



RATES AND FX OUTLOOK

POLISH FINANCIAL MARKETS

March 2015



Bank Zachodni WBK

 Grupa Santander

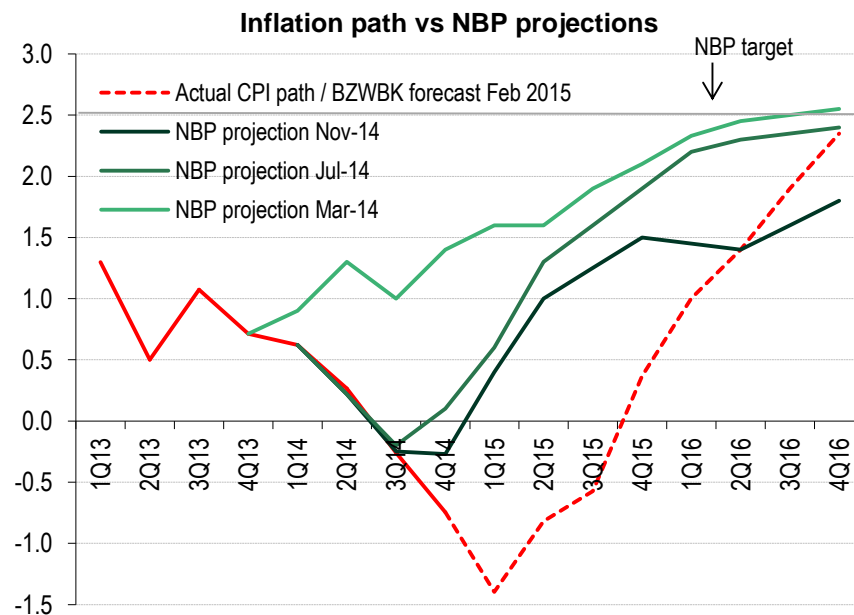
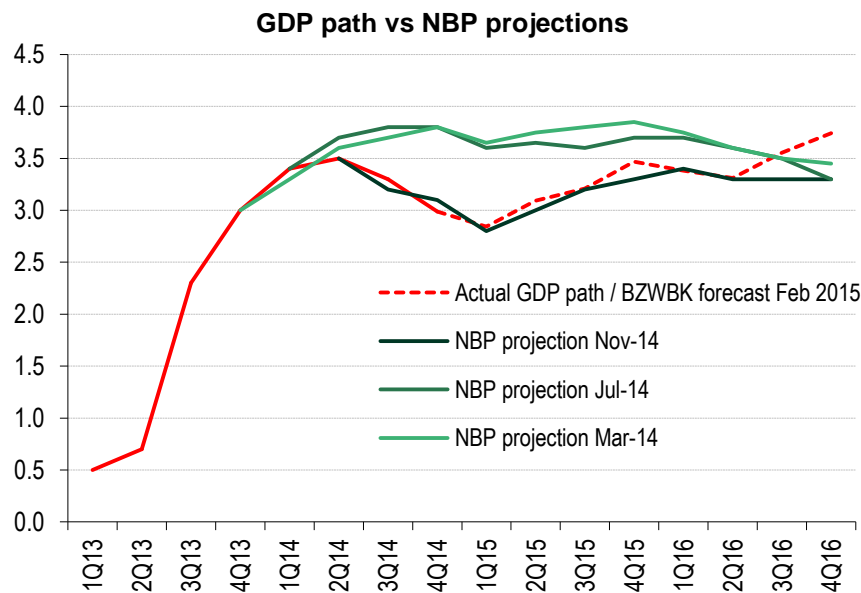
Table of Contents

