October 18, 2018

# Polish Weekly Review

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## Comment on the upcoming data and forecasts

This Friday, Statistics Poland will release retail sales data for September. We expect it do decelerate from 9.0 to 7.4% y/y (below market consensus of 8.3% – in nominal terms), in part due to very warm weather which delayed Autumn sales of clothing and footwear. Next week will begin with the release of business sentiment indicators from Statistics Poland – the earliest measure of business tendencies published in October. On the same day the NBP will publish money supply data along with detailed credit and deposit data. We expect a slight deceleration in M3. On Tuesday the monthly Statistical Bulletin will be released, along with final unemployment rate data. Our original forecast and market consensus are both below the Ministry of Family's preliminary estimate of September unemployment rate (5.7 vs. 5.8%). MPC Minutes (due next Thursday) will not impact the markets.

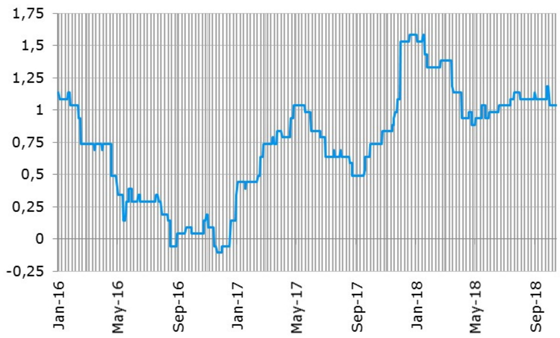
### Polish data to watch: October 19th to October 26th

| Publication | Date | Period | mBank | Consensus | Prior |
|---|---|---|---|---|---|
| Retail sales y/y (%) | 19.10 | Sep | 7.4 | 8.3 | 9.0 |
| Business sentiment indices | 22.10 | Oct | | | |
| M3 y/y (%) | 22.10 | Sep | 7.2 | 7.5 | 7.5 |
| Unemployment rate (%) | 23.10 | Sep | 5.7 | 5.7 | 5.8 |
| MPC Minutes | 25.10 | Oct | | | |

### Treasury bonds and bills auctions

| Paper | Next auction | Last Offer | Yield on the prev auction (%) | Prev auction |
|---|---|---|---|---|
| (29–37/52) Week T-bills | - | 700 | 1.500 | 2/22/2017 |
| 2Y T-bond OK0720 | 10/26/2018 | 1000 | 1.517 | 10/4/2018 |
| 5Y T-bond PS0424 | 10/26/2018 | 1500 | 2.732 | 10/4/2018 |
| 10Y T-bond WS0428 | 10/26/2018 | 1200 | 3.303 | 10/4/2018 |
| 30Y T-bond WS0447 | 10/26/2018 | 20 | 3.643 | 10/4/2010 |

## Reality vs analysts' expectations (surprise index* for Poland)




**Comment**
Unchanged – CPI was revised upward, lifting the Polish surprise index upward, but industrial output surprised to the downside, bringing it back down. There are two potential index movers in the coming days: retail sales and unemployment data.

* Surprise index presents in a synthetic way how the market was surprised by macroeconomic releases (it is constructed on daily basis as weighted average of differences between selected releases and Bloomberg forecast consensus).

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## Our view in a nutshell

### Fundamentals

- Q2 2018 marked the top of the business cycle. 2018 GDP will fall marginally short of 5% and gently decelerate furhter in 2019. Poland is entering the upcoming election cycle (local elections in 2018, parliamentary elections in 2019 and presidential elections in 2020) with very tight labor market, rather benign external environment and stimulation on all fronts. Those exogenous factors speak in favor of a smooth transition towards less spectacular GDP growth.
- Recent increases in oil, gas, coal and electricity prices (the latter only in wholesale markets and for corporate & SME clients) are raising the inflation outlook. In particular, base effects in the coming months will not be as strong as previously forecast, inflation will hit the target in early 2018 and there is considerable uncertainty regarding second-round effects of sharply higher electricity prices on consumer goods and services prices. Wages are no longer accelerating, but the wide gap between them and prices should still close if history is a guide.
- MPC stays calm and sees stable rates as having an intrinsic value. In our view, as long as inflation stays within the target band, the MPC will keep its rhetoric in place. Weaker PLN has likely no impact on the MPC's discussions, since pass-through effect are seen as negligible. Our current forecast reflects this reality – no change in interest rates until Q4 2019.
- Fiscal situation continues to be very comfortable. We judge that the increase in VAT revenues is 70% consumption growth and 30% crackdown on tax avoidance. The latter has not ended and the prospects for increases in tax collectibility are very good.

### Financial markets

- Political issues moved into the background and the markets are clearly unconcerned with local risks. The impact of PLN-specific factors (other than loose monetary policy) on the currency has been relatively small.
- Risk off mood impacted the PLN negatively and better sentiment may only bring a transient relief rally. With the MPC dead-set on keeping rates low, the only path to stronger PLN runs through lower interest rate / easier monetary policy expectations globally. Therefore, the floor on EURPLN is quite high by historical standards.
- As a result, in the coming months PLN is set to depreciate further. In addition, weaker PLN will act as a pressure valve on exporters' margins squeezed by rapidly rising labor and commodity costs.

