share in total debt) and non-residents' holdings of PLN-denominated debt**



Source: Ministry of Finance, BZ WBK.

# Hard to finance deficit without foreigners (and local banks)

- In 2015, as in previous years, domestic commercial banks are playing the main role in financing the country's net borrowing requirements. In January-October their holding increased by more than PLN11bn, i.e. they purchased over 50% of total debt issued during that time. Non-residents were the second biggest buyers (they purchased c PLN10bn, or 44% of total debt issued in the first ten months of 2015), increasing their role in financing in 2015. The nominal value of debt bought by non-residents in 2015 is likely to be the highest since 2012. While the new finance minister suggested also he would like to see a lower share of non-residents in total debt market (currently at 40%), it will be rather hard to achieve, we reckon.
- We think that the two above-mentioned groups of investors will continue to play the key role in financing domestic needs in 2016. Domestic commercial banks may be less important, as the introduction of a bank tax, to be paid on monthly basis, will not help. Despite earlier rumours that Treasury debt might be not included in the tax base, this does not seem to be the case. It cannot be excluded, though, that some new Hungarian-style measures, will be introduced, which would discourage banks from participating in open market operations (and moving towards Treasury papers). We think that first T-bill auctions since 2012 will be bought mostly by domestic commercial banks next year, as was the case in the past.
- Higher yields in 2016 (see next page) could attract more demand from foreign institutional investors. We think that central banks, in particular Asian ones, will continue to be on the buy-side. Also, easy monetary policy in the Euro zone is likely to fuel demand for domestic bonds from abroad.

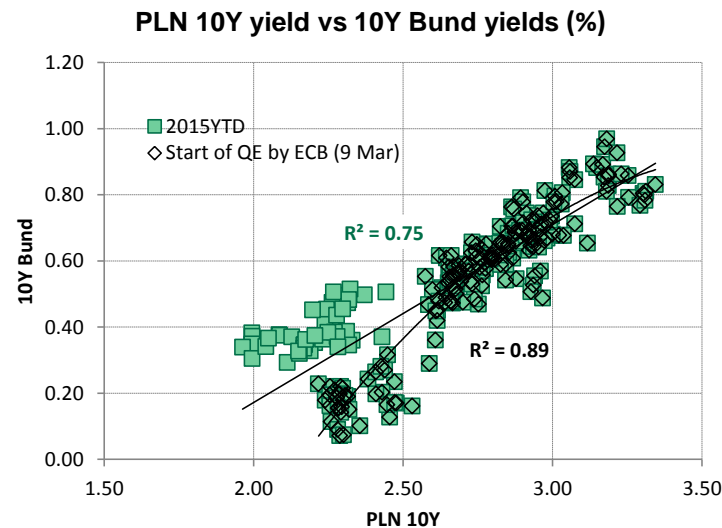
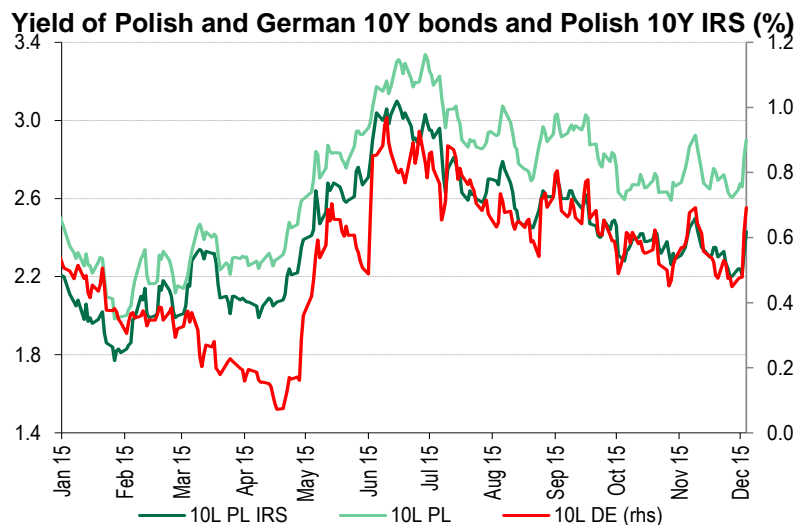


Sources: Ministry of Finance, BZ WBK.



# Polish yield curve should steepen in 2016

- Given a low inflation environment and likely additional monetary policy easing, we remain mildly bullish on the front end of the curve. We believe pricing-in of monetary easing in 2016 could intensify at the start of a new year and the market may even overshoot the scale of rate cuts after dovish appointments to the MPC. The spread between WIBOR and the 2Y sector suggests there is still room for yields to fall, especially because we believe leaving deflation behind will be a slower process than we had previously expected.
- As regards the long-term instruments, we expect yields to remain more vulnerable to global factors, in particular, signals from the main central banks. In our view, the spill-over from higher US yields should result in some upward pressure on Bunds, particularly in the 10Y segment. Our estimates show that the impact of changes in 10Y Bund yields on the Polish 10Y sector increased markedly over the past year (regression coefficient up from 0.42 to 0.49). Therefore, the increase in the yield of the German 10Y benchmark that we expect to see may stimulate an increase in the yield of the domestic 10Y.
- We look for the Polish curve to steepen, supported by relatively high GDP growth, rising inflation during 2016 and loosening in fiscal policy with more structural risks in the medium term (as presented in previous pages), which should add to the risk premium. We forecast a 2Y yield slightly below 1.50% and a 10Y yield of 3.50% at the end of 2016.

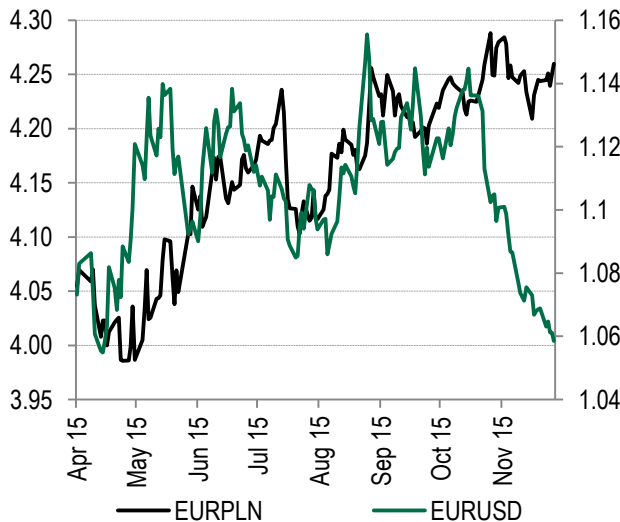


Sources: GUS, Reuters, BZ WBK.

