



RATES AND FX OUTLOOK

POLISH FINANCIAL MARKETS

October 2015



Bank Zachodni WBK

 Grupa Santander

Table of Contents

| | |
|------------------------------------|----|
| Summary | 3 |
| Short- and Medium-Term Strategy | 4 |
| Domestic Money Market | 6 |
| Domestic IRS and T-Bond Market | 7 |
| Demand Corner | 8 |
| Supply Corner | 9 |
| International Money Market and IRS | 10 |
| International Bond Market | 11 |
| Foreign Exchange Market | 12 |
| FX Technical Analysis Corner | 13 |
| Economic and Market Forecasts | 15 |
| Economic Calendar and Events | 17 |
| Appendix | 18 |

Summary

- We see a strong resemblance between the current economic situation and the pattern of almost exactly a year ago: the PMI index is falling sharply, we have some disappointments in economic data releases (except the labour market, which is doing fine), and we are facing external shocks that fuel uncertainty about the global economic outlook (currently a slowdown in China and the Emerging Markets, and a year ago Russian sanctions following the crisis in Ukraine).
- **We believe that there are good reasons to expect the Polish economy to continue its healthy economic growth of around 3.5%YoY in the coming quarters, just as it did one year ago, despite the headwinds and risk factors.** Robust investment growth is likely to continue, alongside high capacity usage, more-generous public spending and an accelerating stream of funds from the new EU financial framework. The outlook for export growth is also optimistic, in our view. The Euro zone, Poland's biggest trading partner, continues a moderate but healthy economic expansion. Consequently, the labour market should continue to boom (with unemployment approaching a record low), resulting in healthy wage growth and private consumption.
- Flash CPI data showed deflation deepening in September to -0.8%YoY, but we think this was only a temporary pause in the upward trend, which will push inflation above zero in November and towards 2% in 2016E. We still argue that, in those circumstances, **there should be no need for Polish monetary policy to ease in 2016E, even though market speculation about possible rate cuts has been growing recently.**
- **We think that speculation about interest rate cuts in Poland may continue in the nearest weeks, amid persistent investor concern about an economic slowdown and prolonged deflation, which may push domestic interest rates even lower.** The long end of the domestic yield curve may obtain further support from falling yields on core markets, limited debt supply in October and a substantial inflow of money from bond redemptions and coupon payments. However, we think the scope for strengthening is limited, as upcoming domestic macro data releases should be decent and some investors may be willing to cut their exposure just before the general election at the end of October. We still expect yields and IRS to start rising at the end of the year, in a context of an expected Federal Reserve lift-off, decent economic growth and rising inflation.
- EURPLN volatility dropped substantially in September and **we now see a risk of a zloty depreciation vs the euro in the nearest weeks, given the uncertainty ahead of the October election and the Fed meeting. However, we think such a move would be only temporary.** The Polish currency should regain strength at the end of this year, supported by the following factors: (1) continuation of healthy economic growth; (2) rising inflation, which will reduce rate cut expectations; and (3) a US interest rate hike before the end of the year.

Short- and Medium-Term Strategy: Interest Rate Market

| | Change (bp) | | Current Level | Expected Trend | |
|-------------------|-------------|---------|----------------|----------------|----|
| | Last 3M | Last 1M | 5 October 2015 | 1M | 3M |
| Reference rate | 0 | 0 | 1.50 | → | → |
| 3M WIBOR | 1 | 1 | 1.73 | → | → |
| 2Y bond yield | -35 | -17 | 1.62 | → | ↗↗ |
| 5Y bond yield | -63 | -35 | 2.11 | → | ↗↗ |
| 10Y bond yield | -73 | -36 | 2.57 | → | ↗↗ |
| 2/10Y curve slope | -38 | -19 | 95 | → | ↗↗ |

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: In our view, speculation about interest rate cuts in Poland may continue, given investors' persistent worries about an economic slowdown and prolonged deflation, which may keep FRA rates low in the short run. However, in the medium to long term we still expect FRAs to trend higher, as we think the next macro data releases will confirm healthy economic growth and inflation heading north.

Short end: As is the case in the money market, persistent speculation about rate cuts may keep the short ends of yield curves low. The impact of global market sentiment and October elections on this market segment should be limited.

Long end: The long end of the domestic yield curve may also be supported by lower yields in core markets, limited debt supply in October and a substantial inflow of money from bond redemptions and coupon payments. However, we think the scope for strengthening is limited, as upcoming domestic data releases should be decent and some investors may be willing to cut their exposure just before the general election at the end of October. We still expect yields/IRS rates to start rising at the end of the year.

Risks to our view: A Fed decision to hike interest rates in October would be a big surprise for investors and would probably send global yields much higher (currently markets are pricing in no hike before March 2016). By contrast, signals of a sharp economic deterioration in Europe (e.g. due to the Volkswagen scandal) and an extension of the ECB's QE programme would be highly supportive for fixed income.

Short- and Medium-Term Strategy: FX Market

| | Change (%) | | Current Level | Expected trend | |
|--------|------------|---------|----------------|----------------|----|
| | Last 3M | Last 1M | 5 October 2015 | 1M | 3M |
| EURPLN | 1.3 | 0.3 | 4.25 | ↘ | ↘ |
| USDPLN | 0.2 | -0.1 | 3.77 | ↘ | ↘↘ |
| CHFPLN | -3.8 | -1.0 | 3.89 | ↘ | ↘ |
| GBPPLN | -3.2 | -1.7 | 5.73 | → | → |
| EURUSD | 1.0 | 0.4 | 1.13 | → | ↗ |

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 a risk of zloty depreciation vs. the euro in the nearest weeks, amid uncertainty ahead of the Polish general election and the Fed's October meeting. However, this should be temporary and the Polish currency should regain strength at the end of this year, supported by: (1) continuation of healthy economic growth; (2) rising inflation, which will reduce rate cut expectations; (3) our expectations of a Fed hike by year end.

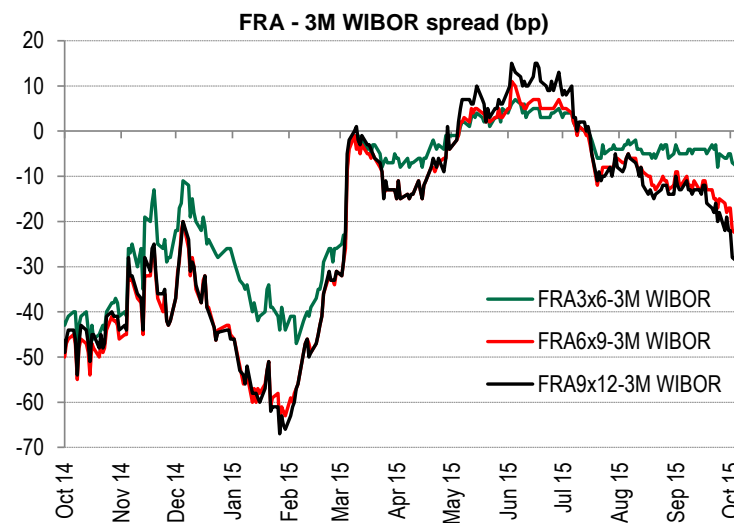
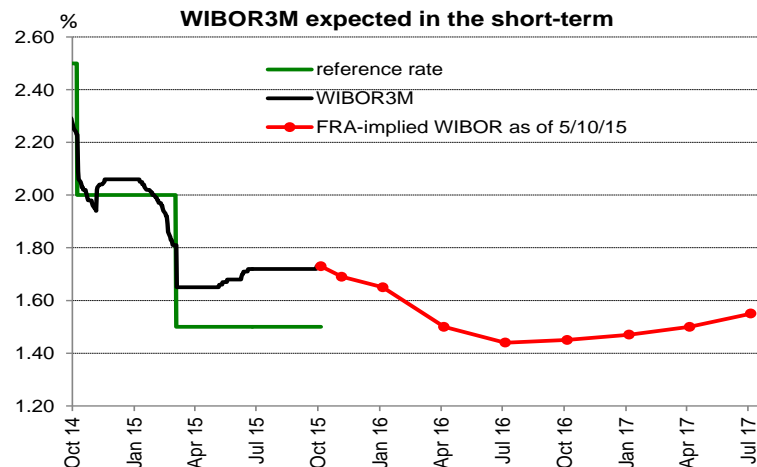
USD: We think an FOMC rate hike before the end of the year is still possible and this would be USD positive in the short term. However, we still expect the EUR/USD rate to rise towards 1.16 at the year-end (we doubt more ECB QE is warranted by the economic outlook and, also, the market is still significantly long the USD), which is likely to push the dollar much lower against the PLN.

CHF: EUR/CHF rose towards 1.10 in September, which is 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 zloty sell-off could intensify in the event of a significant deterioration of the economic situation in Europe or further weakness in emerging markets (if, for example, the slowdown in China and/or the recession in Brazil intensify).