### mBank forecasts

| | 2014 | 2015 | 2016 | 2017 | 2018 F | 2019 F |
|---|---|---|---|---|---|---|
| GDP y/y (%) | 3.3 | 3.8 | 3.0 | 4.8 | 5.0 | 4.1 |
| CPI Inflation y/y (average %) | -0.1 | -0.9 | -0.6 | 2.0 | 1.7 | 2.4 |
| Current account (%GDP) | -2.1 | -0.6 | -0.3 | 0.2 | -0.4 | -0.8 |
| Unemployment rate (end of period %) | 11.4 | 9.8 | 8.2 | 6.6 | 5.6 | 5.0 |
| Repo rate (end of period %) | 2.00 | 1.50 | 1.50 | 1.50 | 1.50 | 1.75 |

| | 2018 Q1 | 2018 Q2 | 2018 Q3 F | 2018 Q4 F | 2019 Q1 F | 2019 Q2 F | 2019 Q3 F | 2019 Q4 F |
|---|---|---|---|---|---|---|---|---|
| GDP y/y (%) | 5.2 | 5.1 | 4.8 | 4.7 | 4.4 | 4.2 | 4.0 | 3.7 |
| Individual consumption y/y (%) | 4.8 | 4.9 | 4.8 | 4.2 | 4.0 | 3.8 | 3.8 | 3.8 |
| Public Consumption y/y (%) | 3.6 | 4.4 | 4.0 | 4.0 | 2.0 | 2.0 | 2.0 | 2.0 |
| Investment y/y (%) | 8.1 | 4.5 | 6.5 | 7.0 | 7.0 | 6.0 | 5.0 | 4.0 |
| Inflation rate (% average) | 1.5 | 1.7 | 1.9 | 1.8 | 2.2 | 2.5 | 2.4 | 2.4 |
| Unemployment rate (% eop) | 6.6 | 5.9 | 5.7 | 5.6 | 5.5 | 5.0 | 4.9 | 5.0 |
| NBP repo rate (% eop) | 1.50 | 1.50 | 1.50 | 1.50 | 1.50 | 1.50 | 1.50 | 1.75 |
| Wibor 3M (% eop) | 1.70 | 1.70 | 1.72 | 1.70 | 1.70 | 1.71 | 1.72 | 1.98 |
| 2Y Polish bond yields (% eop) | 1.49 | 1.63 | 1.56 | 1.60 | 1.65 | 1.85 | 2.00 | 2.20 |
| 10Y Polish bond yields (% eop) | 3.18 | 3.22 | 3.24 | 3.40 | 3.50 | 3.59 | 3.71 | 3.88 |
| EUR/PLN (eop) | 4.21 | 4.37 | 4.28 | 4.40 | 4.35 | 4.30 | 4.25 | 4.20 |
| USD/PLN (eop) | 3.42 | 3.74 | 3.69 | 3.83 | 3.75 | 3.68 | 3.60 | 3.51 |

F - forecast

# Economics

## A surprise upgrade from the S&P

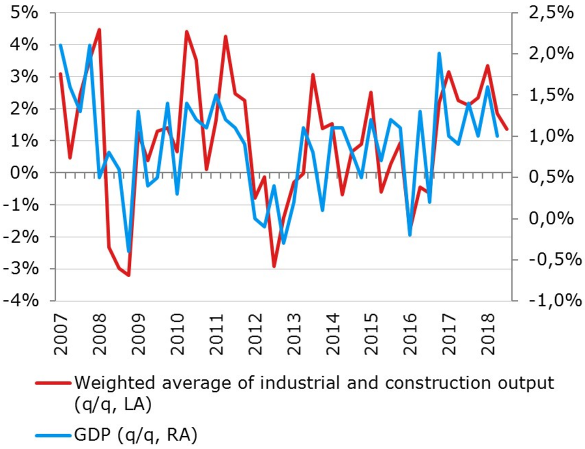
Last Friday, two agencies, Fitch and S&P, rated Polish sovereign debt. The first one did not change the rating (still A- in foreign currency), the second raised credit rating to A- (from BBB+) and the rating's outlook is now stable.

Fitch's decision is not a surprise. The agency rates economies by comparing to groups of countries of the same rating. This method leads to stable outcomes as the comparative metrics among groups of countries change very slowly. But the upgrade of the S&P rating is quite a surprise. We stressed that, with every review of rating from this agency, one should entertain the possibility of rating upgrade. Positive outlook (raised in April) and negative difference compared to the other agencies were the two obvious reasons for it. We thought, though, that it was too early for changing the rating.

Obviously, the details of the agency's report are positive. It stressed the strong growth of Polish economy, openness (relative to its size), and the downward trajectory of debt ratios. At the same time, the agency thinks that, absent external shocks, GDP growth will not be lower than 3%, but will be accompanied with higher current account deficit. Institutional risks, changes in the pension system and in financing future pensions (Employee Capital Plans – PPK), were pushed out as long-term factors, therefore not interesting for the agency (the effective period of the rating is no longer than 2 years). Upgrade of the rating is possible if: (1) wage growth remains fast, but without creating external imbalances, (2) PPK will increase domestic savings, which will reduce government's contingent liabilities (pensions); (3) public debt will decrease nominally. Analogously, negative factors are: deterioration of fiscal performance indices or the wage growth leading to the increase of net external borrowing. All the conditions above, together with the current rating outlook indicate that without strong external shocks, Polish rating will not be changed neither this nor the next year.

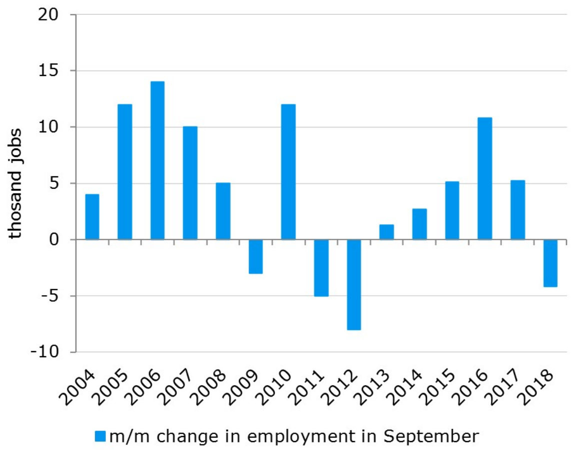
## We are revising Q3 GDP forecast downward after weak industry and construction data