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
Annexe	18

Summary

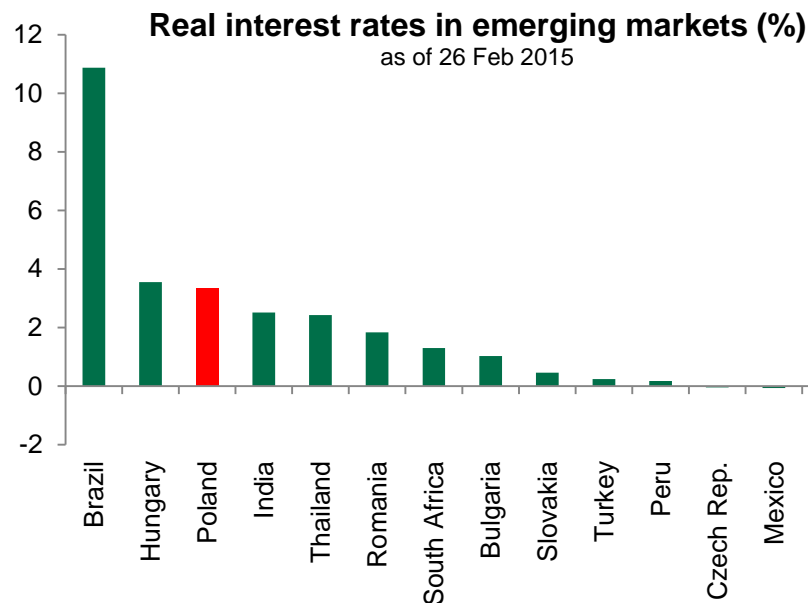
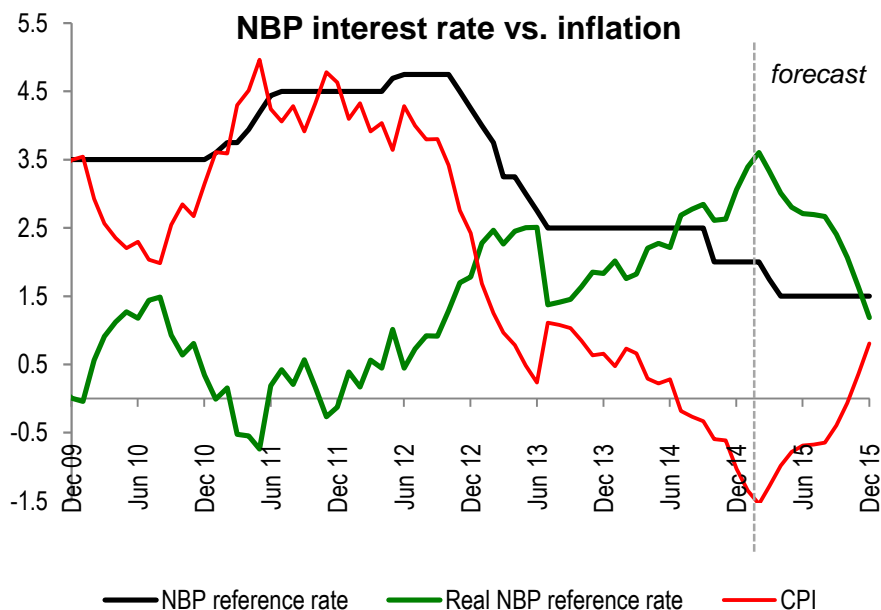
- Poland's Monetary Policy Council (MPC) kept interest rates on hold in February, but it also made it clear that a decision to ease monetary conditions is coming closer and that a cut, or cuts, could exceed 25bp. The central bank conditioned a decision on an extension of the expected period of deflation, which is very likely in our view. In March, new central bank projections are due for release and they will most likely show deeper and longer deflation, compared with the previous forecast from November. At the same time, central banks around the world are on a monetary easing spree: At least 20 have eased policy so far in 2015, aiming to drive down their currencies and/or address deepening deflation. All these factors create room for monetary easing in Poland, in our view. **We think it is very likely that the MPC will cut its main interest rates by 25bp in March and may cut again by 25bp as soon as April.** While a 50bp rate cut in one move cannot be ruled out completely, we think that two cuts of 25bp are more likely as geopolitical risk persists (an escalation of the conflict in Ukraine cannot be ruled out) and data on real economic activity are not bad.
- In fact, there are many signs that the Polish economy is faring better than expected. The labour market is in full upswing (with unemployment approaching pre-crisis levels and decent real wage growth), which should keep supporting private consumption. The impact of CHF appreciation on consumers should be insignificant. Recent data from the Euro zone suggest that the economic outlook in Europe is improving, helped by lower oil prices, the weaker euro and the ECB's QE. **Even though the recent high-frequency data showed some signs of slowdown in Poland at the start of the year (we predict that GDP growth in 1Q15 will be below 3%YoY), it seems the deceleration should be relatively mild and short-lived.**
- The bond market saw a correction in February, triggered by worries about Greece (and probably partly by signs of recovery in the Euro zone), but **we think that once the ECB starts large-scale buying of sovereign debt, which should absorb a large part of new bond supply in the Euro zone, European yields may come down again in the nearest months.** An upward correction is possible in the second half of the year, as the economic recovery strengthens and the Fed's interest rate hike comes closer.
- We expect EUR/PLN to move sideways in the coming weeks.** We think the zloty has limited scope to appreciate given expected interest rate cuts in Poland and continuing geopolitical risk (uncertainty about Greece, albeit lower, has not disappeared, while the risk of escalation of the conflict with Russia seems to be rising), among other things. The zloty may resume its rise in 2Q, assuming signs of economic recovery become more apparent, global sentiment improves and the ECB runs a fully-fledged QE programme.

