



POLAND: GENERAL ELECTIONS

THE WINNER TAKES IT ALL

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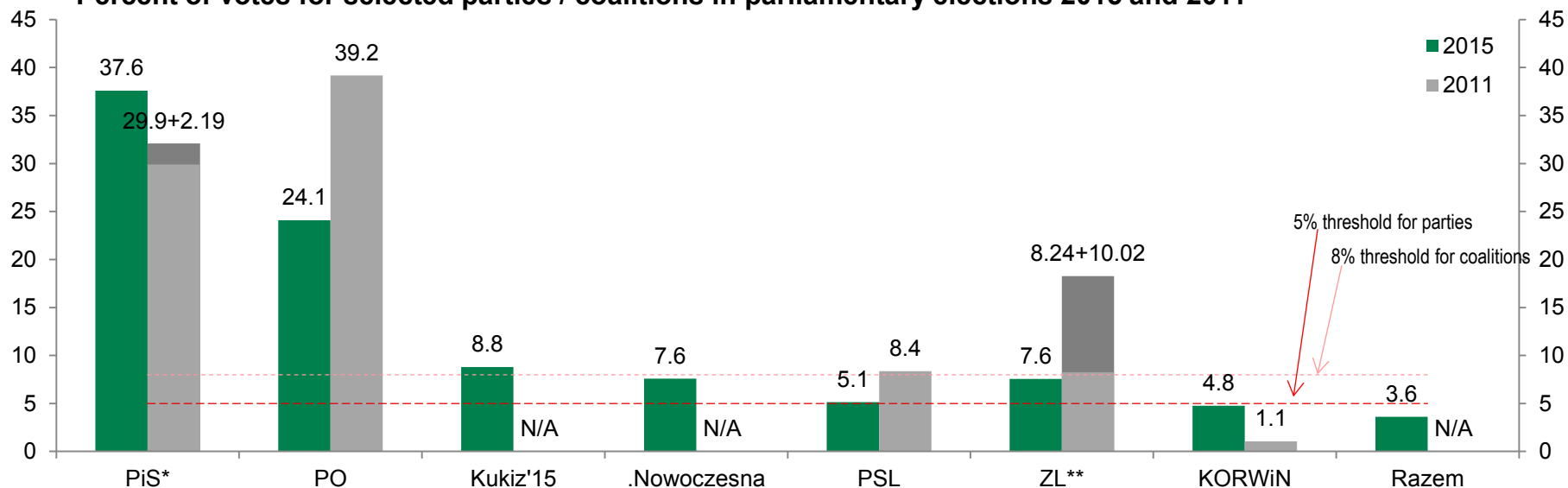
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The winner takes it all...

- The official results of Polish general elections show a clear victory for Law and Justice (PiS). This confirmed the opinion polls, in which the party had been leading for months. PiS won in 33 out of 41 voting precincts and in all age groups. The spread over the ruling Civic Platform (PO) party, which came second, amounted to c13.5pp. The PO's junior coalition partner Peasants' Party (PSL) was just above the 5% threshold for representation in parliament.
- There will be only five parties in the new parliament. The three mentioned above and two completely new movements:: 1. Kukiz'15 (right-wing, anti-establishment) ranked third in the elections; 2. .Nowoczesna (strongly liberal and market oriented) ranked fourth. The left-wing parties alliance (ZL) did not manage to reach the 8% threshold for coalitions in the election. Anti-EU KORWiN was also just below the threshold of 5%.

Percent of votes for selected parties / coalitions in parliamentary elections 2015 and 2011