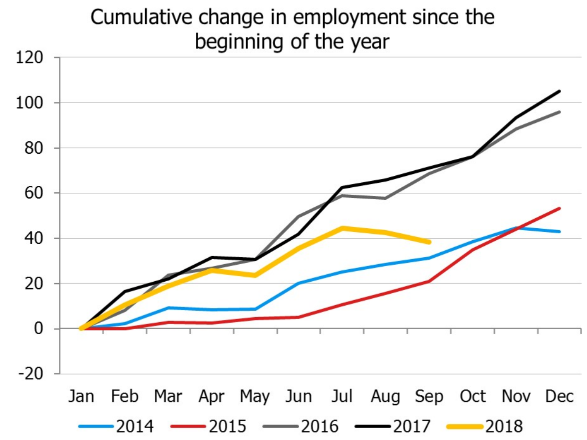
September data on economic activity came out on the weak side (we are still waiting for retail sales and foreign trade data, though). Manufacturing output growth dropped to a mere 2% y/y, while construction output is slowing down on annual basis and losing momentum in the middle of what would normally be a public investment spree. This has been the worst quarter for industry and construction since Q3'16 (see the graph below). In addition, services growth peaked before the overall economy, in 2016. As a result, our Q3 GDP nowcast dropped a bit, from 4.8 to 4.6% y/y. It is still a strong number, but the direction of surprises, growth rates and forecast revisions will be downward from now on. This clearly is a development expected by most economy watchers and by NBP and government officials. What is genuinely surprising for us is the state of the labor market. Whether caused by weaker labor demand, or by binding supply constraints, it's losing momentum at a fast clip, with the first two-month summer decline in employment since the dreadful 2012.




As usual, the detailed comments on this week's data can be found below.

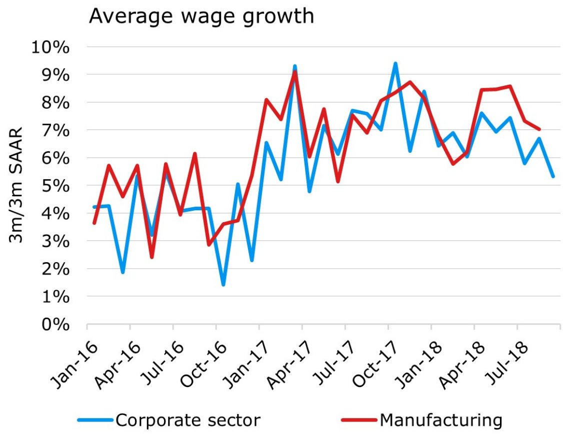
**Employment** in the enterprise sector slowed down to 3.2% y/y in September. The growth was slower than overall market expectations, including our forecast of 3.4%. In nominal terms, September recorded second consecutive drop in employment that now cumulates to 6k. Given the slow-changing momentum in historical series of employment growth, it is unlikely that we will see any meaningful acceleration ahead. The question is, what will be the pace of the deceleration.





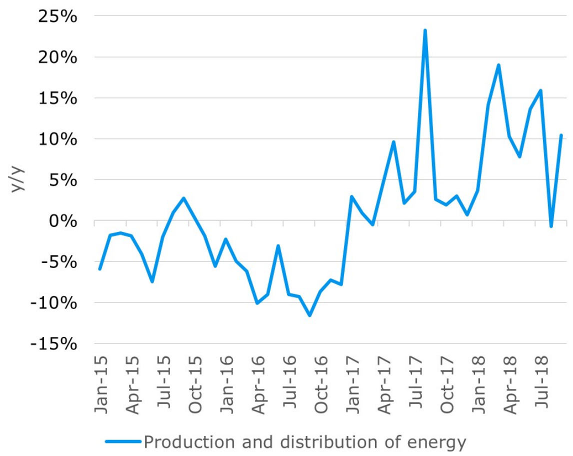

We have stressed the importance supply constraints on the labor market for several months. We argued that at the supply barrier the usual pace of filling vacancies slows down, putting downside pressure on the growth rate of overall employment. It was a tempting explanation as economy showed signs of healthy growth and number of vacancies was growing. At this juncture, the incoming evidence is more and more mixed. October employment reading may be decisive as it is usually strong month for employment. Another disappointment that month would clearly speak in favor of vividly slowing economy, with consequences for weaker domestic demand in 2019.

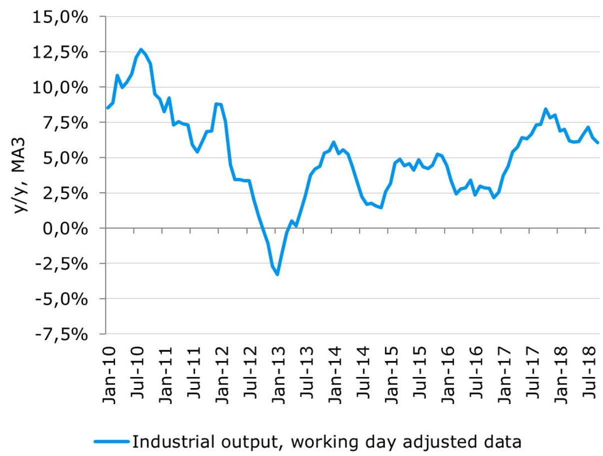
**Average gross wage** rose by 6.7% y/y in September, below market expectations (7.1% y/y), but close to our forecast of 6.6% y/y. Our predictions were based on the assumption that unfavorable calendar effects would push working-day-sensitive manufacturing and construction wages and that growth in services would not compensate this. Taking a broader look, one should note that wages have not accelerated for many months now and that the overall momentum is waning. As of September, it was consistent with trend growth of 5-6% y/y, not 7-8% y/y as it was the case early this year.