Domestic Money Market: Investors expect a 25bp rate cut in six months' time

- FRA rates continued to decline in September, as macro data releases confirmed some slowdown in economic activity. The downward trend accelerated slightly at the turn of the month after a decline in the flash CPI for September and a lower-than-expected PMI reading for Poland's manufacturing sector. The FRA curve shifted down by 4-22 bp over the month, while WIBORs had inched up 1 bp.
- Recently-published domestic data, many of which were weaker than expected, have increased market speculation about interest rate cuts in the first half of 2016. The market is now nearly fully pricing-in a rate cut of 25 bp in six months' time (FRA6x9 at 1.51%) and investors see odds of slightly above 50% of a 50 bp cut in nine months. Furthermore, the market does not expect a rate hike in the next 21 months (FRA21x24 at 1.46%).
- In our view, speculation about rate cuts in Poland may continue, given investors' concern about an economic slowdown and prolonged deflation, which is likely to keep FRA rates low in the short run. However, in the medium to long term, we expect FRAs to trend higher, as we expect the next macro data releases to confirm healthy economic growth and inflation heading north.
- In our view, WIBOR rates are likely to be stable in the short term, but they usually edge gradually higher towards the end of the year.



Source: Reuters, BZ WBK

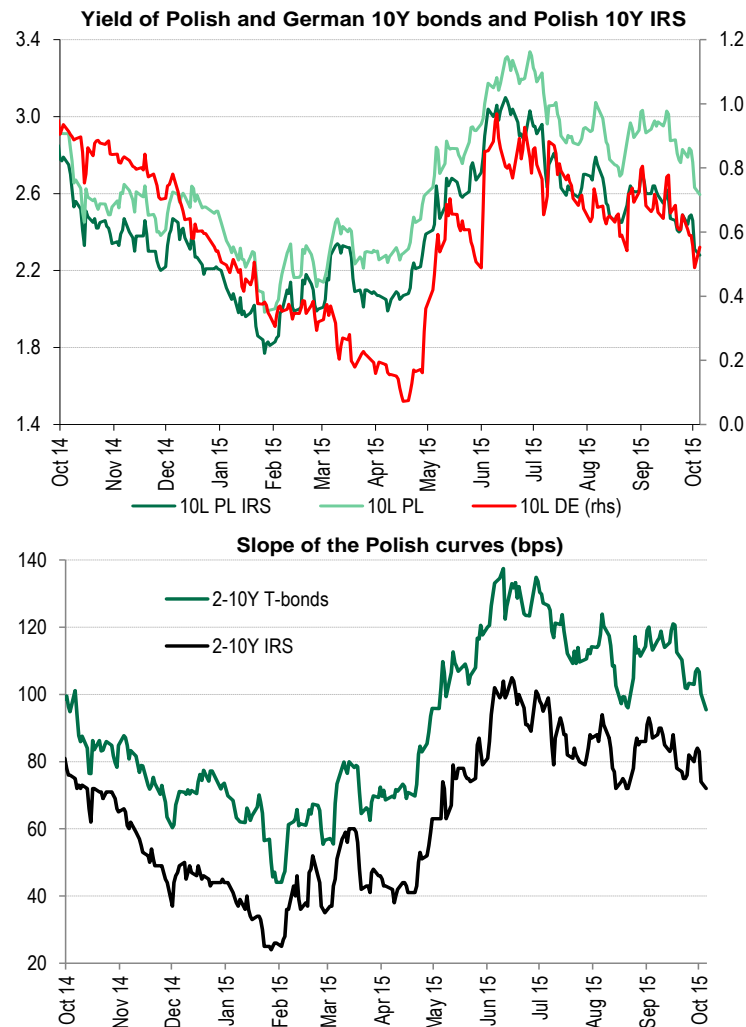
Domestic IRS and the T-Bond Market: Modest downward pressure in the short run

September was a favourable month for the domestic interest rate market. Polish bonds and IRS, like the core and peripheral Euro zone debt markets, benefited from the FOMC's decision to keep rates unchanged and from its dovish rhetoric. Additionally, the clearly below-consensus domestic macro data supported domestic curves. However, the end of the month brought some profit taking as the Fed's chair, Janet Yellen, reiterated that a rate rise was still very likely later this year. As a result, the Polish 10Y benchmark yield increased temporarily to 2.85%, from September's minimum of nearly 2.75%.

Last month 2-10Y spreads narrowed moderately as the bull flattener developed on both markets. The spread over Bunds in the 10Y sector was more or less stable, oscillating slightly above 220 bp.

We think that yields and IRS rates could fall further in the nearest weeks, in the context of an expected moderate decline in yields on core markets (due to postponed lift-off in the US and market expectations of further easing by the ECB) and limited debt supply in October, plus a substantial inflow of money from bond redemptions and coupon payments. However, we think the scope for strengthening is limited as upcoming domestic macro data should be decent and some investors may want to cut their exposure just before the general election at the end of October.

Given our expectations that the Fed will start normalising its monetary policy in the coming months, and taking into account the likely rebound in Poland's headline inflation and GDP growth in upcoming quarters, we expect higher yields/IRS rates at the end of the year.

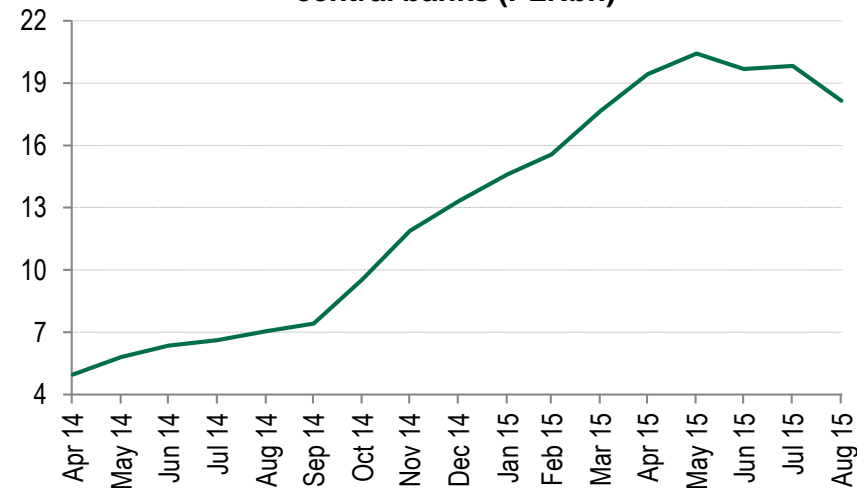


Source: Reuters, Bloomberg, BZ WBK.

Demand Corner: Polish banks accumulate, Asian central banks sell

- The biggest monthly change in holdings of Poland's marketable PLN bonds in August was recorded for domestic banks, which purchased debt worth PLN5bn, taking the nominal value of their portfolio to an all-time high of nearly PLN170bn. This was the domestic banks' biggest buying spree since February. Their activity was concentrated in the PS series – PLN1.8bn for PS0718, PLN1.0bn for PS0416, PLN0.8bn for PS0418.
- Non-residents' holdings rose by a mere PLN0.7bn but there were big shifts in the specific portfolios within this group. Foreign banks purchased PLN2.7bn (cPLN1.1 of each of OK0116, PS0719 and WZ0124), the omnibus accounts added nearly PLN1.5bn (including PLN1.8bn in DS0725). At the same time, central banks disposed of PLN1.8bn worth of bonds (including PLN1.0bn of PS0418) with mutual funds selling PLN1.6bn (concentrated in the short end).
- Among foreign central banks, Asian banks sold PLN1.7bn. Since April 2014 (when data became available), Asian CBs have only been net sellers of Polish bonds in two months, with August being the most intense of the two. The nominal value of this group's portfolio is now PLN18.1bn, its lowest since March 2015.
- If we look at the geographical breakdown, the central banks' reduction constituted 85% of the total selling seen from Asia. At the same time, investors from the Euro zone bought bonds worth nearly PLN2.0bn.

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

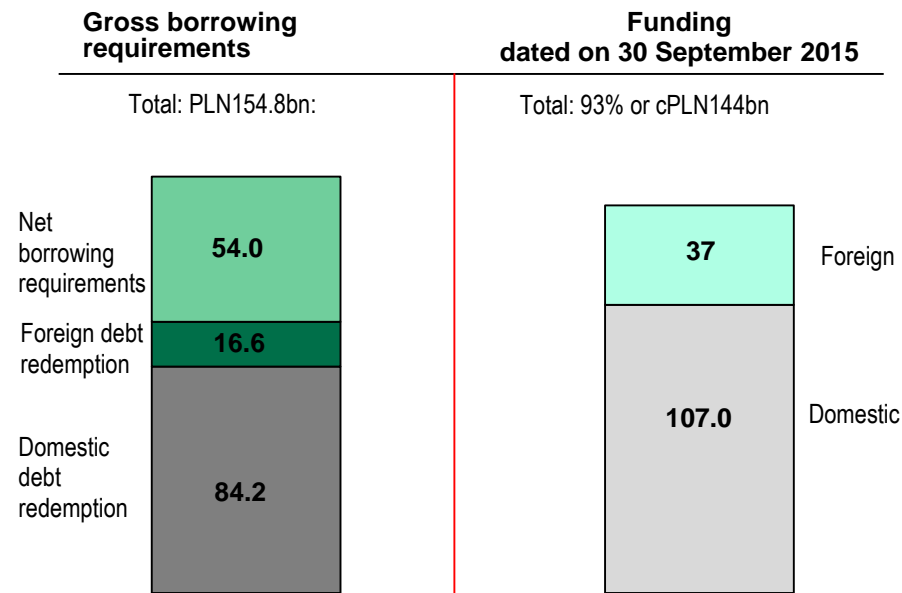


Source: Finance Ministry. BZ WBK.