MPC Preview: Longer deflation, but the trough looks near



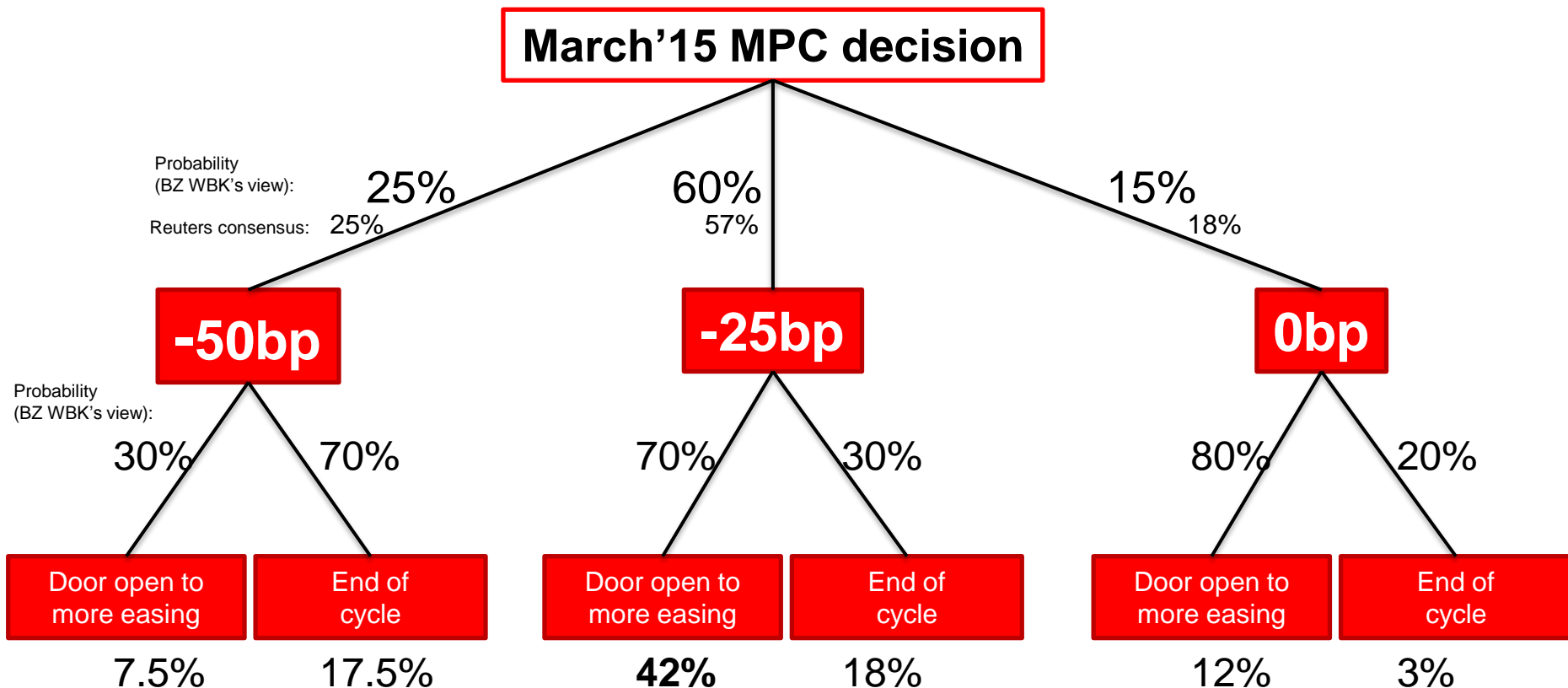
- ▶ The NBP's new projection for inflation (due in March) should show the same general direction as the previous one, although deflation proved sharper than expected, so the starting point for prices to rise will be much lower than it had assumed. No substantial rise in inflationary pressure is likely in the near term. We see 12M CPI below zero, at least until the end of 3Q15.
- ▶ We expect the path of economic growth to be similar to the previous projection. The output gap will probably close only at the end of the projection period (2017). However, there are more and more signs of strength in the labour market, with a possibility of rising wage pressure. We expect a gradual increase in unit labour costs (from a very low level), which should lead to an accompanying rise in core inflation in the medium-term. We think the central bank's 2.5% inflation target will be reached in 2016-17.
- ▶ The two main risks to this scenario are: the PLN exchange rate and a change in VAT (a possible 1pp cut).