Curiously, the behavior of wages is consistent with signs of lower wage pressure seen in NBP's enterprise surveys and with stable inflation and household inflation expectations. In these circumstances one has to reevaluate the factors that influence wage growth in the near term. First, the labor supply-demand imbalance might have declined as labor demand decelerated in the wake of weaker external environment. Second, productivity growth has not kept up with wage growth for many quarters now, especially if one adjusts it for the impact of immigration. Third, perhaps private companies have reached the limit of their capacity to raise wages in an increasingly unfavorable environment (lower external demand, troubles with public investment, sharp increase in energy costs in the pipeline). Finally, overall wage growth continues to be anchored by low public sector wage growth which serves as an anchor and prevents competitive wage hikes in many regions.

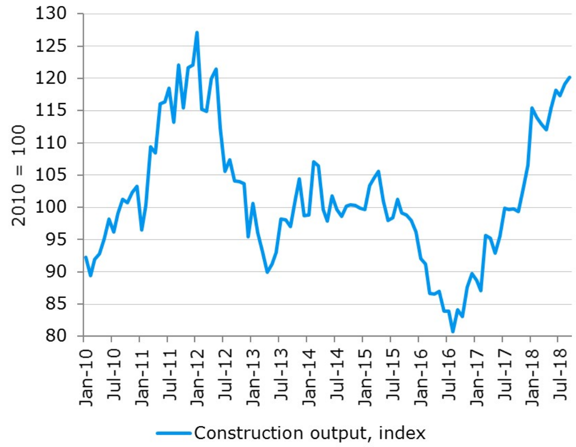
Industrial production grew in September by 2.8%, which was lower than both the consensus and our forecast (about 4%). The slowdown, compared to the August reading, is mostly due to the unfavorable arrangement of working days (down from 0 to -1 y/y), which was not a surprise. However, in details the industrial production is weaker than the overall dynamics would imply (which was higher because of the jump on the energy production (from -0.7 to 10.4% y/y) resulted from the base effect from the previous year). The manufacturing itself is close to stagnation, growing only by 2% y/y, which was below our expectations. Moreover, we can see the weak momentum – dynamic of the production, adjusted for the seasonal and calendar effects, resulted in -0.7% m/m and 5.4% y/y. The downward trend of the industrial production dynamics continues.




Industrial production is still negatively affected by the foreign demand, the downturn of both the euro zone and the global economy. In next months we expect at least one episode of acceleration (due to the positive difference of working days in October), but high statistical base from the end of last year will have its negative impact. By the end of the year, the trend in industrial production should slow down to 3% y/y.

Construction output slowed down to 16.4% y/y, mostly due to the effect of working days and modest high statistical base. This result is lower than both the consensus (18.0%) and our forecast (17.2%). Monthly growth, adjusted for the seasonal effects, was a meagre 0.9%. The largest yearly growth was recorded in infrastructure-related construction activity which can be attributed to investments finished before the local elections. Monthly, the biggest growth was recorded in housing construction. Weaker reading, can be considered also as a result of supply barriers (mostly seen in a lack of workers, or problems with finishing public investments auctions, due to the unrealistic tender pricing), which may also affect future readings.

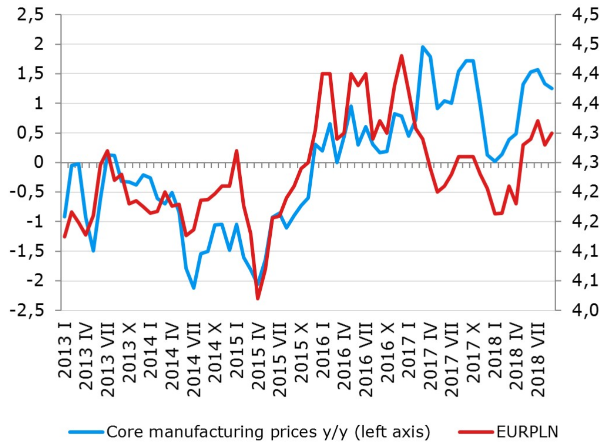



## Inflation stable, inflation expectations anchored at a low level

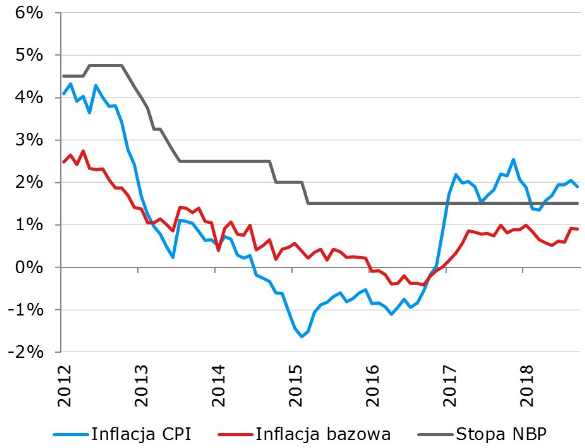
This week we got a batch of nominal sphere data. Inflation pressure eased across the board. Consumer inflation fell to 1.85% (from 2.05% in August), producer inflation to 2.9% (from 3.0% in August). Core measures, both on consumer and producer side, stabilized (and eased in y/y comparison taking account the figures without rounding). We also took a look at consumer inflation expectations. We found them anchored, but below current CPI inflation (regardless of parameters, they are at the lower band of inflation target). It is a result worth bearing in mind in the context of symmetric NBP inflation goal and the issue of energy prices. This way NBP may treat even an unexpected explosion of CPI above 2.5% differently than in the past. With rather low CPI expectations it is going to be hardly detrimental to the conduct of the monetary policy thereafter and as such may be well treated as temporary. We still argue that it is core inflation along with the growth prospects for 2020 and 2021 that is going to be decisive for rates outlook in Poland. We still see a rate hike in late 2019.

You can find a more detailed take on the nominal sphere below.

