RATES AND FX OUTLOOK

POLISH FINANCIAL MARKETS

November 2015

Bank Zachodni WBK

Grupa Santander

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Summary

- The conservative Law and Justice (PiS) won the general elections with 37.8% of the votes and an outright majority in both the Sejm (235 out of 460 seats) and the Senate (61 out of 100), which means it is able to form a government without a coalition partner (the first such case in Poland's post-communist history). We expect the new government (led by Beata Szydło as the new Prime Minister) to be formed by the end of November. PiS would like to name the cabinet as soon as possible, as it would like to propose an amendment to the 2016 budget to include some of its pre-election proposals.
- Our knowledge about PiS' post-election programme is still quite limited, as we are waiting for the new government's line-up and announcement of its plans. However, we see a risk of an expansionary policy mix. PiS officials pledged to use all available monetary and fiscal policy tools to boost GDP growth towards 5%-6%. They declared, among other things, that there is still room to cut interest rate cuts by 25-50bp and revealed that willingness to cut rates will be among the criteria used to choose candidates to join the central bank's Monetary Policy Council. We currently believe interest rates are indeed likely to be cut by 50bp at the start of 2016. Inflation will probably be above zero by then and trending upwards, while GDP growth should hold steady above 3%. Thus, if the new MPC wanted to trim borrowing costs, the best strategy would probably be to do it as soon as possible, to (try to) avoid the impression that it is a pro-cyclical move. By the time the February MPC meeting takes place, there will be five new MPC members* (plus two designated by PiS president L.Kaczyński, who suddenly became more dovish in recent months). Meanwhile, the FRA market is pricing-in almost entire 50bp cut over the next nine months, so we see scope for a decline at the very short end of the curve.
- We also see a risk of fiscal policy being effectively loosened (at least in the short term) if the government aims to deliver its key election promises (incl. a PLN500 monthly child allowance, costing the budget c.PLN20bn a year) and party's ambitious assumptions about much higher tax collection do not materialise. On balance, this may be positive for economic growth in the short run, in our view, bit it could lead to higher economic imbalances and more volatile growth in the longer term. The EU may force a tightening of fiscal policy in the following years if the deficit is heading for more than 3% of GDP, and interest rates may have to rise after several quarters if inflation's upward trend is strengthened by policies aimed at stimulating demand and by retailers passing on a new supermarket tax to customers.
- We think such a scenario calls for a steeper yield curve in 2016. The main risk for the zloty is connected with the issue of converting FX loans and ideas to amend the NBP charter. As we do not think those will be top 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, as the new government is likely to start implementing some of its more controversial policy measures.

* In the POLAND: GENERAL ELECTIONS report released earlier we have mistakenly reported that the MPC will have 5 new members before its January 13-14 meeting. This is incorrect, as only 2 new members will be present at the MPC meeting in January. Three members that were nominated by the Senate on January 13, 2010, officially started their term of office on January 24 that year.

Short- and Medium-Term Strategy: Interest Rate Market

	Change (bp)		Current Level	Expected Trend	
	Last 3M	Last 1M	2 November 2015	1M	3M
Reference rate	0	0	**1.50**	→	↘↘
3M WIBOR	1	0	**1.73**	→	↘↘
2Y bond yield	-21	-22	**1.56**	↘	↘↘
5Y bond yield	-26	-27	**2.09**	↘	→
10Y bond yield	-18	-11	**2.69**	↗	↗
2/10Y curve slope	3	10	**113**	↗↗	↗↗

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: We think the new MPC may cut interest rates by 50bp at the very start of its term of office, before inflation rebound gets stronger. Meanwhile, the FRA market is pricing-in c.80% odds of a 50bp rate reduction on a nine-month horizon. Thus, we see scope for a decline at the very short end of the money market curve after we see more comments by PiS politicians and possible new MPC members about looming rate cuts. The risk is, however, that talk about the MPC candidates may not start before December.

Short end: Short-term bond yields are already near all-time lows, but they may fall even further, in our view, helped by strengthening expectations of bold interest rate cuts in Poland at the start of 2016. A slower-than-expected rebound in CPI growth is supportive for debt strengthening.

Long end: The nearest weeks are likely to be volatile, in our view, with a possible weakening of long-term debt at the end of the month as the market braces for an FOMC rate hike in December. Low debt supply and rate cut expectations may be supportive, but the room for yields to decline will be limited by worries about pro-cyclical government policy after elections. Global sentiment should be the key factor overall.

Risks to our view: We think that the biggest risk for the fixed income market is changing global sentiment and expectations about monetary policy outlook in two key economic areas – the Euro zone and the US. Stronger-than-expected data, suggesting a better economic outlook, would be negative for bonds, while disappointing figures may trigger a broad-based strengthening in fixed income.

Short- and Medium-Term Strategy: FX Market

	Change (%)		Current Level	Expected trend	
	Last 3M	Last 1M	2 November 2015	1M	3M
EURPLN	2.9	0.4	**4.25**	→	↘
USDPLN	3.5	1.9	**3.86**	→	↘↘
CHFPLN	1.0	1.0	**3.91**	→	↘
GBPPLN	2.7	3.6	**5.97**	→	↘
EURUSD	-0.5	-1.5	**1.10**	→	↗

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 think the zloty has a room to regain strength in the short run after the elections, 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 and PiS starts implementing its most controversial ideas (e.g. FX loans conversion, lowering retirement age).

USD: We think the FOMC may hike interest rates before the year-end, while the ECB is on the way to easing its policy further in December. This should be USD positive, so the zloty has limited potential to gain vs. the dollar before the year-end. For 2016 we maintain an upward bias for EUR/USD, which should imply that the room for the zloty to gain against the dollar should be greater than vs. the euro.

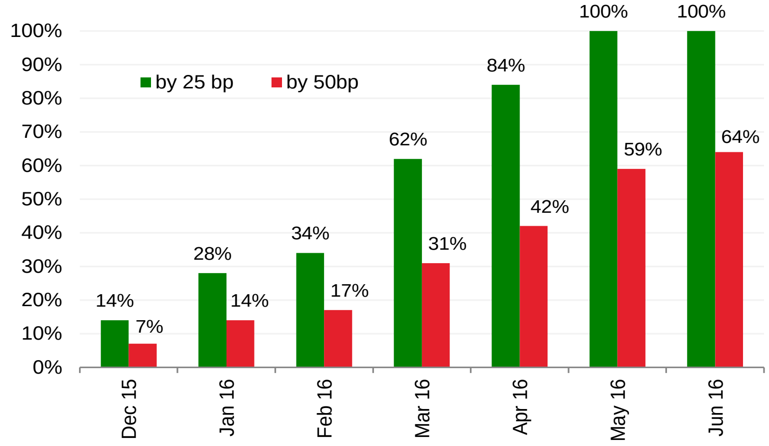
CHF: EUR/CHF is near our year-end target. We think that further gains are possible in 2016, so, in the medium term, the zloty should appreciate relatively quickly against the Swiss franc.

Risks to our view: The main risk for the zloty is the issue of FX loan conversion, with PiS promising to deal with these at the banks' cost. We guess it will not be at the top of the PiS' agenda and expect details in a few months' time. On the other hand, President Andrzej Duda promised in the election campaign to present a draft bill three months after his election, which means November.

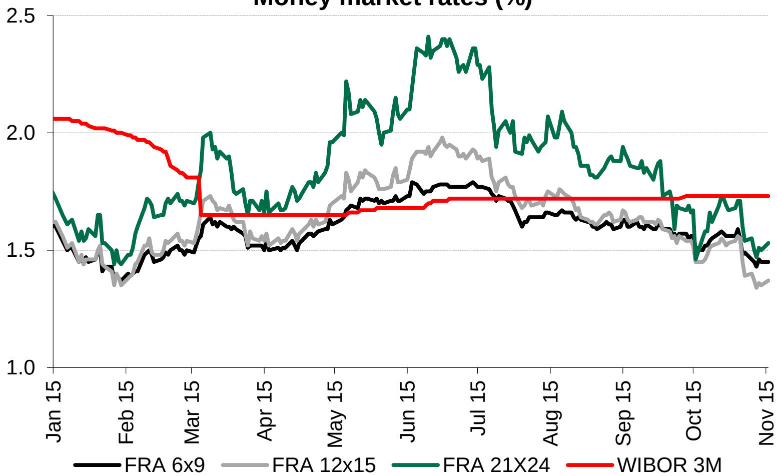
Domestic Money Market: Expectations for rate cuts in 1Q16 have strengthened

- In October FRA rates declined for the fourth month in a row. On a monthly basis FRAs were 1-20bp lower than at the end of September, as the decisive PiS victory in the autumn parliamentary election increased the probability of monetary easing in 2016. At the same time WIBOR rates were more or less stable, with only a 1bp fall in 6-12M rates. Currently, the market sees almost 60% odds of a 50bp cut in six months' time and c.80% odds of a cut of that size within nine months.
- We still believe that, given the balance of risks for GDP and CPI, the rate cut is not needed. However, a clear PiS victory in the elections and a clear message from PiS officials about preferences as regards new MPC members have led us to change our forecast for the reference rate to 1% in 2016E (ie a cut of 50bp in 1Q16E). There will be five new MPC members by the February meeting and they are likely to be very dovish. Given that FRAs are currently pricing-in monetary policy easing in 2Q, there is still room for the shorter FRAs to drop.
- We also cut our WIBOR forecast for 2016, keeping rates more or less stable in the last two months of 2015 as the turn of the year might be expensive on the money market. We see a more significant decline in WIBOR rates at the beginning of 2016.
- Macro data releases due this month are unlikely to bring any significant changes in the general outlook for Poland's economy and CPI inflation. Their impact on money market rates will probably be muted.