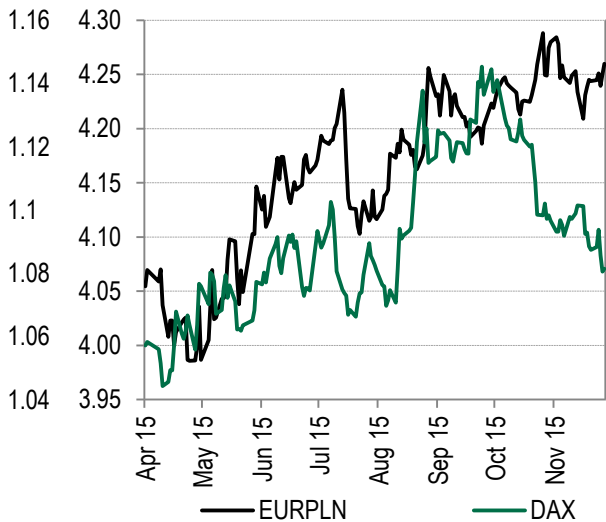
# The zloty started 2015 stronger on monetary policy...

- The zloty appreciated vs the euro in January-April on significant monetary policy easing launched in the Euro zone and the conclusion of the rate cut cycle by the Polish MPC. In April, EUR/PLN tested 4.0 but did not manage to break this level due to renewed concerns about Grexit. In the next months, worries about EMs (due to weak data from China), uncertainty related to Polish politics and the looming Fed rate hike weighed on the zloty, pushing EUR/PLN well above our year-end target expected in early 2015.
- For most of the year EUR/PLN and EUR/USD were moving in the same direction. First, the zloty was gaining and the euro was losing on more ECB easing. Later, global risk aversion was hitting the zloty, but at the same time it was making the Fed rate hike less likely, and this was positive for the euro vs the dollar. Polish bonds performed poorly due to rising odds of a Fed rate hike and concerns about Grexit, but they managed to recover slightly on hopes for more ECB action.
- As the charts below show, however, at some point the zloty stopped benefiting from hopes for even more ECB easing and a positive global economic outlook, as other factors became more important.

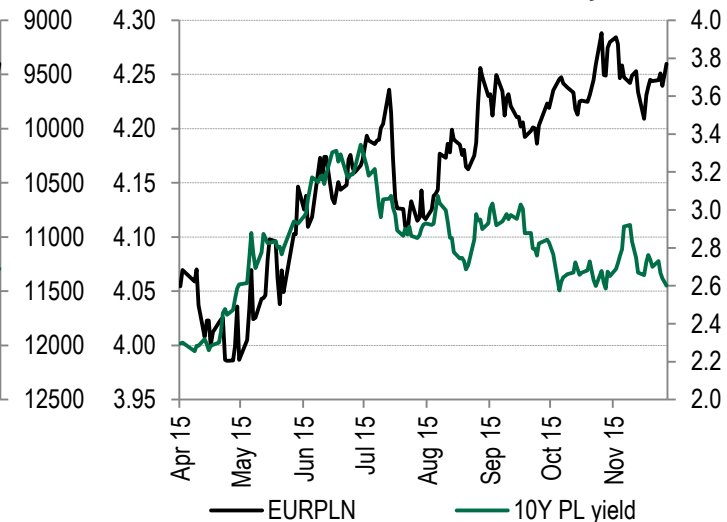
EUR/PLN and EUR/USD



EUR/PLN and DAX



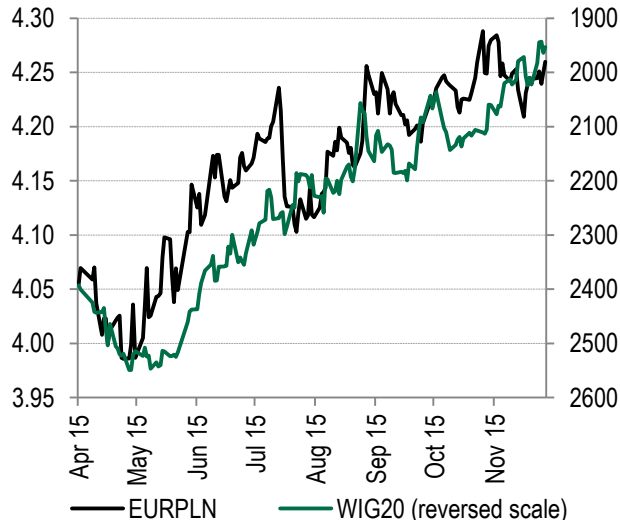
EUR/PLN and 10Y Poland bond yield



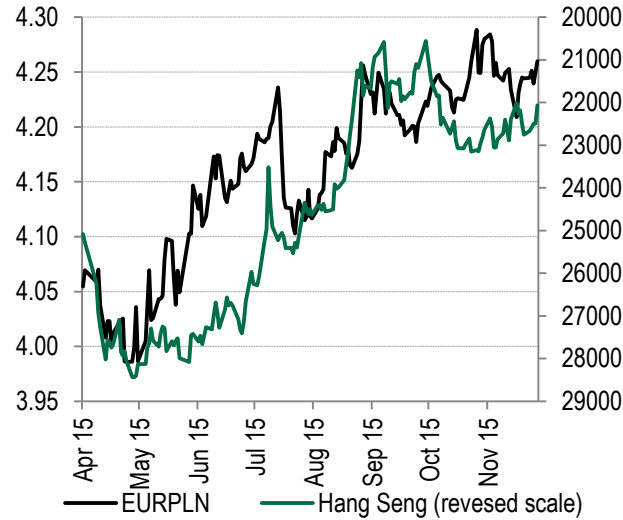
## ... but then China and Polish politics gained importance

- Throughout the year there has been a high EUR/PLN correlation with the equity market, but with emerging market equities not developed market ones. We see two factors that could have been working negatively on the zloty.
- First, high correlation with Chinese stocks suggests that market worries about the emerging markets are still alive. This is also reflected in the fact that nearly all of the main EM currencies depreciated this year vs the dollar and the UK pound.
- Second, Polish assets have been additionally pressured by higher political risk. Similarly, this affected the main Polish stock index with banking and utilities companies being a major part of this. The former will be affected by the bank tax and uncertainty about how the issue of FX mortgage loans will be settled. The latter was under influence of crisis in the mining sector and a possibility of utility companies involvement in the rescue process. This also could have added some pressure on the zloty in 2015, especially in the second half of the year.