Supply Corner: Poland has covered 93% of 2015 borrowing needs

- In September Poland tapped both the domestic and international markets. The Finance Ministry launched 10Y eurobonds worth €1bn and sold domestic bonds worth PLN10.23bn (OK0717, PS0420, WZ0126 and a new series of 10Y DS0726). In August it sold PLN4.66bn on the domestic market. As a result, Poland has now completed 93% of its 2015 issuance requirements.
- T-bond supply in October will be very limited as the Finance Ministry has only scheduled one regular auction (29 October or 5 November) worth PLN5-10bn. In the October-December period, in contrast to previous quarters, the ministry wants to tap T-bonds mainly through switch tenders as it will conduct three auctions (one each month). This should allow it to speed up pre-financing of the 2016 gross borrowing needs.
- Among its international issue options, the ministry is considering a private placement. It also plans to obtain loan funding from international financial institutions of €0.9-1.1bn. We think these funds will also pre-finance next year's FX-borrowing requirements.
- Significant inflows from the DS1015 redemption (PLN22.4bn) and interest payments (PLN7.72bn) in October should be very supportive for auction results and the ministry should easily complete this year's issuance target. The switch tenders and foreign issuance should allow it to cover c20% of 2016 gross borrowing needs (PLN180bn).

Gross borrowing requirements and financing in 2015



Auction plan for October 2015

| Auction date | Settlement date | Series | Planned offer (PLN mn) |
|--------------|-----------------|-----------------|------------------------|
| 29 Oct 2015 | 2 Nov 2015 | To be announced | 5,000 – 10,000 |

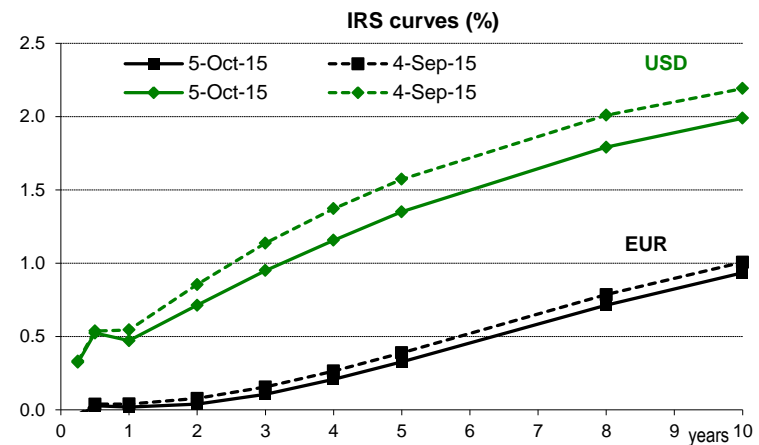
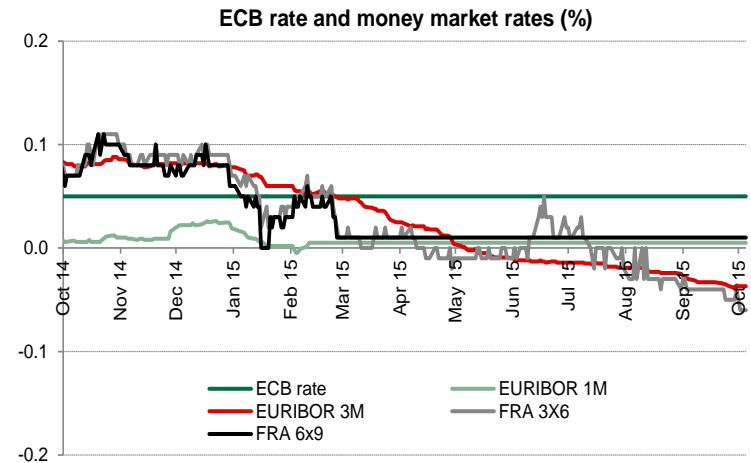
Source: Finance Ministry, BZ WBK.

International Money Market and IRS: Expectations of ECB stimulus strengthened

US and in the Euro zone money market rates fell gradually in September. USD Libor rates declined after FOMC decided to delay tightening and on expectations that it would start its rate hikes in 1Q16. Euribors continued their moderate fall on expectations the ECB could extend its QE programme. This trend intensified after the negative reading of the September flash HICP for the Euro zone. It is worth noting that the Hungarian central bank implemented unconventional monetary policy in September (replacing a 2-week deposit rate with a 3M deposit, and tightening liquidity rules for banks, effectively forcing them to buy government securities).

September brought a significant decline in IRS rates, due to persistent worries over global growth, which strengthened after a lack of September lift-off by the Fed and a downward revision in economic forecasts by both the FOMC and ECB. USD IRS rates declined more than EUR ones. Strong signals from the Czech economy meant CZK IRS underperformed HUF IRS rates.

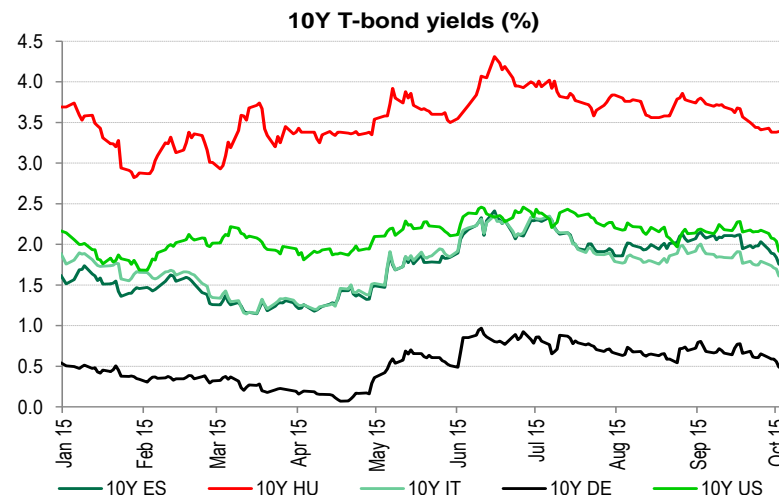
Central banks' monetary policy and macro data are likely to occupy centre stage for investors this month. The main central banks have recognized global economic and financial developments as factors that could restrain economic activity somewhat and put further downward pressure on inflation in the near term. In our view, the ECB, FOMC and CEE central banks will all leave monetary policy unchanged this month, pushing money market rates slightly lower. However, in the medium term, we still expect USD Libor rates to underperform European ones. As regards the IRS market, rates will remain more volatile and strongly dependent on macro news.



Source: Reuters, ECB, Fed, BZ WBK.

International Bond Market: The market is losing faith in a rate hike by the FOMC in 2015

- The global debt market benefited significantly last month from the delay in lift-off by the FOMC, although the extent of yield declines were also determined by specific factors for each country. For example, the sharp decline in Hungarian debt yields (33-52 bp across the curve, with the highest drop at the front end) was also a result of weak macro data and the Hungarian central bank's decision to implement unconventional measures, which are aimed at squeezing funds out from short-dated central bank instruments and into HUF-denominated T-bills and T-bonds. Hungary's 10Y benchmark yield reached its lowest level since April 2015.
- The September bond rally was strong enough to trim all, or nearly all, the August losses. Most curves flattened gradually, as the long end benefited the most from the improved mood. These trends strengthened in early October after disappointing labour market data in the US.
- In our view, mixed economic data and unchanged monetary policy this month are likely to push yields down moderately in the short term. However, we still expect the Fed to normalize its monetary policy in the next few months. Therefore, we expect US yields to trend higher, most significantly at the short end of the curve. The upside to the US 10Y yield is limited by market expectations that the ECB would announce an extension of its QE programme. This speculation could also push European yields slightly lower in the short-run. However, political risk (Spain, Portugal) might prevent peripheral debt from undergoing a sharper decline in yields. Therefore, we uphold our view of higher yields at the end of the year.

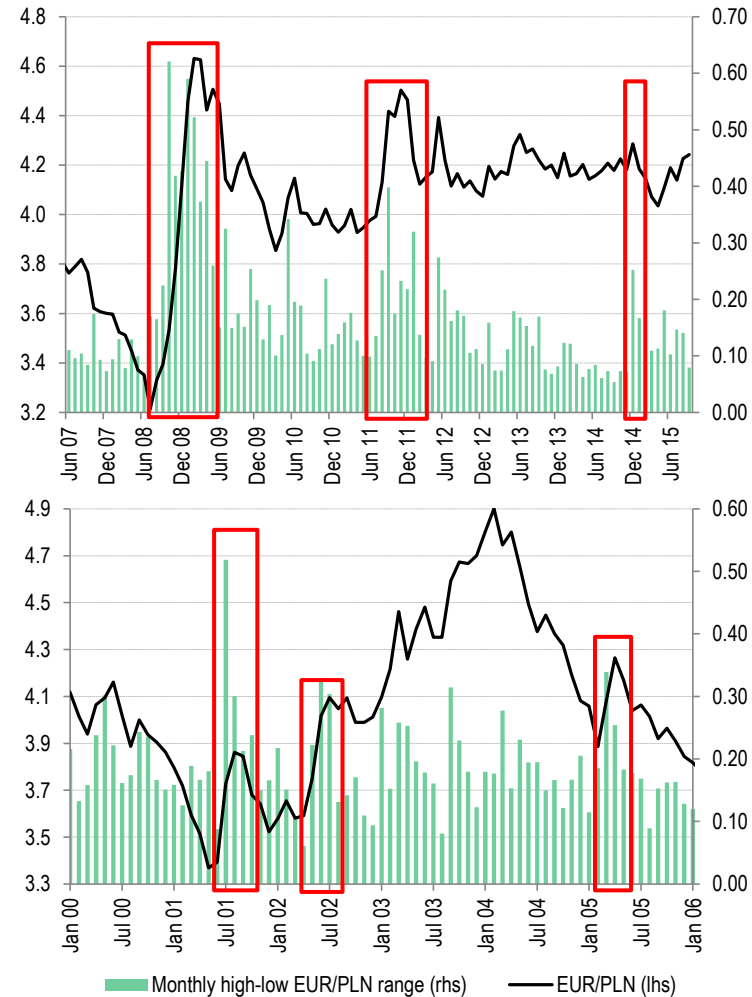


Source: Reuters, BZ WBK.