Probability of rate cuts
(implied by FRA rates on November 3)



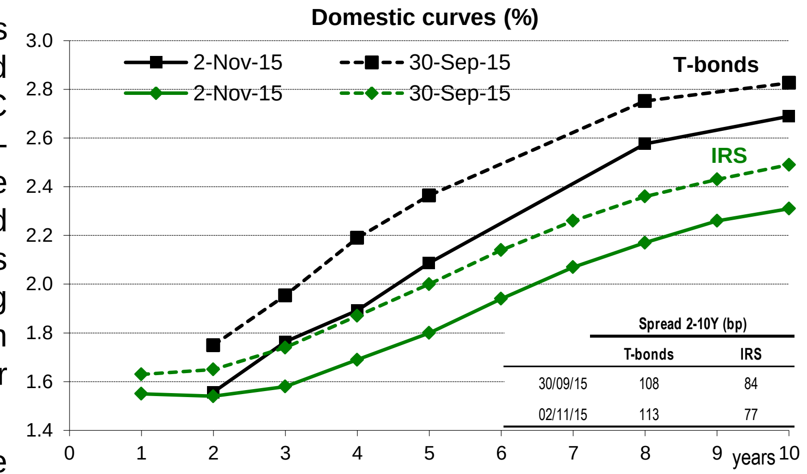
Money market rates (%)

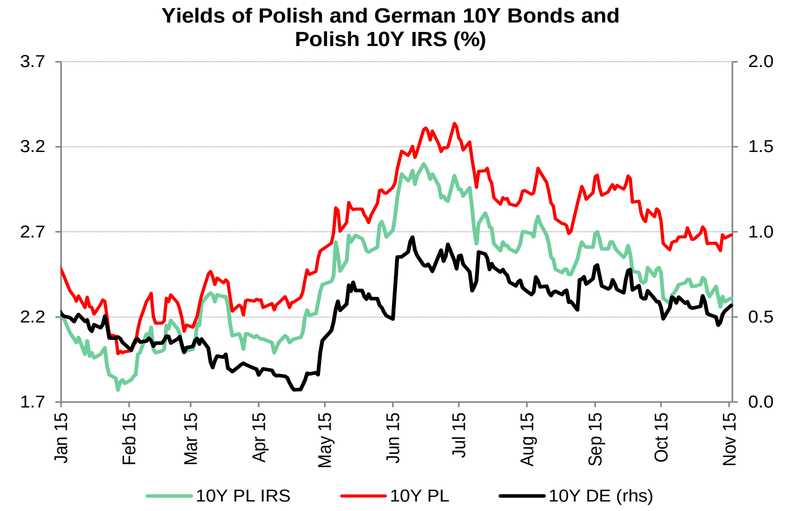


Source: Reuters, BZ WBK

Domestic IRS and the T-Bond Market: More steepening likely

- In October, the decline in yields/IRS rates deepened significantly. This stemmed from ECB President Mario Draghi's dovish comments and growing expectations of further monetary easing by Poland's MPC after the decisive PiS election victory. However, the more-hawkish-than-expected October FOMC comments, suggesting that a US rate hike is on the card for December, effectively stopped the downward trend at the long-end of the curves. Both the yield and IRS curves moved down by 10-30 bp over the month, with the belly outperforming other segments of the curve. The T-bond curve remained steep, with the 2-10Y spread remaining close to 110bp, while the 2-10Y spread for IRS narrowed to less than 80bp at the end of October.
- Given our new interest rate scenario (a rate cut of 50bp in 1Q16), we see some room for a further decline at the front end of the curves in the coming months. We do not rule out the 2Y benchmark testing the all-time low of 1.49%. In our view, the 5Y benchmark could also benefit from interest rate cut expectations, but to a slightly lesser extent.
- As regards the long end of curves, 10Y instruments should remain more vulnerable to global factors, in particular signals from the Fed. Some strengthening is possible during the month, we think, if new data from the US economy is disappointing. We see yields/IRS rates higher at the end of the month as investors brace for the approaching December FOMC meeting and the risk of a rates lift-off. All in all, we expect the long end of the curves to remain quite volatile and look for a steepening of Polish curves.





Source: Reuters, Bloomberg, BZ WBK.

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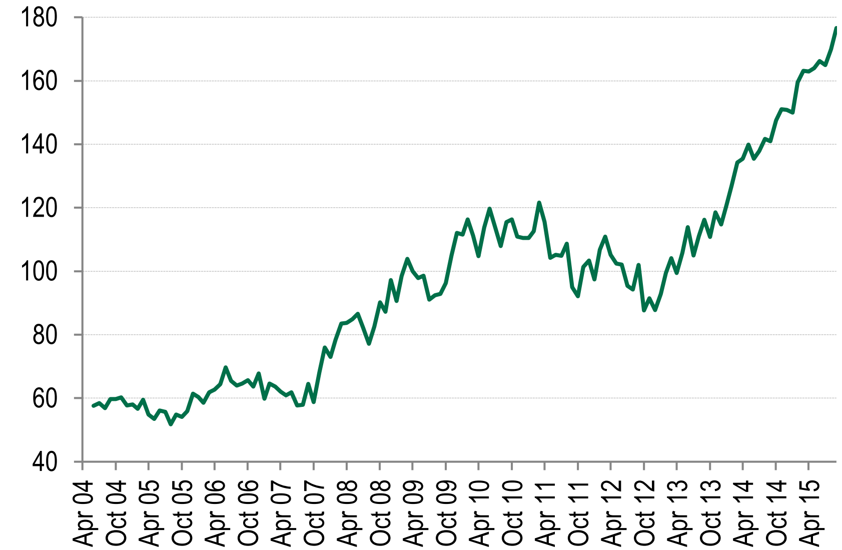
Demand Corner: Polish bank holdings hit another all-time high

- Finance Ministry data showed that foreign investors raised their holdings of government, marketable, PLN-denominated bonds by PLN2.6bn in September, taking the nominal value of their portfolio to PLN208.1bn at the end of 3Q. Over the quarter, non-residents bought bonds with a nominal value of almost PLN4.5bn vs. their sales of PLN84mn in 2Q and PLN7.8bn buying in 1Q.
- As far as this group is concerned, the pronounced sell-off by commercial banks (PLN2.5bn) and mutual funds (PLN4.6bn) and the strength of central bank purchases (PLN7.2bn mainly thanks to the Asian central banks) are worth mentioning.
- As regards the geographical breakdown, entities from the Euro zone sold PLN3.1bn of Polish bonds while non-Euro zone EU institutions purchased PLN2.2bn. North Americans purchased PLN2.2bn of Polish bonds.
- Significant buying – the most intense since February -- was also seen from Polish commercial banks, which bought bonds worth PLN6.7bn, with their total portfolio reaching a fresh all-time high of PLN176.7bn. In the whole 3Q, Polish banks bought bonds with a nominal value of PLN10.4bn vs. PLN3.2bn in 2Q and PLN12.3bn in 1Q.
- By bond series, the biggest monthly flows were recorded for PS0420 (Polish banks and non-residents accumulated cPLN3bn), DS0725 (foreign investors bought PLN2.1bn) and WZ0124 (non-residents cut their exposure by PLN850mn, more than half of their holdings).

Polish PLN, marketable bonds held by the Polish commercial banks (PLNbn)

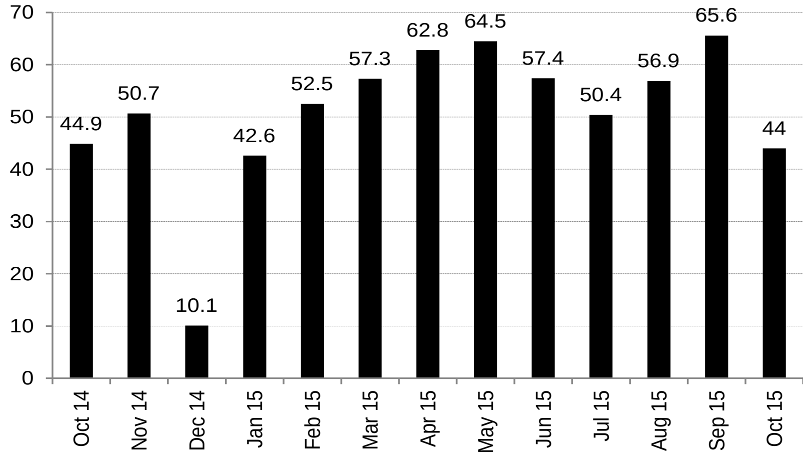


Source: Finance Ministry. BZ WBK.