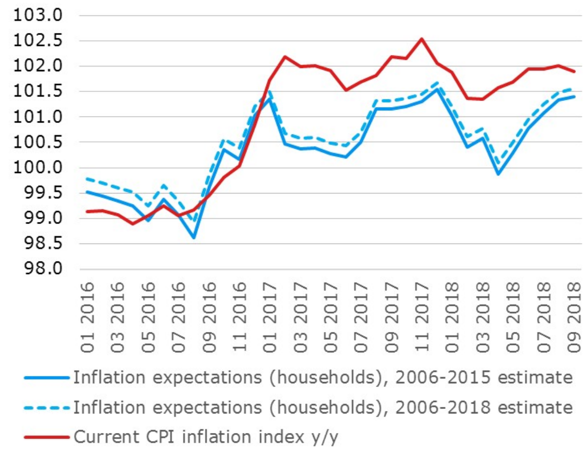
**Producer prices** decelerated a bit in September to 2.9%. We still see no new momentum in core manufacturing prices (still 1.3% y/y). Energy prices are slowly drifting upwards, but the drift is very gentle (with this pace 6% annual growth is achievable within a year). However, it is not the direct effect that matters but the transmission to core manufacturing prices. Historical evidence do not support a meaningful pass-through, but we continue to monitor it closely. Next month is going to bring a slight uptick in PPI growth on the back of higher oil prices. Mid-term view boils down to the core manufacturing. Unless it accelerates, producer price outlook stays benign.




**CPI inflation** was revised upwards vs the flash reading. It finally stood at 1.9% in September. The breakdown reveals lots of noise. Among the non-core categories, there were no major surprises: food +0.6% m/m, fuels +0.5% m/m, energy +0.3% m/m. Core categories proved to be highly volatile. It suffices to write that 8 (out of 13) major core items recorded a change higher than ±0.4% m/m, many of them exceeded ±1% m/m. Some jumps are evidently seasonal (education, package holidays) or of one-off nature (telecommunications). Looking through the monthly variation the upward trend in y/y growth rates can be visible in alcoholic beverages, wearing apparel, recreation and culture and restaurant and hotels. Despite lots of noise, core inflation stayed at August's level of 0.9% y/y. All in all the data is too noisy to reject our scenario of steadily accelerating core inflation. We await for acceleration above 2% in 2019.




Consumer **inflation expectations** stayed in September at the lower band of NBP's inflation target. We decided to transform inflation expectations in a numerical format, as published by GUS within consumer confidence analysis, to the number corresponding to current CPI reading and as such comparable to current inflation. Polish inflation expectations used to be adaptive and track current CPI reading. We run simple regression and estimate the parameters for transformation using different time spans (2008-2015 and 2008-2018). We tried to look for the difference in parameters in both samples to check whether a change of the MPC affected them meaningfully. It did not. However, the whole sample estimation gives slightly higher in-sample inflation expectations (see the graph). We think, though, that there is a simple and meaningful explanation: longer sample encloses two more years of positive inflation bringing parameters upwards. We plan to track such constructed inflation expectations on a monthly basis.



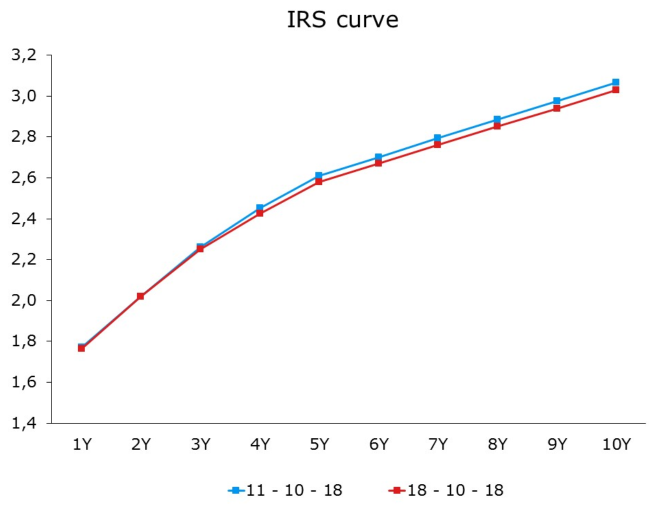
## Fixed income

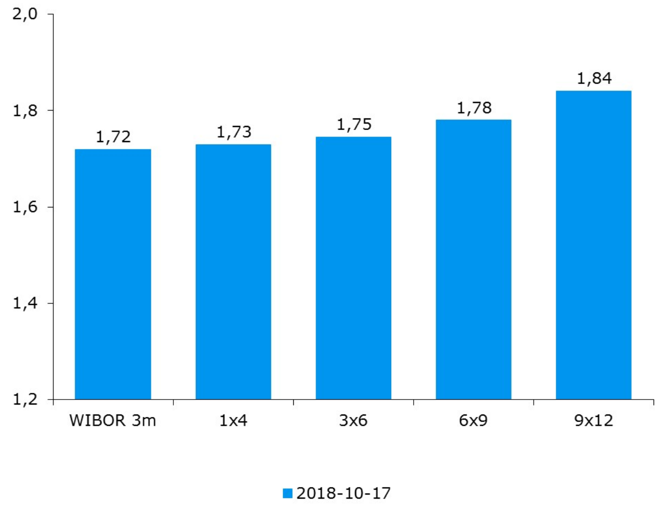
### ASWs and FRNs diverged

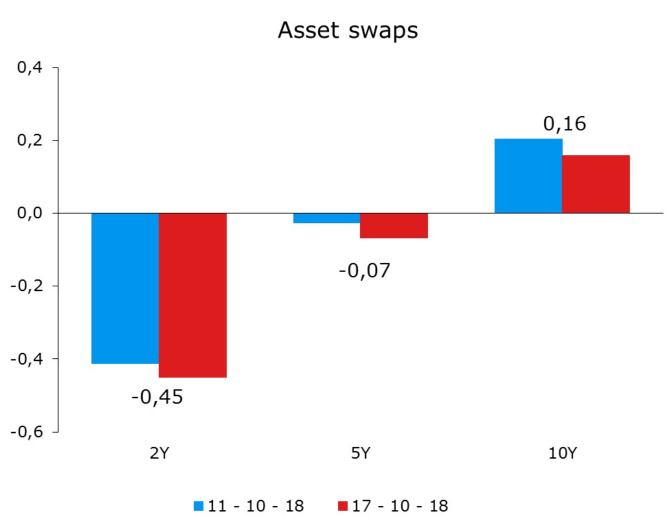
The swap market attracted more foreign investors with paying interest, while local players on the bond market were drawn by expected low supply in the upcoming auctions. As a result, ASW spreads narrowed significantly. FRN didn't rise concurrently, though.