Foreign Exchange Market: Dynamics is the key

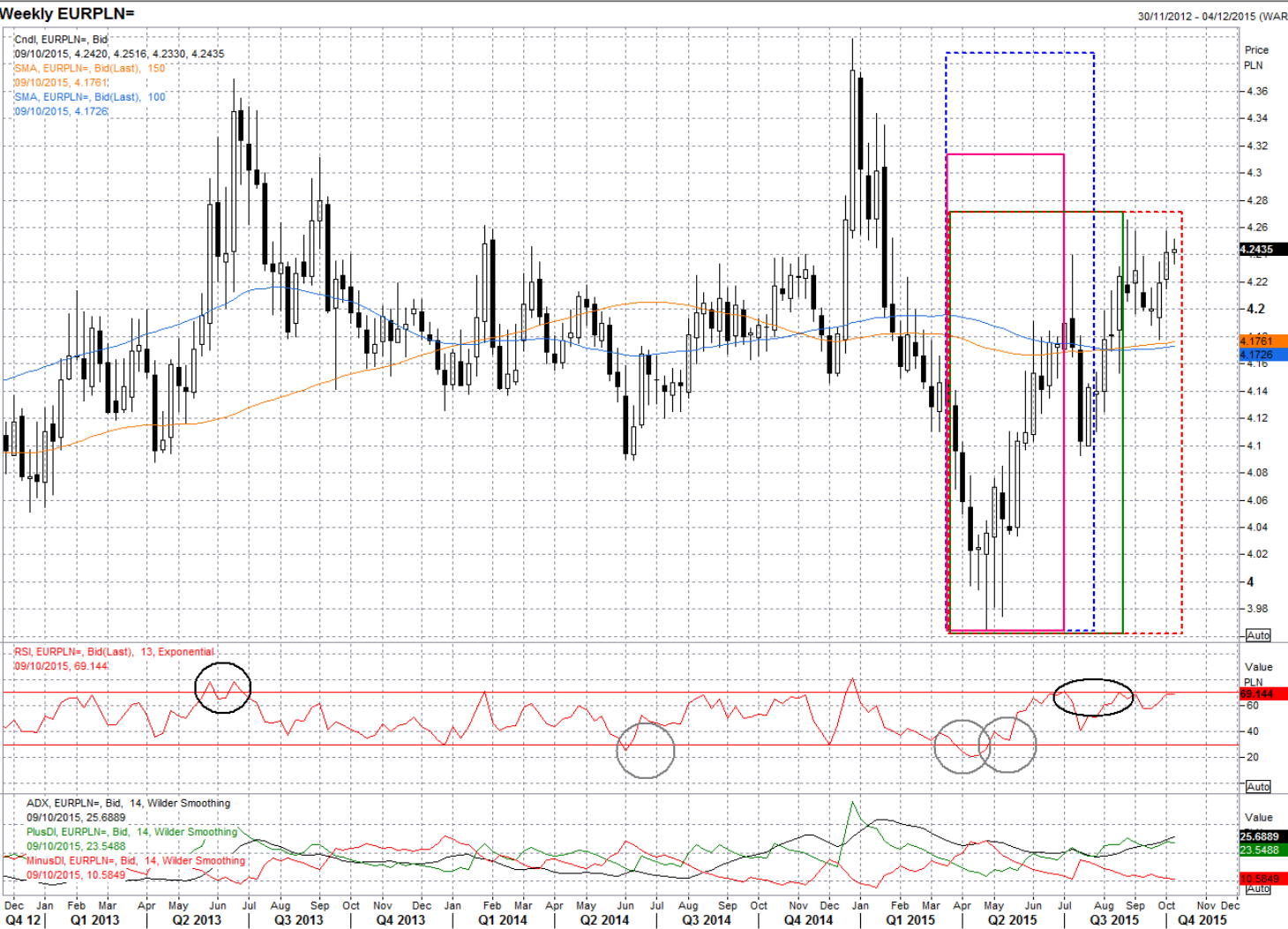
- September's high-low spread for EUR/PLN at cPLN0.08 was the smallest monthly spread since November 2014. The Zloty's CEE peers and the EUR/USD are also recording monthly ranges at multi-month lows.
- Periods of low volatility quite often end very abruptly and precede a drop in demand for riskier assets. In the last 20 years EUR/PLN recorded a monthly drop only nine times (less than 4%) when the monthly low-high spread was above PLN0.25.
- It is hard to guess when volatility will rise substantially again, but the uncertainty before Poland's general election (October 25) and before the FOMC meeting (October 28) may be the triggers.
- However, we think that even if the zloty depreciates sharply vs. the euro in the near future, this may be only temporary. A significant rebound is possible in the last week of October, after the general election takes place.
- The opposition Law and Justice party (PiS) is well ahead in the opinion polls but it is not certain whether it will win more than 50% of seats in parliament. If not, PiS may have problems finding a coalition partner, which may imply a prolonged delay in forming a government. We think the zloty may react positively to such a scenario, as it would decrease the probability of a major political shift in Poland after the election.
- In the coming months, we expect the zloty to strengthen, supported by decent GDP growth, rising inflation (which would curb speculation about rate cuts), and our expectations of a Fed hike before year end (which would be a sign of the Fed's faith in global economic growth).

EUR/PLN and monthly high-low spreads



Source: Reuters, BZ WBK

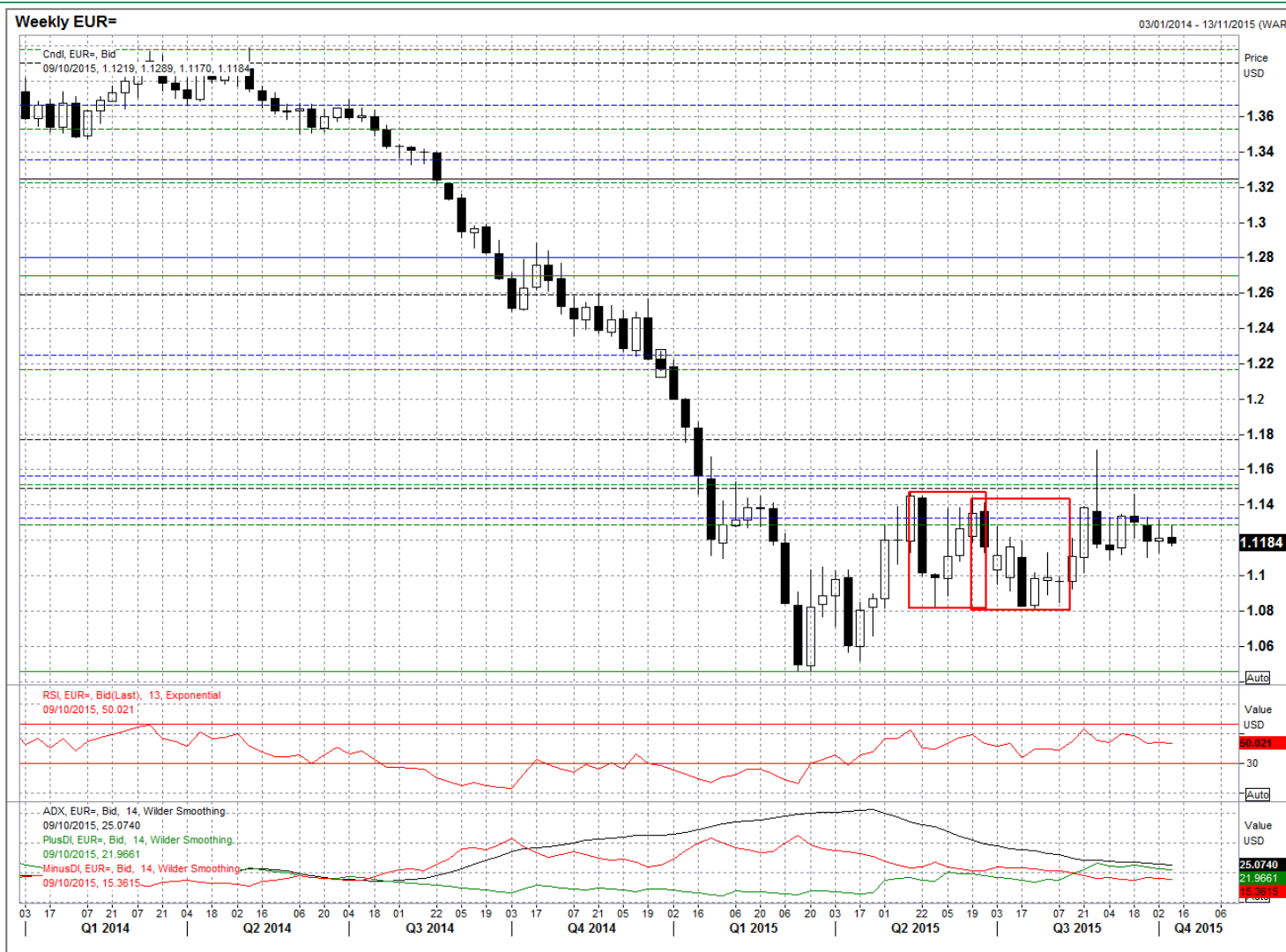
FX Technical Analysis Corner: EUR/PLN still high



- Last month we said we thought EUR/PLN could stay high in the first half of September and decline later on. In fact, the zloty appreciated for the better part of the month and EUR/PLN only rebounded at the end.
- The situation has not changed much and the "double sell" signal is still valid. The ADX points to an upward trend now developing in the market that it is gaining strength very gradually and this generates risk for the scenario of a stronger zloty.