Supply Corner: Poland's Finance Ministry has started to pre-finance its 2016 needs

- In October, demand for Poland's government bonds on the primary market remained decent. The ministry launched T-bonds worth PLN8.08bn in total on both regular and top-up auctions, with demand worth cPLN10.66bn. The 5Y benchmark PS0421 attracted the lion's part of total recorded bids, while the 10Y benchmark was the least popular, due to the higher risk of Fed tightening in December.
- As expected, in October Poland's Finance Ministry effectively finished financing this year's borrowing needs and started pre-financing its 2016 requirements, mainly through switch tenders. Despite significant payments last month for the redemption of DS1015 and debt servicing, the ministry managed to maintain its PLN and FX reserves at a prudent PLN44bn.
- The ministry confirmed its issuance plan for November. There will be only one switch tender, at which it will offer to repurchase OK0116 and PS0416. It also plans to redeem up to €1bn of eurobonds maturing in February 2016. That would amount to 20% of the issue, which had a nominal value of €3bn. As a result, pre-financing of 2016 gross borrowing needs might speed up slightly. In our view, Poland may be able to cover 20%-30% of 2016 gross borrowing needs (PLN180bn) by the end of 2015.

Funds in PLN and in foreign currency held by the MoF (end of month, in PLN bn)



Auction plan for November 2015

Auction/ settlement date	Settlement T-bond	Source T-bond	Outstanding (PLN m)
19 Nov 2015 / 23 Nov 2015	choice will depend on the market conditions	OK0116	22,338
		PS0426	22,308

Auction/ settlement date	Buy-back T-bonds		Nominal value of buyback (EUR m)
	Series	Maturity date	
26 Nov 2015 / 30 Nov 2015	EUR20160201	1 Feb 2016	Up to 1,000

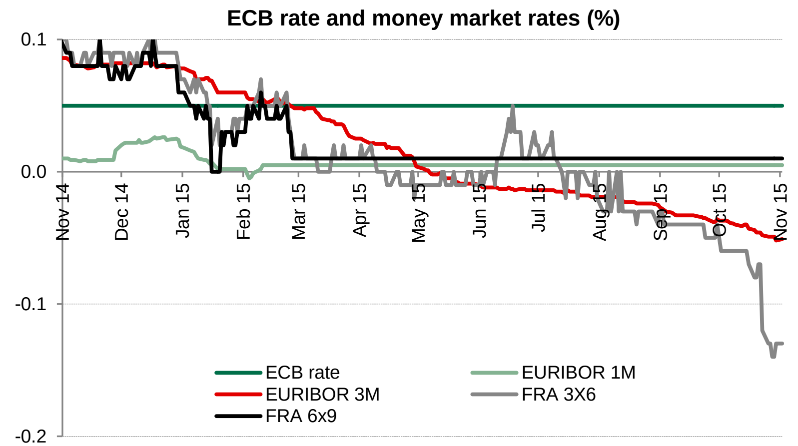
Source: Finance Ministry, BZ WBK.

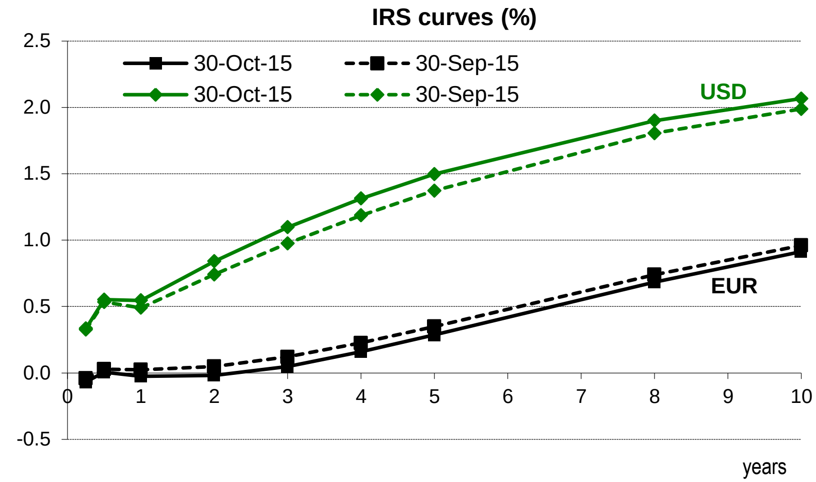
International Money Market and IRS: Markets driven by central bank policy signals

- Last month Euro zone money market rates were the most vulnerable among European and USD markets. EURIBORs continued to fall, as the ECB at its October meeting suggested changes in the size, composition and/or design of its QE programme in December. Expectations of a further cut in the deposit rate also strengthened. Other European money market rates (CHF LIBOR, GBP LIBOR, BUBOR, PRIBOR) were more or less stable, supported by dovish central banks, while USD LIBORs increased gradually over the past month as a result of more hawkish-than-expected Fed rhetoric.

- More significant changes were noted in IRS markets, both in the US and Europe. European IRS fell markedly, in particular at the long end of the curves, because of the cloudy economic outlook for both the Euro zone and the European Union. Meanwhile, USD IRS rates inched higher (by 6-13bp across the curve) as the market took the surprisingly hawkish rhetoric from the Fed as a sign of confidence in the US economy.

- The combination of low inflation and expectations that the ECB may soon extend and/or expand the current QE programme, and even set a deposit rate further into negative territory, could push EUR rates lower across the curve in the coming weeks. At the same time, mixed data from the US economy in the next few months are likely to add to market volatility in the short term. As we move closer to the December FOMC meeting, we see US rates trending higher, most significantly in money market rates and the short end of the IRS curve.

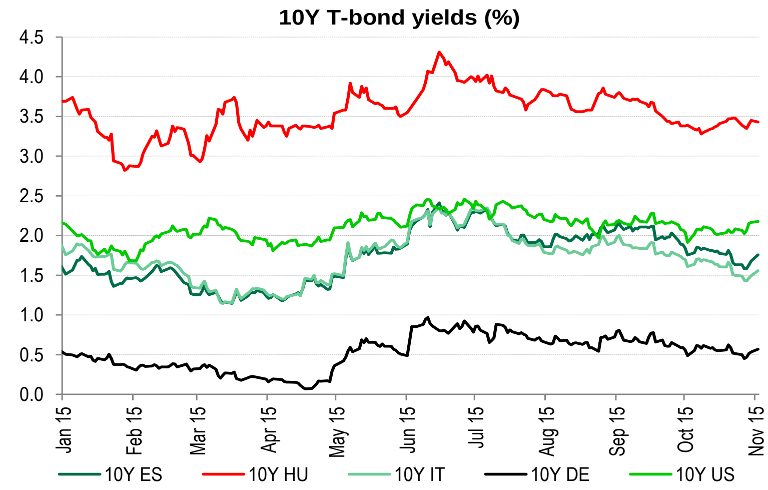


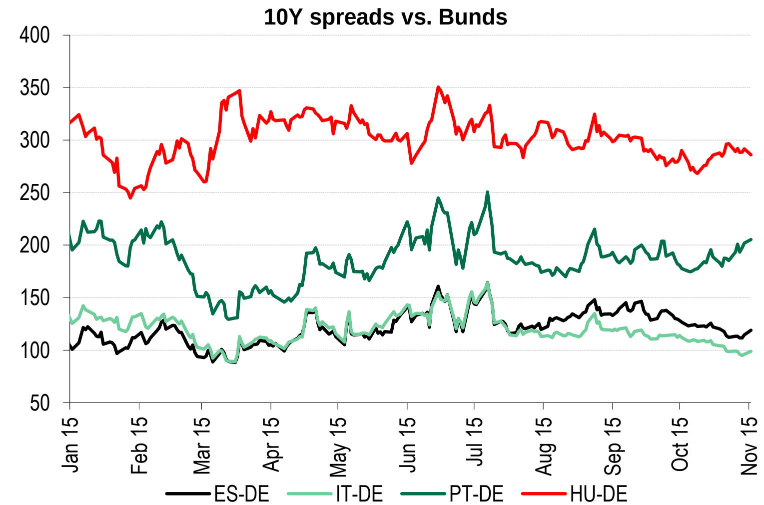


Source: Reuters, ECB, Fed, BZ WBK.

International Bond Market: Central banks set the direction for the coming months

- Draghi's dovish comments after the October meeting, suggesting that the ECB's monetary policy stimulus would be re-examined in December, prompted a global debt market rally and the 10Y Bund yield reached 0.45%, the lowest level since early May. However, unexpectedly hawkish Fed rhetoric, increasing the probability of lift-off in December, trimmed most of the earlier gains. While most of the European bond markets ended October with lower yields compared with the previous month, yields of the US Treasuries edged higher across the board. What is more, the peripheral debt market performed better than Germany's and spreads over Bund gradually narrowed.
- In our view, future central bank monetary policy remains key to market direction. We see the front end of both core and peripheral curves trending lower, due to strong expectations of further monetary easing by the ECB in December. We think that global growth worries and hyper-cautious monetary policy in Europe should keep yields quite low in the coming weeks. The improving periphery macro outlook should result in further spread tightening.
- As regard the US debt market, rates should remain more volatile, strongly dependent on macro data releases, in particular from the labour market. While US Treasury yields are likely to move sideways this month, the approaching Fed meeting looks set to push yields higher in December.



