RATES AND FX OUTLOOK

POLISH FINANCIAL MARKETS

September 2016

Bank Zachodni WBK

Grupa Santander

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Summary

- **Poland's GDP growth failed to accelerate in 2Q16, with investments surprising negatively (-4.9% y/y), and we think that the second half of the year will see no significant improvement in economic growth.** Although private consumption is likely to gain strength in the coming quarters, supported by solid labour income and the new child subsidies, it may take time until investments recover, and the positive impact of net exports will be hard to maintain (export growth may decelerate and imports accelerate). We expect a more significant investment pick-up next year, but by then the impact of the 500+ child benefit programme on consumption will be dissipating. Therefore, we forecast that GDP will grow 3.1% in 2016 and 2.9% in 2017.
- Such a pace of economic growth should be quite surprising for the Monetary Policy Council. We point out that at its last meeting in July, the panel was confident that GDP growth would be significantly better than envisaged by the NBP projection and would accelerate later this year. Nevertheless, **we doubt if the first central bank meeting after the summer break will pave the way for further policy easing**, as even the most dovish Monetary Policy Council (MPC) members seem to doubt that further interest rate cuts would be effective and think that low inflation does not have a serious negative impact on the economy. Meanwhile, deflation has probably already passed its trough, and we expect the CPI to gradually climb towards zero in the coming months.
- The MPC's Marek Chrzanowski resigned from his post for personal reasons. His replacement is not known yet, so it is hard to guess whether this will tilt the balance of votes significantly.
- The government's draft budget for 2017 assumes a fiscal deficit of 2.9% of GDP. Some of its underlying assumptions (economic growth forecast, expected rise in tax collection) seem optimistic, but overall the budget deficit is not unachievable, in our view. Meanwhile, this year's budget deficit may be lower than planned by up to PLN10bn.
- The last two weeks saw a sizeable sell-off in the Polish debt market, and we think a rebound is likely. The room for yields to decline may be limited until Moody's rating decision on September 9, but **we do not expect a rating downgrade, so a marked strengthening is possible later on**, especially if the ECB announces additional stimulus measures at the next meeting.
- **We see more risks for PLN depreciation than factors that could trigger its strengthening in coming months, but the lack of a rating cut by Moody's on September 9 may trigger a short-term currency gain.** Later on, the zloty may suffer from both global and local factors. The former includes a looming Fed rate hike before year end, and the latter, disappointing economic growth, political uncertainty and possible speculation about interest rate cuts.

Short- and Medium-Term Strategy: Interest Rate Market

	Change (bp)		Current Level	Expected Trend	
	Last 3M	Last 1M	5 September 2016	1M	3M
Reference rate	0	0	**1.50**	→	→
3M WIBOR	3	0	**1.71**	→	→
2Y bond yield	6	2	**1.66**	→	→
5Y bond yield	-7	3	**2.26**	→	→
10Y bond yield	-27	5	**2.87**	→	↗↗
2/10Y curve slope	-33	4	**121**	↗	↗↗

Note: Single arrow down/up indicates at least a 5bp expected move down/up, double arrow means at least a 15bp move. Source: BZ WBK.

PLN Rates: Our view and risk factors

Money market: Weak economic data and MPC members' comments revived speculation about possible rate cuts in August, but only temporarily, as later comments suggested that even the biggest MPC's doves doubt rate cuts' effectiveness. We think that speculations about policy easing may return later this year if economic data keep disappointing, but in the next few weeks, money market rates should remain quite stable.

Short end: A rebound in August's CPI and PMI and no significant softening of the tone of the MPC post-meeting statement may not be very supportive for bonds with short maturity, in our opinion. Thus, a strengthening after Moody's decision may be less pronounced than for longer tenors.

Long end: The last two weeks saw a sizeable selloff in the Polish debt market, and we think a rebound is likely. The room for a decline in yields may be limited until Moody's rating decision on September 9, but we do not expect a rating downgrade Therefore, in our view, a significant strengthening is possible later on, especially if the ECB announces additional stimulus measures at the next meeting.

Risks to our view: If Moody's downgrades the rating, yields will rise further, at least in the short run. Another factor that may be negative for Polish bonds is surprisingly strong US data, suggesting a higher probability of an imminent Fed rate hike.

Short- and Medium-Term Strategy: FX Market

	Change (%)		Current Level	Expected Trend	
	Last 3M	Last 1M	5 September 2016	1M	3M
EUR/PLN	-0.9	-0.2	**4.35**	→	→
USD/PLN	-1.0	-0.3	**3.89**	→	↗
CHF/PLN	0.3	-1.3	**3.98**	→	→
GBP/PLN	-8.5	1.1	**5.20**	↘	↘
EUR/USD	0.1	0.0	**1.12**	→	→

Note: Single arrow down/up indicates at least a 1.5% expected move down/up, double arrow means at least a 5% move. Source: BZ WBK.

PLN FX Market: Our View and Risk Factors

EUR: We see more risks for PLN depreciation than factors that could trigger its strengthening in coming months, but the lack of a rating cut by Moody's on September 9 may trigger a short-term currency gain. Later on, the zloty may suffer from both global and local factors. The former includes looming Fed rate hike before year-end, and the latter, disappointing economic growth, political uncertainty and possible speculation about interest rate cuts.

USD: We remain mildly positive on the USD over the next few months. A dovish ECB should allow EUR/USD to decrease in September, which may push the USD/PLN higher.

CHF: We are still negative on the CHF and continue to expect EUR/CHF to edge higher over the forecast horizon. However, a sustained and significant increase in the cross is likely to require a notable improvement in global risk and/or a stronger EUR, both of which seem unlikely in 2H16. Thus, we see a moderate weakening of the zloty vs the Swiss franc this year, followed by its appreciation in the following quarters.

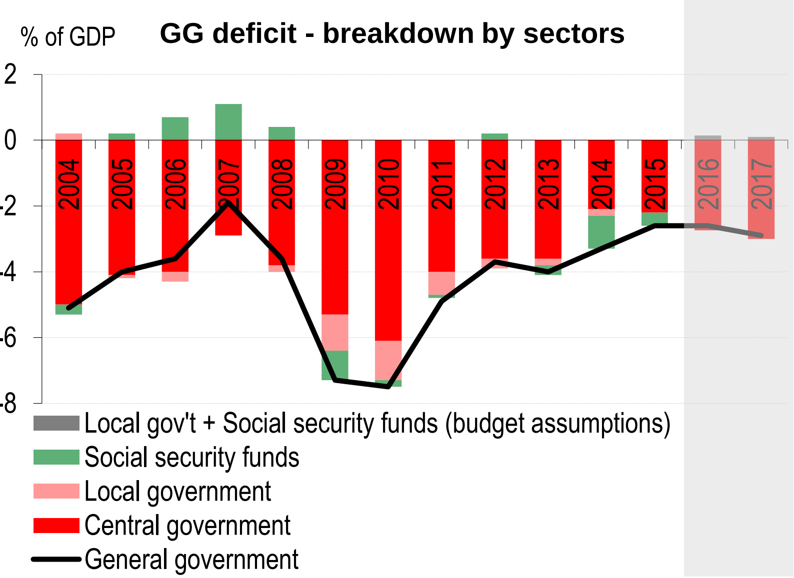
Risks to our view: In the case of a Moody's downgrade, the zloty is likely to depreciate, but the move may be temporary, as was the case in January, after S&P's decision to cut Poland's rating.

Budget 2017: Macro Assumptions Look Optimistic

- The government presented its draft budget for 2017 with central budget deficit at PLN59.3bn, revenues at PLN324bn, spending at PLN383bn, and the general government (GG) deficit at 2.9% of GDP. The central budget deficit is projected at 3.0% of GDP, thus the government assumed a surplus in local government and social security funds (FUS).
- Local governments have time to prepare their budgets until December 31, and some have not done it yet, including large cities like Warsaw or Wrocław, so it is too early to be precise about local government budgets in 2017. However, the government's plan to boost public investment spending is in contrast with the target of surpluses at local government level. As regards FUS, the position of this sector may indeed be favourable next year, amid strong labour market and the fact that the government decided to replace its loans to FUS by a subsidy (a loan is shown in FUS spending, a subsidy in central budget spending).
- Macroeconomic assumptions behind the budget seem optimistic – most important categories sit above market consensus and our forecasts. In general, the budget macro assumptions are realistic but not conservative, so we see some upward risk for the general government deficit.

Budget macroeconomic assumptions for 2017 (% y/y)

Variable	Budget	BZ WBK	Consensus
GDP	3.6	2.9	3.3
Investment	5.9	2.9	5.6
Private consumption	4.1	3.9	3.7
Employment	0.7	0.3	-
Unemployment	8.0	7.9	8.2
Wages	5.0	5.9	-
Inflation	1.3	1.3	1.5



Source: Government, Eurostat, Bloomberg, BZ WBK

Budget 2017: Revenues Driven by Higher Tax Collection

- Total central government revenues are expected to rise by 2% y/y. After a correction for one-offs from 2016 (which generated a high base effect), new taxes, as well as expected better tax collection, revenues are envisaged to grow 3.7% y/y, which seems to be quite conservative (below the nominal growth rate, not to mention domestic demand).
- The government expects better tax collection to be a major source of higher tax revenues in 2017. The government expects to raise PLN8bn from improved VAT collection (VAT excl. this effect is expected to grow by a solid, though not excessive, 4.7% y/y) and PLN2bn from CIT collection (CIT excl. this factor is expected to grow by 1.9% y/y). Thus, total VAT and CIT revenues are expected to grow by PLN16.6bn with PLN10.0bn stemming from better tax collection.
- According to the Finance Ministry, income from improved tax collection reached PLN832mn in 1H2016 versus PLN486mn in 1H2015. These numbers are far from the government's expectations for next year. The government plans to introduce some new measures to achieve its target in 2017, but at this stage it is hard to assess to what extent it will be successful. At the same time, however, assumptions regarding growth of tax revenues excl. collection seem rather conservative. Additionally, in the worst-case scenario of not achieving the revenues plan, the government might try to reduce some spending, avoiding a budget amendment and keeping the deficit under control.