MPC Preview: Will relatively high real rates affect PLN?



- Deeper-than-previously-expected deflation and a changed path for inflation going forward led to an increase in real interest rates in Poland. What is more, this happened in a context of many central banks putting in place expansionary policies, with negative rates in many countries and the announcement of the ECB's expanded asset purchases.
- Since the NBP released its last projection, the environment has changed in two ways: much lower inflation and stronger domestic demand (an argument against further cuts). However, the external environment seems to favour easing on the part of the Polish central bank. The big question is, therefore, whether the MPC will decide to be pre-emptive to avoid excessive capital inflow / zloty appreciation (as a result of relatively high rates) and cut interest rates again, or will it wait for the zloty to appreciate enough to trigger it to act?
- In any case, we only see rates remaining unchanged in the following scenarios: 1. confirmation of strong GDP and domestic demand growth; 2. deflation ending soon; 3. no significant zloty appreciation.

MPC Preview: Rate cut in March seems very likely



- ▶ Andrzej Bratkowski has recently been the biggest advocate of deep interest rate cuts (the only one who voted for a 100bp cut in December and January). But even his approach has become more cautious, due to the recent FX volatility. It implies, in our view, that an interest rate cut bigger than by 25bp in one go is not very likely (even though the probability of such a scenario is rising slightly as the zloty appreciates). It seems that market consensus is similar to our view in this regard.