Source: Reuters, BZ WBK.

FX Technical Analysis Corner: EUR/USD still moving sideways



- ▶ EUR/USD remained in a horizontal trend, just below the local peak reached in late August.
- ▶ Volatility is very low and the ADX reached its lowest level since September 2014. The market is waiting for something to trigger a sustainable directional move.
- ▶ Important levels for EUR/USD are support at 1.08 and resistance at 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 | 1,794.4 | 1,886.8 | 417.8 | 433.8 | 443.1 | 499.7 | 438.1 | 457.5 | 465.2 | 526.1 |
| GDP | %YoY | 1.7 | 3.4 | 3.5 | 3.5 | 3.6 | 3.3 | 3.4 | 3.5 | 3.1 | 3.6 | 3.6 | 3.6 |
| Domestic demand | %YoY | 0.2 | 4.9 | 3.3 | 3.5 | 2.6 | 3.3 | 3.3 | 3.7 | 3.3 | 3.6 | 3.5 | 3.7 |
| 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 | 11.5 | 10.0 | 9.2 | 11.7 | 10.3 | 9.8 | 10.0 | 10.2 | 9.3 | 9.0 | 9.2 |
| Current account balance | EURmn | -5,031 | -8,303 | -1,032 | -246 | 900 | 1,110 | -1,557 | -1,485 | 1,462 | 1,033 | -1,452 | -1,289 |
| Current account balance | % GDP | -1.3 | -2.0 | -0.2 | -0.1 | -1.3 | -0.4 | -0.2 | -0.2 | -0.1 | -0.1 | -0.1 | -0.1 |
| General government balance (ESA 2010) | % GDP | -4.0 | -3.2 | -2.7 | -2.9 | - | - | - | - | - | - | - | - |
| CPI | %YoY | 0.9 | 0.0 | -0.8 | 1.7 | -1.5 | -0.9 | -0.7 | 0.0 | 1.2 | 1.6 | 1.8 | 2.1 |
| CPI ^a | %YoY | 0.7 | -1.0 | 0.5 | 2.1 | -1.5 | -0.8 | -0.8 | 0.5 | 1.4 | 1.7 | 2.1 | 2.1 |
| CPI excluding food and energy prices | %YoY | 1.2 | 0.6 | 0.5 | 1.2 | 0.4 | 0.3 | 0.4 | 0.8 | 1.0 | 1.2 | 1.2 | 1.2 |

Source: CSO, NBP, Finance Ministry, BZ WBK estimates.

^a at the end of the period

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 | 1.50 | 1.50 | 1.50 | 1.50 | 1.50 | 1.50 | 1.50 | 1.50 | 1.50 |
| WIBOR 3M | % | 3.02 | 2.52 | 1.75 | 1.75 | 1.87 | 1.67 | 1.72 | 1.73 | 1.74 | 1.75 | 1.75 | 1.75 |
| Yield on 2-year T-bonds | % | 2.98 | 2.46 | 1.72 | 2.00 | 1.61 | 1.75 | 1.80 | 1.72 | 1.82 | 1.95 | 2.07 | 2.17 |
| Yield on 5-year T-bonds | % | 3.46 | 2.96 | 2.25 | 2.68 | 1.90 | 2.35 | 2.43 | 2.31 | 2.54 | 2.63 | 2.72 | 2.82 |
| Yield on 10-year T-bonds | % | 4.04 | 3.49 | 2.70 | 3.42 | 2.24 | 2.79 | 2.93 | 2.84 | 3.17 | 3.35 | 3.50 | 3.65 |
| 2-year IRS | % | 3.10 | 2.51 | 1.74 | 1.99 | 1.65 | 1.85 | 1.78 | 1.66 | 1.80 | 1.98 | 2.05 | 2.12 |
| 5-year IRS | % | 3.51 | 2.92 | 2.05 | 2.42 | 1.80 | 2.23 | 2.17 | 2.00 | 2.28 | 2.38 | 2.47 | 2.57 |
| 10-year IRS | % | 3.86 | 3.34 | 2.43 | 3.11 | 2.06 | 2.57 | 2.62 | 2.49 | 2.85 | 3.05 | 3.20 | 3.35 |
| EUR/PLN | PLN | 4.20 | 4.18 | 4.17 | 4.11 | 4.20 | 4.09 | 4.19 | 4.19 | 4.13 | 4.11 | 4.10 | 4.10 |
| USD/PLN | PLN | 3.16 | 3.15 | 3.71 | 3.46 | 3.72 | 3.70 | 3.77 | 3.65 | 3.51 | 3.47 | 3.43 | 3.42 |
| CHF/PLN | PLN | 3.41 | 3.45 | 3.89 | 3.56 | 3.93 | 3.93 | 3.90 | 3.81 | 3.73 | 3.63 | 3.50 | 3.39 |
| GBP/PLN | PLN | 4.94 | 5.19 | 5.71 | 5.61 | 5.64 | 5.67 | 5.84 | 5.70 | 5.62 | 5.59 | 5.62 | 5.62 |

Source: CSO, NBP, Finance Ministry, BZ WBK estimates.

^a at the end of period

Economic Calendar and Events

| Date | | Event: | Note: |
|--------|----|---------------------------------------|---|
| 6-Oct | PL | MPC meeting – interest rate decision | No change in monetary policy conditions |
| 8-Oct | PL | Switch tender | Offer to repurchase DS1015 and T-bonds maturing in 2016 |
| 14-Oct | PL | C/A balance for August | We expect a current account gap of €0.77bn, lower than market consensus |
| 15-Oct | PL | CPI for September | Our forecast is -0.8%YoY, in line with the flash outcome |
| 16-Oct | PL | Core CPI measures for September | We see core inflation, excluding food and energy, at 0.5%YoY, slightly higher than market expectations of 0.4%YoY |
| | PL | Wages and employment for August | We expect employment growth of 1%YoY, and an increase in wages of 3.3%YoY, close to market consensus |
| 19-Oct | PL | Industrial output for September | We expect a modest increase of 3.9%YoY, slightly below market expectations (4%) |
| | PL | Construction output for September | In our view, construction output will increase by 1.4%YoY vs the median forecast of 1.1%YoY |
| | PL | Retail sales for September | We estimate retail sales grew 1.4%YoY, more than the previous month |
| 20-Oct | HU | NMB meeting – interest rate decision | We expect rates to remain unchanged |
| 22-Oct | EZ | ECB meeting – interest rate decision | |
| | PL | Minutes from July MPC meeting | - |
| 23-Oct | PL | Unemployment rate for September | We expect a further slide in unemployment to 9.8% |
| 25-Oct | PL | General election | - |
| 28-Oct | US | FOMC meeting – interest rate decision | We expect the Fed to keep rates unchanged |
| 29-Oct | PL | Regular auction of T-bond | Offer: PLN5-10bn |

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

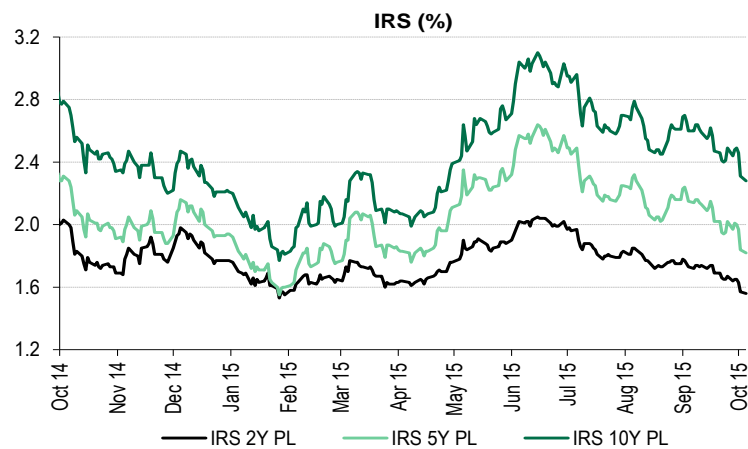
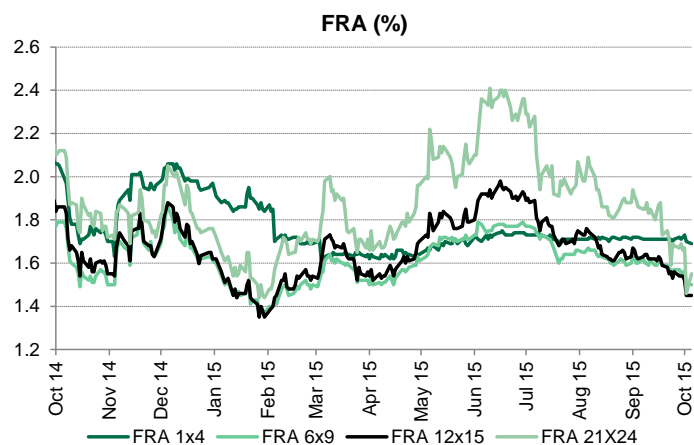
1. Domestic Market Performance