Budget revenue assumptions for 2017 and plans for 2016 (PLNbn)

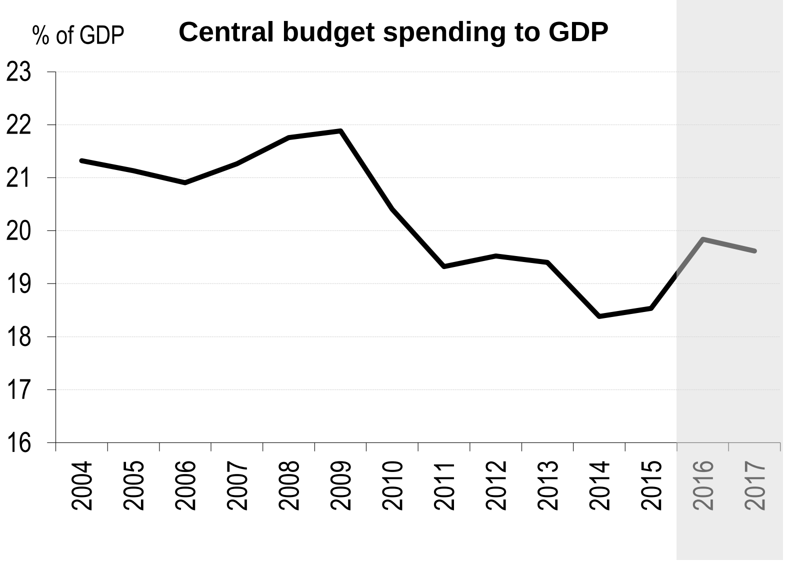
Revenue	2016	2017	% y/y
Total revenues	317.7	324.1	2.0
Total revenues corrected for one-offs, new taxes and better collection	296.8	307.9	3.7
Tax revenues	275.3	299.8	8.9
VAT	128.9	143.0	10.9
VAT corrected for better collection	128.9	135.0	4.7
Excise duties	65.3	69.0	5.7
CIT	26.1	28.6	9.6
CIT corrected for better collection	26.1	26.6	1.9
PIT	48.6	51.0	4.9
Non-tax revenues	40.7	22.4	-44.9

Source: Government, BZ WBK

Budget 2017: Spending Likely to Rise Only Slightly

- Total government spending is planned to rise by 4.0% y/y. However, if one deducts one-off and discretionary in expenditures (eg, children benefit programme 500+, a lower retirement age, wage increases for public administration, free medicine for older people), we arrive at a mere 0.9% y/y growth rate, which is very low. Total spending rise is expected to be slower than GDP growth, so the government expects the spending-to-GDP ratio to fall to 19.6% from 19.8%.
- The government assumed that the negative effect of a lower retirement age will amount to PLN1.4bn. In our view, this sum is underestimated, and we expect something closer to PLN2.5bn (we presented our estimates of the cost of a lower retirement age in our instant comment). Other planned cuts in spending versus 2016 include debt servicing (PLN30.4bn vs PLN31.8bn in 2016) and payments to the EU budget (PLN18.2bn vs PLN19.bn in 2016). We think that debt servicing costs are quite likely to come down, given falling Polish bond yields. Payments to the EU will depend on the final EU budget in 2017, which is still at draft stage.

Central budget spending to GDP



Budget spending assumptions for 2017 and budget for 2016 (PLNbn)

Spending	2016E	2017E	% y/y
Total spending	368.5	383.4	4.0
Subsidies	197.0	209.6	6.4
Benefits for individuals	25.2	25.7	1.9
Current spending of budget entities	68.8	71.2	3.3
Investment spending	17.7	19.3	9.3
Debt servicing	31.8	30.4	-4.4
Payment to EU budget	19.2	18.2	-5.6
Co-financing of EU projects	8.7	8.9	2.7

Source: Government, Eurostat, BZ WBK

Budget 2017: Net Borrowing Requirements Rise

- The 2017 budget draft assumes net borrowing needs of PLN79bn (22% higher than this year's target) and gross borrowing needs of cPLN178.5bn (only 2% higher). The increase is mainly due to the larger deficit, while debt redemptions (both domestic and foreign) are 10% lower than in 2016. On a net basis, the government plans to slightly decrease domestic financing (by 6.5% to PLN62.6bn), while foreign financing is expected to increase sharply, mainly due to flows from credits and flows connected with the FX account (management of funds from the EU). The foreign financing will depend on the performance of domestic financing. The ministry will reduce foreign financing (as it did in 2016 and previous years) if tapping T-bonds domestically is more favourable.
- We expect the structure of domestic financing needs in 2017 to be similar to 2016. Domestic commercial banks should remain on the bid-side, contributing most to total financing. We also expect a positive contribution from foreign investors. In our view, Poland's yields are still attractive for non-residents, given the expansion of bonds with negative yields. The hunt for yields may also dominate in 2017 and, therefore, we expect decent demand from foreign institutional investors such as mutual funds and central banks.
- In September, Poland's Ministry of Finance will start pre-financing its 2017 requirements through a switch tender. The ministry expects to cover c20% of its 2017 gross borrowing needs by the end of this year, which in our view is realistic.

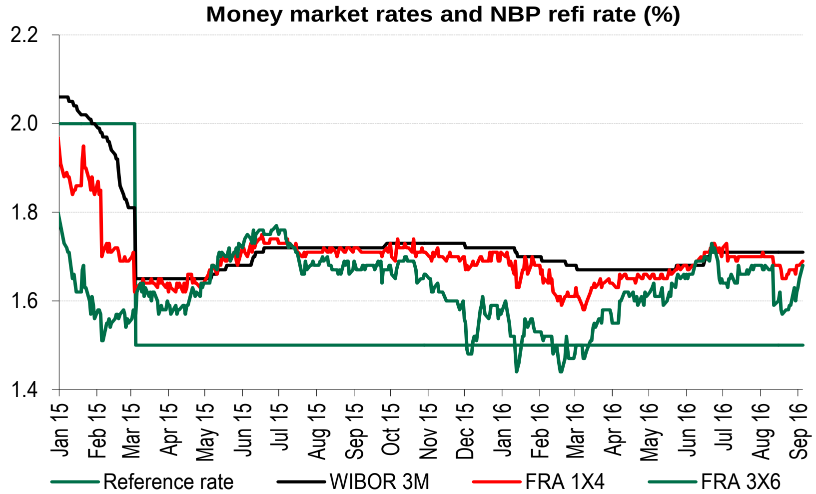
Net borrowing needs and their funding (PLNbn)

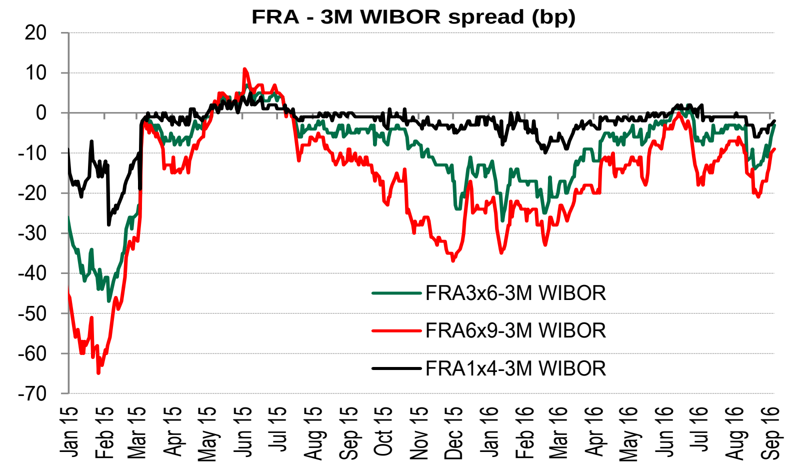
		2016E (1)	2017E (2)	change (2) / (1)
Total net borrowing needs:		64.7	79.0	22.1%
▪	budget deficit	42.0	59.3	41.3%
▪	EU budget deficit	9.2	9.6	4.3%
▪	other	13.5	10.0	-25.5%
Funding of net borrowing needs:		64.7	79.0	22.1%
▪	***domestic funding, of which***	66.9	62.6	-6.5%
-	marketable T-bonds	55.4	59.5	7.4%
-	T-bills	9.8	2.0	-80.0%
-	other	1.7	1.1	-32.3%
▪	***foreign funding, in which***	-2.2	16.4	-
-	bonds	6.6	6.6	-0.4%
-	credits from IFI	-1.0	4.0	-
-	FX account	-7.9	5.8	-

Source: Government, BZ WBK

Domestic Money Market: Rate Cut Expectations May Revive if Economic Data Disappoint

- During the summer, comments about possible rate cuts (by the MPC's Żyżyński) and weak macro data reinforced market speculation about possible policy easing in Poland. This resulted in sharp decrease in FRA rates, while WIBORs remained stable. As a result market priced-in the reference rate cut by 25bp in the next six months. However, it was only short-lived and at the turn of August-September FRA rates inched higher despite disappointing 2Q16 GDP data (particularly investment). Consequently, the scale of interest rate cut priced in by the market decreased quite markedly – to merely 17bp in the 12-18 months horizon. The FRA rise was probably a reaction to higher than expected flash CPI and PMI, less dovish comments of MPC members, and zloty depreciation (weaker zloty = lower probability of interest rate cuts).
- We think that the consensus in the central bank may be gradually changing later this year if next economic data keep disappointing. However, in the nearest weeks hopes for policy easing may remain subdued, as macroeconomic data due late September will probably look much better than those released in August. Additionally, Marek Chrzanowski's resignation from the MPC could make interest rate cut less likely, at least until appointment of his successor.
- All in all, we expect stable WIBOR and FRA rates in the next few weeks, with potential for a decline later this year if new disappointing data revive the discussion about monetary policy easing.