Short- and Medium-term Strategy: Interest rate market

	Change (bp)		Current level	Expected trend	
	Last 3M	Last 1M	27 Feb 2015	1M	3M
Reference rate	-50	0	2.00	↓↓↓	↓↓↓
3M WIBOR	-25	-19	1.81	↓↓↓	↓↓↓
2Y bond yield	-16	6	1.58	↓	↓↓↓
5Y bond yield	-8	23	1.88	↓	↓↓↓
10Y bond yield	-22	18	2.15	↓	↓↓↓
2/10Y curve slope	-7	13	57	→	→

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

PLN rates: our view and risk factors

Money market: WIBORs fell sharply in February, in anticipation of monetary easing in March. If the MPC cuts interest rates by 25bp at the nearest meeting, keeping the door open for further easing in the near future (which is our baseline scenario), money market rates may continue trending downwards, with 3M WIBOR approaching the 1.60% target even before the end of this month.

Short end: Front ends of the curves remain anchored by expectations of MPC rate cuts and we think the situation is unlikely to change after the next central bank meeting unless the MPC strongly disappoints.

Long end: The bond market saw a correction in recent weeks, triggered by worries about Greece leaving the euro (and probably partly by signs of recovery in the Euro zone), but we think that after the ECB starts large-scale buying of sovereign debt, wiping out a large part of new bond supply in the euro area, European and Polish yields may come down again. In the short run, this move may be limited by concern about looming Fed policy tightening, but we think that the first interest rate hike in the US could be delayed until September. An upward correction in yields is possible in the second half of the year, in our view, after economic recovery strengthens and Fed's interest rate hike comes closer.

Risks to our view: The Eurogroup's approval of the Greek bailout extension was just one step forward, but there are more hurdles to go in the coming weeks and months. If the situation in Greece becomes complicated again, Polish yields may rise. Another risk is a potential escalation of the conflict with Russia with NATO countries sending personnel and equipment to Ukraine. Moreover, if the Fed drops the word "patient" from its statement as soon as March, it may negatively affect bonds.

Short- and Medium-term Strategy: FX market

	Change (%)		Current Level	Expected trend	
	Last 3M	Last 1M	27 Feb 2015	1M	3M
EURPLN	-0.8	-1.4	4.15	→	→
USDPLN	10.0	-0.6	3.70	→	↘
CHFPLN	11.9	-3.1	3.89	→	→
GBPPLN	7.8	1.5	5.69	→	↘
EURUSD	-9.8	-0.8	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.

PLN FX Market: Our view and risk factors

EUR: We expect EUR/PLN to move sideways in the coming weeks. Factors limiting the scope for zloty appreciation include expected interest rate cuts in Poland (in March and probably in April) and persistent geopolitical risk (uncertainty about Greece, albeit less, has not disappeared, while the risk of an escalation of the conflict with Russia seems to be rising). The zloty may resume its rise in 2Q, after signs of economic recovery become more apparent, global sentiment improves and the ECB runs a full-fledged QE programme.

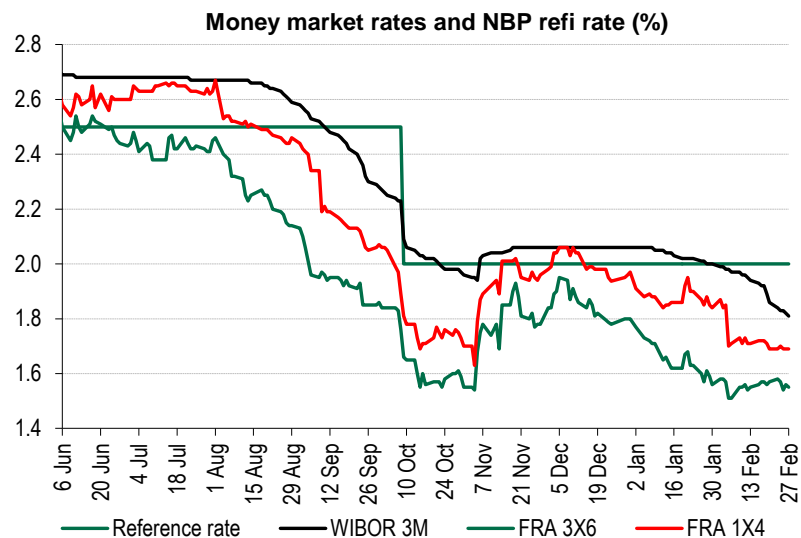
USD: We assume the dollar may strengthen further versus the euro in the next few weeks, as the ECB starts expanding its balance sheet faster, and investors mull the approaching Fed rate hike. Consequently, USD/PLN may rise above 3.70 in March, before decreasing gradually later in the year.