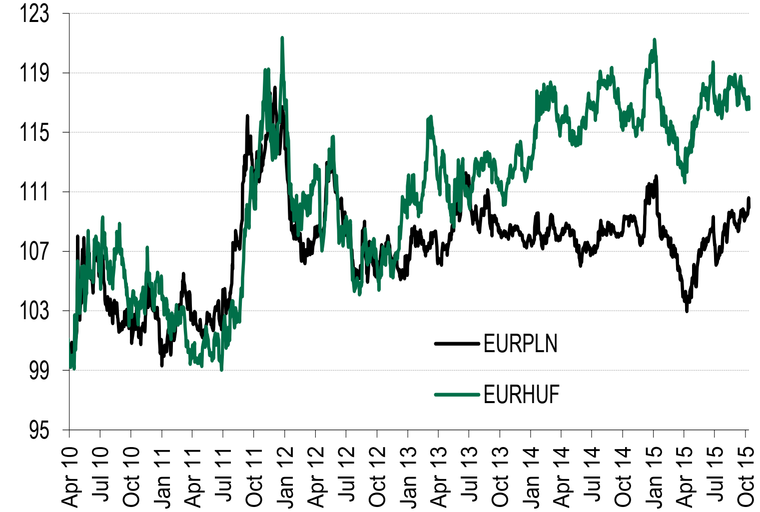


Source: Reuters, BZ WBK.

Foreign Exchange Market: Zloty may gain in the short run

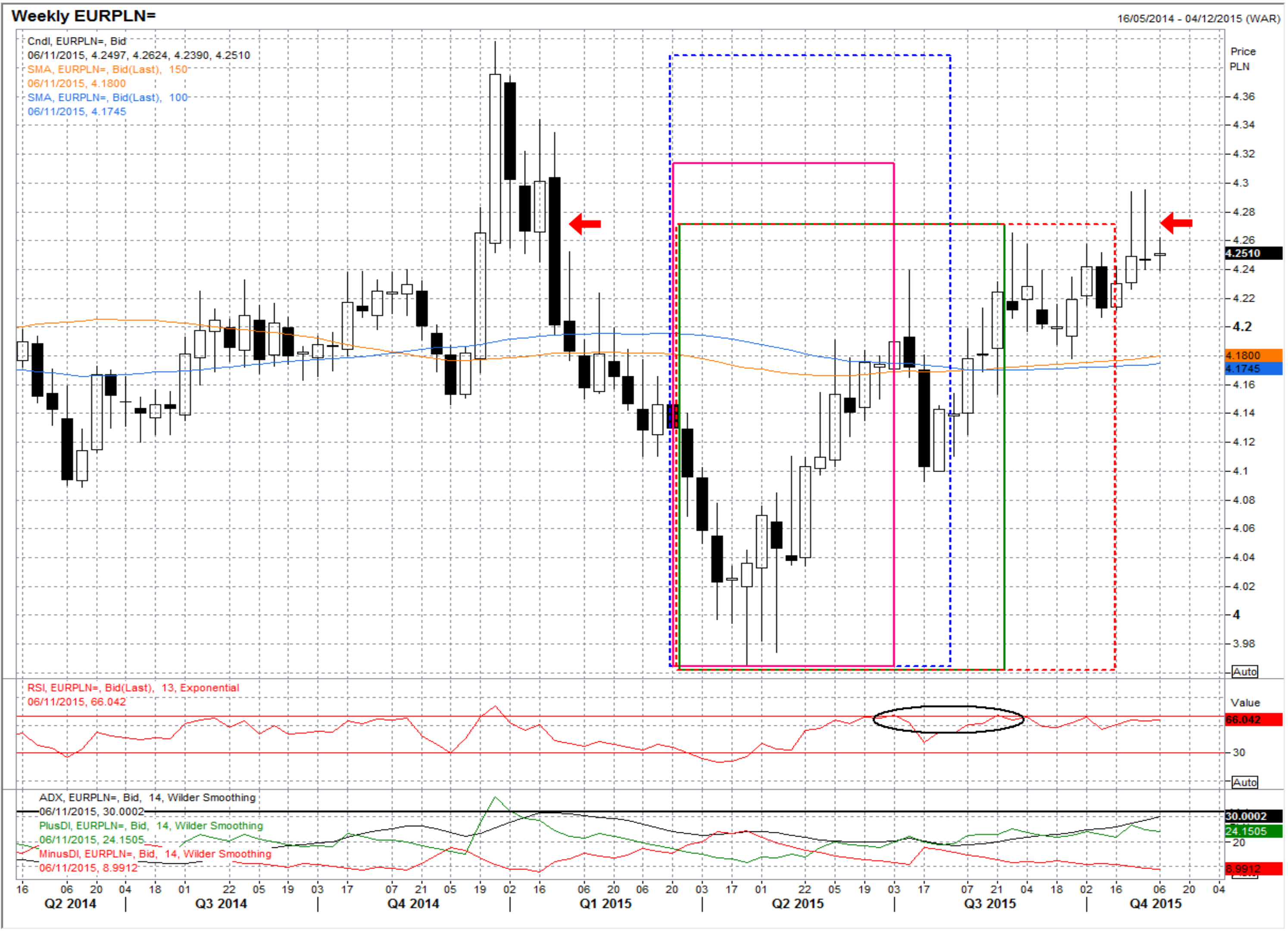
- In October we suggested that volatility in the Polish FX market could rise and might have a temporary negative impact on the zloty. The last few weeks seemed to have confirmed our call. EUR/PLN jumped to c4.295, its highest since late January, on the back of higher odds of further monetary policy easing in Poland after the election. As expected, the depreciation was only temporary and in early November EUR/PLN was back close to 4.25, partly thanks to the dovish signal from the ECB.
- The FX market reacted little to the election result and we think the zloty may even gain further in the short run, with global market sentiment possibly sending EUR/PLN lower (after its recent highs).
- We think the current situation could be quite similar to the Hungarian case. In 2010, in the first three years 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 Hungarian National Bank was cutting rates.
- Therefore, even though we see a room for short-term appreciation, we see a risk that the Polish currency could underperform its peers in 2016 if there is a major shift in economic policy and PiS starts implementing its most controversial ideas. 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 and EUR/HUF (April 12, 2010 = 100)



Source: Reuters, BZ WBK

FX Technical Analysis Corner: EUR/PLN could drop



- Last month we said that rising ADX generates risk for the scenario of a stronger zloty and this has materialized in the recent weeks.
- ADX is approaching its local high and this makes us think that room for more EUR/PLN rise is limited in the short term. Also, the big black candle should work as a strong resistance and long upper shadows drawn in the last two weeks suggest there is a limited willingness in the market to push EUR/PLN significantly higher.
- Support levels to watch are 4.21 and 4.18.

Source: Reuters, BZ WBK.

FX Technical Analysis Corner: EUR/USD – time for a rebound?

- EUR/USD fell on monthly basis but remained above the 1.08 support.
- ADX reached its local high (suggesting there is limited room for the downtrend to strengthen) and RSI gave a buy signal. This suggests that the euro can recover in the coming weeks.
- Important levels for EUR/USD are support at 1.08 and resistance at 1.11 (next ones at 1.135 and 1.17).

Source: Reuters, BZ WBK.

Macroeconomic Forecasts

Poland		2013	2014	2015E	2016E	1Q15	2Q15	3Q15E	4Q15E	1Q16E	2Q16E	3Q16E	4Q16E
GDP	PLNbn	1,662.1	1,728.7	1,792.3	1,878.7	417.8	433.8	442.7	498.0	438.1	455.3	462.6	522.7
GDP	%YoY	1.7	3.4	3.4	3.5	3.6	3.3	3.3	3.5	3.5	3.5	3.5	3.3
Domestic demand	%YoY	0.2	4.9	3.3	3.6	2.6	3.3	3.4	3.9	3.8	3.5	3.5	3.5
Private consumption	%YoY	1.1	3.1	3.2	3.2	3.1	3.0	3.3	3.3	3.3	3.2	3.1	3.1
Fixed investment	%YoY	0.9	9.2	7.0	6.0	11.4	6.4	6.2	6.0	6.0	6.0	6.0	6.0
Unemployment rate [a]	%	13.4	11.4	9.9	9.1	11.5	10.2	9.7	9.9	10.1	9.2	8.9	9.1
Current account balance	EURmn	-5,031	-8,303	-1,198	-790	900	1,110	-1,474	-1,734	1,407	963	-1,549	-1,611
Current account balance	% GDP	-1.3	-2.0	-0.3	-0.2	-1.3	-0.4	-0.2	-0.3	-0.2	-0.2	-0.2	-0.2
General government balance (ESA 2010)	% GDP	-4.0	-3.2	-2.7	-3.2	-	-	-	-	-	-	-	-
CPI	%YoY	0.9	0.0	-0.9	1.4	-1.5	-0.9	-0.7	-0.3	0.9	1.2	1.4	2.0
CPI [a]	%YoY	0.7	-1.0	0.2	2.0	-1.5	-0.8	-0.8	0.2	1.0	1.3	1.7	2.0
CPI excluding food and energy prices	%YoY	1.2	0.6	0.4	1.0	0.4	0.3	0.3	0.5	0.7	0.9	1.0	1.2