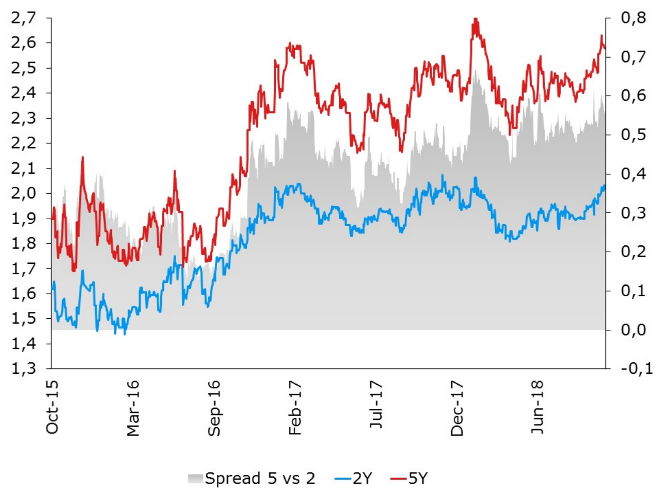
DS1023/5y is -10 bps, WS0428/10y is 17 bps. DS1023/WS0428 is 70 bps. WS0428/Bund is 273 bps.

DS1020 is trading at 1.55% (4 bps down), DS1023 is trading at 2.5% (8 bps down) and WS0428 is trading at 3.19% (8 bps down).



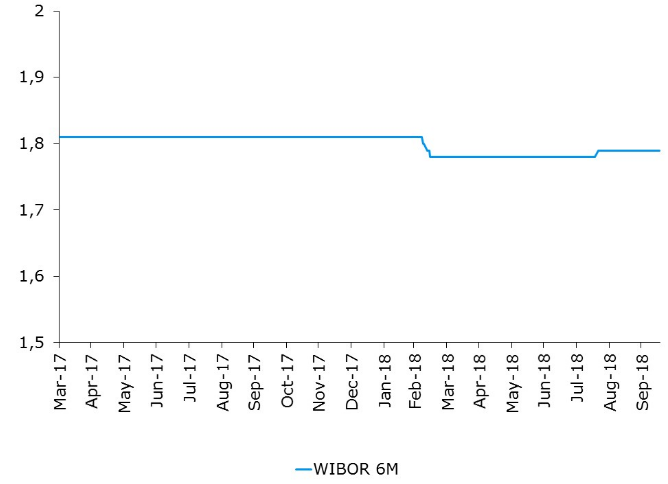
# Money market

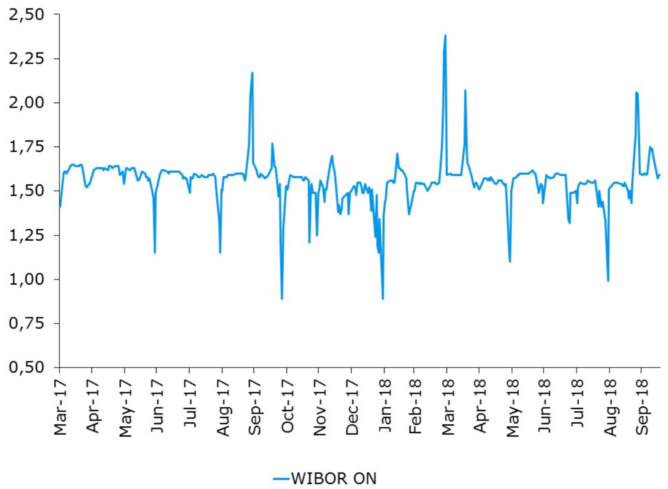
## Still strong and stable

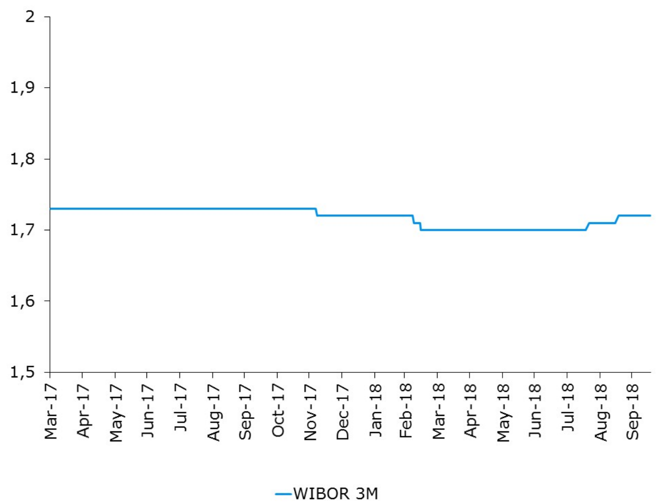
Polish bonds continue to trade on a strong note. While US 10 year yield trades near multi-year heights, Polish 10 year benchmark moves in opposite direction. As a result, Polish 10y bond trades flat to US 10y bond. Most recent local factors are: unexpected rating uprade from S&P plus big redemptions on Polgbs. All in all, Polish market is still extremely stable and we don’t see any upcoming events to change that.