CHF: As we suggested last month, the EUR/CHF rate has increased gradually as it seems that the Swiss National Bank is not willing to tolerate excessive CHF strength. We think the zloty should keep gaining versus the Swiss franc in the coming months.

Risks to our view: First, the zloty appreciation may become faster and stronger if the Polish MPC appears hesitant in policy easing, Polish macro data surprise to the upside and geopolitical uncertainties disappear quickly. On the other hand, if the situation in Greece or Ukraine gets out of control (which still cannot be ruled out), the short-term burst of risk aversion may result in significant currency weakening.

Domestic Money Market: The downward trend may continue

- WIBOR rates fell sharply in February, when the Monetary Policy Council signalled very clearly that policy easing is coming closer, in anticipation of an interest rate cut in March. Rates fell 12-18bp across the board, which was the biggest monthly drop since September 2014. At the same time, FRAs moved in the opposite direction, climbing 1-27bp (starting from the 3x6 rate) over the past month.
- Currently the FRA3x6 is c30bp below 3M WIBOR, while the latter is c18bp below the NBP reference rate. If the MPC cuts interest rates by 25bp in March and leaves the door open for further easing in the near future (which is our baseline scenario), money market rates may continue trending downwards, with WIBOR 3M approaching the 1.60% target even before March. Otherwise, the downward trend in WIBORs may slow a bit.
- Next round of domestic data releases may have a mixed impact on the money market. While a further deepening of CPI deflation (to -1.5%YoY in February) is likely to reinforce hopes of more easing, supporting a decline in rates, data on production or retail sales may trigger short-term corrections if they signal relatively decent economic activity at the start of the year.

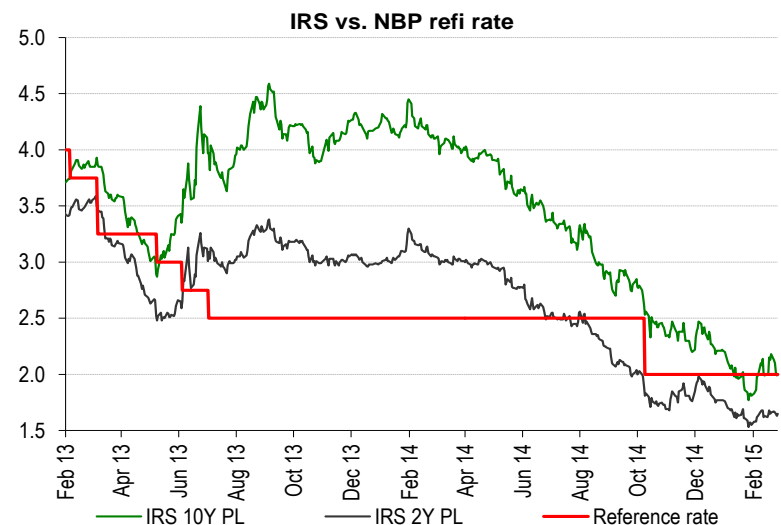
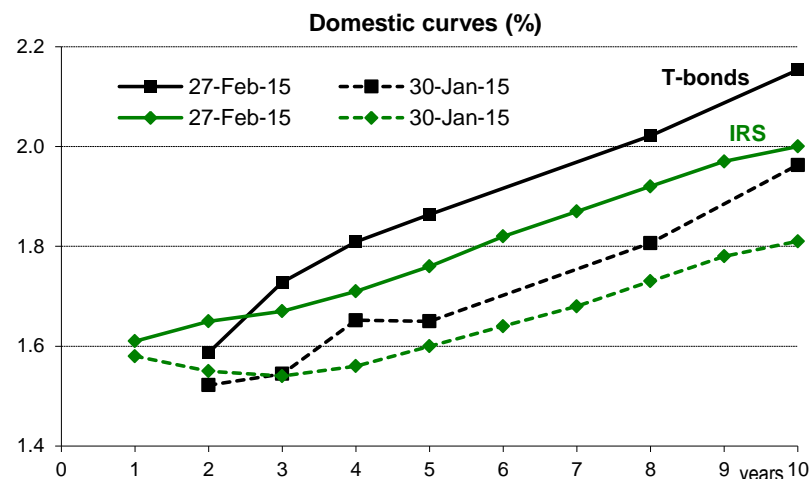