Source: Reuters, BZ WBK

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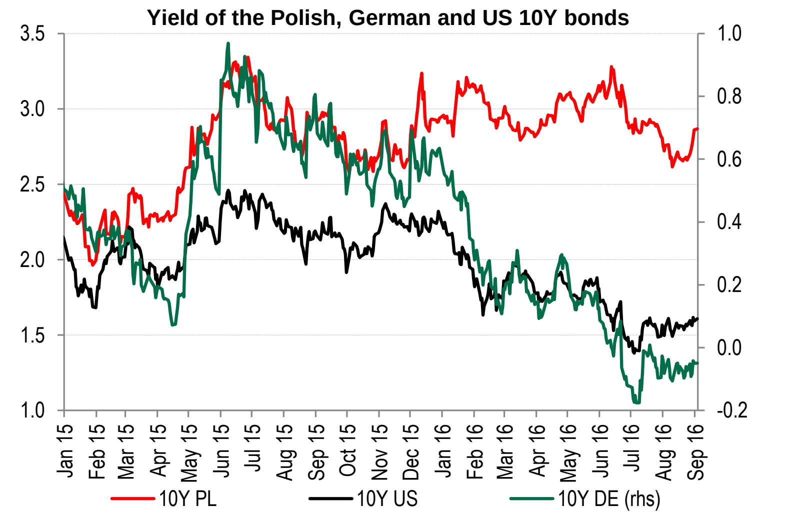
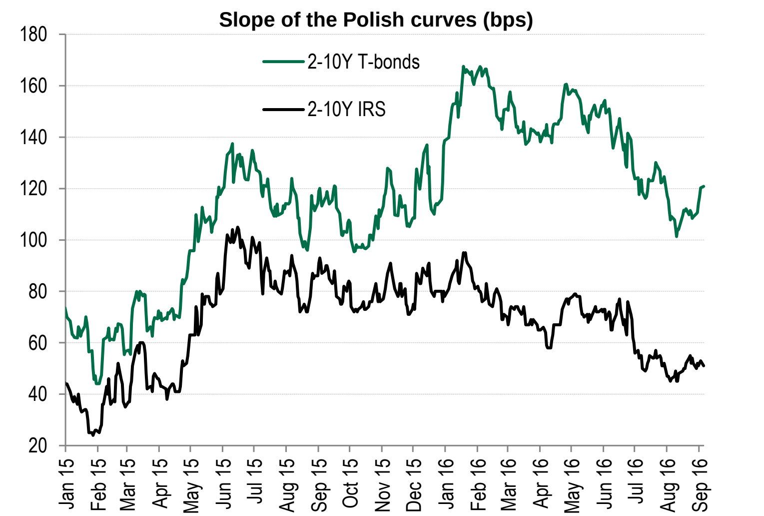
Domestic IRS and the T-Bond Market: Time for a Rebound after Significant Increase in Yields

- Bond yields and IRS rates were falling in July-August, as international sentiment improved, and President Andrzej Duda's new proposal on FX loans suggested lower risk for the banking sector.
- After a significant strengthening, a correction took place in the last week of August and the start of September. Two main factors behind the trend reversal were probably concerns about possible rate hikes by the US Fed and worries about a possible rating downgrade by Moody's after the agency warned that the escalating constitutional crisis is credit negative.
- Measures of country-specific risks (asset swap spreads or spreads vs German bunds) increased, and the yield curve got steeper – the 2-10Y spread widened to 120bp, its highest since late July.
- We think that after such a sizeable sell-off in the Polish debt market in the last two weeks, a rebound is likely. The room for a decline in yields may be limited until Moody's rating decision on September 9, but we do not expect the agency to cut Poland's rating, so a significant strengthening is possible later on. This move may be reinforced if the ECB announces additional stimulus measures at its policy meeting this week and there is no Fed interest rate hike in September.
- A rebound may be less pronounced in the case of short-term securities, as higher-than-expected August CPI and PMI and the expected lack of softening of the tone of the MPC post-meeting statement may limit hopes for monetary policy easing in Poland, in our view. Therefore, yield curve flattening is possible in the coming weeks.





Source: Reuters, BZ WBK.

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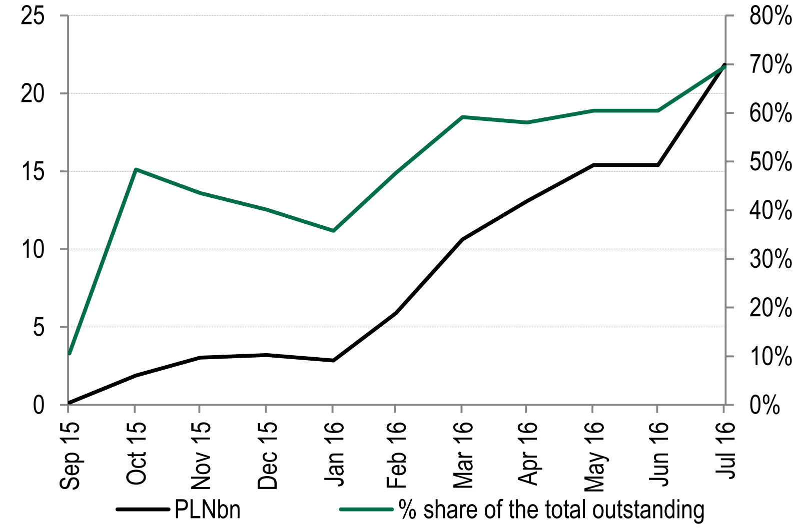
Demand Corner: Non-Residents Hold 70% of DS0726

- According to the Ministry of Finance, in July the portfolio of Polish T-bonds held by foreign investors fell by PLN3.7bn in nominal terms. This was due mainly to redemption of PLN2.2bn of OK0716 held by non-residents – the majority of those funds were reinvested at the auction on July 28 and will be visible in data for August, according to Deputy Finance Minister Piotr Nowak. Nowak added that in August the ministry observed rising foreign investor involvement in medium- and long-term Polish bonds, while they reduced portfolios of short-term bonds.
- In regards to other non-resident holdings, the biggest portfolio reduction was recorded for pension companies (nearly PLN2bn), as well as mutual funds and commercial banks (PLN1.2bn in each case).
- Turning to Polish investors, the portfolio of bonds held by banks shrank by PLN1.6bn and insurance companies sold debt for PLN1.1bn, while the mutual funds added nearly PLN1.1bn.
- Concerning holdings of the individual series, at the end of July, foreign investors held PLN21.8bn of DS0726 and after the biggest monthly accumulation (+PLN6.4bn), their share in total of this series outstanding reached new high of nearly 70%. Polish banks are the second-biggest holder with a 14% share.

Foreign investors' nominal holdings of and share in DS0726 outstanding



Source: Finance Ministry. BZ WBK.

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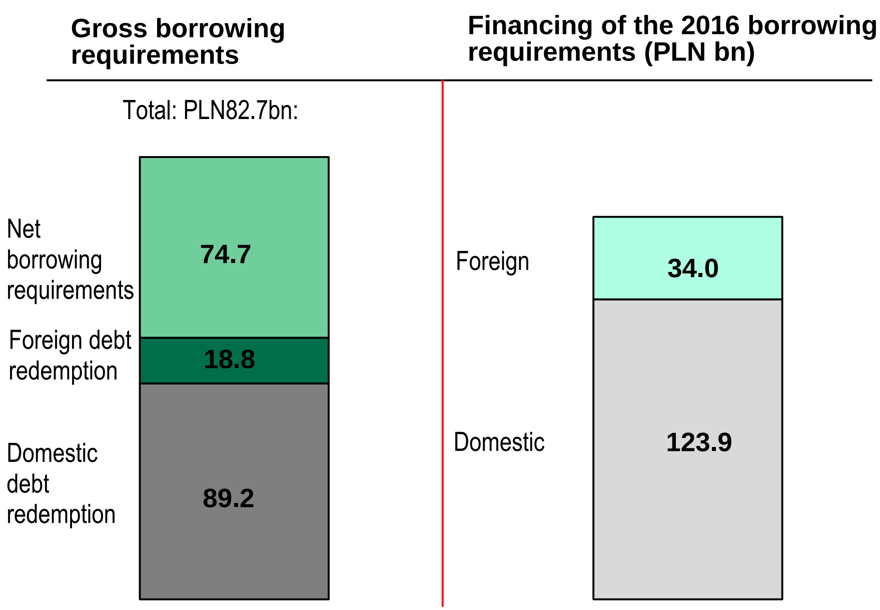
Supply Corner: Issuance Plan for 4Q16E Could Increase

- The July-August period for the Polish primary market was quite intense. The Ministry of Finance launched T-bonds (both fixed-rate and floaters) worth PLN20.3bn. Healthy and solid demand at auctions helped the MoF to tap T-bonds with prices close to or even above the levels on the secondary market.
- At the end of August, Poland successfully launched the so-called panda bonds worth RMB3bn (PLN1.7bn), becoming the first European country to issue debt on China's mainland bond market. The yield of the three-year bond reached 3.4%, ie, -0.17% after a swap to EUR.
- In early September the MoF tapped the primary market with T-bonds worth PLN7.6bn, slightly above the upper limit of the planned offer. The auction attracted decent demand, which helped the ministry to launch T-bonds with yields close to the secondary market levels despite some deterioration of investors' mood. After this auction, the MoF covered 86% of this year's borrowing needs.
- At the end of this month, the ministry will announce T-bond supply for 4Q16E and we think the offer can slightly increase (vs sale of cPLN28bn in 3Q16), taking into account the liquidity situation in the market. In the October-December period, flows from both redemptions (PS1016) and interest payments (WZ, PS, DS series) will amount to cPLN29bn in total.