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		2013	2014	2015E	2016E	1Q15	2Q15	3Q15E	4Q15E	1Q16E	2Q16E	3Q16E	4Q16E
Reference rate [a]	%	2.50	2.00	1.50	1.00	1.50	1.50	1.50	1.50	1.00	1.00	1.00	1.00
WIBOR 3M	%	3.02	2.52	1.75	1.30	1.87	1.67	1.72	1.73	1.42	1.25	1.25	1.26
Yield on 2-year T-bonds	%	2.98	2.46	1.67	1.35	1.61	1.75	1.80	1.54	1.36	1.30	1.33	1.42
Yield on 5-year T-bonds	%	3.46	2.96	2.20	2.51	1.90	2.35	2.43	2.11	2.27	2.45	2.60	2.72
Yield on 10-year T-bonds	%	4.04	3.49	2.66	3.08	2.24	2.79	2.93	2.66	2.76	2.97	3.18	3.42
2-year IRS	%	3.10	2.51	1.69	1.34	1.65	1.85	1.78	1.50	1.33	1.33	1.32	1.37
5-year IRS	%	3.51	2.92	2.01	2.26	1.80	2.23	2.17	1.83	2.01	2.20	2.35	2.47
10-year IRS	%	3.86	3.34	2.41	2.78	2.06	2.57	2.62	2.37	2.46	2.67	2.88	3.12
EUR/PLN	PLN	4.20	4.18	4.18	4.20	4.20	4.09	4.19	4.23	4.17	4.20	4.25	4.21
USD/PLN	PLN	3.16	3.15	3.75	3.54	3.72	3.70	3.77	3.82	3.54	3.55	3.55	3.51
CHF/PLN	PLN	3.41	3.45	3.91	3.64	3.93	3.93	3.90	3.87	3.76	3.71	3.63	3.48
GBP/PLN	PLN	4.94	5.19	5.75	5.74	5.64	5.67	5.84	5.85	5.67	5.71	5.82	5.76

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

Economic Calendar and Events

Date		Event:	Note:
4-Nov	**PL**	**MPC meeting – interest rate decision**	**No change in monetary policy conditions**
5-Nov	CZ	CNB meeting – interest rate decision	No change in monetary policy conditions
13-Nov	**PL**	**C/A balance for September**	**We expect a current account gap of €0.52bn, in line with consensus**
13-Nov	**PL**	**CPI for October**	**Flash estimate was -0.8%YoY, we expect it to be confirmed**
	PL	**Flash GDP for 3Q15**	**We expect steady GDP growth of c.3.3%YoY in 3Q15**
14-Nov	**PL**	**Core CPI measures for October**	**Flash CPI suggests, in our view, that core inflation excluding food and energy remained flat at 0.2%YoY or inched up slightly to 0.3%YoY**
17-Nov	HU	HNB meeting – interest rate decision	We expect rates to remain unchanged
18-Nov	**PL**	**Wages and employment for October**	**We expect employment growth of 1%YoY and an increase in wages of 3.6%YoY, close to market consensus**
19-Nov	**PL**	**Industrial output for October**	**We expect a slight increase of 1.4%YoY (mainly due to fewer working days), well below market expectations (2.8%)**
	PL	**Construction output for October**	**In our view, construction output will fall by 3.5%YoY vs the median forecast of -0.8%YoY**
	PL	**Retail sales for October**	**We estimate retail sales growth (in constant prices) of c.3%YoY**
	PL	**Minutes from November MPC meeting**	**These may confirm that two presidential MPC members have turned more dovish**
	PL	**Switch tender**	**OK0116 and PS0416 will be bought back**
26-Nov	**PL**	**Buy-back auction**	**The MoF will buy back EUR20160201 up to €1bn**
TBA	**PL**	**Unemployment rate for October**	**We expect a further slide in unemployment to 9.6%**
30-Nov	**PL**	**3Q15 GDP**	**We expect GDP growth of 3.3%. In our view, private consumption grew 3.3%YoY and investment by 6.1%YoY**

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

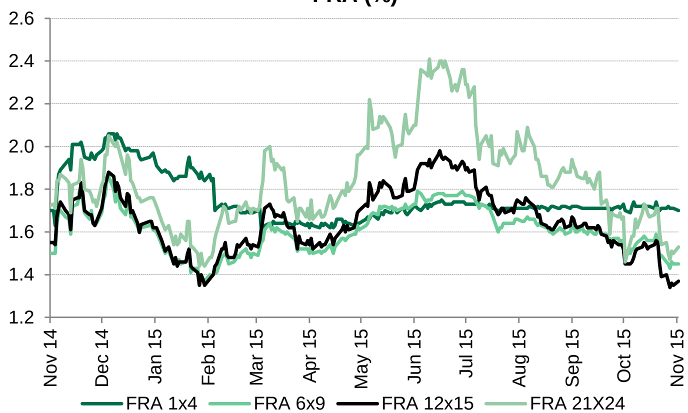
Money market rates (%)

	Reference rate (%)	Poland (%)	WIBOR (%) 1M	WIBOR (%) 3M	WIBOR (%) 6M	WIBOR (%) 12M	OIS (%) 1M	OIS (%) 3M	OIS (%) 6M	OIS (%) 12M	FRA (%) 1x4	FRA (%) 3x6	FRA (%) 6x9	FRA (%) 9x12
End of October	**1.50**	**1.53**	**1.67**	**1.73**	**1.80**	**1.83**	**1.46**	**1.46**	**1.38**	**1.29**	**1.71**	**1.66**	**1.45**	**1.35**
Last 1M change (bp)	0	-1	0	0	-1	-1	-1	-1	-9	-13	-1	-2	-11	-16
Last 3M change (bp)	0	4	1	1	1	0	1	1	-7	-17	0	-2	-21	-32
Last 1Y change (bp)	-50	-47	-34	-24	-16	-12	-25	-17	-18	-25	-2	7	-9	-21

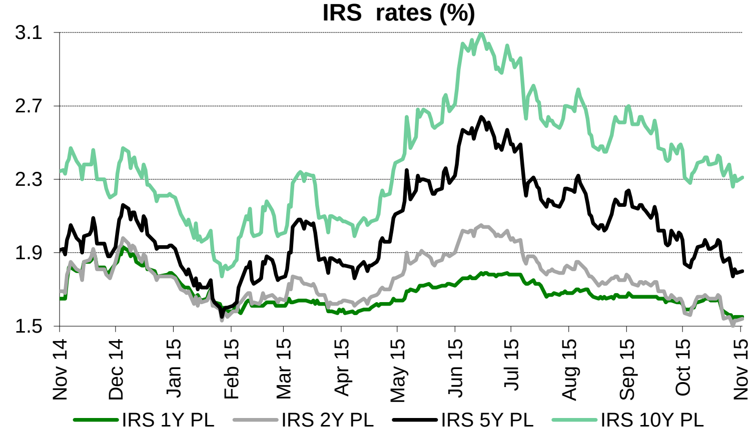
Bond and IRS market (%)

	BONDS 2Y	BONDS 5Y	BONDS 10Y	IRS 2Y	IRS 5Y	IRS 10Y	Spread BONDS / IRS (bp) 2Y	Spread BONDS / IRS (bp) 5Y	Spread BONDS / IRS (bp) 10Y
End of October	**1.56**	**2.07**	**2.65**	**1.53**	**1.79**	**2.29**	**3**	**28**	**36**
Last 1M change (bp)	-19	-29	-17	-12	-21	-20	-7	-8	3
Last 3M change (bp)	-24	-36	-27	-29	-46	-41	5	10	14
Last 1Y change (bp)	-16	2	15	-20	-17	-10	4	19	25

FRA (%)



IRS rates (%)



Source: Reuters, BZ WBK

2. Polish Bonds: Supply Recap

Total issuance in 2015 by instrument (in PLN mn, nominal terms)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
T-bond auctions	11,204	10,908	4,639	11,442	4,056	4,237	8,283	4,656	10,233	8,082			77,739
T-bill auctions													0
Retail bonds	97	126	127	129	207	181	214	262	245	200	950	200	2,938
Foreign bonds/credits				4,127	2,278		3,797						10,202
Pre-financing and financial resources at the end of 2014	38,700												38,700
Total	**50,001**	**11,034**	**4,766**	**15,698**	**6,541**	**4,417**	**12,294**	**4,918**	**10,478**	**8,282**	**950**	**200**	**129,580**
Redemption	6,071	159	98	14,774	6,007	110	12,897	1,643	467	26,224	213	241	68,906
Net inflows	**43,930**	**10,875**	**4,668**	**924**	**534**	**4,307**	**-603**	**3,275**	**10,011**	**-17,942**	**737**	**-41**	**60,673**
Rolled-over T-bonds			6,502			2,082				5,644			**14,229**
Buy-back of T-bills/ FX-denominated bonds													**0**
Total	**43,930**	**10,875**	**11,170**	**924**	**534**	**6,389**	**-603**	**3,275**	**10,011**	**-12,298**	**737**	**-41**	**74,902**
Coupon payments from domestic debt	*3,491*			*4,382*			*3,306*		*1,295*	*7,720*			*20,194*