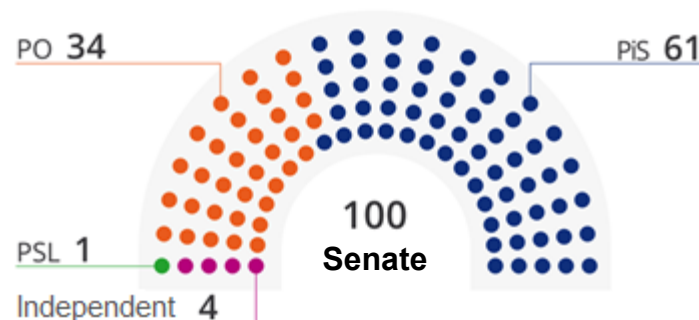
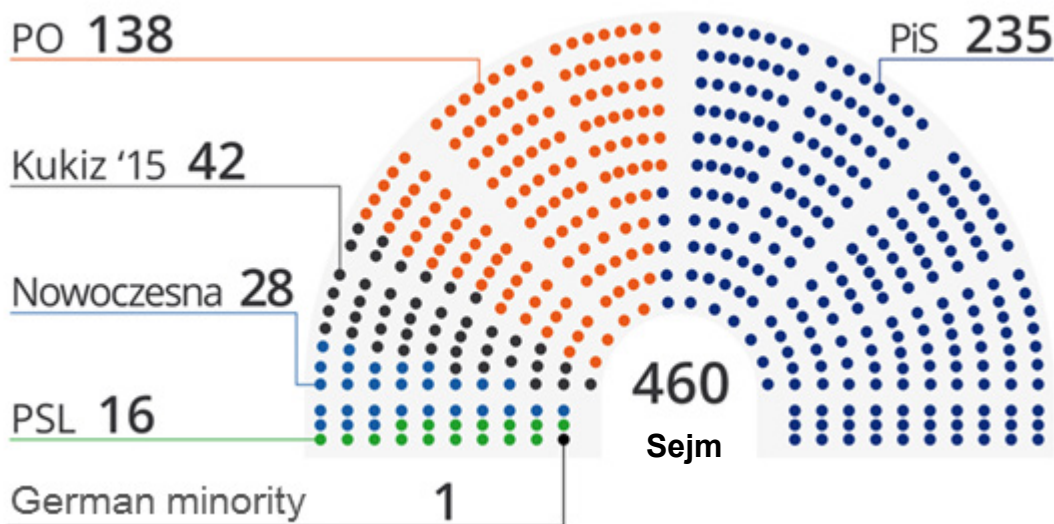
*PiS united with smaller parties, which won about 2% of votes in 2011.

**ZL is a coalition of left-wing parties, biggest are: Ruch Palikota (10% of votes in 2011) and SLD (8% of votes in 2011).

... the loser standing (not so) small

- Given the fact that only five parties managed to enter parliament, PiS' result of below 40% (less than that gained by the PO four years ago) gave it an absolute majority in Sejm (the Lower House). Additionally, PiS won most of the seats in the Senat (Upper House). As a reminder, the recently elected President Andrzej Duda is also from PiS.
- PO will be the biggest opposition party in the new parliament. Still, in practice, the only comfort for the PO is that they (together with .Nowoczesna) have a blocking minority in terms of any changes in the Polish Constitution (2/3 of votes required). Still, it is to be seen what the consequences of defeat will be for the PO: perhaps there could be a change of leader, or the party could split into factions.

Breakdown of seats in parliament after October elections



Beside the victory, what's the cabinet's destiny?

- According to Polish law, the President calls the first session of the new Parliament and then designates the new PM and his cabinet. The deadlines for those steps are outlined on the right. We suspect the steps will be faster as the President clearly supports PiS and will not postpone the process.
- The government will have two weeks to present his programme (exposé) and to win a vote of confidence in the Sejm. The confidence vote must be approved by an absolute majority, i.e. more than 50% of votes, which will be a pure formality given that PiS has 235 out of 460 seats in the lower chamber of the Parliament. Also, it is quite possible that Kukiz'15 will support a PiS government.
- **We expect the new government (with Beata Szydło as new Prime Minister) to be established by the end of November.** PiS would like to form the cabinet as soon as possible, as they would like to propose the amendment to the 2016 budget, which would include some of their pre-election proposals – see the following pages.