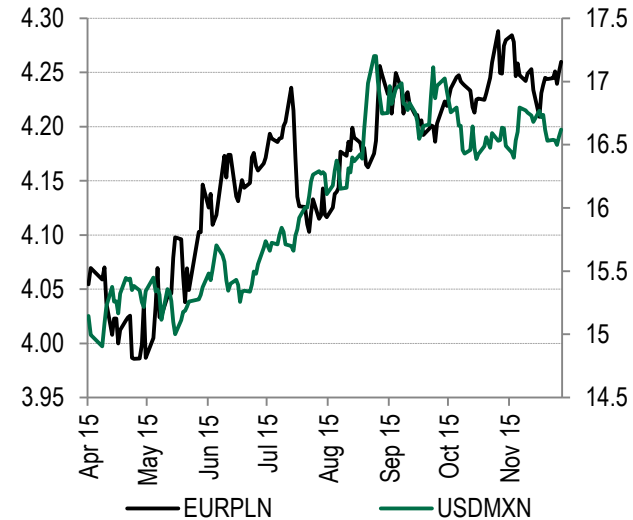
EUR/PLN and WIG20



EUR/PLN and Hang Seng

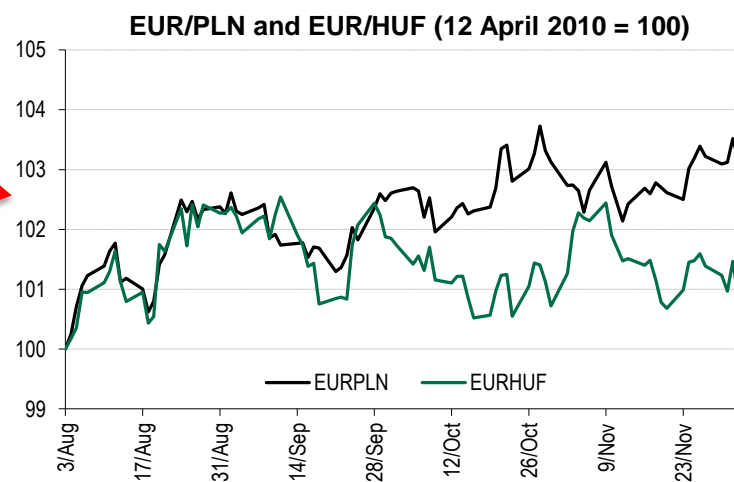
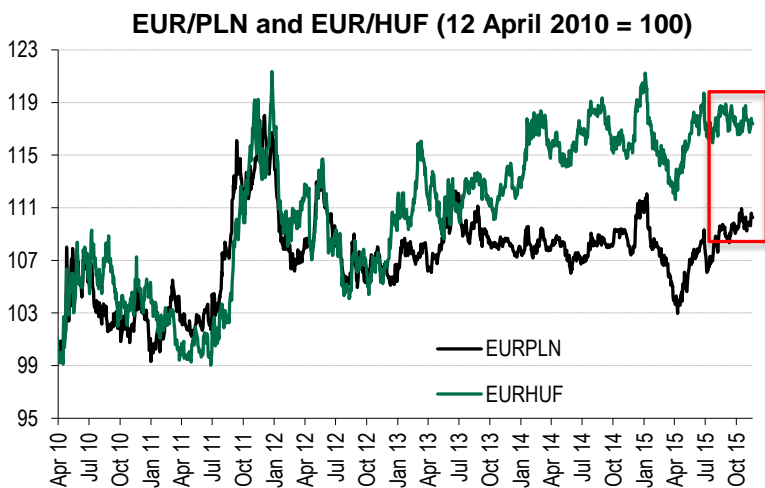


EUR/PLN and USD/MXN



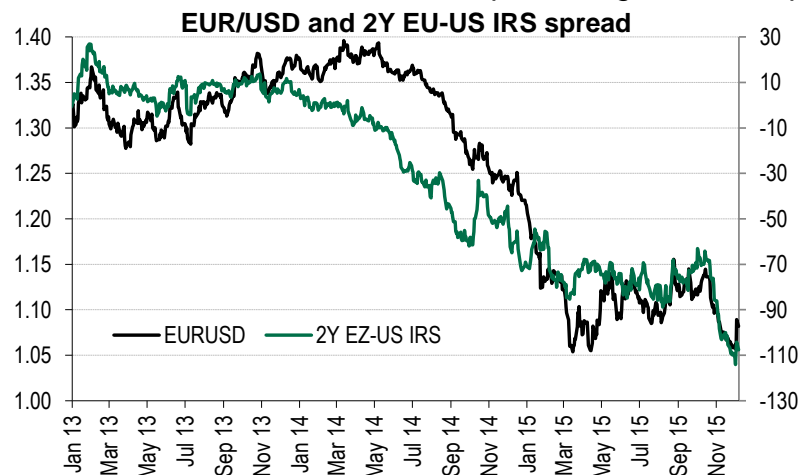
# Little room for stronger zloty in 2016

- We think that the Hungarian experience could be a good hint for the EUR/PLN outlook. After Fidesz won a parliamentary majority in Hungary in 2010, the forint was moving in line with the zloty and other CEE currencies for the next three years. However, it started to underperform when the Hungarian government started to deal with FX mortgage-loan conversions and the central bank cut rates.
- In Poland, however, the period before the currency starts underperforming may be much shorter, as the government looks determined to implement (at least partly) its pre-election promises rather quickly. Except for fiscal risks, a possibility of FX mortgage-loans conversion is an additional factor, as we are still waiting for the final proposition on how this issue could be settled. Also, rate cuts in 1Q16 would not be supportive for the currency. GDP growth would only stabilise and lack of acceleration would make it difficult for the zloty to appreciate sustainably (assuming the zloty is a cyclical currency).
- As regards the global factors, we think they could be supportive for the zloty. The Fed rate hike may interpreted as a vote of confidence for the US and global economy (if concerns about China do not increase) providing support for the risky assets. Also, more monetary policy easing in the Euro zone has a potential to work in favour of the Polish currency.
- All in all, we see limited room for the zloty to gain and the volatility in 2016 could be higher than in 2015.