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	6,023		48	**6,071**	0	**6,071**
February	0		159	**159**	0	**159**
March	0		98	**98**	0	**98**
April	14,679		95	**14,774**	0	**14,774**
May	0		116	**116**	5,742	**5,858**
June	0		110	**110**	0	**110**
July	7,658		136	**7,794**	4,802	**12,597**
August	0		184	**184**	1,412	**1,597**
September	0		162	**162**	284	**446**
October	22,420		146	**22,567**	3,658	**26,224**
November	0		213	**213**	0	**213**
December	0		241	**241**	0	**241**
Total 2015	50,781		1,710	**52,491**	16,415	**68,906**
Total 2016	84,909		2,034	**86,943**	18,949	**105,891**
Total 2017	70,023		1,032	**71,055**	14,670	**85,725**
Total 2018	66,317		1,103	**67,420**	19,221	**86,641**
Total 2019+	63,811		972	**64,783**	31,163	**95,946**
Total 2020+	226,571		2,383	**228,954**	174,556	**403,510**

Source: MF, BZ WBK.

2. Polish Bonds: Supply Recap (cont.)

Scheduled wholesale bond redemptions by holders (data at the end of September 2015, in PLN mn)

	Foreign investors	Domestic banks	Insurance funds	Pension funds	Mutual funds	Individuals	Non-financial sector	Other	Total
Q1 2015	328	3,998	775	121	233	80	15	544	6,093
Q2 2015	9,472	2,217	1,610	130	279	38	37	897	14,679
Q3 2015	2,832	3,301	1,067	108	116	35	9	189	7,658
Q4 2015	9,951	5,050	4,489	94	1,016	23	165	1,632	22,420
Total 2015	**9,951**	**5,050**	**4,489**	**94**	**1,016**	**23**	**165**	**1,632**	**22,420**
	44%	**23%**	**20%**	**0%**	**5%**	**0%**	**1%**	**7%**	**100%**
Total 2016	39,768	28,466	6,823	505	5,365	120	110	6,698	87,857
	45%	32%	8%	1%	6%	0%	0%	8%	100%
Total 2017	25,512	24,326	6,598	547	6,362	109	138	5,348	68,940
	37%	35%	10%	1%	9%	0%	0%	8%	100%
Total 2018	18,809	29,616	3,943	298	7,372	87	179	6,014	66,317
	28%	45%	6%	0%	11%	0%	0%	9%	100%
Total 2019+	20,208	25,699	5,776	487	7,302	84	151	4,102	63,811
	32%	40%	9%	1%	11%	0%	0%	6%	100%
Total 2020+	93,902	63,514	24,914	1,024	22,240	221	322	8,913	215,048
	44%	30%	12%	0%	10%	0%	0%	4%	100%

Source: MF, BZ WBK.

3. Polish Bonds: Demand Recap

Holders of marketable PLN bonds

	Nominal value (PLN bn)			Nominal value (PLN bn)			% change in September			Share of total in September (%)
	End Sep'15	End Aug'15	End Jun'15	End 1Q 2015	End 2014	End 2013	MoM	3-mth	YoY	
Domestic investors	325.5	317.8	314.3	309.1	295.9	381.2	3.9	6.3	25.4	61.0 (0.3pp)
Commercial banks	176.7	170.0	166.3	163.1	150.8	114.7	0.0	-1.4	-1.7	33.1 (0.6pp)
Insurance companies	52.5	52.5	53.3	52.4	52.8	52.0	0.3	2.8	-16.1	9.8 (-0.2pp)
Pension funds	3.0	2.9	2.9	3.1	3.3	125.8	1.2	0.6	12.6	0.6
Mutual funds	49.7	49.1	49.3	48.5	46.9	46.7	3.9	6.3	25.4	9.3 (-0.1pp)
Others	43.7	43.3	42.6	42.0	42.0	42.0	0.9	2.7	6.1	8.2 (-0.1)
Foreign investors*	208.2	205.6	203.7	203.8	196.0	193.2	1.2	2.2	5.4	39.0 (-0.3pp)
Banks	13.5	16.0	14.0	9.9	9.9	n.a.	-15.9	-3.3	11.9	2.5 (-0.5pp)
Central banks	28.3	21.1	22.6	20.3	16.4	n.a.	34.3	25.2	46.6	5.3 (1.3pp)
Public institutions	9.7	9.5	9.4	8.8	8.1	n.a.	2.3	3.3	1674.5	1.8
Insurance companies	11.6	11.6	11.0	11.0	10.7	n.a.	0.3	5.4	6.0	2.2
Pension funds	13.0	13.1	12.4	13.2	13.0	n.a.	-0.5	5.2	2.3	2.4 (-0.1pp)
Mutual funds	64.7	69.3	71.5	80.2	78.1	n.a.	-6.6	-9.6	-19.9	12.1 (-1.1pp)
Hedge funds	0.04	0.04	0.04	0.1	1.1	n.a.	-1.2	-0.8	-51.7	0.0
Non-financial sector	8.7	8.0	8.4	12.6	8.2	n.a.	9.6	3.8	-28.6	1.6 (0.1pp)
Others	19.5	18.7	18.6	17.0	14.3	n.a.	4.0	4.9	10.3	3.7 (0.1pp)
TOTAL	533.7	523.5	518.0	512.9	491.8	574.3	2.0	3.6	11.0	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 only since April 2014 .*

Source: MF. BZ WBK.

4. Euro Zone Bonds: Supply Recap

Euro zone: 2014 issuance completion and 2015 estimated gross borrowing requirements and redemptions (€ bn)

	2014 bond supply	% of completion	2015 total redemption	2015 bond supply	% of completion (YTD*)
Austria	24.7	91.4	13.3	17.0	96
Belgium	31.8	102.2	28.1	32.5	99
Finland	10.0	119.6	7.6	11.4	97
France	173.0	117.4	116.5	187.0	104
Germany	161.0	100.0	155.0	147.0	90
Greece	-	-	-	-	-
Ireland	10.0	117.5	2.3	7.5	99
Italy	235.4	111.8	205.2	252.9	87
Netherlands	50.0	101.7	39.9	48.0	91
Portugal	16.7	101.7	7.2	13.9	101
Spain	129.3	105.4	86.4	130.0	89
Total	**841.9**	**108.1**	661.5	**847.3**	**93**

** YTD is supply since January 1, 2015*

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)	
	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016
Poland	**3.3**	**3.4**	**-0.4**	**1.1**	**-1.8**	**-2.2**	**-2.8**	**-2.6**	**50.9**	**50.8**
Czech Republic	2.5	2.6	0.2	1.4	0.4	0.7	-2.0	-1.5	41.5	41.6
Hungary	2.8	2.2	0.0	2.5	5.5	6.2	-2.5	-2.2	75.0	73.5
EU	1.8	2.1	0.1	1.5	1.9	1.9	-2.5	-2.0	88.0	86.9
Euro zone	1.5	1.9	0.1	1.5	3.5	3.4	-2.0	-1.7	94.0	92.5
Germany	1.9	2.0	0.3	1.8	7.9	7.7	0.6	0.5	71.5	68.2

Main market indicators (%, end of period)

	Reference rate (%)		3M market rate (%)		10Y yields (%)		10Y spread vs Bund (bp)		CDS 5Y	
	2014	end-Oct 2015	2014	end-Oct 2015	2014	end-Oct 2015	2014	end-Oct 2015	2014	end-Oct 2015
Poland	**2.00**	**1.50**	**2.06**	**1.73**	**2.51**	**2.65**	**197**	**213**	**71**	**74**
Czech Republic	0.05	0.05	0.04	0.29	0.75	0.50	2	-3	55	50
Hungary	2.10	1.35	2.10	1.35	3.69	3.45	315	292	178	163
Euro zone	0.05	0.05	0.08	-0.07						
Germany					0.54	0.53			17	12

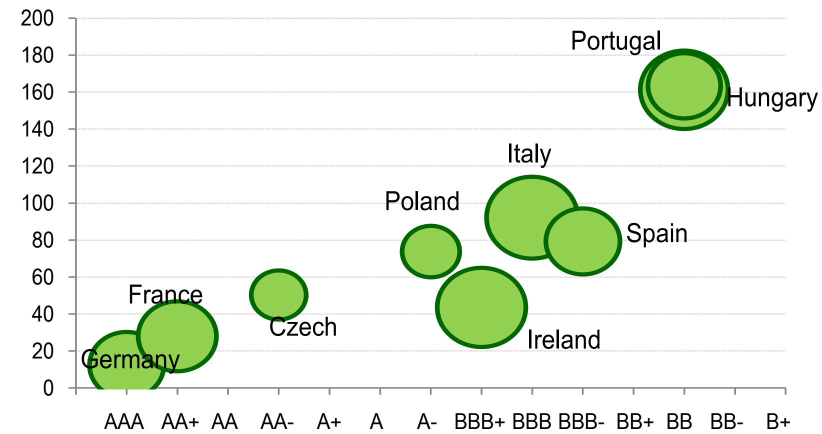
Source: EC – Spring 2015, statistics offices, central banks, Reuters, BZ WBK.