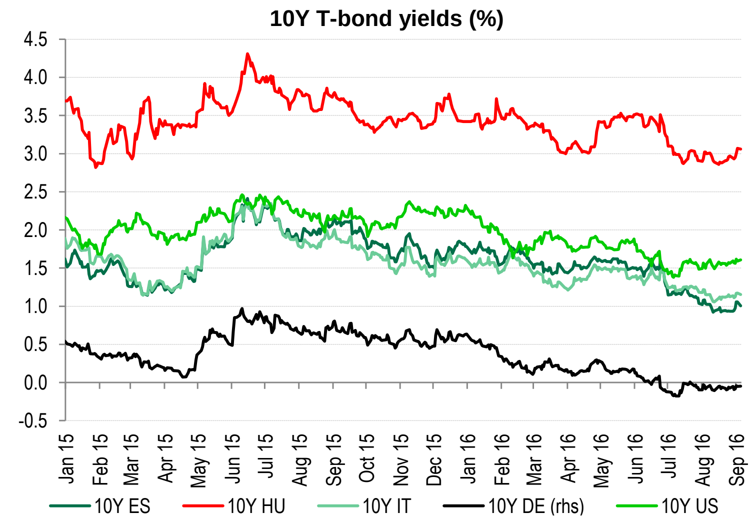
Gross borrowing requirements and its financing in 2016

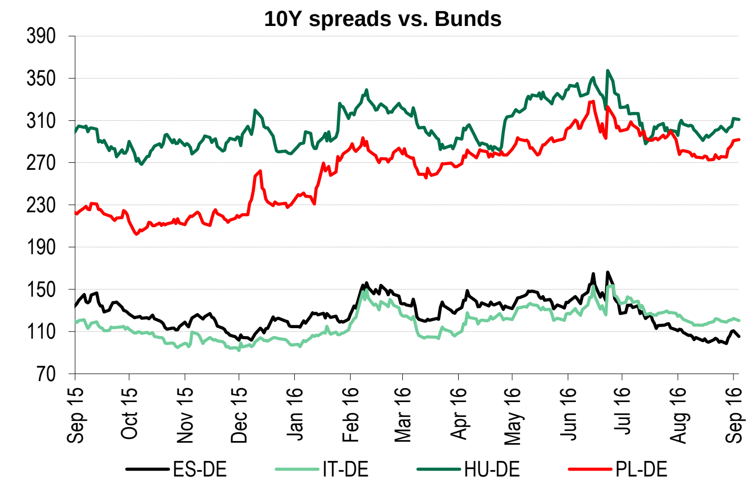


Source: Finance Ministry, BZ WBK.

International Interest Rate Market: Low Yields Underpinned by Monetary Policy

- The summer vacation period brought a gradual increase in core yields after reaching local minimums early in July. This stemmed from quite decent macro data from Europe (including solid GDP growth in the euro zone in 2Q16) and renewed expectations that Fed may hike rates as early as September. At the same time, both the peripheral and the CEE debt market strengthened markedly, with a yield of 10Y Spanish benchmark reaching a new all-time low (at c0.90%). What is more, the spread over the 10Y Bund tightened visibly, and for Spain it fell below 100bp for a while.
- Central Bank policy will remain a key for the market direction in coming months as the data front seems quiescent. September's ECB meeting could further extend the asset purchasing programme (APP). This should help to drive European yields lower, in particular at the longer end of the curves. Consequently, curves could flatten somewhat. What is more, peripheral debt should outperform core debt, in our view, supported by the APP and the hunt for a yield strategy.
- Recent weeks have seen renewed speculation that the Fed will hike rates by the end of the year. This resulted from signals from Fed officials, which suggested that monetary tightening was drawing closer and the market consequently assigned a bigger possibility of a rate hike, even in September. We continue to expect the FOMC to hike rates at its December meeting rather than in September. Therefore, we are bearish on the US front end, expecting an upward move in yields to continue. At the same time, we expect the belly and the long end to remain more protected.

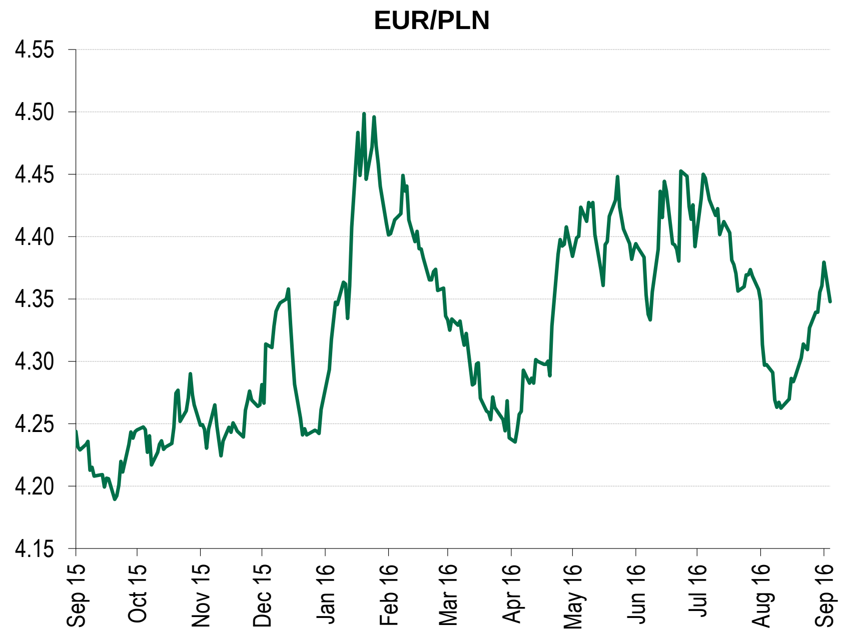




Source: Reuters, BZ WBK.

Foreign Exchange Market: EUR/PLN to Remain High

- The July-August period was pretty volatile for EUR/PLN. The market has reacted positively to the president's new proposal on FX loans and this pushed the exchange rate down to 4.25. However, the following weeks showed a correction and the zloty gave up all of gains recorded on the president's proposal. In early September EUR/PLN is back near 4.35 due to disappointing economic data from Poland, higher chances for rate cuts by the MPC and for rate hikes by the FOMC.
- We expect EUR/PLN to remain elevated and we do not think the exchange rate could near its local bottom anytime soon.
- First, we think that the weaker economic outlook may prevent zloty from appreciating. 2Q16 GDP numbers confirmed that the slowdown in 1Q was not a one-off and monthly data for 3Q suggest that economic growth will probably not accelerate in 2H16. The zloty is a cyclical currency, so only stabilisation in economic activity should prevent EUR/PLN from a deeper decline. Additionally, more evidence that GDP growth is weaker than Monetary Policy Council members expected may spur market speculation about interest rate cuts later this year, which could hit the zloty.
- Market attention has recently switched towards rating agencies. We do not expect Moody's to cut the rating in early September and such decision could trigger a strengthening of the zloty, but such move should not be long-lasting, in our view.



Source: Bloomberg, Reuters, BZ WBK

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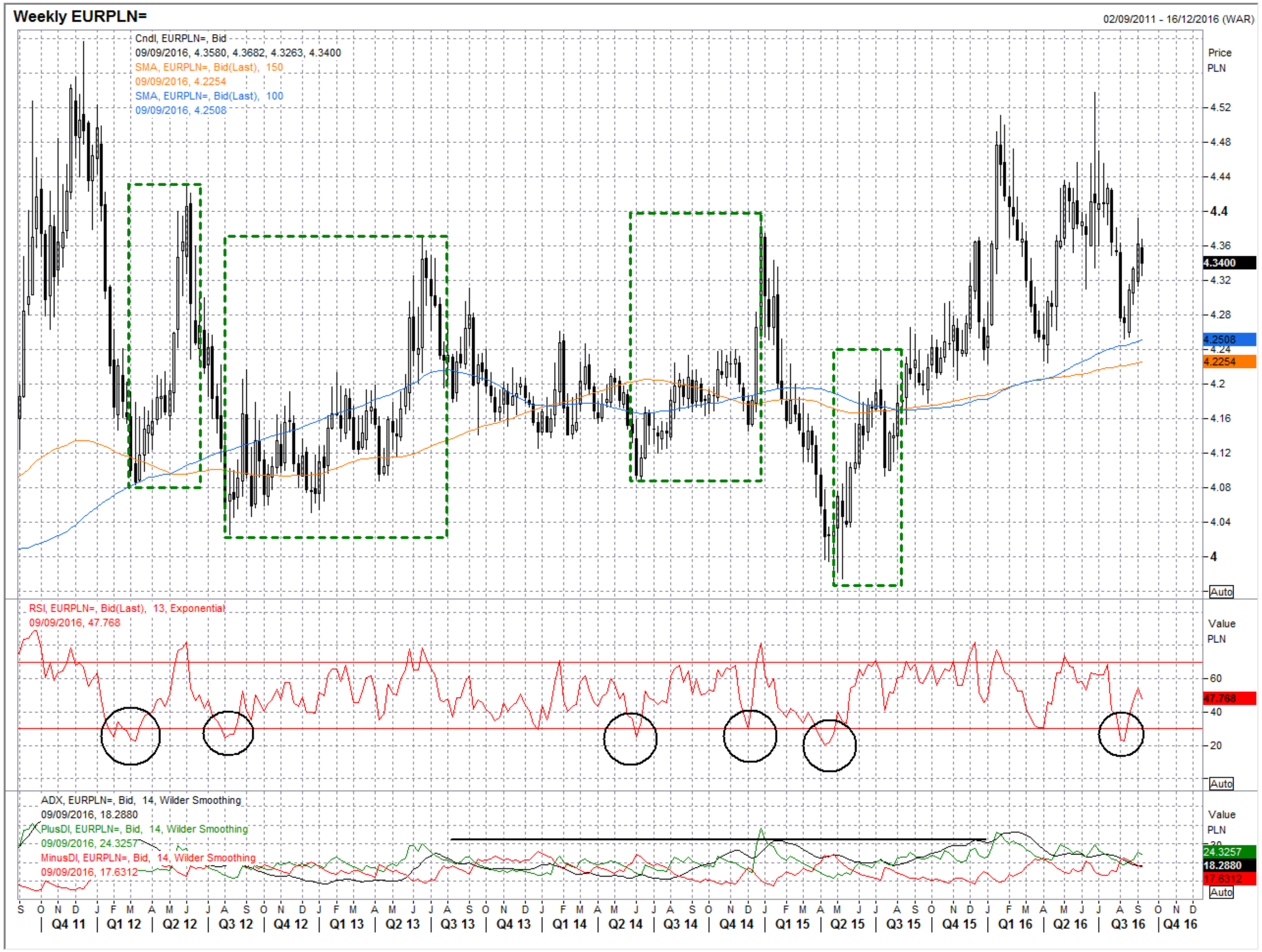
FX Technical Analysis Corner: RSI Says Buy EUR/PLN



- EUR/PLN is on the rise since it hit 4.25 and RSI gave a buy signal on the weekly chart. This is only the 6th such signal in this interval since 2010, and looking at the past experience, one can see that these signals proved very reliable.
- That is why we do not expect EUR/PLN to return to 4.25 but rather to stay high (and go even higher) in the weeks/months to come.