Post-election timeline – procedural steps after election determined by the Polish Constitution

Deadline	Procedural step
Oct 25	Election day
↓	+ max 30 days
Nov 24	The first session of Parliament
↓	+ max 14 days
Dec 8	The President appoints the government – 1 st attempt
↓	+ max 14 days
Dec 22	Sejm's vote of confidence (requires absolute majority of votes)
↓ if unsuccessful	+ max 14 days
Jan 05	Sejm appoints the government – 2 nd attempt (requires absolute majority of votes)
↓ if unsuccessful	+ max 14 days
Jan 19	The President appoints the government – 3 rd attempt
↓	+ max 14 days
Feb 02	Sejm's vote of confidence (requires simple majority of votes)
↓ if unsuccessful	
Feb 02	The President calls early elections
↓	+ max 45 days
Mar 18	New elections

PiS Programme: They've played all their cards

- The three main PiS proposals included: higher tax-free income, child benefits and a lower retirement age. The first comments of PiS officials after elections mentioned mainly the latter two. Child benefits are expected to be introduced in 2016, while a bill on a lower retirement age has been prepared in the President's office. Additionally, a bank tax seems to be a PiS priority (to at least partly finance its costly proposals) and may be introduced in 2016.
- **PiS emphasises that the fiscal deficit has to be maintained at 3%.** However, the ruling PO's budget for 2016 already included a higher deficit – general government (GG) deficit of c3% of GDP against 2.3% in the Convergence Programme. Therefore, the room for additional spending is very limited.
- The table below shows the impact of the proposals on public finances, as estimated by PiS. They are expected to be covered by higher tax collection. Interestingly, as compared to calculations presented a few months ago, the amount expected from better tax collection is significantly lower, while better corporate and excise collection appeared on the agenda. No details are known in this regard. The new PM's exposé will be the key to assess PiS' fiscal programme.

PiS' proposals and financing (annual figures, calculation by PiS)

Proposals	Financing
<ul style="list-style-type: none"> ■ hike of tax free income from PLN3091 to PLN8000 – cost PLN7.0bn ■ return to lower retirement age (60Y for women and 65Y for men) –PLN5.5bn (in 1 year) ■ PLN500 allowance for every second and subsequent child and for every child in the poorest families – PLN21.5bn ■ Free drugs for elderly – PLN0.25bn 	<ul style="list-style-type: none"> ■ better VAT tax collection – PLN19bn (<i>note: PLN50bn in previous version</i>) ■ better CIT tax collection – PLN4.5bn ■ better excise duty collection – PLN8bn ■ introduction of bank tax (most likely 0.39% of assets) – cPLN5bn ■ introduction of large shops tax – cPLN3.5bn
TOTAL PLN34.25bn	TOTAL PLN40bn

PiS Investment Plan: It's simple and it's plain

Additionally to the fiscal proposals, a few days before elections, PiS presented its investment programme (see table below). It was unclear whether the plan includes only new investments, but the fact that EU funds are included does not suggest so. Therefore, the total amount of PLN1.4 trillion in the next six years is not impressive at all, as in the previous six years total fixed investments amounted to PLN1.9 trillion (despite a major economic slowdown and a financial crisis in Europe). Please see below our comments on the proposals: whether they are needed and/or likely to be introduced.