5. Poland vs. Other Countries (cont.)

Sovereign ratings

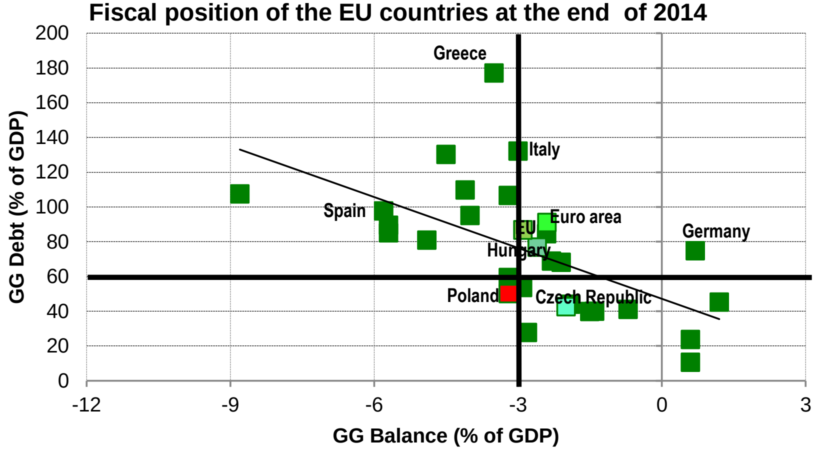
	S&P		Moody's		Fitch	
	rating	outlook	rating	outlook	rating	outlook
Poland	A	stable	A2	stable	A-	stable
Czech	AA	stable	A1	stable	A+	stable
Hungary	BB+	stable	Ba1	stable	BB+	positive
Germany	AAA	negative	Aaa	stable	AAA	stable
France	AA+	negative	Aa2	stable	AA	stable
UK	AAA	stable	Aa1	stable	AA+	stable
Greece	CCC	stable	Caa3	negative	CCC	stable
Ireland	BBB+	stable	Baa1	positive	A-	positive
Italy	BBB	negative	Baa2	stable	BBB+	stable
Portugal	BB	negative	Ba1	stable	BB+	positive
Spain	BBB+	stable	Baa2	positive	BBB+	stable

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

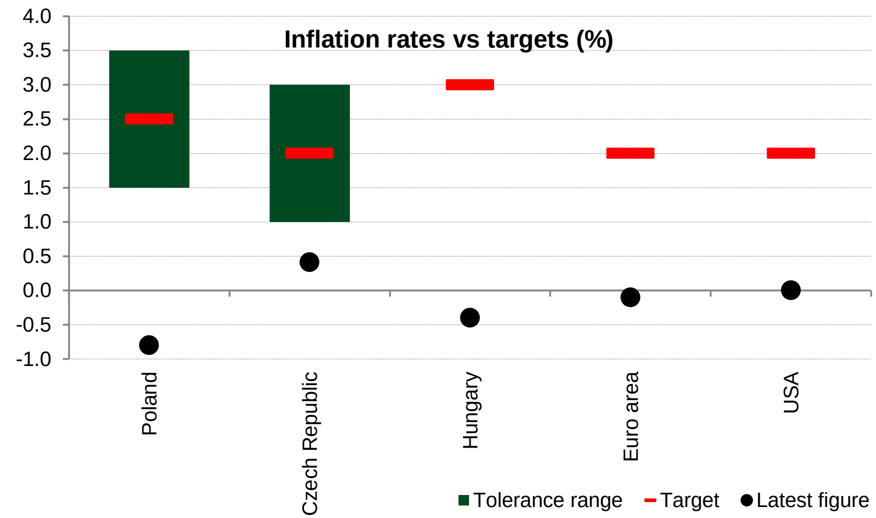


Note: Size of bubbles reflects the debt/GDP ratio

Fiscal position of the EU countries at the end of 2014



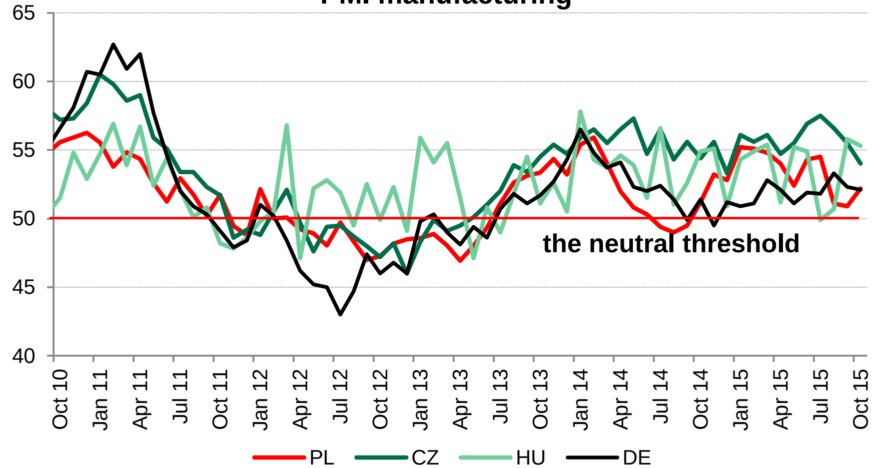
Inflation rates vs targets (%)



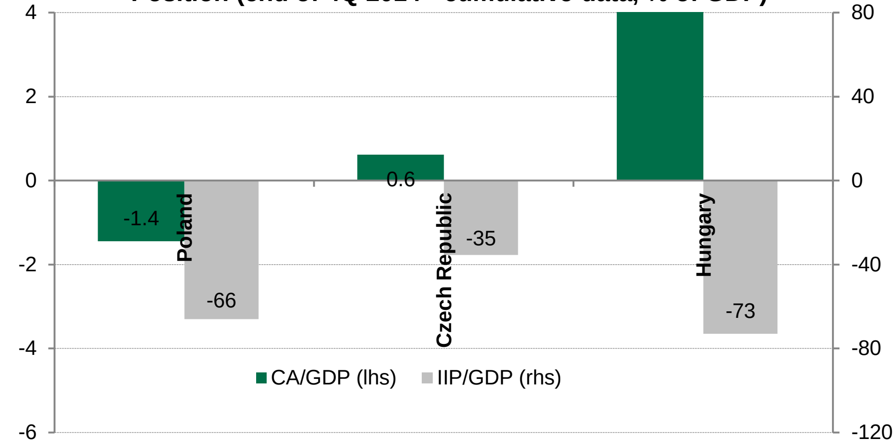
Source: Rating agencies, Reuters, EC, BZ WBK.

5. Poland vs. Other Countries (cont.)

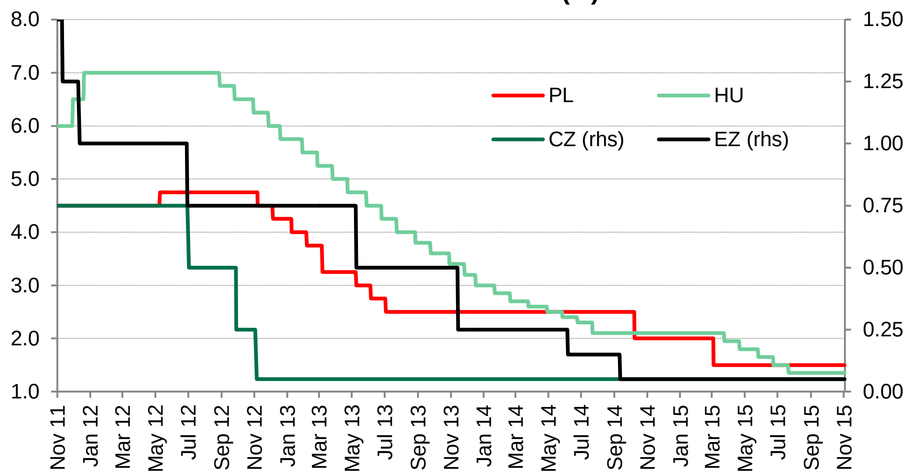
PMI manufacturing



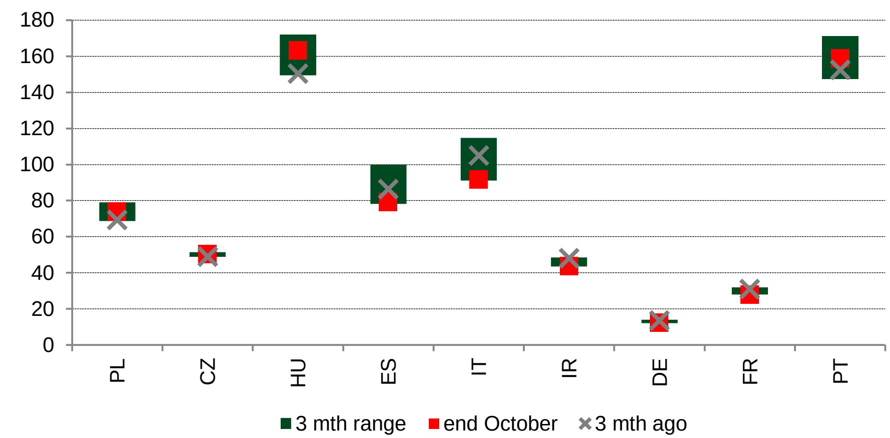
Current account balance & International Investment Position (end of 4Q 2014 - cumulative data, % of GDP)