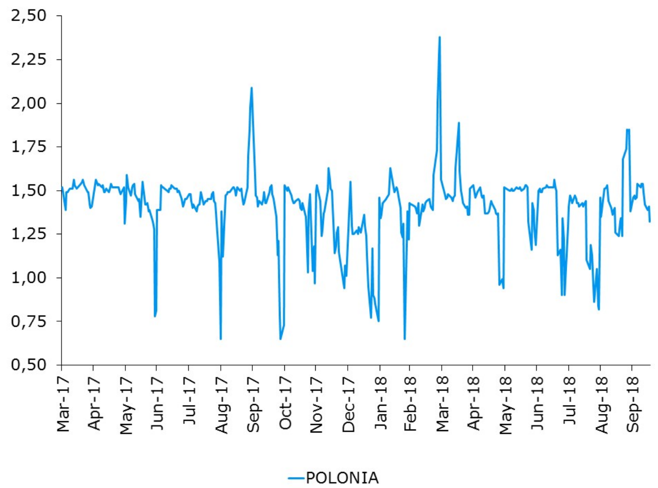
Cash rates were low throughout the whole week. Next week, we have October redemptions plus bond auction distorting the short term market.

Ref rate vs Polonia averages:
30 day 2 bp
90 day 15 bp



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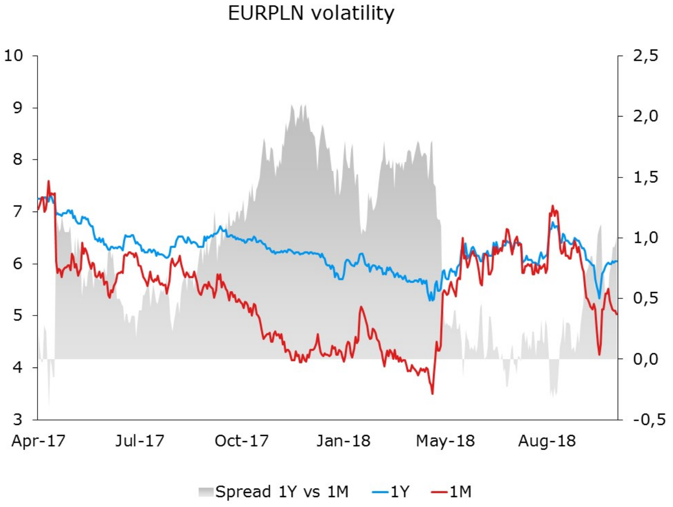
# Forex

**Spot – EUR/PLN – stable** The EUR/PLN is still trapped in the narrow 4.285 – 4.31 range. Neither the S&P's decision about upgrading Poland's rating last Friday nor the worse-than-expected economic data (Polish manufacturing) were able to produce enough momentum to push PLN out of the current, range 4.26-4.34. Fundamentally, EM world is currently pushed and pulled around by USD fluctuations, and PLN is no exception. The range trading continues.



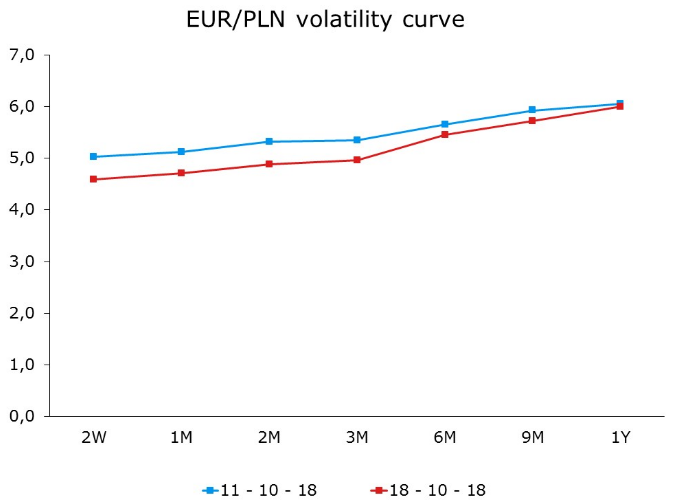

**Opts – Volatility lower** The EUR/PLN vol curve melted a little as spot was really calm. 1 month EUR/PLN ATM mid is this Thursday at 4.5% (0.6% lower than a week ago), 3 months are 4.9% (0.4% lower) and 1 year is fixing 5.9% (0.1% lower). The skew was at the same level as week before. The currency spread (difference between USD/PLN and EUR/PLN) moved lower by around 0.25%.