# Global FX: Time for EUR/USD to reverse? \*

- 2015 was the second year in a row of the dollar's appreciation vs the euro. Next to the resurface of the Grexit problem, the euro was pressured by more monetary policy easing in the Euro zone and rising odds of Fed rate hikes. Consequently, EUR/USD fell to c1.045, its lowest since 2003.
- We think this trend could reverse over the course of 2016. The market seems to have already priced in a first Fed rate hike and we expect that the next ones should be very gradual in order not to allow the dollar to gain too much and not to hurt US economic growth. Also, if global economic growth is sound next year, then demand for the perceived safe-haven assets, like the dollar, could fall.
- We also point out that in June 2004 the FOMC started the tightening cycle and interest rates rose from 1% to 5.25% just before the US financial crisis. The tightening cycle in the Euro zone started in late 2005 and rates rose from 2% to 4.25% pre crisis. This divergence did not prevent EUR/USD from rising to 1.60 from 1.20 within this time frame (with a temporary correction to 1.16 in 2005). Current expectations for monetary policy in the US and the Euro zone are fairly similar to what they were then, and past experience shows that stronger tightening in the US does not have to imply a stronger USD as long as the economic situation is sound and stock indexes are rising.
- We expect EUR/USD to rise to 1.18 at the end of 2016 and this implies a significant drop in USD/PLN to nearly 3.50.

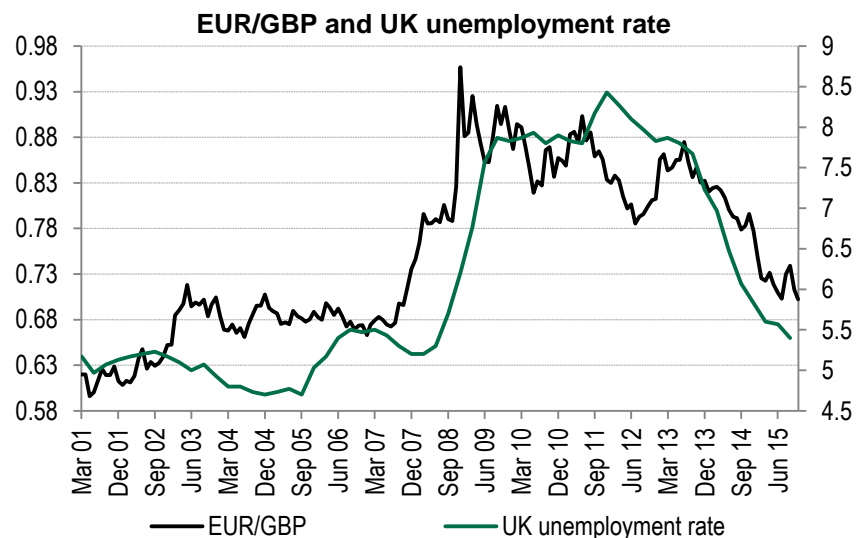
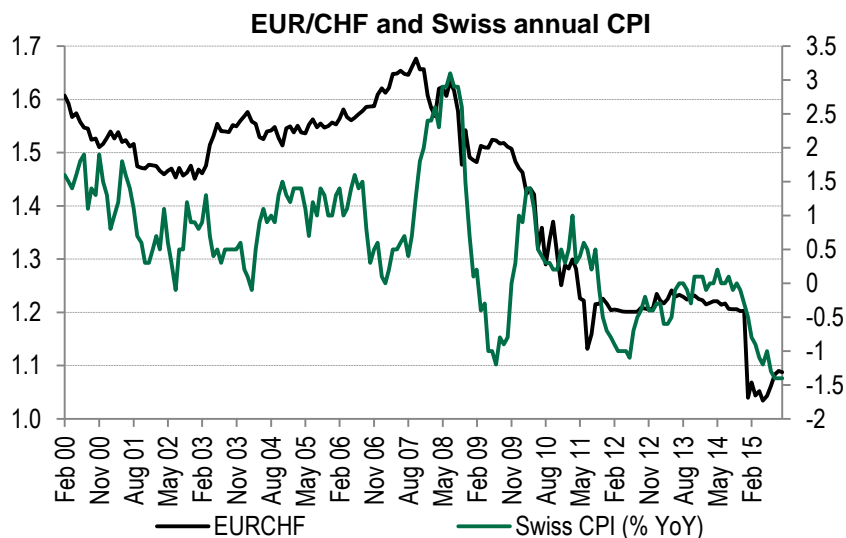


Sources: BZ WBK, Bloomberg

\* Partly based on the Santander Global FX Strategy FX Compass published on November 25, 2015

# Global FX: EUR/GBP flat; EUR/CHF higher \*

- Monetary policy easing in the euro zone and the likely rate hikes by the Bank of England in 1Q16 should favour the pound vs the euro for the better part of 2016. We think EUR/GBP might stay close to 0.70 and upside risk to this forecast would come from slower inflation growth and BoE rhetoric trying to talk the GBP down. The UK's EU membership referendum may be held next year, and if Brexit supporters start to gather higher support this also may weigh on the pound. EUR/GBP assumptions and the EUR/PLN forecast imply that GBP/PLN will stay in 6.0-6.10 range for better part of the year, with a possible drop to 5.80 only at the end of the year.
- Swiss authorities still perceive the franc as overvalued and given the downside pressure that the ECB is and will be generating on the euro, the SNB may need to take additional action to depreciate the CHF. We forecast that inflation will run below the CPI target until 2017, and the pace of economic growth will be rather sluggish, making room for SNB to do more monetary policy easing. We assume EUR/CHF will rise to 1.23 at the end of 2016. This would generate appreciation pressure on the zloty vs the Swiss franc, and we expect CHF/PLN to drop to 3.40 by December 2016.



\* based on the Santander Global FX Strategy FX Compass published on November 25, 2015

Sources: BZ WBK, Bloomberg

# Macroeconomic Forecasts

Poland		2013	2014	2015E	2016E	1Q15	2Q15	3Q15	4Q15E	1Q16E	2Q16E	3Q16E	4Q16E
GDP	PLNbn	1,656.3	1,719.1	1,775.6	1,837.6	414.6	432.2	438.6	490.2	427.5	447.4	452.4	510.5
GDP	%YoY	1.3	3.3	3.5	3.5	3.7	3.3	3.5	3.4	3.2	3.5	3.5	3.8
Domestic demand	%YoY	-0.7	4.9	3.2	4.1	2.9	3.1	3.2	3.5	4.6	3.8	4.1	3.9
Private consumption	%YoY	0.2	2.6	3.1	3.2	3.1	3.1	3.1	3.1	3.1	3.2	3.4	3.3
Fixed investment	%YoY	-1.1	9.8	6.0	5.7	11.5	6.1	4.6	4.5	4.0	6.0	6.0	6.0
Unemployment rate <sup>a</sup>	%	13.4	11.4	9.8	9.1	11.5	10.2	9.7	9.8	10.1	9.2	8.9	9.1
Current account balance	EURmn	-5,031	-8,303	-3,794	-5,749	900	1,110	-3,101	-2,703	-327	651	-3,076	-2,996
Current account balance	% GDP	-1.3	-2.0	-0.9	-1.3	-1.3	-0.4	-0.5	-0.9	-1.2	-1.3	-1.3	-1.3
CPI	%YoY	0.9	0.0	-0.9	0.3	-1.5	-0.9	-0.7	-0.4	0.0	0.2	0.2	0.9
CPI <sup>a</sup>	%YoY	0.7	-1.0	-0.1	1.0	-1.5	-0.8	-0.8	-0.1	0.1	0.2	0.5	1.0
CPI excluding food and energy prices	%YoY	1.2	0.6	0.3	0.5	0.4	0.3	0.3	0.3	0.3	0.4	0.5	0.9

Source: CSO, NBP, Finance Ministry, BZ WBK estimates.