Money market rates (%)

| | Reference | Poland | WIBOR (%) | | | | OIS (%) | | | | FRA (%) | | | |
|---------------------|-----------|--------|-----------|------|------|------|---------|------|------|------|---------|------|------|------|
| | rate (%) | (%) | 1M | 3M | 6M | 12M | 1M | 3M | 6M | 12M | 1x4 | 3x6 | 6x9 | 9x12 |
| End of September | 1.50 | 1.53 | 1.67 | 1.73 | 1.81 | 1.84 | 1.47 | 1.47 | 1.47 | 1.42 | 1.72 | 1.68 | 1.56 | 1.51 |
| Last 1M change (bp) | 0 | 3 | 1 | 1 | 1 | 1 | 2 | 2 | 2 | -4 | 1 | 1 | -4 | -7 |
| Last 3M change (bp) | 0 | 3 | 1 | 1 | 2 | 2 | 2 | 0 | -2 | -10 | -2 | -8 | -22 | -31 |
| Last 1Y change (bp) | -100 | -98 | -73 | -55 | -44 | -39 | -64 | -36 | -28 | -29 | -35 | -18 | -24 | -31 |

Bond and IRS market (%)

| | BONDS | | | IRS | | | Spread BONDS / IRS (bp) | | |
|---------------------|-------|------|------|------|------|------|-------------------------|----|-----|
| | 2Y | 5Y | 10Y | 2Y | 5Y | 10Y | 2Y | 5Y | 10Y |
| End of September | 1.75 | 2.36 | 2.83 | 1.65 | 2.00 | 2.49 | 10 | 36 | 34 |
| Last 1M change (bp) | -4 | -10 | -10 | -10 | -16 | -12 | 6 | 6 | 2 |
| Last 3M change (bp) | -22 | -38 | -48 | -34 | -53 | -50 | 12 | 15 | 2 |
| Last 1Y change (bp) | -23 | 0 | -14 | -39 | -33 | -36 | 16 | 33 | 22 |



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 | 10,000 | | | 79,657 |
| T-bill auctions | | | | | | | | | | | | | 0 |
| Retail bonds | 97 | 126 | 127 | 129 | 207 | 181 | 150 | 150 | 150 | 150 | 150 | 150 | 1,767 |
| 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 | 12,230 | 4,806 | 10,383 | 10,150 | 150 | 150 | 130,326 |
| 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 | -667 | 3,163 | 9,916 | -16,074 | -63 | -91 | 61,420 |
| Rolled-over T-bonds | | | 6,502 | | | 2,082 | | | | | | | 8,585 |
| Buy-back of T-bills/ FX-denominated bonds | | | | | | | | | | | | | 0 |
| Total | 43,930 | 10,875 | 11,170 | 924 | 534 | 6,389 | -667 | 3,163 | 9,916 | -16,074 | -63 | -91 | 70,005 |
| 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 | 88,624 | | 2,034 | 90,657 | 18,949 | 109,606 |
| Total 2017 | 68,940 | | 1,032 | 69,972 | 14,670 | 84,642 |
| 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+ | 214,330 | | 2,383 | 216,714 | 174,556 | 391,270 |

Source: MF, BZ WBK.

2. Polish Bonds: Supply Recap (cont.)

Scheduled wholesale bond redemptions by holders (data at the end of August 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 | 9,993 | 4,729 | 4,503 | 94 | 1,037 | 24 | 168 | 1,872 | 22,420 |
| Total 2015 | 9,993 | 4,729 | 4,503 | 94 | 1,037 | 24 | 168 | 1,872 | 22,420 |
| | 45% | 21% | 20% | 0% | 5% | 0% | 1% | 8% | 100% |
| Total 2016 | 39,306 | 26,943 | 7,286 | 533 | 7,822 | 121 | 107 | 6,506 | 88,624 |
| | 44% | 30% | 8% | 1% | 9% | 0% | 0% | 7% | 100% |
| Total 2017 | 25,746 | 23,894 | 6,443 | 546 | 5,999 | 96 | 148 | 5,123 | 67,997 |
| | 38% | 35% | 9% | 1% | 9% | 0% | 0% | 8% | 100% |
| Total 2018 | 18,887 | 30,159 | 4,046 | 297 | 6,709 | 86 | 179 | 5,954 | 66,317 |
| | 28% | 45% | 6% | 0% | 10% | 0% | 0% | 9% | 100% |
| Total 2019+ | 21,555 | 25,666 | 5,606 | 456 | 6,208 | 77 | 143 | 4,100 | 63,811 |
| | 34% | 40% | 9% | 1% | 10% | 0% | 0% | 6% | 100% |
| Total 2020+ | 90,106 | 58,569 | 24,651 | 1,019 | 21,304 | 209 | 282 | 8,899 | 205,040 |
| | 44% | 29% | 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 August | | | Share of total in August (%) |
|-----------------------------|------------------------|------------|------------|------------------------|----------|----------|--------------------|-------|--------|------------------------------|
| | End Aug'15 | End Jul'15 | End Jun'15 | End 1Q 2015 | End 2014 | End 2013 | MoM | 3-mth | YoY | |
| Domestic investors | 317.8 | 313.8 | 314.3 | 309.1 | 295.9 | 381.2 | 1.3 | 1.9 | 11.8 | 60.7 (0.2pp) |
| Commercial banks | 170.0 | 164.9 | 166.3 | 163.1 | 150.8 | 114.7 | 3.1 | 3.6 | 19.9 | 32.5 (0.7pp) |
| Insurance companies | 52.5 | 53.1 | 53.3 | 52.4 | 52.8 | 52.0 | -1.0 | -2.3 | -2.0 | 10.0 (-0.2pp) |
| Pension funds | 2.9 | 2.9 | 2.9 | 3.1 | 3.3 | 125.8 | 0.6 | 4.5 | -14.0 | 0.6 |
| Mutual funds | 49.1 | 49.8 | 49.3 | 48.5 | 46.9 | 46.7 | -1.4 | -2.9 | 10.8 | 9.4 (-0.2pp) |
| Others | 43.3 | 43.1 | 42.6 | 42.0 | 42.0 | 42.0 | 0.5 | 1.7 | 5.3 | 8.3 |
| Foreign investors* | 205.6 | 205.0 | 203.7 | 203.8 | 196.0 | 193.2 | 0.3 | 2.9 | 6.5 | 39.3 (-0.2pp) |
| Banks | 16.0 | 13.3 | 14.0 | 9.9 | 9.9 | n.a. | 20.5 | 26.5 | 61.0 | 3.1 (0.5pp) |
| Central banks | 21.1 | 22.9 | 22.6 | 20.3 | 16.4 | n.a. | -7.8 | -8.6 | 14.6 | 4.0 (-0.4pp) |
| Public institutions | 9.5 | 9.5 | 9.4 | 8.8 | 8.1 | n.a. | -0.1 | 1.9 | 1227.6 | 1.8 |
| Insurance companies | 11.6 | 11.7 | 11.0 | 11.0 | 10.7 | n.a. | -1.4 | 9.0 | 8.2 | 2.2 (-0.1pp) |
| Pension funds | 13.1 | 12.9 | 12.4 | 13.2 | 13.0 | n.a. | 1.5 | 6.9 | 7.0 | 2.5 |
| Mutual funds | 69.3 | 70.9 | 71.5 | 80.2 | 78.1 | n.a. | -2.3 | -2.1 | -13.4 | 13.2 (-0.4pp) |
| Hedge funds | 0.0 | 0.0 | 0.0 | 0.1 | 1.1 | n.a. | 0.4 | -93.1 | -52.0 | 0.0 |
| Non-financial sector | 8.0 | 8.1 | 8.4 | 12.6 | 8.2 | n.a. | -1.7 | -6.6 | -35.2 | 1.5 |
| Others | 18.7 | 18.7 | 18.6 | 17.0 | 14.3 | n.a. | 0.0 | 13.7 | 0.6 | 3.6 |
| TOTAL | 523.5 | 518.7 | 518.0 | 512.9 | 491.8 | 574.3 | 0.9 | 1.3 | 9.7 | 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 | 87 |
| Belgium | 31.8 | 102.2 | 28.1 | 32.5 | 90 |
| Finland | 10.0 | 119.6 | 7.6 | 11.4 | 97 |
| France | 173.0 | 117.4 | 116.5 | 187.0 | 98 |
| Germany | 161.0 | 100.0 | 155.0 | 147.0 | 80 |
| Greece | - | - | - | - | - |
| Ireland | 10.0 | 117.5 | 2.3 | 7.5 | 91 |
| Italy | 235.4 | 111.8 | 205.2 | 252.9 | 79 |
| Netherlands | 50.0 | 101.7 | 39.9 | 48.0 | 82 |
| Portugal | 16.7 | 101.7 | 7.2 | 13.9 | 94 |
| Spain | 129.3 | 105.4 | 86.4 | 130.0 | 86 |
| Total | 841.9 | 108.1 | 661.5 | 847.3 | 86 |