Source: Reuters, BZ WBK

Domestic IRS and the T-Bond Market: Yields may drop again after the ECB starts large-scale QE

Bond yields and IRS rates were under pressure in February, due to a risk-off mood and uncertainty about Greece, Ukraine and the timing of Fed's rate hikes. As a result, the 10Y benchmark yield increased temporarily to 2.35%, the highest level since the start of the year. However, strong expectations of a rate cut in March, the Eurogroup's approval of the Greek bailout and dovish Fed's rhetoric (FOMC minutes, Yellen's testimony) helped the domestic fixed income market rebound, trimming a significant part of earlier losses. Bear-steepening took place with the 2-10Y bond spread widening to 60bp from 44bp at the end of January.

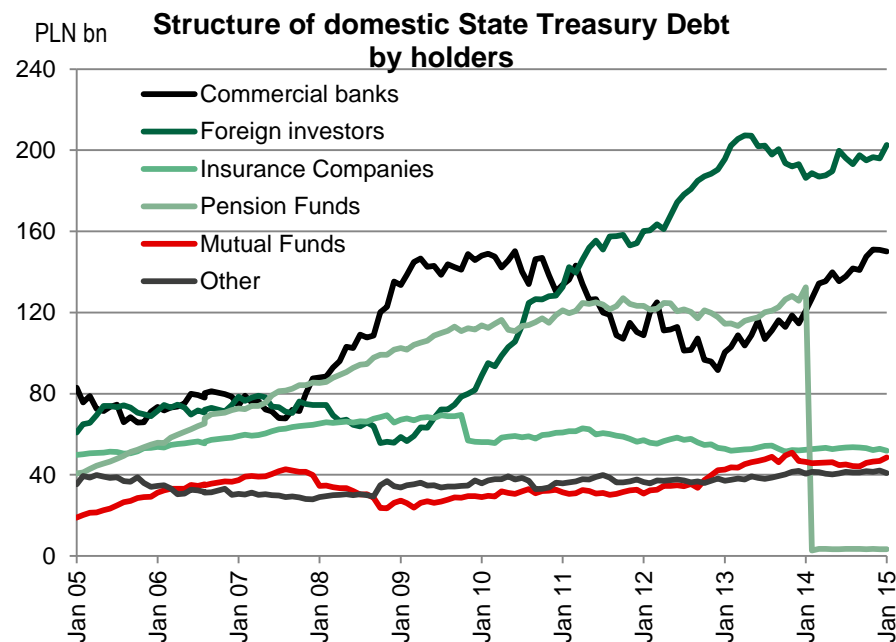
The MPC decision to cut rates by 25bp in March is fully priced-in by the market, so, if the tone of the post-meeting statement does not disappoint, there should be little reaction to the central bank meeting. We think the action of central banks in other countries may have more impact. After the ECB starts large-scale buying of sovereign debt, wiping out a large part of new bond supply in the Euro zone, European and Polish yields may come down again, in our opinion. In the short run, this move may be limited by concern about the Fed's policy tightening, but we think that the first interest rate hike in the US could be delayed until September. However, if Fed drops the word 'patient' from its statement in March, it may negatively affect bonds. Domestic data will probably remain overshadowed by events abroad, with no significant impact on domestic curves. All in all, we expect yields/IRS rates to shift down, testing their minimums in the coming weeks and flattening the curve.