<sup>a</sup> at the end of the period

# Interest Rate and FX Forecasts

Poland		2013	2014	2015E	2016E	1Q15	2Q15	3Q15	4Q15E	1Q16E	2Q16E	3Q16E	4Q16E
Reference rate <sup>a</sup>	%	2.50	2.00	1.50	1.00	1.50	1.50	1.50	1.50	1.00	1.00	1.00	1.00
WIBOR 3M	%	3.02	2.52	1.75	1.30	1.87	1.67	1.72	1.73	1.42	1.25	1.25	1.26
Yield on 2-year T-bonds	%	2.98	2.46	1.69	1.43	1.61	1.75	1.80	1.60	1.39	1.37	1.43	1.55
Yield on 5-year T-bonds	%	3.46	2.96	2.20	2.49	1.90	2.35	2.43	2.12	2.26	2.45	2.57	2.67
Yield on 10-year T-bonds	%	4.04	3.49	2.67	3.12	2.24	2.79	2.93	2.70	2.83	3.03	3.20	3.42
2-year IRS	%	3.10	2.51	1.71	1.42	1.65	1.85	1.78	1.55	1.37	1.40	1.42	1.50
5-year IRS	%	3.51	2.92	2.01	2.23	1.80	2.23	2.17	1.83	2.00	2.20	2.32	2.42
10-year IRS	%	3.86	3.34	2.40	2.82	2.06	2.57	2.62	2.36	2.53	2.73	2.90	3.12
EUR/PLN	PLN	4.20	4.18	4.18	4.23	4.20	4.09	4.19	4.27	4.25	4.24	4.25	4.21
USD/PLN	PLN	3.16	3.15	3.78	3.74	3.72	3.70	3.77	3.91	3.83	3.77	3.74	3.63
CHF/PLN	PLN	3.41	3.45	3.92	3.67	3.93	3.93	3.90	3.91	3.84	3.74	3.63	3.48
GBP/PLN	PLN	4.94	5.19	5.78	6.02	5.64	5.67	5.84	5.97	6.02	6.05	6.07	5.93

Source: CSO, NBP, Finance Ministry, BZ WBK estimates.

<sup>a</sup> at the end of period



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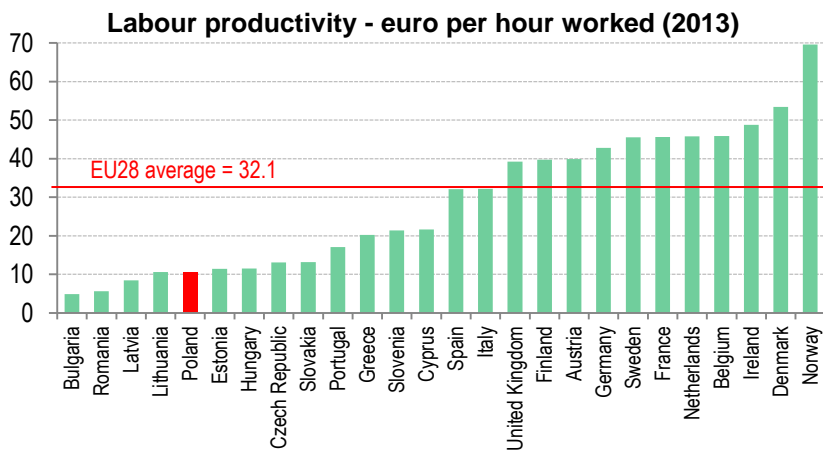
# ANNEX

Labour market – a bottleneck for growth?

# Employment growth needed to sustain economic growth ...

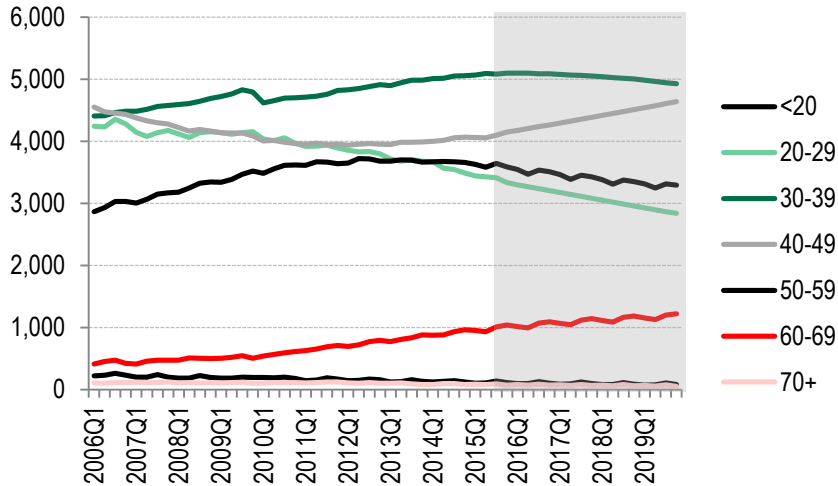


- Labour productivity in Poland (the level of real output per person employed) has been growing in the last three years, on average, by slightly above 1.5%YoY.
- It seems clear that an acceleration of productivity growth should be Poland's key medium-term objective, necessary to close the income gap versus major developed economies. However, in our view, the scope for a significant productivity pick-up in the short run is quite limited. We do believe that Poland may be moving towards a more innovative and technologically advanced economy, but it would be a gradual process, not a sudden technological swing. Please note that productivity growth has not picked up much in the last two years despite an impressive increase in fixed investments over this period. In our view, even if productivity growth accelerates in the near future, it is unlikely to go persistently above 3%YoY in the coming years.
- This implies that in order to maintain GDP growth at a current level of around 3.5%YoY (not to mention its acceleration), **employment growth in Poland would need to keep growing by at least 0.5%-1.0% per year.**