* 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-Sep 2015 | 2014 | end-Sep 2015 | 2014 | end-Sep 2015 | 2014 | end-Sep 2015 | 2014 | end-Sep 2015 |
| Poland | 2.00 | 1.50 | 2.06 | 1.73 | 2.51 | 2.83 | 197 | 223 | 71 | 79 |
| Czech Republic | 0.05 | 0.05 | 0.04 | 0.29 | 0.75 | 0.69 | 2 | 10 | 55 | 50 |
| Hungary | 2.10 | 1.35 | 2.10 | 1.35 | 3.69 | 3.38 | 315 | 279 | 178 | 172 |
| Euro zone | 0.05 | 0.05 | 0.08 | -0.04 | | | | | | |
| Germany | | | | | 0.54 | 0.59 | | | 17 | 14 |

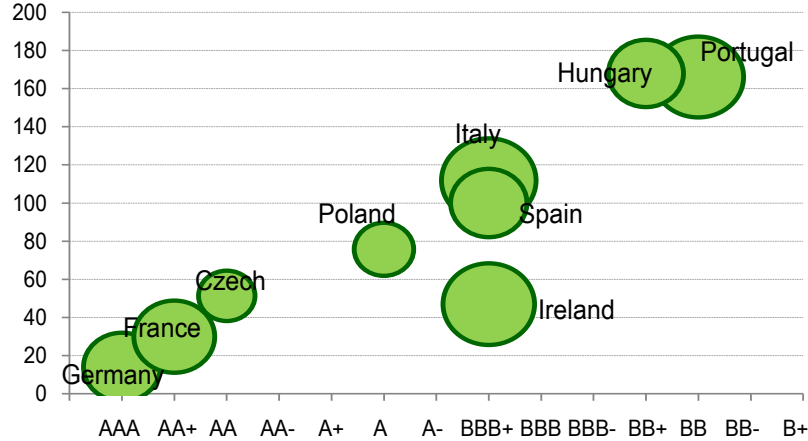
Source: EC – Spring 2015, statistics offices, central banks, Reuters, BZ WBK.

5. Poland vs. Other Countries (cont.)

Sovereign ratings

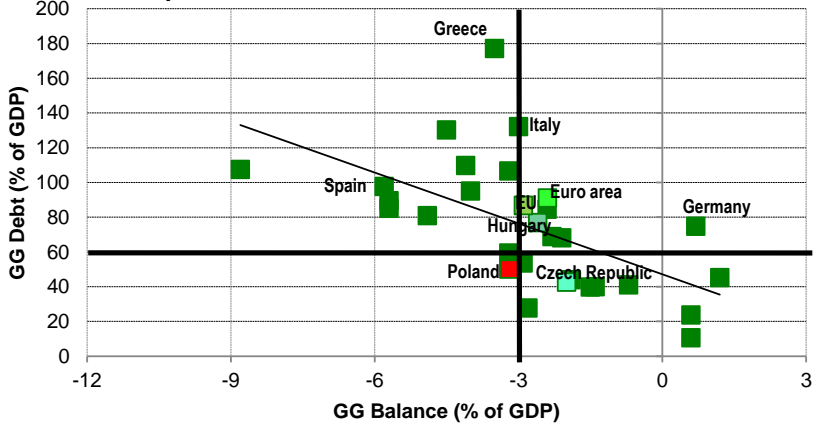
| | S&P | | Moody's | | Fitch | |
|----------|--------|----------|---------|----------|--------|----------|
| | rating | outlook | rating | outlook | rating | outlook |
| Poland | A | stable | A2 | stable | A- | stable |
| Czech | AA | stable | A1 | stable | A+ | stable |
| Hungary | BB+ | stable | Ba1 | 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



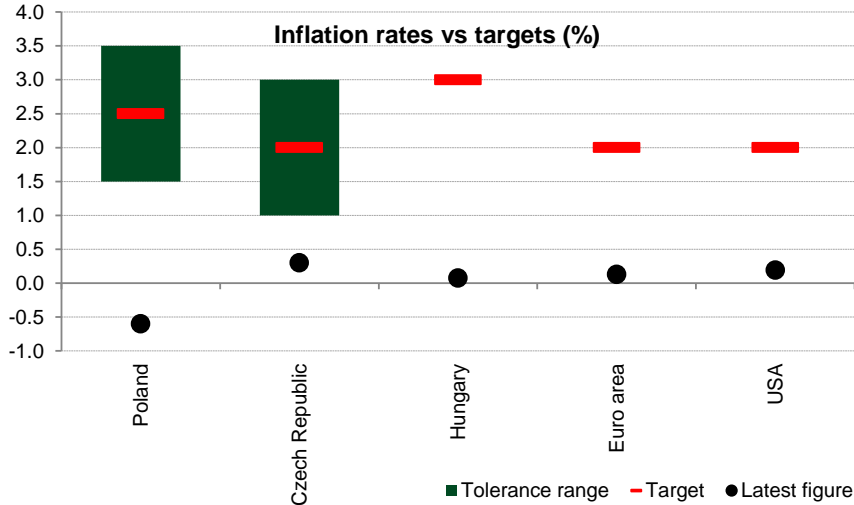
Note: Size of bubbles reflects the debt/GDP ratio

Fiscal position of the EU countries at the end of 2014

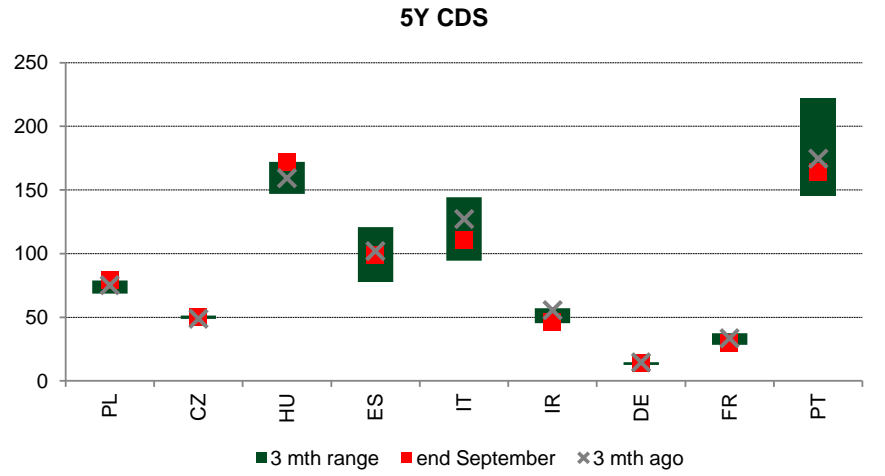
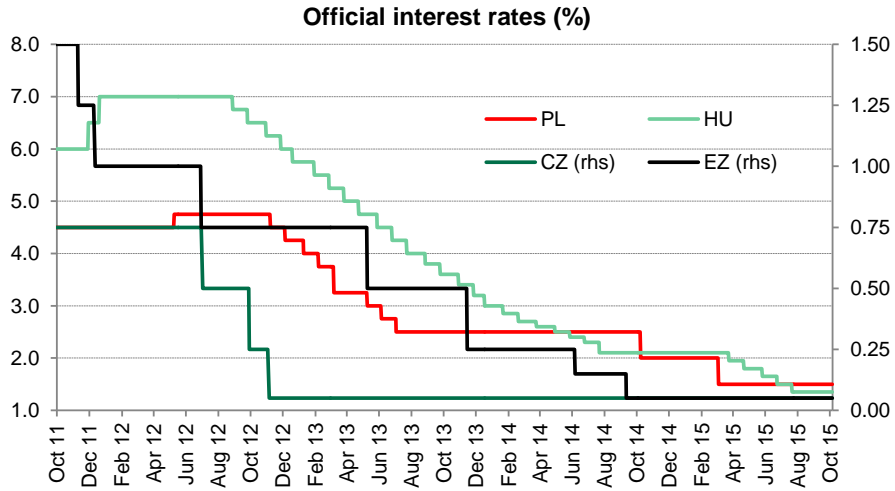
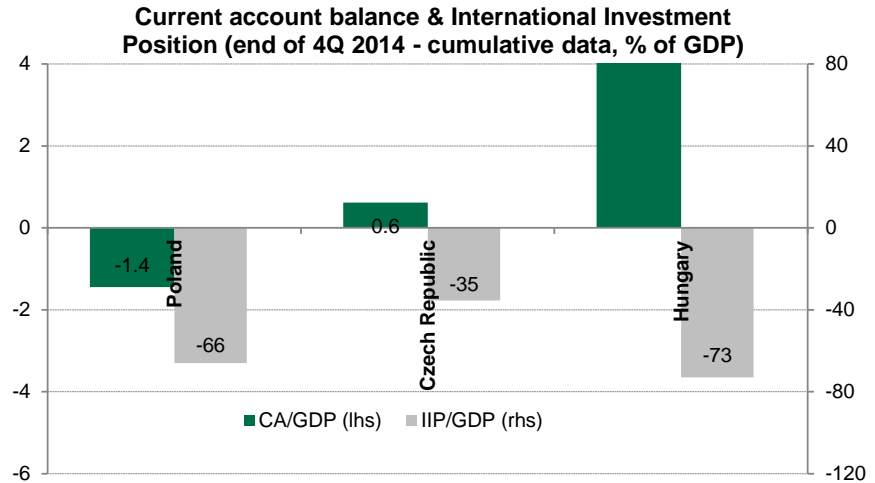
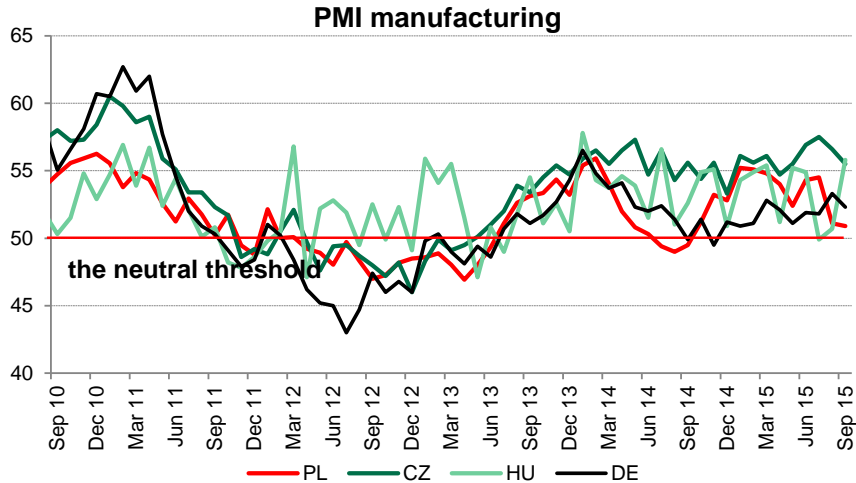


Source: Rating agencies, Reuters, EC, BZ WBK.

