

## Poland: Supreme Court ruling on FX mortgages weighs on the zloty

On 13 April, the Polish Supreme Court is to provide guidance on FX denominated mortgages. The ruling will largely determine the scope of potential losses for the local banking sector in relation to these products. Bloomberg data reveals higher volumes of FX options opened ahead of the ruling, most likely as a hedge



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### What's at stake

FX denominated credit has been a significant issue for the Polish banking sector since the financial crisis. The rise in the Swiss franc against the zloty massively increased banks' outstanding volume of assets denominated in zloty. Given a number of controversial clauses in mortgage contracts, many customers successfully contested them in courts as "abusive" - currently as much as 90% of court cases have ended in favour of customers while courts have ruled that the wording of some paragraphs in the contracts is indeed "abusive". This is largely a result of a European Court of Justice ruling which sided with debtors and required either the removal of such clauses, or the invalidation of entire loans if they cannot continue without them. In many court cases, the ruling was to convert the mortgage back into zloty at the original rate, at a loss to the creditor.

However, the rulings of Polish courts still differ on:

- whether banks may charge their clients for the use of capital over the course of the now-invalidated credit;
- whether after conversion into PLN the 'new' credit should be charged with Wibor rate or Libor CHF.

Both questions are to be clarified by the Supreme Court rulings scheduled for 13 and 15 April. This

ruling will largely determine the scale of the losses for the banking sector. The consensus among equity analysts seems to be between PLN30bn and PLN60bn, compared to PLN230bn of own capital funds in the banking sector.

The ruling is likely to determine the banking sector's willingness to settle with clients. So far, the sector has been unwilling to seek compromise, as the number of loans contested in courts is just about 10% of total CHF credit. The more pro-consumer the Supreme Court guidance is, the more likely the banking sector should be to settle and the larger the losses it will need to bear. A key Polish bank announced that it will create reserves for potential settlements and has already closed the resulting FX position.

## What we expect

We expect the most likely option to be a widespread settlement, offering to convert FX mortgages into PLN at the original FX rate. But banks might be allowed to charge Wibor rather than Libor CHF. This should limit the overall losses to PLN30-60bn. The conversion is likely to take place via the central bank, rather than via the market. The National Bank of Poland's Chairman Adam Glapiński has admitted this is a possibility and recently added that the central bank is aiming for PLN stability. A relatively high level of FX reserves (25% of GDP) also supports such a scenario.

## What it means for the zloty

The ruling seems to have triggered increased FX option activity, both in terms of volume and implied volatility. According to Bloomberg data, implied volatility is already at levels similar to those from the period of the ECJ ruling on FX mortgages (VIII-X 2019). Risk reversals signal an expected rise in EUR/PLN and are already above the levels from said period. The FX options mentioned above are likely to be one of the factors behind PLN weakness in 2021. Delta hedging of those positions requires the sale of PLN as the market nears call option strike levels (4.65-70).

Based on our relative value model (gauging FX equilibrium based on other market variables such as swaps) EUR/PLN 'fair' level is at 4.45, rather than 4.60 currently. Long-term models suggest EUR/PLN should head even lower (4.30-40) given a considerable current account surplus (expected above 2% of GDP in 2021). Consequently, we look for a pronounced decline in EUR/PLN in 2H21. On top of domestic factors (e.g. NBP helping with the credit conversion), an expected rise in EUR/USD should trigger stronger demand for central and eastern European currencies.

We are unsure if the banking sector will have to book the resulting losses on day one. If so, this may affect its ability to provide credit. While this is not a concern currently, given very low demand, it supports our call for a very slow private investment recovery in the coming quarters.

## Author

**Piotr Poplawski**

Senior Economist, Poland

[piotr.poplawski@ing.pl](mailto:piotr.poplawski@ing.pl)

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