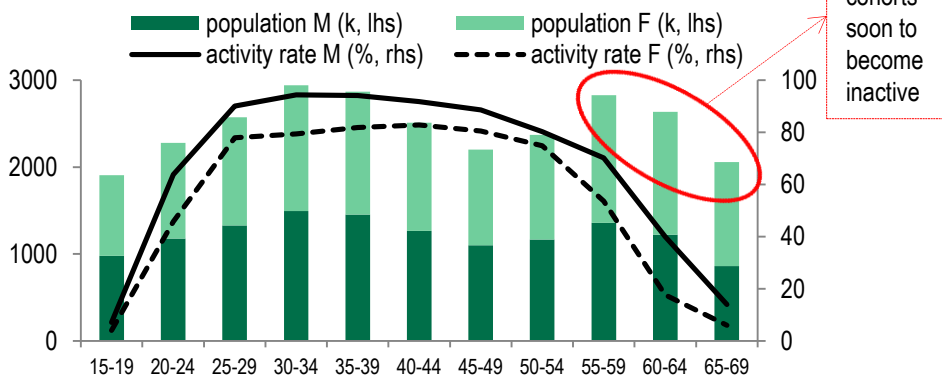
# ... but the available workforce will shrink

Active population by age groups ('000)



- Meanwhile, it appears that the reserves of available workforce are quickly running out. The jobless rate is likely to hit the all-time low of 6.8% even before the end of 2015.
- This is despite the fact that the labour activity rate – the ratio of people active in the labour market to the total population – has risen recently to its all-time high (albeit still well below EU average). Labour activity rate for people aged 15-64 has increased from 63.6% in 4Q06 to 68.2% in 4Q14, which resulted in a rise in available workforce by c440k people over the past eight years.
- Even if we assume – quite optimistically – that the upward trend in labour activity rate will continue (which may not be true, especially if the government fulfils its pledge to lower the retirement age), our estimates show that the active population is going to shrink in the coming years. It will be the result of ageing population, i.e., growing number of people falling into the oldest age groups (60+) and becoming inactive. **The number of people active on the labour market may drop by 450k-650k in the next five years, according to our calculations** (depending on the assumptions), while the total population is likely to shrink by c160k over this period.

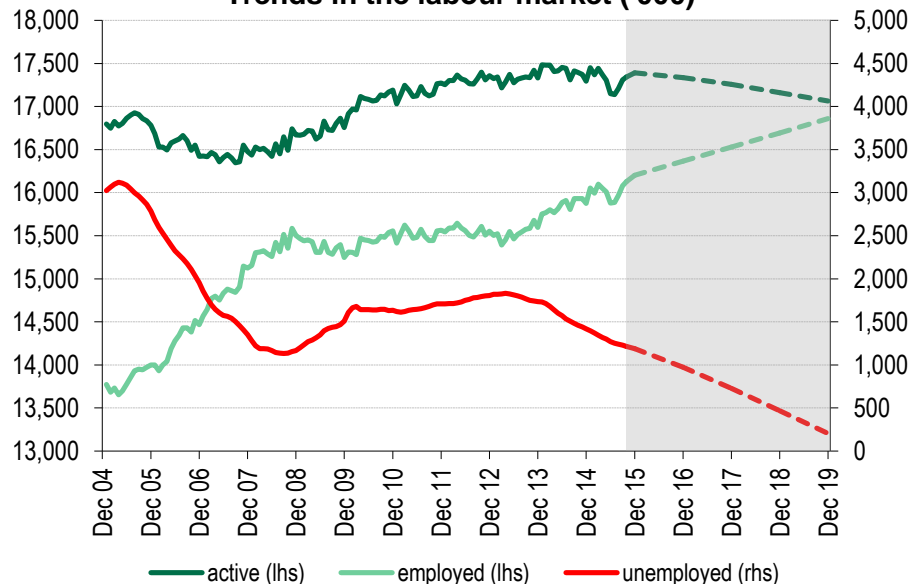
Population and labour activity by sex and age groups



Source: Eurostat, BZ WBK

# Approaching full employment?

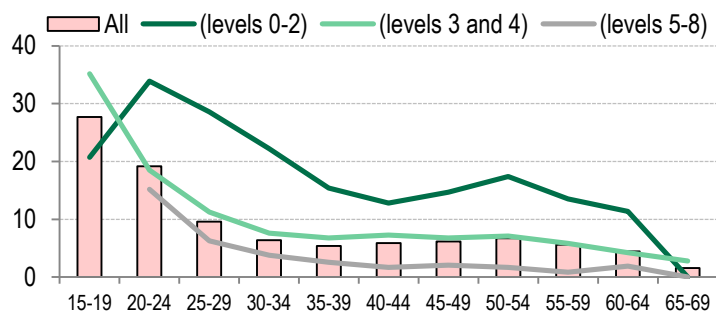
Trends in the labour market ('000)



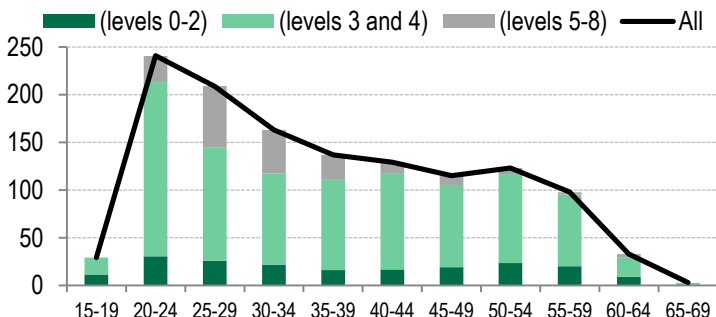
- The looming decline in the number of active people raises the question about sustainability of Poland's growth model based on low labour costs and labour-intensive production. We argue that the scarcity of available workforce may constrict GDP growth in Poland in the coming years, much sooner than many could have suspected.
- If our predictions of the number of active people materialise, **maintaining employment growth at c1% per annum would take unemployment to zero in four to five years.**
- Of course, this is not a forecast, but only a static simulation, showing that there may be serious limitations to Poland's growth model in the coming years. In the real world, unemployment will never drop to zero, but the **tensions in the labour market are likely to build in the coming years, resulting in either a significant wage growth acceleration or a GDP growth slowdown** (or both). We think the former scenario is more likely, at least in the short run, especially given the probable scenario of monetary and fiscal easing in the coming year.
- The tensions may be exacerbated by the fact that a large part of current unemployment seems to be structural – see the next pages for details.