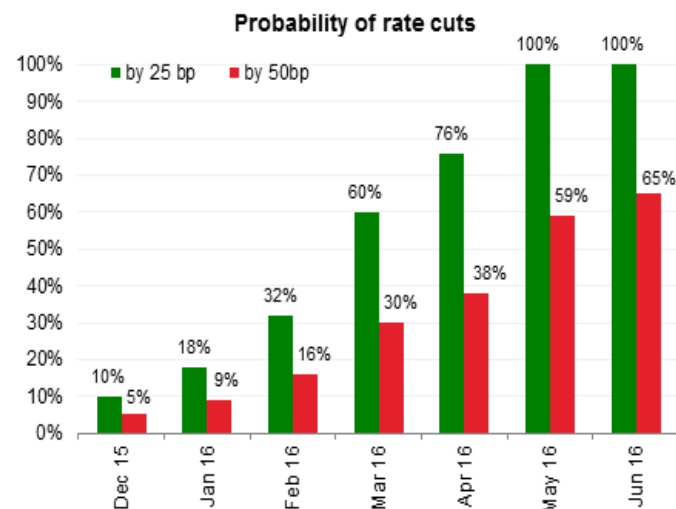
PiS Investments Plan – <u>PLN1.4trn</u> in total	BZWBK's comment
<p>Money from the cohesion fund <u>PLN500bn</u> EUR83bn from EU + own share EUR120bn</p> <p>Money from CAP for development <u>PLN50bn</u> Programme of rural areas development 2014-2020 EUR13.3bn</p>	<p>Nothing new, the money will flow into Poland anyway</p>
<p>Central Bank Programme <u>PLN350bn</u> ECB launched 3-year programme equal 10% of euro zone GDP under which the central bank lends banks money without interest. Analogy: NBP will launch 6-year programme worth 20% of GDP = PLN350bn</p>	<p>A very controversial idea. It is not needed, as there is no problem with credit supply, over-liquidity in the banking sector is cPLN90bn (not to mention a different economic situation in Poland and the Euro zone)</p>
<p>Increasing guarantee capacity of BGK by c. <u>PLN100bn</u></p>	<p>Similar to the current "<i>de minimis</i>" guarantee programme (for SME, PLN23bn in 2.5 years), but much higher scale (not likely to materialise).</p>
<p>Rebuilding of PIR SA (Polish Investments for Development fund) <u>PLN40bn</u> Increasing investment capacity by c.PLN40bn (structural investments, roads, environment, energy, etc.)</p>	<p>PIR was one of flagship projects of the previous government, expected to invest PLN40bn in three years, while only PLN23bn was spent up to May 2015. Without details it is hard to assess the possible effects of continuing the programme.</p>
<p>Closed Investment Fund (from part of profits of state-owned companies) <u>PLN160bn</u> (2012 profit reached PLN25bn, c1/3 of the profit could be used, i.e. PLN8bn x 5 years = PLN40bn). Capital leveraged with loans and guarantees, will give resources of PLN160bn</p>	<p>Not clear if the state-owned companies will be forced to raise fixed investments or to engage in M&A (e.g. in order to re-nationalize some sectors).</p>
<p>Long-term corporate deposits <u>PLN200bn</u> Creation of incentives to invest by 100% amortisation</p>	<p>Adding private deposits to public investment programme is rather dubious. (companies will not spend all their deposits on investment).</p>

New MPC: The (easing) game is on again?

- The term for 8 out of the 10 members of the Monetary Policy Council ends in January and February 2016.
- According to the NBP Act, the appointment of new members of the Council should take place no later than the expiry of the previous term of office. Therefore, the Council will have 5 new members before its January 13-14 meeting. Together with current members designated by PiS (who have recently become more dovish despite having voted against cuts 17 times in a row), this will give a majority. Therefore, if markets are to believe that monetary easing is to take place ONLY because of the MPC changes, we would ask why the cut in January is not priced-in (see chart below). Theoretically, a cut is more probable in February as the MPC will see new projection (assuming it is important for new members).
- We still believe that, given balance of risks for GDP and CPI, the rate cut is not needed. However, the clear message from PiS officials about preferences as regards new members and a clear PiS victory in the elections lead us to change our forecast for the reference rate to 1% in 2016 (ie a cut of 50bp in 1Q16). Rates will probably stay low for longer.

MPC member:	Designated by (recommended by):	Term of office (six years) expires:
Andrzej Bratkowski	Sejm (PO)	7 Jan 2016
Elżbieta Chojna Duch	Sejm (PSL)	7 Jan 2016
Jerzy Haunser	Senat (PO)	12 Jan 2016
Andrzej Rzońca	Senat (PO)	12 Jan 2016
Jan Winiński	Senat (PO)	12 Jan 2016
Anna Zielińska-Głębocka	Sejm (PO)	8 Feb 2016
Adam Głapiński	President (PiS)	15 Feb 2016
Andrzej Kaźmierczak	President (PiS)	15 Feb 2016
Marek Belka, the NBP Governor	President / Sejm (PO)	10 Jun 2016
Jerzy Osiatyński	President (PO)	19 Dec 2019