Source: Reuters, BZ WBK.

FX Technical Analysis Corner: Trading Range for EUR/USD

- The most recent down move is larger than the previous correction, indicating there could be a limited potential for a more persistent rise in EUR/USD.
- On the other hand, however, we have a ‘reversal day” formation on the daily interval which proved quite useful in the last months.
- Falling ADX indicates there is no strong directional trend on the EUR/USD market, so we believe the exchange rate could stay within a 1.112-1.136 rage in the weeks to come.

Source: Reuters, BZ WBK.

Macroeconomic Forecasts

Poland		2014	2015	2016E	2017E	1Q16	2Q16	3Q16E	4Q16E	1Q17E	2Q17E	3Q17E	4Q17E
GDP	PLNbn	1,719.1	1,790.1	1,852.6	1,933.5	426.2	446.3	452.5	527.6	447.5	465.7	470.9	549.4
GDP	%YoY	3.3	3.6	3.1	2.9	3.0	3.1	3.2	2.9	3.1	2.9	2.7	2.8
Domestic demand	%YoY	4.9	3.3	3.3	3.5	4.1	2.4	3.4	3.4	3.9	3.8	3.3	3.2
Private consumption	%YoY	2.6	3.1	4.0	3.9	3.2	3.3	4.6	4.9	4.7	4.2	3.4	3.2
Fixed investment	%YoY	9.8	6.1	-1.2	2.9	-1.8	-4.9	-2.0	1.5	2.6	3.0	3.0	3.0
Unemployment rate [a]	%	11.4	9.8	8.5	7.9	10.0	8.8	8.3	8.5	8.8	7.9	7.6	7.9
Current account balance	EURmn	-8,303	-1,059	-310	-3,660	296	984	-1,315	-275	-366	174	-2,253	-1,216
Current account balance	% GDP	-2.0	-0.2	-0.1	-0.8	-0.4	-0.4	-0.1	-0.1	-0.2	-0.4	-0.6	-0.8
General government balance (ESA 2010)	% GDP	-3.3	-2.6	-2.8	-3.0	-	-	-	-	-	-	-	-
CPI	%YoY	0.0	-0.9	-0.6	1.3	-0.9	-0.9	-0.7	0.1	1.3	1.4	1.3	1.3
CPI [a]	%YoY	-1.0	-0.5	0.4	1.4	-1.1	-0.8	-0.3	0.4	1.4	1.3	1.2	1.4
CPI excluding food and energy prices	%YoY	0.6	0.3	-0.1	0.9	-0.1	-0.3	-0.2	0.2	0.5	0.9	1.0	1.1

Source: CSO, NBP, Finance Ministry, BZ WBK estimates. [a] at the end of the period

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Interest Rate and FX Forecasts

Poland		2014	2015	2016E	2017E	1Q16	2Q16	3Q16E	4Q16E	1Q17E	2Q17E	3Q17E	4Q17E
Reference rate [a]	%	2.00	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
WIBOR 3M	%	2.52	1.75	1.70	1.75	1.69	1.68	1.71	1.74	1.75	1.75	1.75	1.75
Yield on 2-year T-bonds	%	2.46	1.70	1.58	1.79	1.45	1.57	1.62	1.67	1.70	1.73	1.82	1.92
Yield on 5-year T-bonds	%	2.96	2.21	2.24	2.56	2.23	2.29	2.19	2.27	2.33	2.45	2.63	2.83
Yield on 10-year T-bonds	%	3.49	2.69	2.97	3.35	2.98	3.04	2.83	3.03	3.17	3.27	3.40	3.55
2-year IRS	%	2.51	1.72	1.63	1.79	1.54	1.64	1.66	1.67	1.66	1.68	1.83	1.97
5-year IRS	%	2.92	2.02	1.88	2.35	1.85	1.92	1.82	1.95	2.10	2.25	2.43	2.63
10-year IRS	%	3.34	2.41	2.31	2.93	2.32	2.34	2.19	2.38	2.62	2.83	3.03	3.23
EUR/PLN	PLN	4.18	4.18	4.37	4.32	4.37	4.37	4.35	4.38	4.37	4.32	4.30	4.30
USD/PLN	PLN	3.15	3.77	3.93	3.81	3.96	3.87	3.91	3.97	3.93	3.82	3.76	3.72
CHF/PLN	PLN	3.45	3.92	3.99	3.83	3.98	3.99	3.99	3.98	3.93	3.84	3.79	3.76
GBP/PLN	PLN	5.19	5.77	5.35	4.63	5.67	5.55	5.12	5.04	4.83	4.59	4.55	4.57

Source: CSO, NBP, Finance Ministry, BZ WBK estimates. [a] at the end of period

Economic Calendar and Events

Date		Event:	Note:
7 September	**PL**	**MPC decision**	**Reference rate: unchanged**
8 September	EU	ECB decision	Refi rate: unchanged
9 September	EU	Eurogroup meeting	The agenda includes discussions on Greece's progress
12 September	**PL**	**CPI for August**	**We expect the final CPI to confirm flash figure of -0.8% y/y**
13 September	**PL**	**Balance of payments for July**	**We expect a current account deficit of €367mn**
	PL	**Core CPI**	**Our forecast is at -0.3% y/y**
14 September	**PL**	**Money supply for August**	**We expect M3 growth at 10.5% y/y**
16 September	**PL**	**Wages and employment for August**	**We expect wages growth of 4.4% y/y and employment growth of 3.3%**
19 August	**PL**	**Industrial production for August**	**We predict solid output growth of 6.9% y/y**
	PL	**Retail sales for August**	**We expect decent growth of 6% y/y in constant prices**
	PL	**PPI for August**	**We expect -0.4% y/y**
20 September	HU	Central bank decision	3M base rate: unchanged
21 September	US	FOMC decision	Fed rate: unchanged
22 September	**PL**	**T-bond switch auction**	**T-bonds to be bought back: PS1016, WZ0117, PS0417**
	PL	**Minutes of July MPC meeting**	
23 September	**PL**	**Registered unemployment rate for August**	**Our forecast is at 8.4%**
29 September	CZ	Central bank decision	Base rate: unchanged
30 September	**PL**	**Flash CPI for September**	
3 October	**PL**	**PMI for manufacturing**	
5 October	**PL**	**MPC decision**	

Source: CB, Markit, CSO, Finance Ministry

Annex

1. Domestic Market Performance
2. Polish Bonds: Supply Recap
3. Polish Bonds: Demand Recap
4. Euro Zone Bonds: Supply Recap
5. Poland vs Other Countries
6. Central Bank Watch

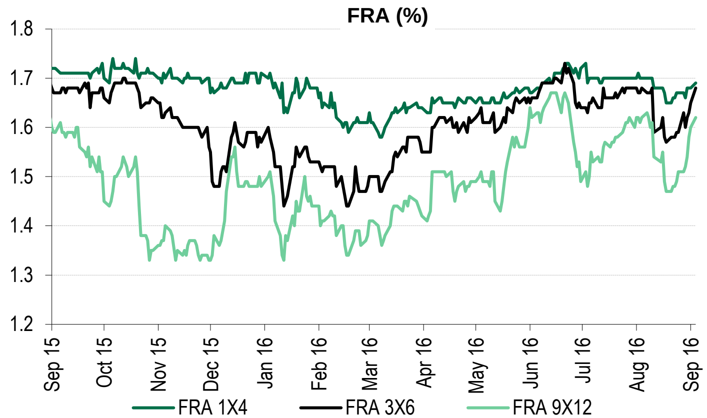
1. Domestic Market Performance

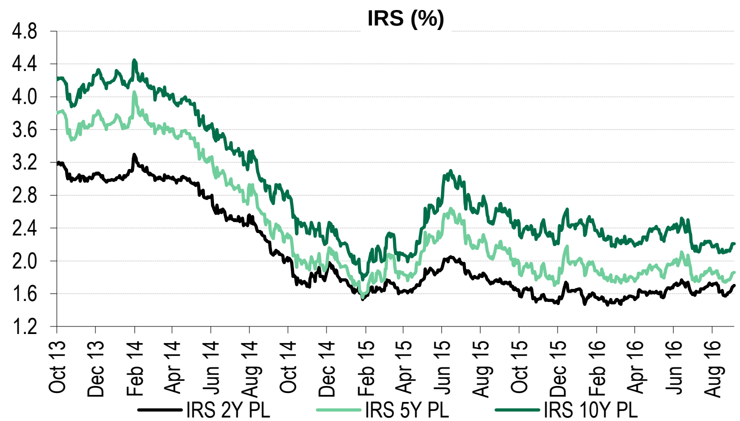
Money Market Rates (%)

	Reference rate (%)	Poland (%)	WIBOR (%) 1M	3M	6M	12M	OIS (%) 1M	3M	6M	12M	FRA (%) 1x4	3x6	6x9	9x12
End of August	**1.50**	**1.25**	**1.65**	**1.71**	**1.79**	**1.81**	**1.43**	**1.42**	**1.38**	**1.38**	**1.68**	**1.62**	**1.57**	**1.54**
Last 1M change (bp)	0	3	0	0	0	0	0	0	0	0	-2	-6	-7	-8
Last 3M change (bp)	0	-35	6	3	5	5	1	2	3	5	0	-3	-4	-4
Last 1Y change (bp)	0	-23	-1	-1	-1	-2	-2	-3	-7	-8	-3	-5	-3	-4

Bond and IRS Market (%)

	BONDS 2Y	5Y	10Y	IRS 2Y	5Y	10Y	Spread BONDS / IRS (bp) 2Y	5Y	10Y
End of August	**1.62**	**2.15**	**2.76**	**1.64**	**1.80**	**2.15**	**-2**	**35**	**61**
Last 1M change (bp)	-1	-14	-12	-8	-11	-9	7	-3	-3
Last 3M change (bp)	3	-16	-35	-3	-16	-24	6	0	-11
Last 1Y change (bp)	-17	-31	-17	-11	-36	-46	-6	5	29