# Structural skills mismatch? (1)

Unemployment rate by age and education level in 2Q15



Number of unemployed by age and education level in 2Q15



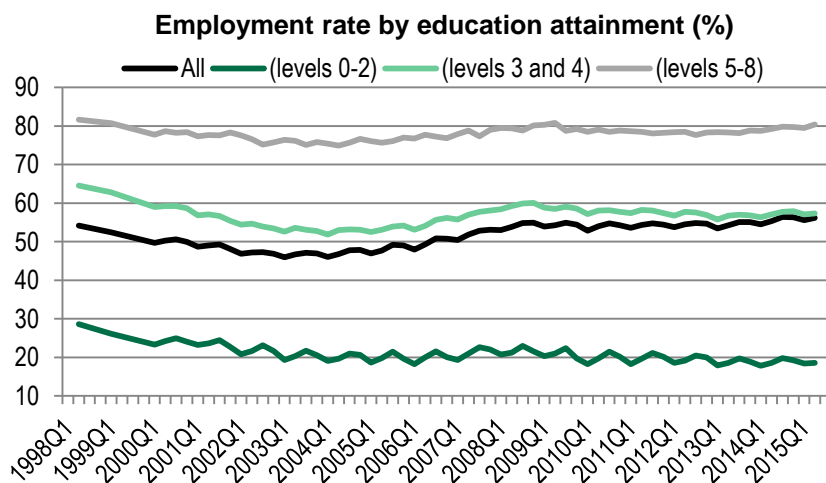
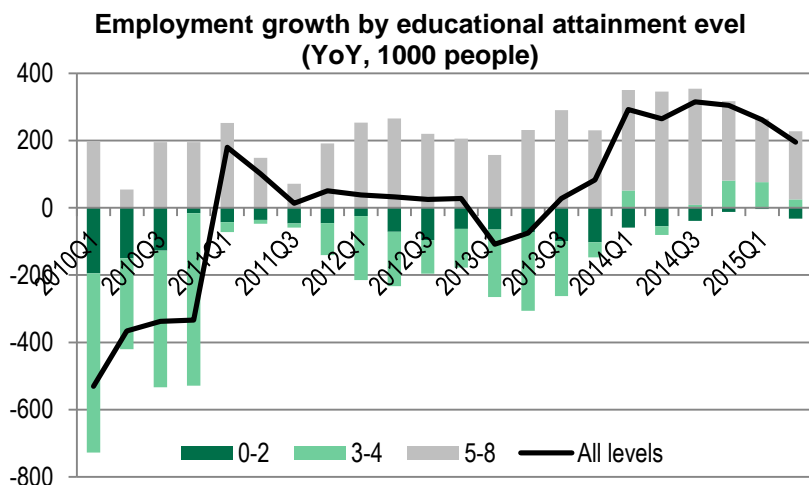
- The tensions in the labour market may be exacerbated by the structural mismatch of skills and competences. The recent ‘Study of Human Capital in Poland’ by the Polish Agency for Enterprise Development (PARP) shows that as much as 80% of firms searching for new employees are having problems with recruitment, mainly due to inadequate competences of the candidates. This is despite the fact that the number of unemployed is still above 1.2 million according to the Labour Force Survey (LFS).
- The LFS data clearly show the ratio of unemployed is the highest among people with a low level of education and/or who are young (inexperienced). Meanwhile, **there is almost no unemployment among people with tertiary education aged 35+.**
- The Study of Human Capital confirms that there is a structural shortage of well qualified white collar and blue collar workers, and at the same time the oversupply of poorly qualified workers with inadequate skills and competences.

Unemployment rate by age and educational attainment in 2Q15 (%)

	15-19	20-24	25-29	30-34	35-39	40-44	45-49	50-54	55-59	60-64	65-69	15-64	Number of unemployed
All levels	27.7	19.2	9.6	6.4	5.4	5.9	6.2	6.7	5.6	4.5	1.6	7.5	1277.3
levels 0-2	20.7	33.9	28.6	22.2	15.4	12.8	14.7	17.4	13.5	11.4	0.0	18.3	194.7
levels 3-4	35.2	18.5	11.3	7.6	6.8	7.3	6.8	7.1	5.8	4.2	2.8	8.4	886.4
levels 5-8	-	15.2	6.3	3.8	2.5	1.7	2.1	1.7	0.8	1.9	0.0	3.6	196.1

Note: ISCED education levels: **levels 0-2**: less than primary, primary and lower secondary education; **levels 3-4**: upper secondary and post-secondary non-tertiary education; **levels 5-8**: tertiary education

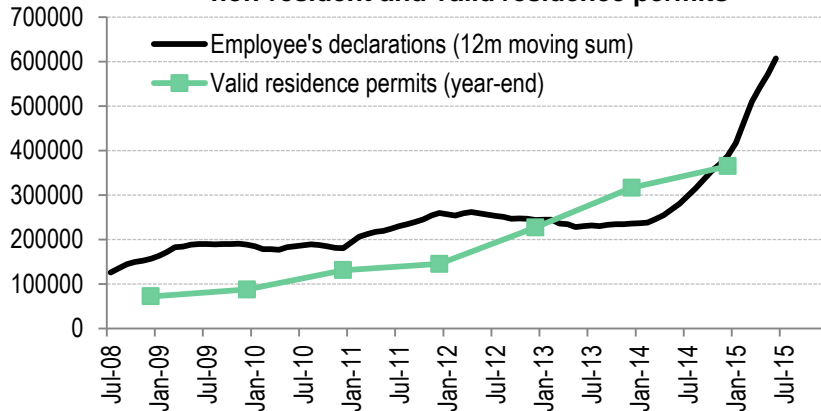
## Structural skills mismatch? (2)