The Governor of the Polish Financial Supervision Authority (KNF), appointed by the Prime Minister	Term of office (five years) expires:
Andrzej Jakubiak	11 October 2016



NBP Act: Playing by the rules

- According to the NBP Act, the MPC is responsible for setting: interest rates, the minimum reserve requirement ratio and the principles for open market operations. It also approves the NBP financial plan and the report on the activity of NBP and accepts the annual financial statements of NBP. However, the NBP Management Board supervises exchange rate policy. Therefore, an almost complete change in the MPC's composition does not imply any changes to FX policy. Although Governor Marek Belka and Deputy Governor Andrzej Raczko end their term of office next year, the majority of the board will be unchanged.
- Theoretically, it is possible that the new parliament will change the NBP Act, including for example a dual mandate (inflation + growth/unemployment), as was mentioned by some PiS officials in the past. We think any changes that raise questions about a stable institutional framework and the central bank's independence in Poland would trigger a negative reaction in the markets (and from the ECB). We do not expect a discussion on this subject to start in the nearest months.
- Overall, we think that a possibility of a kind of QE/LTRO should be included in the set of instruments in the hands of the central bank (the MPC), to be used in the case of a severe slowdown / recession or if zero rates proved ineffective. Of course, such an instrument would have to be used to reach a primary objective of price stability rather than to influence economic indicators.

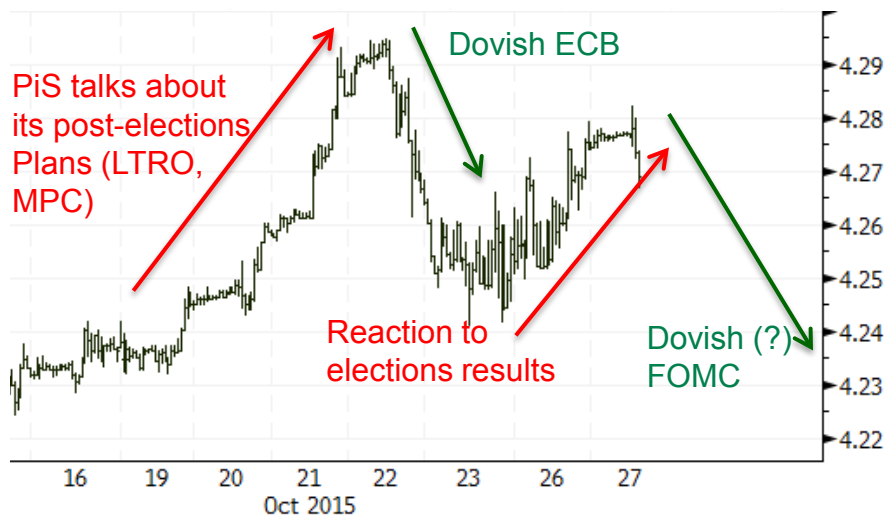
NBP Board Member:	Term of office (six years) expires:
Eugeniusz Gatnar	24 Mar 2016
Marek Belka, the NBP Governor	10 Jun 2016
Andrzej Raczko	6 Sep 2016
Jacek Bartkiewicz	1 Apr 2019
Katarzyna Zajdel Kurowska	1 Apr 2019
Paweł Samecki	16 Feb 2020
Piotr Wiesiołek	6 Mar 2020
Anna Trzecińska	2 Nov 2020
Ryszard Kokoszczyński	3 Aug 2021