Inflation rates vs targets (%)

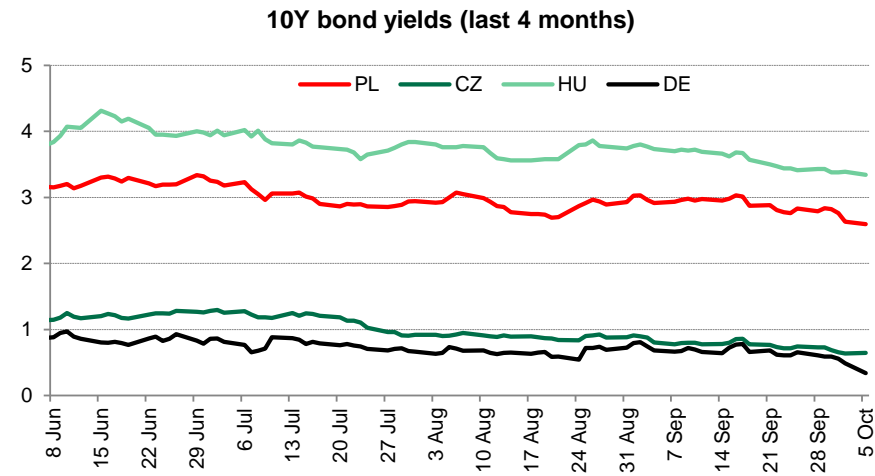
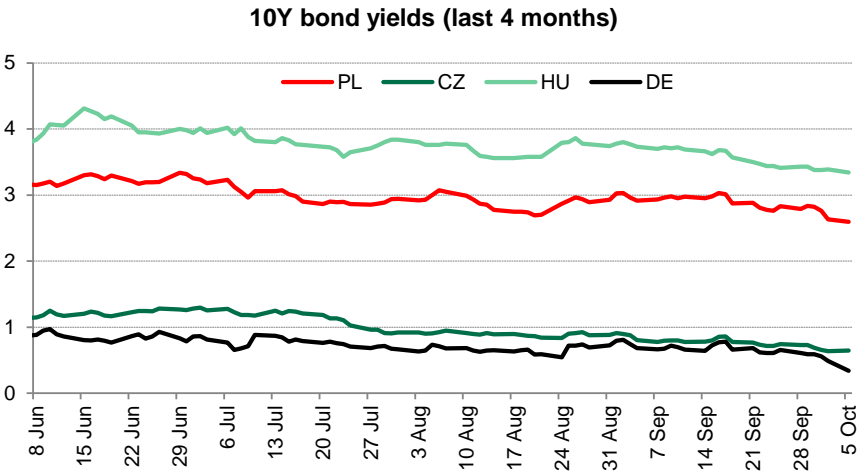
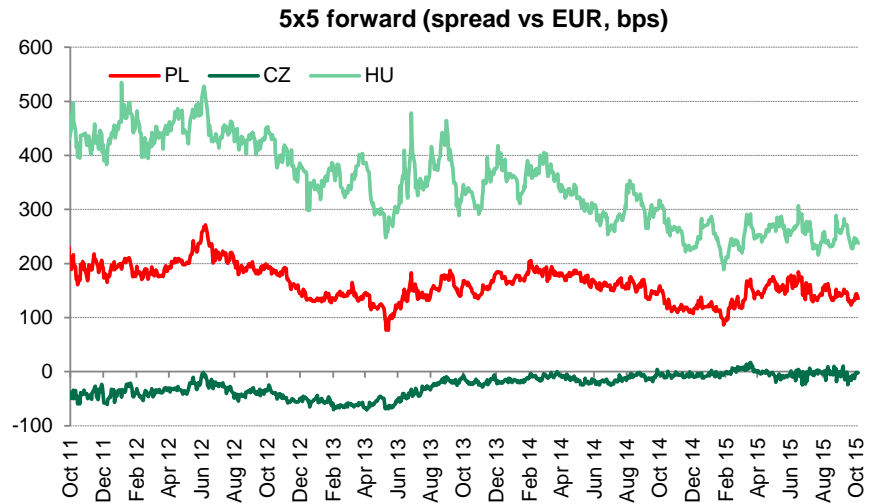
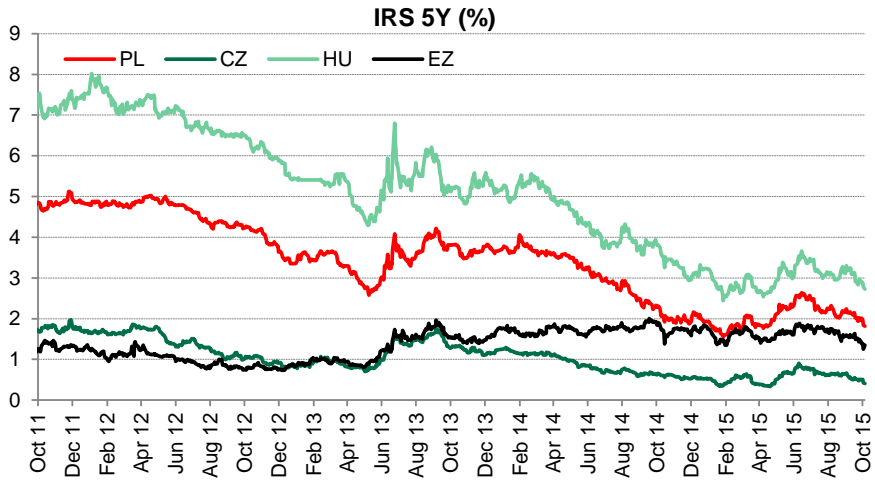


5. Poland vs. Other Countries (cont.)



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

5. Poland vs. Other Countries (cont.)



Source: Reuters, BZ WBK.

6. Central Bank Watch

| | | Last | 2014 | 2015 | Expected changes (bp) | | | Comments |
|-----------------------|------------------|--------|--------|------|-----------------------|-----|-----|---|
| | | | | | 1M | 3M | 6M | |
| Euro zone | Forecast | 0.05 | 0.05 | 0.05 | | | | In September the ECB left interest rates unchanged and matched market expectations as regards providing dovish signals. The ECB's chair Mario Draghi highlighted that the central bank is ready to provide more support if needed. The chances of it increasing or extending its QE programme have risen, but that is not our baseline scenario. |
| | Market implied » | | | | -11 | -12 | -14 | |
| UK | Forecast | 0.50 | 0.50 | 0.50 | | | | In our view, the BoE will keep its key rates unchanged, not only this month but also until the end of the year. Recently-released macro data point to quite decent economic growth, while inflation could ease in the near term. All these factors should justify keeping monetary conditions stable in the coming months. |
| | Market implied » | | | | 1 | 3 | 8 | |
| US | Forecast | 0-0.25 | 0-0.25 | 0.50 | | | | The FOMC left rates unchanged and the rhetoric was more dovish than expected. However, the Fed chair Janet Yellen highlighted in her speeches after the meeting that an interest rate hike is possible this year, unless the economy surprises. We expect the FOMC to start normalising its monetary policy in December rather than in October. |
| | Market implied » | | | | 19 | 32 | 52 | |
| Poland | Forecast | 1.50 | 2.00 | 1.50 | | | | As expected the MPC left interest rates unchanged at its September meeting. The Council confirmed that rates will remain at the current level until the end of the MPC's term. Some MPC members suggested that the Council should think about normalizing interest rates early in order to expand its room for manoeuvre, but such a view is in a clear minority. |
| | Market implied » | | | | -4 | -8 | -23 | |
| Czech Republic | Forecast | 0.05 | 0.05 | 0.05 | | | | The CNB left monetary conditions unchanged at its September's meeting, in line with expectations. The Council discussed an extension of the FX regime and negative interest rates, but agreed that the current situation and economic outlook do not justify such moves this month. In our view, monetary policy will not change until year-end. |
| | Market implied » | | | | -2 | -5 | -10 | |
| Hungary | Forecast | 1.35 | 2.10 | 1.35 | | | | The NBH kept its key rate unchanged at 1.35%, but the 2-week deposit was replaced with a 3M deposit as announced in June. What is more, the Board decided to tighten the O/N corridor asymmetrically. This was because the NBH wants to shift funds from short-dated central bank instruments towards longer-dated government securities. |
| | Market implied » | | | | -2 | -8 | -8 | |

This analysis is based on information available through October 5, 2015 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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