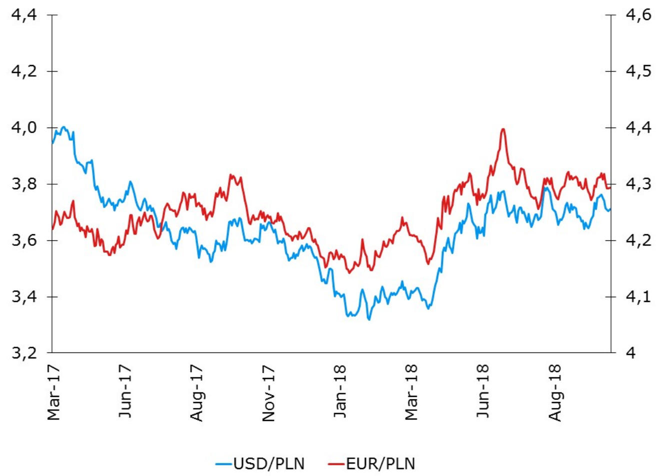
## Short-term forecasts

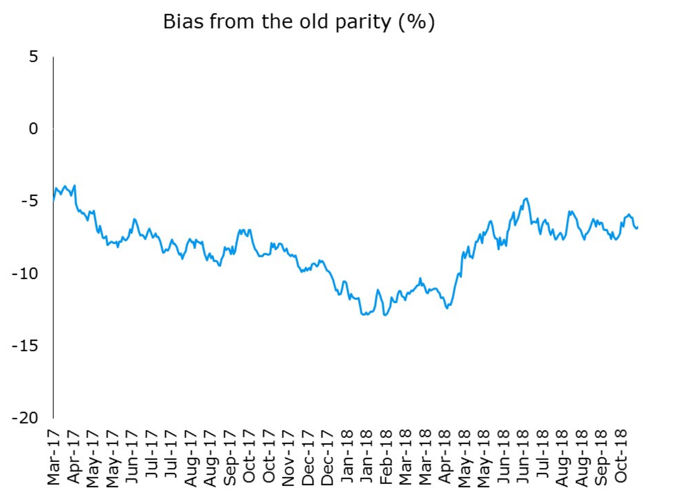
Main supports / resistances:
EUR/PLN: 4.2600 / 4.3400
USD/PLN: 3.6000 / 3.8000

**Spot – Sidelined.**

We think that 4.26-4.34 is the most likely scenario for now. We will try to tactically play that range, without any bias.



# Market prices update

| Money market rates (mid close) | | | | | | | | FRA rates (mid close) | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Date | FXSW 3M | WIBOR 3M | FXSW 6M | WIBOR 6M | FXSW 1Y | WIBOR 1Y | 1x4 | 3x6 | 6x9 | 9x12 | 12x15 | 6x12 |
| 10/11/2018 | 1.92 | 1.72 | 1.96 | 1.69 | 2.14 | 1.77 | 1.73 | 1.75 | 1.79 | 1.85 | 1.97 | 1.86 |
| 10/14/2018 | 1.86 | 1.72 | 1.90 | 1.69 | 2.06 | 1.77 | 1.72 | 1.74 | 1.78 | 1.84 | 1.97 | 1.86 |
| 10/15/2018 | 1.93 | 1.72 | 1.98 | 1.69 | 2.05 | 1.77 | 1.73 | 1.77 | 1.79 | 1.85 | 1.98 | 1.89 |
| 10/16/2018 | 1.74 | 1.72 | 1.78 | 1.69 | 1.95 | 1.77 | 1.73 | 1.75 | 1.79 | 1.85 | 1.99 | 1.89 |
| 10/17/2018 | 1.93 | 1.72 | 1.89 | 1.69 | 2.13 | 1.77 | 1.73 | 1.75 | 1.78 | 1.84 | 1.98 | 1.86 |

| Last primary market rates | | | | | | | |
|---|---|---|---|---|---|---|---|
| Paper | Au. date | Maturity | Avg. price | Avg. yield | Supply | Demand | Sold |
| 32W TB | 2/22/2017 | 8/30/2017 | 99.21 | 1.50 | 700 | 1832 | 726 |
| OK0720 | 10/4/2018 | 7/25/2020 | 97.33 | 1.52 | 1000 | 1577 | 927 |
| PS0424 | 10/4/2018 | 4/25/2024 | 98.80 | 2.73 | 1500 | 3701 | 2651 |
| WS0428 | 10/4/2018 | 4/25/2028 | 95.50 | 3.30 | 1200 | 1926 | 1196 |

| Fixed income market rates (closing mid-market levels) | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Date | 1Y WIBOR | 1Y T-bill | 2Y IRS | OK0720 | 5Y IRS | PS0423 | 10Y IRS | WS0428 |
| 10/11/2018 | 1.770 | 1.345 | 2.018 | 1.606 | 2.610 | 2.583 | 3.067 | 3.270 |
| 10/14/2018 | 1.770 | 1.325 | 2.012 | 1.592 | 2.592 | 2.537 | 3.047 | 3.235 |
| 10/15/2018 | 1.770 | 1.324 | 2.027 | 1.593 | 2.590 | 2.542 | 3.033 | 3.236 |
| 10/16/2018 | 1.770 | 1.322 | 2.032 | 1.564 | 2.583 | 2.524 | 3.025 | 3.232 |
| 10/17/2018 | 1.770 | 1.321 | 2.020 | 1.569 | 2.580 | 2.512 | 3.030 | 3.188 |

| EUR/PLN 0-delta stradle | | | | | | 25-delta RR | | | 25-delta FLY |
|---|---|---|---|---|---|---|---|---|---|
| Date | 1M | 3M | 6M | 1Y | | 1M | 1Y | | 1Y |
| 10/11/2018 | 5.13 | 5.35 | 5.65 | 6.05 | | 6.05 | 1.58 | | 0.52 |
| 10/14/2018 | 5.10 | 5.35 | 5.68 | 6.03 | | 6.03 | 1.58 | | 0.52 |
| 10/15/2018 | 5.10 | 5.30 | 5.65 | 6.05 | | 6.05 | 1.56 | | 0.52 |
| 10/16/2018 | 5.03 | 5.28 | 5.60 | 6.05 | | 6.05 | 1.56 | | 0.50 |
| 10/17/2018 | 4.71 | 4.96 | 5.45 | 6.00 | | 6.00 | 1.62 | | 0.52 |

| PLN Spot performance | | | | | | |
|---|---|---|---|---|---|---|
| Date | EURPLN | USDPLN | CHFPLN | JPYPLN | HUFPLN | CZKPLN |
| 10/11/2018 | 4.3179 | 3.7399 | 3.7818 | 3.3313 | 1.3274 | 0.1670 |
| 10/14/2018 | 4.3022 | 3.7130 | 3.7494 | 3.3076 | 1.3241 | 0.1666 |
| 10/15/2018 | 4.2927 | 3.7091 | 3.7502 | 3.3223 | 1.3243 | 0.1664 |
| 10/16/2018 | 4.2919 | 3.7036 | 3.7505 | 3.3035 | 1.3323 | 0.1664 |
| 10/17/2018 | 4.2936 | 3.7123 | 3.7456 | 3.3082 | 1.3322 | 0.1661 |

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