Source: NBP, BZ WBK

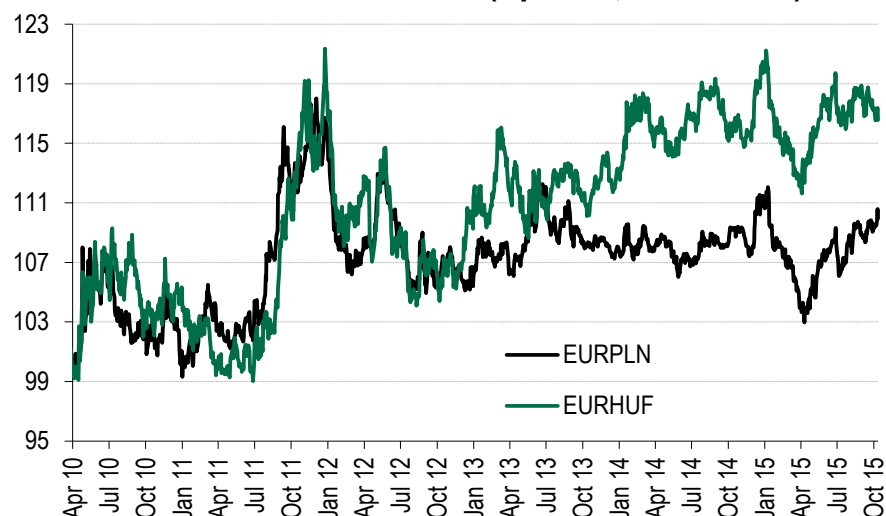
Seeing (markets) so tense

- Markets did not react significantly to the election outcome. Analysis of market reaction to the 2005/2006 parliamentary election (presented in our [2015 Outlook](#)), when the Law and Justice party won and formed a coalition with populist parties, does not prove that politics had a decisive impact on the zloty at that time.
- The situation was quite similar in the Hungarian case. In 2010, in the first months after Fidesz won a majority in parliament, EUR/PLN and EUR/HUF moved quite closely in line. The forint started to underperform only in 2014, when the Hungarian government started to deal with FX mortgage loan conversions and the NBH was cutting rates.
- We would expect a limited effect of Poland's elections on the zloty in the short-term with global market sentiment possibly sending EUR/PLN lower (after its recent highs). However, we see a risk that the currency could underperform its peers in 2016 if there is a major shift in economic policy. The main risk is the issue of CHF mortgages (with PiS promising to deal with them at the banks' cost). We expect details in a few months' time.

EUR/PLN just before and just after elections



EUR/PLN and EUR/HUF (April 12, 2010 = 100)



Source: Bloomberg, Reuters, BZ WBK

Summary: A big thing or a small?

- After a long period of Polish politics being stable and fairly boring, from an investment point of view, we are now facing a major change. After winning the presidential election in May, the opposition party PiS have now taken a majority in the Sejm and the Senate. This raises a lot of questions about macroeconomic policy in the next few years.
- In terms of fiscal policy, we think that in the medium-term keeping the deficit at c.3% of GDP will be more important for the new government than quickly fulfilling all its costly pre-election promises. It does not mean there is no risk of a higher deficit in 2016. As the previous government used the so-called spending rule in full, any additional spending proposed in the budget amendment (e.g. benefits for children) will be accompanied by assuming better tax collection. If the latter does not materialise, a higher deficit would probably be temporary. We do not see fiscal consolidation and the GG deficit reaching the medium-term objective of previous government (1% of GDP), but we do not think this will have major market consequences, as long as the spending rule and Constitution's debt limit are binding.
- The significant political change has implications also for monetary policy. In 2016 PiS will appoint eight new members of the MPC, the governor and deputy governor of the NBP, as well as the head of KNF (the Polish Financial Supervision Authority). The most likely outcome is additional monetary easing (not really necessary, in our view), probably to be delivered in 1Q16 (50bp).
- We do not see any changes in FX policy by the NBP. The main risk for the zloty is connected with the FX loans conversion issue, as the new government and the president promised to resolve it. As we do not think this will be one of priorities for the cabinet in the first few months, we think that global factors will dominate and should support the zloty. For 2016, we see a risk of a higher EUR/PLN.
- In terms of the yield curve, as we said in previous reports, macroeconomic prospects accompanied by looser macroeconomic policy than in the previous scenario (both monetary and fiscal) and higher FX risk speaks in favour of a steeper yield curve in 2016. In the short-term, however, we see lower yields across the curve.
- The new prime minister's exposé should be expected within a month. We will publish a more detailed update on macroeconomic policy after elections in our Outlook for 2016, to be released at the start of December.

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