Source: Reuters, BZ WBK

2. Polish Bonds: Supply Recap

Total Issuance in 2016 by Instrument (in PLN mn, nominal terms)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
T-bond auctions	12,629	16,221	8,387	14,891	9,506	4,322	4,432	15,900	7,594	10,000	3,000		106,882
T-bill auctions	2,400	2,390	1,000										5,790
Retail bonds	315	626	368	335	275	223	407	100	100	100	100	100	3,049
Foreign bonds/credits	7,700			9,883				1,700					19,283
Pre-financing and financial resources at the end of 2015	36,500												36,500
Total	**59,544**	**19,237**	**9,756**	**25,109**	**9,780**	**4,545**	**4,839**	**17,700**	**7,694**	**10,100**	**3,100**	**100**	**171,504**
Redemption	13,680	11,645	153	13,688	146	124	11,067	8,688	2,590	23,572	3,684	210	89,249
Net inflows	**45,864**	**7,592**	**9,603**	**11,421**	**9,634**	**4,420**	**-6,228**	**9,012**	**5,103**	**-13,472**	**-584**	**-110**	**82,255**
Rolled-over T-bonds			8,590										**8,590**
Buy-back of T-bills/ FX-denominated bonds													**0**
Total	**45,864**	**7,592**	**18,193**	**11,421**	**9,634**	**4,420**	**-6,228**	**9,012**	**5,103**	**-13,472**	**-584**	**-110**	**90,845**
Coupon payments from domestic debt	*1,084*			*3,767*			*4,461*		*1,295*	*6,276*			*16,883*

Note: Our forecasts = shaded area

Source: MF, BZ WBK

2. Polish Bonds: Supply Recap (cont.)

Schedule of Treasury Security Redemptions by Instrument (in PLN mn)

	Bonds	Bills	Retail Bonds	Total Domestic Redemption	Foreign Bonds/Credits	Total Redemptions
January	13,451		229	**13,680**	0	**13,680**
February	0		647	**647**	10,999	**11,645**
March	0		153	**153**	0	**153**
April	12,637		136	**12,773**	915	**13,688**
May	0		146	**146**	0	**146**
June	0		124	**124**	0	**124**
July	9,931		226	**10,156**	911	**11,067**
August	3,689	2,400	199	**6,288**	0	**6,288**
September	0	2,390	200	**2,590**	0	**2,590**
October	22,420		242	**22,661**	911	**23,572**
November	0		1,056	**1,056**	1,628	**2,684**
December	0		210	**210**	0	**210**
Total 2016E	62,127	4,790	3,567	**70,485**	15,364	**85,848**
Total 2017E	72,603		2,485	**75,087**	11,728	**86,815**
Total 2018E	86,907		1,313	**88,220**	12,977	**101,196**
Total 2019E	63,811		1,237	**65,048**	23,512	**88,559**
Total 2020E	65,481		634	**66,115**	21,805	**87,920**
Total 2021E+	255,421		1,749	**257,170**	134,266	**391,436**

Source: MF, BZ WBK.

2. Polish Bonds: Supply Recap (cont.)

Scheduled Wholesale Bond Redemptions by Holders (data at the end of July 2016, in PLN mn)

	Foreign Investors	Domestic Banks	Insurance Funds	Pension Funds	Mutual Funds	Individuals	Non-financial Sector	Other	Total
Q1 2016	8,007	2,151	2,027	54	579	26	42	459	13,346
Q2 2016	4,631	4,876	1,710	180	361	15	45	820	12,637
Q3 2016	1,050	1,841	492	44	1,189	7	3	30	4,658
Q4 2016	5,009	11,454	2,407	68	1,654	5	43	1,539	22,178
Total 2016	**6,059**	**13,295**	**2,899**	**113**	**2,844**	**12**	**46**	**1,569**	**26,837**
	23%	**50%**	**11%**	**0%**	**11%**	**0%**	**0%**	**6%**	**100%**
Total 2017	21,048	32,915	7,612	412	4,824	108	96	5,670	72,685
	29%	45%	10%	1%	7%	0%	0%	8%	100%
Total 2018	19,108	42,856	4,838	634	7,531	98	157	7,990	83,211
	23%	52%	6%	1%	9%	0%	0%	10%	100%
Total 2019	16,458	30,397	5,343	191	6,027	90	139	5,165	63,811
	26%	48%	8%	0%	9%	0%	0%	8%	100%
Total 2020	24,580	25,146	3,992	152	7,024	67	54	4,466	65,481
	38%	38%	6%	0%	11%	0%	0%	7%	100%
Total 2021+	105,551	72,720	24,525	264	24,107	456	333	8,354	236,309
	45%	31%	10%	0%	10%	0%	0%	4%	100%

Source: MF, BZ WBK.

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3. Polish Bonds: Demand Recap

Holders of Marketable PLN Bonds

	Nominal Value (PLN bn)			Nominal Value (PLN bn)			%Change in July			Share of Total in July (%)
	End Jul'16	End Jun'16	End May'16	End 3Q 2015	End 2014	End 2013	MoM	3-mth	YoY	
Domestic investors	366.6	368.3	367.8	325.5	295.9	381.2	-0.5	1.6	16.8	65.5 (0.3pp)
Commercial banks	217.3	218.9	219.0	176.7	150.8	114.7	-0.7	0.9	31.8	38.8 (0.1pp)
Insurance companies	49.2	50.3	50.4	52.5	52.8	52.0	-2.2	-2.8	-7.3	8.8 (-0.1pp)
Pension funds	1.8	1.8	1.8	3.0	3.3	125.8	-3.5	-1.3	-39.7	0.3
Mutual funds	52.4	51.3	51.6	49.7	46.9	46.7	2.1	3.5	5.2	9.4 (0.3pp)
Others	46.0	45.9	45.0	43.7	42.0	42.0	0.1	4.6	6.6	8.2 (0.1pp)
Foreign investors*	192.8	196.5	192.5	208.2	196.0	193.2	-1.9	2.4	-5.9	34.5 (-0.3pp)
Banks	11.3	12.6	11.6	13.5	9.9	n.a.	-9.6	-1.8	-8.2	2.0 (-0.2pp)
Central banks	28.6	29.5	29.5	28.3	16.4	n.a.	-3.1	-3.0	28.7	5.1 (-0.1pp)
Public institutions	9.0	8.9	8.9	9.7	8.1	n.a.	2.0	1.4	0.7	1.6
Insurance companies	9.8	11.8	11.3	11.6	10.7	n.a.	-16.9	-13.5	-0.8	1.7 (-0.3pp)
Pension funds	14.6	14.5	14.4	13.0	13.0	n.a.	0.6	0.9	11.6	2.6
Mutual funds	41.7	43.0	42.3	64.7	78.1	n.a.	-3.0	-1.4	-42.3	7.5 (-0.2pp)
Hedge funds	0.08	0.08	0.08	0.1	1.1	n.a.	-0.4	2.2	-92.7	0.0
Non-financial sector	6.8	7.1	6.5	12.2	8.2	n.a.	-3.3	4.8	-12.6	1.2
Others	17.4	17.3	18.1	19.5	14.3	n.a.	0.7	-3.9	2.9	3.1
TOTAL	559.4	564.8	560.3	533.7	491.8	574.3	-0.9	1.2	7.8	100

**Total for foreign investors does not match the sum of values presented for sub-categories due to omission of a very small group of investors. Detailed data on foreign investors are available since April 2014 .*

Source: MF, BZ WBK.

4. Euro Zone Bonds: Supply Recap

Euro Zone: 2016 Net and Gross Supply by Country vs 2015 (€ bn)

	2016 Gross issuance	% Change (vs 2015)	2016 Net Issuance	% Change (vs 2015)	YTD Bond Issuance Completion
Austria	19.4	14	5.6	50	78%
Belgium	33.6	3	8.0	84	93%
Finland	15.8	58	5.9	169	89%
France	187.0	0	60.5	-14	87%
Germany	168.6	16	0.0	-100	74%
Greece	-	-	-	-	-
Ireland	10.8	-20	2.7	-76	71%
Italy	221.9	-10	38.6	-9	74%
Netherlands	36.8	-23	8.5	5	66%
Portugal	11.9	-34	5.1	-55	76%
Spain	138.8	0	45.5	6	77%
Total	**844.5**	**-1**	**180.3**	**-1**	**78%**

** YTD is supply since January 1, 2016*

Source: European Commission, Euro zone countries' debt agencies, BZ WBK.

5. Poland vs Other Countries

Main Macroeconomic Indicators (European Commission Forecasts)

	GDP (%)		Inflation (HICP, %)		C/A Balance (% of GDP)		Fiscal Balance (% of GDP)		Public Debt (% of GDP)	
	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017
Poland	**3.7**	**3.6**	**0.0**	**1.6**	**-0.3**	**-0.9**	**-2.6**	**-3.1**	**52.0**	**52.7**
Czech Republic	2.1	2.6	0.5	1.4	-1.5	-1.3	-0.7	-0.6	41.3	40.9
Hungary	2.5	2.8	0.4	2.3	5.0	4.5	-2.0	-2.0	74.3	73.0
EU	1.8	1.9	0.3	1.5	2.2	2.1	-2.1	-1.8	86.4	85.5
Euro zone	1.6	1.8	0.2	1.4	3.7	3.6	-1.9	-1.6	92.2	91.1
Germany	1.6	1.6	0.3	1.5	8.5	8.3	0.2	0.1	68.6	66.3

Main Market Indicators (%, end of period)

	Reference Rate (%)		3M Market Rate (%)		10Y Yields (%)		10Y Spread vs Bund (bp)		CDS 5Y	
	2015	End-Aug 2016	2015	End-Aug 2016	2015	End-Aug 2016	2015	End-Aug 2016	2015	End-Aug 2016
Poland	**1.50**	**1.50**	**1.72**	**1.71**	**2.94**	**2.76**	**230**	**285**	**75**	**76**
Czech Republic	0.05	0.05	0.29	0.29	0.60	0.28	-4	36	50	41
Hungary	1.35	0.90	1.35	0.88	3.42	2.95	279	303	164	134
Euro zone	0.05	0.00	-0.13	-0.229						
Germany					0.63	-0.08			12	16

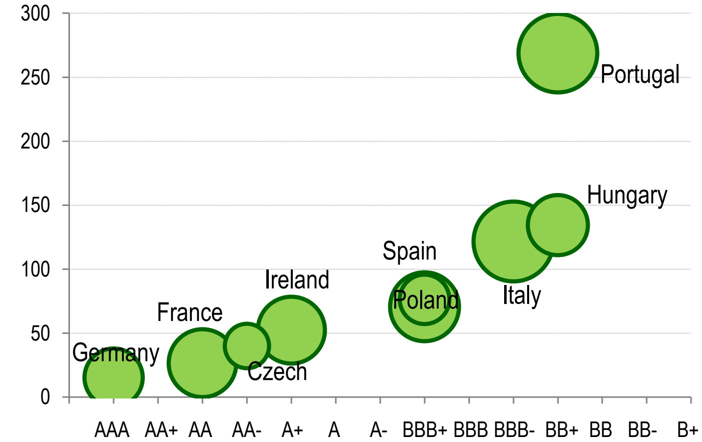
Source: EC – Spring 2016, statistics offices, central banks, Reuters, BZ WBK.