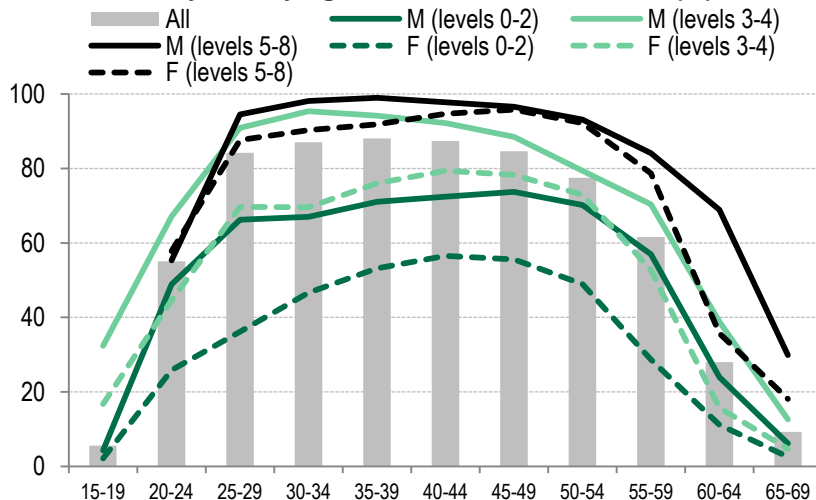
- According to the PARP report, the most sought-after employees on the Polish labour market in the recent years were blue-collar workers, operators and mechanics (40%-47% of demand).
- Meanwhile, the LFS data show that almost all of the employment growth recorded in the last two years (200-300k people per annum) constituted people with tertiary education. Moreover, the data also show that the employment rates for education levels lower than tertiary have been decreasing in recent years despite a rise in total employment rate to its all-time high.
- Another interesting fact, in our opinion, is that despite the unemployment rate nearing its all-time low and demand for jobs rising, the average duration of job search is relatively high (12.2 months in 3Q15 according to the stat office, one of the highest in seven years) – a sign that the skills of the unemployed do not match the needs of recruiters.
- All this suggests, in our view, that tensions in the labour market may grow relatively quickly and could be a significant obstacle to growth. Please bear in mind that according to LFS there were only 197k unemployed people with tertiary education left at the end of 2Q15, which is less than average annual employment growth in this group in the recent years.

# There are still some potential buffers

**Registered employee's declarations about plans to hire non-resident and valid residence permits**



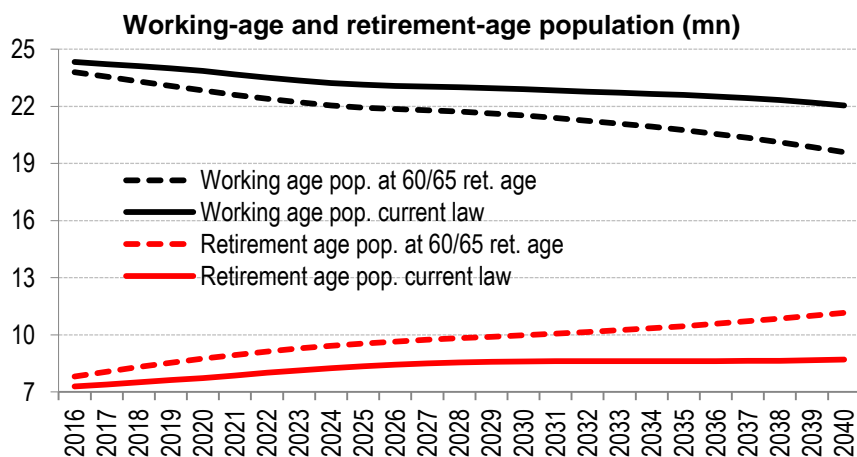
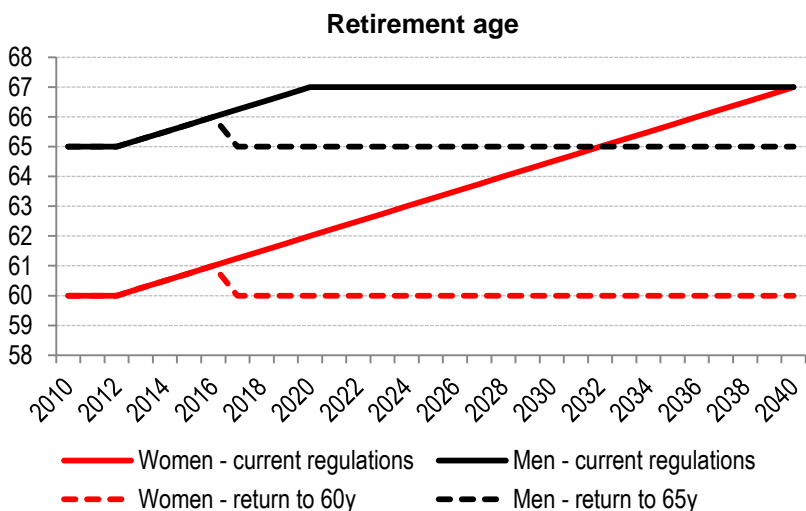
**Activity rate by age, sex and education level (%)**



There are several factors that may alleviate the potential problems with labour force shortage in the coming years:

- Immigrant inflow – Labour Ministry data show that the number of non-residents' recruitments declared by Polish firms surged in mid-2015 to annualised number of 600k (Ukrainians were 98% of the total). It is a short-term relief for the labour market shortages. However, it seems that without any new systemic solution the trend may lose momentum sooner or later, as we are already hearing reports that Polish consulates are running out of capacity to issue residence permits for Ukrainians.
- Large number of Poles working abroad – over 2mn according to the stat office. They might be lured back Poland by (much) higher wages, and possibly higher terrorist threat in Western Europe, but it is risky to assume the trend will reverse soon.
- Large number of people working in agriculture – 1.8mn, i.e. 11.5% of total employment (while agriculture is c.3% of GDP). Large buffer but unlikely to be used in the short run due to skills mismatch.
- Very low activity rate – 67.6% in Poland vs. 72.5% EU average in 2Q15, for people aged 15-64. There is room for improvement, especially in case of women and older people (55+). Unfortunately, a large part of inactive population has lower levels of education, so even if they become more active, the skills mismatch remains the problem.

# Lowering retirement age: a very bad idea



- One of the government's top priorities is lowering the retirement age back to 65 for men and 60 for women. If implemented, it would be a very bad decision for the economy, in our opinion, given the challenges for the labour market outlined above.
- The labour activity rate in Poland in the oldest age groups (55+) is very low as compared to other countries, even though it has been rising quite significantly in recent years. Undoing the reform of the previous government, which has gradually lifted the retirement age to 67 for both men and women would have two negative effects: (1) it would most likely reverse the upward trend in activity; and (2) it would put a strain on public finances, as the ratio of working age population to post-retirement population would deteriorate much faster: in 2014 it would reach 1.75 instead of 2.50 (currently it is at c.3.3).
- One of the possible solutions to make the government's proposal less harmful would be to introduce a minimum working life of, for example, 40 years. Data for 2014 show that among the new retirees as much as c80% of men and 75% of women had worked for 40 years or less.



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