Official interest rates (%)



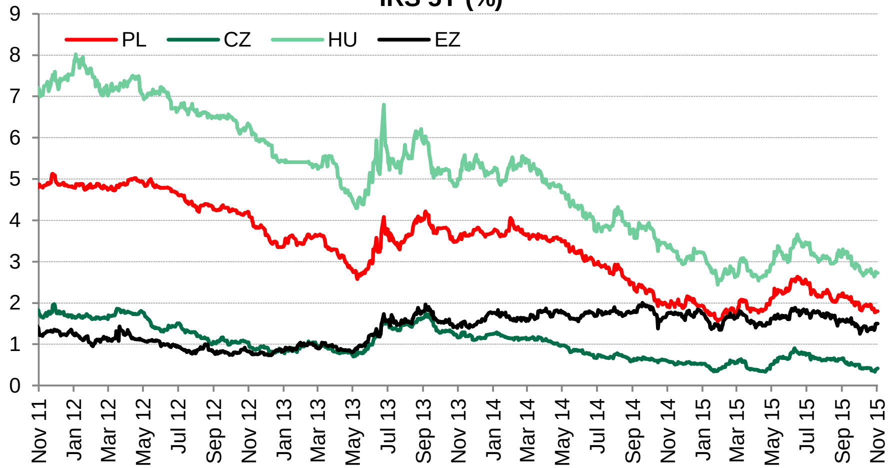
5Y CDS



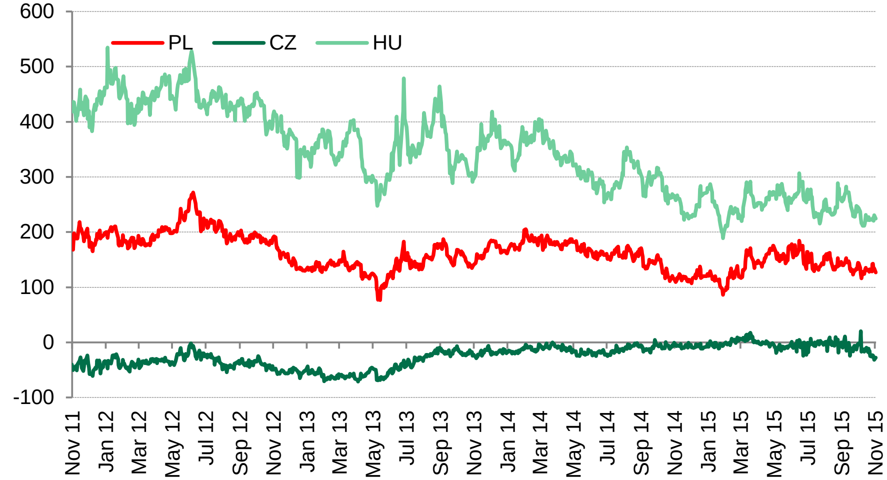
Source: Markit, Eurostat, central banks, Reuters, BZ WBK, EC.

5. Poland vs. Other Countries (cont.)

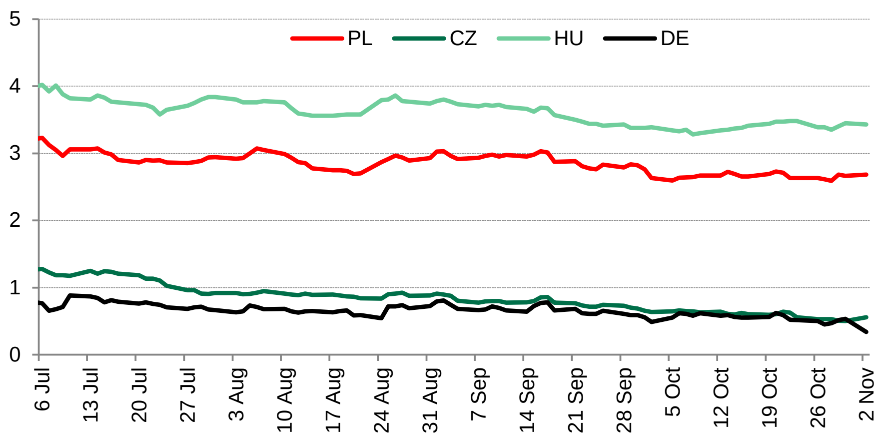
IRS 5Y (%)



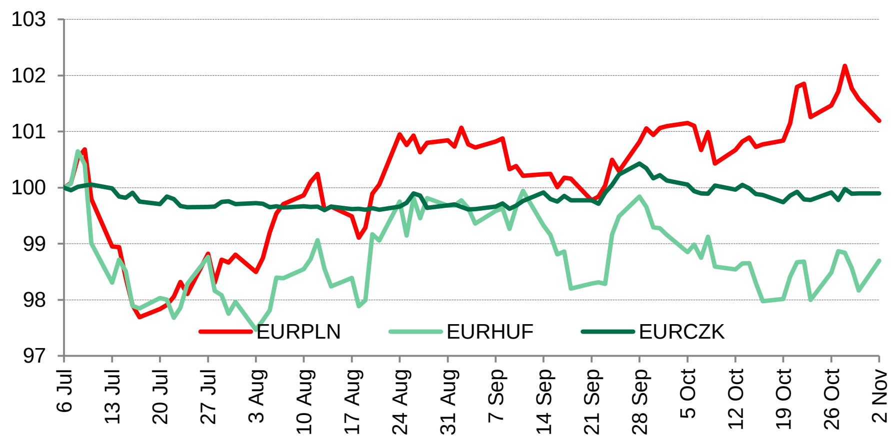
5x5 forward (spread vs EUR, bps)



10Y bond yields (last 4 months)



Zloty and CEE currencies (last 4 months)



Source: Reuters, BZ WBK.

6. Central Bank Watch

					Expected changes (bp)			Comments
		Last	2014	2015	1M	3M	6M	
Euro zone	Forecast	0.05	0.05	0.05				The October ECB outcome clearly suggested that further monetary easing is very likely in December. The ECB announced that the extent of monetary policy accommodation would be reviewed at the next meeting. According to Mr. Draghi, all monetary policy tools are potentially on the table for this purpose. The market is now pricing in a further decline in the deposit rate, but it is not our baseline scenario.
	Market implied »				-16	-19	-21	
UK	Forecast	0.50	0.50	0.50				We uphold our stance that the BoE will keep its key rates unchanged until the end of this year. We think that the monetary policy tightening cycle will start in February 2016.
	Market implied »				1	6	16	
US	Forecast	0-0.25	0-0.25	0.50				As expected, the FOMC left monetary policy unchanged in October, but surprisingly its rhetoric was hawkish. In our view, Fed sent a clear message that a hike in December is a real option and whether we will see the first rate hike (in December or next year) depends crucially on the two labor market reports released before then. We confirm our expectations that the FOMC will start normalising its monetary policy in December.
	Market implied »				5	15	29	
Poland	Forecast	1.50	2.00	1.50				The MPC meeting in November will likely be a non-event as regards monetary policy. However, we will get to see the central bank's new inflation projection, likely to be revised downwards. In the medium term we expect a new MPC to continue monetary easing by trimming the reference rate by 50bp in 1Q16.
	Market implied »				-3	-8	-28	
Czech Republic	Forecast	0.05	0.05	0.05				In our view ,the CNB will keep interest rates unchanged and confirm its FX commitment. With respect to the timing of the exit, we think that the CNB has enough time and will wait for the beginning of 2016 to make any change in its FX statement.
	Market implied »				-2	-6	-10	
Hungary	Forecast	1.35	2.10	1.35				The HNB kept its key rate unchanged at 1.35%. However, according to central bank officials, the base rate may be kept flat for an extended period, potentially beyond 2017. However, given downside risks to Hungarian GDP growth, lack of inflation concerns and the prospect of more easing by the ECB, the bank sees room for further monetary stimulus.
	Market implied »				-1	-6	-9	

Source: Reuters, BZ WBK.

This analysis is based on information available through November 3, 2015 and has been prepared by:

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ANALYST CERTIFICATION:

The views expressed in this report accurately reflect the personal views of the undersigned analyst(s). In addition, the undersigned analyst(s) have not and will not receive any compensation for providing a specific recommendation or view in this report: **Maciej Reluga*, Piotr Bielski*, Agnieszka Decewicz*, Marcin Luziński*, Marcin Sulewski*.**

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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