5. Poland vs Other Countries (cont.)

Sovereign ratings

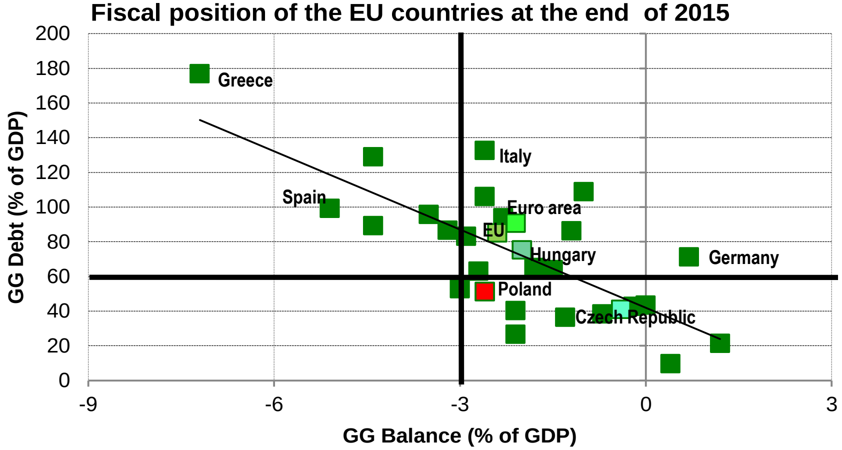
	S&P		Moody's		Fitch	
	rating	outlook	rating	outlook	rating	outlook
Poland	BBB+	negative	A2	negative	A-	stable
Czech	AA-	stable	A1	stable	A+	stable
Hungary	BB+	stable	Ba1	positive	BBB-	stable
Germany	AAA	stable	Aaa	stable	AAA	stable
France	AA	negative	Aa2	stable	AA	stable
UK	AA	negative	Aa1	negative	AA	negative
Greece	B-	stable	Caa3	stable	CCC	stable
Ireland	A+	stable	A3	positive	A	stable
Italy	BBB-	stable	Baa2	stable	BBB+	stable
Portugal	BB+	stable	Ba1	stable	BB+	stable
Spain	BBB+	stable	Baa2	stable	BBB+	stable

5Y CDS rates vs credit ranking according to S&P

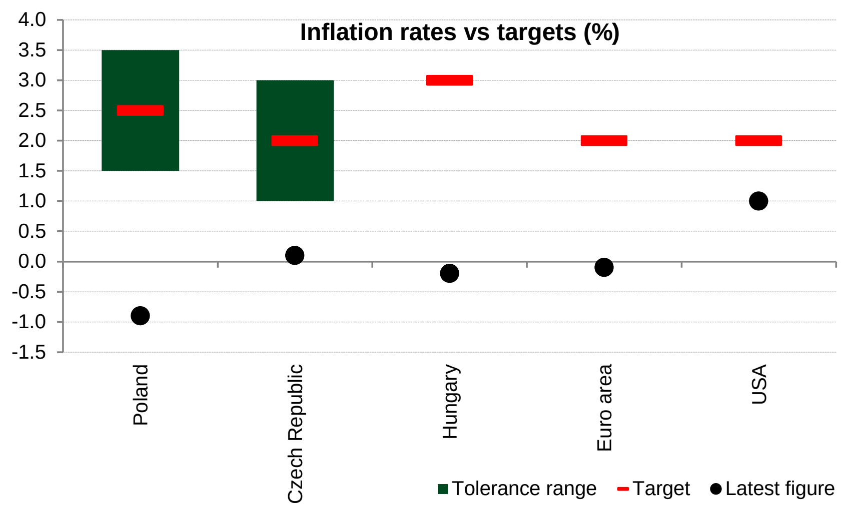


Note: Size of bubbles reflects the debt/GDP ratio

Fiscal position of the EU countries at the end of 2015



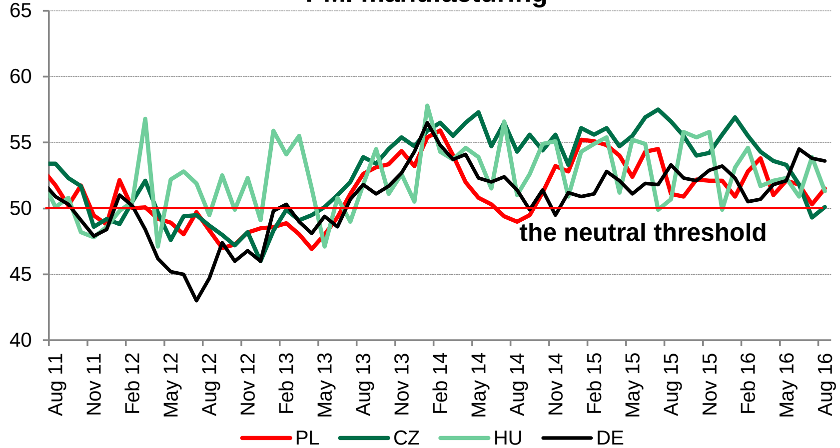
Inflation rates vs targets (%)



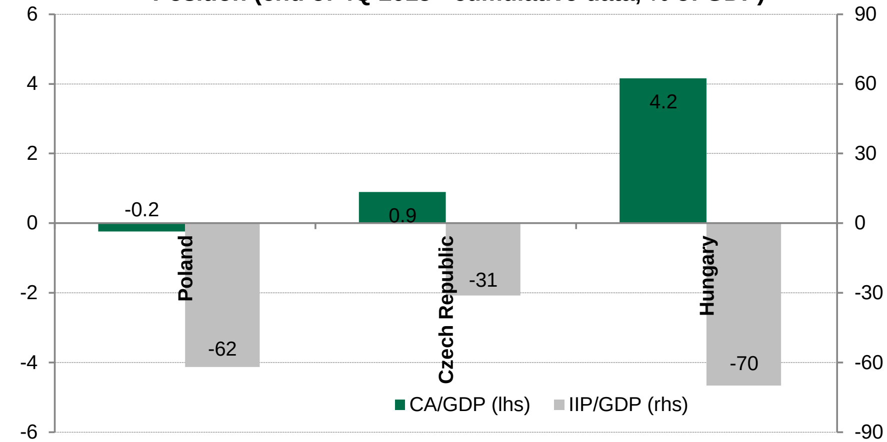
Source: Rating agencies, Reuters, EC, BZ WBK.

5. Poland vs Other Countries (cont.)

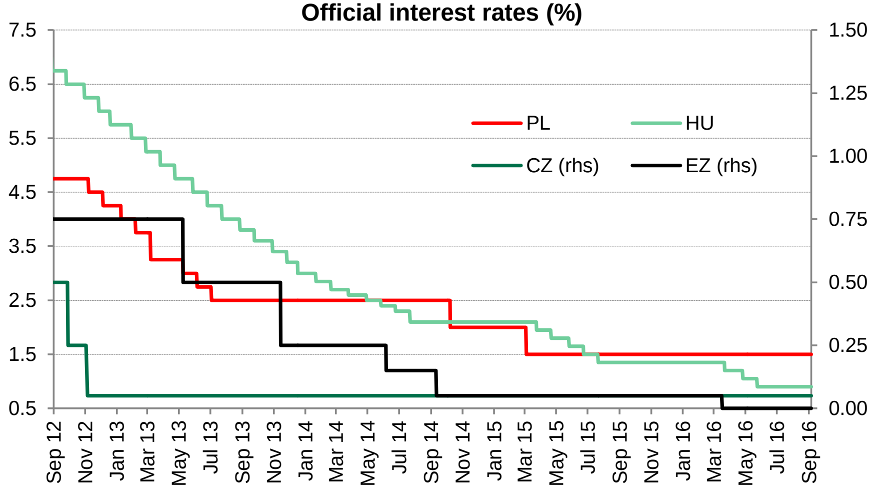
PMI manufacturing



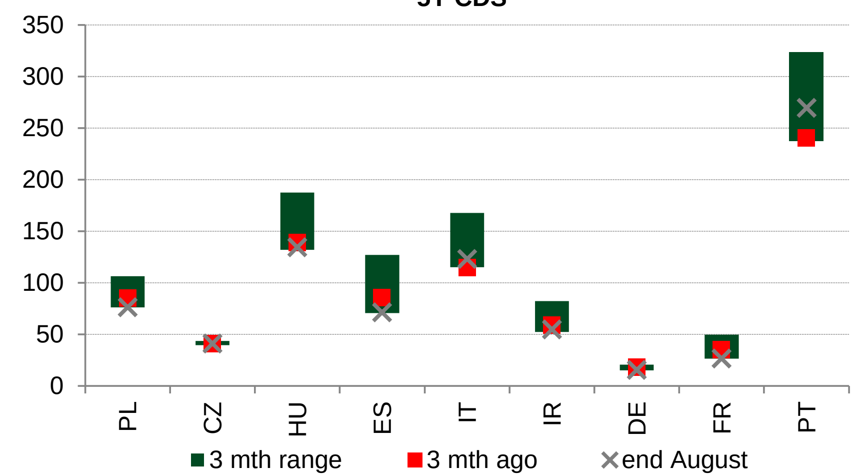
Current account balance & International Investment Position (end of 4Q 2015 - cumulative data, % of GDP)



Official interest rates (%)

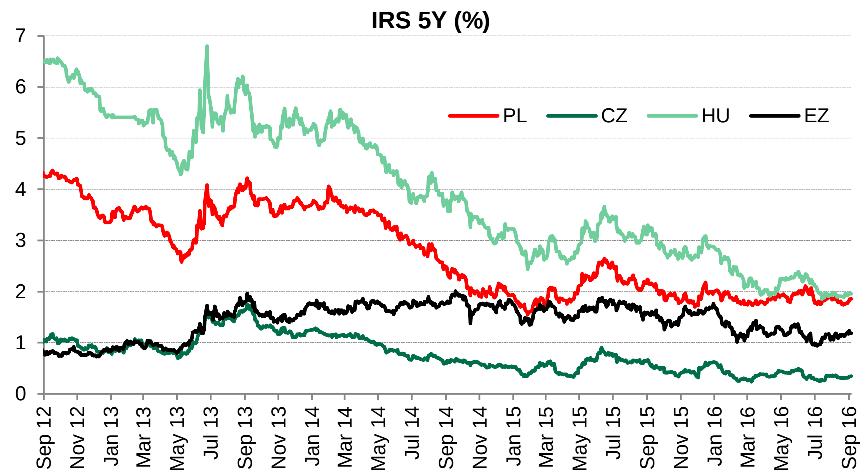


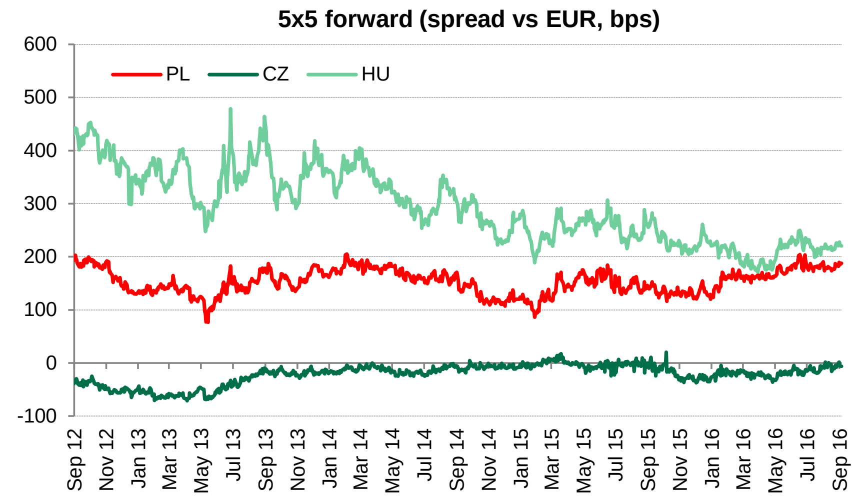
5Y CDS

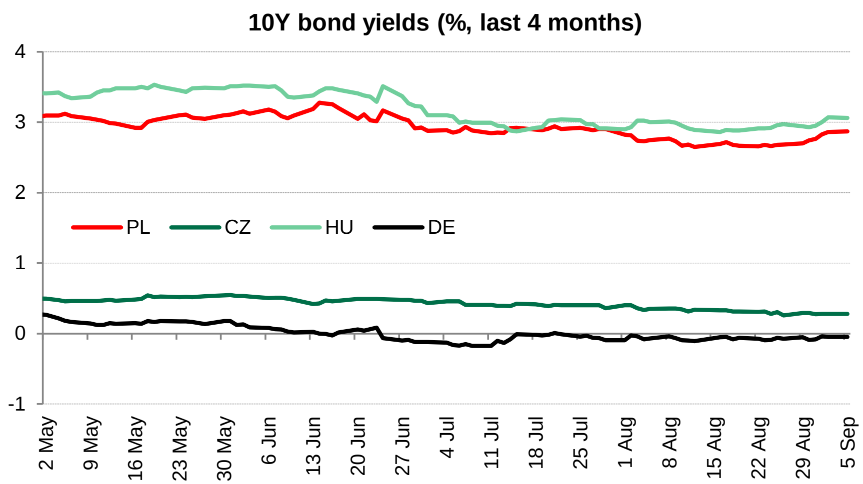


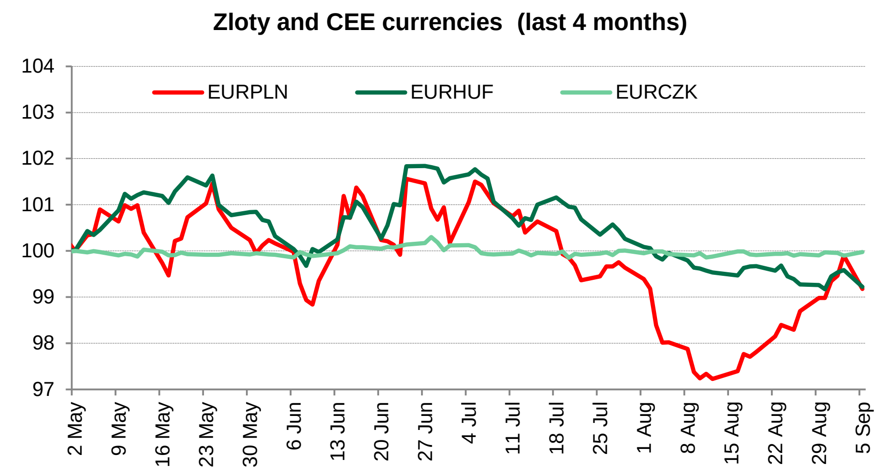
Source: Markit, Eurostat, central banks, Reuters, BZ WBK, EC.

5. Poland vs Other Countries (cont.)









Source: Reuters, BZ WBK.

6. Central Bank Watch

					Expected changes (bp)			Comments
		Last	2015	2016E	1M	3M	6M	
Euro zone	Forecast	0.00	0.05	0.00				We expect the ECB to keep interest rates unchanged, but it may announce that the Asset Purchase Programme will be extended and the allocation of purchases of sovereign debt would be shifted away from the ECB's capital key. What is more, the ECB will reveal its new CPI and GDP outlook for upcoming years.
	Market implied »				-31	-33	-34	
UK	Forecast	0.50	0.50	0.25				The Bank of England surprised investors with an aggressive package of stimulus measures. At its August meeting, the central bank cut interest rates by 25bp to a record-low 0.25% and decided to expand its Asset Purchase Programme. We expect it to continue its monetary easing, trimming rates by 10bp in November.
	Market implied »				-1	-5	-7	
US	Forecast	0.25-0.50	0.25-0.50	0.75				Over the past few weeks, expectations for earlier interest rate hikes by the Fed strengthened visibly. What is more, hawkish comments from Fed members suggest that a rate hike could be delivered sooner than the market is pricing in, even this month. We continue to believe that it is slightly more likely to happen at the December meeting than in September, although it is a very close call.
	Market implied »				52	83	125	
Poland	Forecast	1.50	1.50	1.50				We predict the MPC will keep interest rate unchanged, with the reference rate remaining at 1.50%. The majority of the MPC members believe that current interest rates are at the proper level and a 'wait-and-see' policy is optimal right now. The July minutes confirmed that the MPC is optimistic about GDP growth in 2016. However, we think that worse macroeconomic data from the Polish economy would make the MPC members' views evolve.
	Market implied »				-2	-3	-9	
Czech Republic	Forecast	0.05	0.05	0.05				As widely expected, the CNB left rates on hold at its August meeting (ie, 2W repo rate at 0.05%) and confirmed that there will be no exit from its commitment to keep the koruna close to 27 to the euro before 2017. We stick to our view that the CNB will keep monetary policy unchanged in the coming months, and it will exit from the FX commitment in 2H17E at the earliest.
	Market implied »				-1	-3	-6	
Hungary	Forecast	0.90	1.35	0.90				The Bank of Hungary (MNB) did not change interest rates at its August meeting, in line with expectations. The main rate is still 0.90%. The overall tone of the statement was neutral, and it did not contain any dovish hints. This month, we expect MBH to keep monetary policy unchanged, but investors' focus will be on new economic forecasts as the inflation path could be revised downward.
	Market implied »				-8	-15	-19	

Source: Reuters, BZ WBK.

This analysis is based on information available through September 5, 2016, and has been prepared by:

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EXPLANATION OF THE RECOMMENDATION SYSTEM

DIRECTIONAL RECOMMENDATIONS IN BONDS		DIRECTIONAL RECOMMENDATIONS IN SWAPS	
	Definition		**Definition**
Long / Buy	Buy the bond for an expected average return of at least 10bp in 3 months (decline in the yield rate), assuming a directional risk.	**Long / Receive fixed rate**	Enter a swap receiving the fixed rate for an expected average return of at least 10bp in 3 months (decline in the swap rate), assuming a directional risk.
Short / Sell	Sell the bond for an expected average return of at least 10bp in 3 months (increase in the yield rate), assuming a directional risk.	**Short / Pay fixed rate**	Enter a swap paying the fixed rate for an expected average return of at least 10bp in 3 months (increase in the swap rate), assuming a directional risk.

RELATIVE VALUE RECOMMENDATIONS	
	Definition
Long a spread / Play steepeners	Enter a long position in a given instrument vs a short position in another instrument (with a longer maturity for steepeners) for an expected average return of at least 5bp in 3 months (increase in the spread between both rates).
Short a spread / Play flatteners	Enter a long position in given an instrument vs a short position in other instrument (with a shorter maturity for flatteners) for an expected average return of at least 5bp in 3 months (decline in the spread between both rates).

FX RECOMMENDATIONS	
	Definition
Long / Buy	Appreciation of a given currency with an expected return of at least 5% in 3 months.
Short / Sell	Depreciation of a given currency with an expected return of at least 5% in 3 months.

NOTE: Given the recent volatility seen in the financial markets, the recommendation definitions are only indicative until further notice.

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