Source: Reuters, Bloomberg, BZ WBK.

Demand Corner: Non-residents' holdings exceeded PLN200bn in January

- Finance Ministry data show holdings of Polish, PLN, marketable bonds changed quite considerably after January 2015 as foreign investors increased their portfolios by cPLN6.5bn to PLN202.5bn, the highest level in history. At the same time, domestic investors reduced their portfolios, the exception being investment funds, whose portfolios rose by PLN1.6bn.
- Among non-residents, the most noticeable increase in the holdings was for commercial banks (by cPLN3.4bn) and investment funds (by PLN3bn). It is worth noting that holdings of investment funds again exceeded PLN80bn in January, the first time since September 2014. The geographical breakdown of non-residents' holdings showed Asian investors (excluding Middle East) enlarged their portfolios by PLN3.4bn to PLN42.7bn and investors from the European Union (excluding the Euro zone) increased their holdings by cPLN3.6bn to PLN10.6bn (the highest level since July 2014).
- According to Piotr Marczak, the head of the Finance Ministry's debt department, in February foreign investors slightly reduced their holdings in Polish T-bonds.



Source: Finance Ministry, BZ WBK.

Supply Corner: Bond issues may exceed 50% of plan after 1Q

- February was another favourable month to launch T-bonds on the primary market. In the first two months the ministry conducted four auctions and sold T-bonds worth PLN22.2bn (vs PLN25-30bn assumed in its 1Q15 issuance plan). To date, it has already secured 47% of its 2015 borrowing needs.
- In March, the ministry plans to hold one regular auction, with a supply of long-term bonds (floater WZ0124, 10Y fixed-rate benchmark DS0725 and WS0428) worth PLN3-6bn and a switch tender. During the tender, the ministry will bid for bonds maturing in April, July and October 2015. A repurchase auction for a USD-denominated bond (maturing in July and October 2015) is also set for March and the ministry plans to redeem bonds worth up to US\$500m.
- March's offer of T-bonds is quite limited and we expect auctions to attract solid demand. In our view, after 1Q15, the ministry will have covered more than 50% of its 2015 borrowing requirements.

Auction plan for March 2015

Auction / Settlement date	Buy-back T-bonds		Nominal value of buy-back (USD m)
	Series	Maturity date	
5 Mar 2015 / 9 Mar 2015	USD20150716	16 July 2015	Up to 500
	USD20151019	19 October 2015	

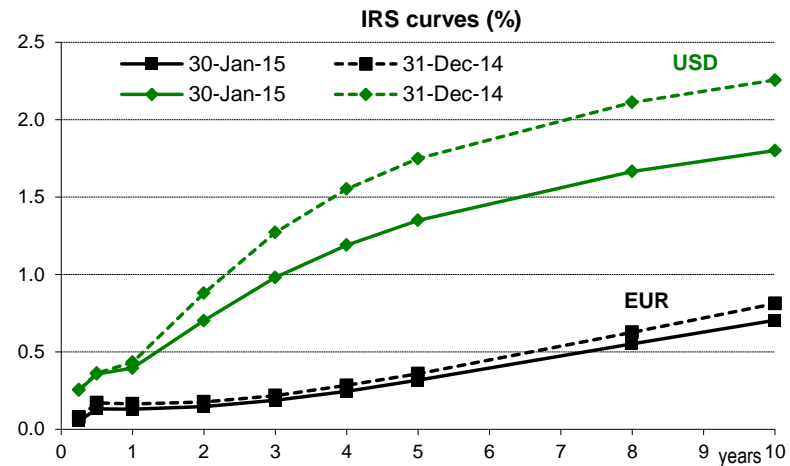
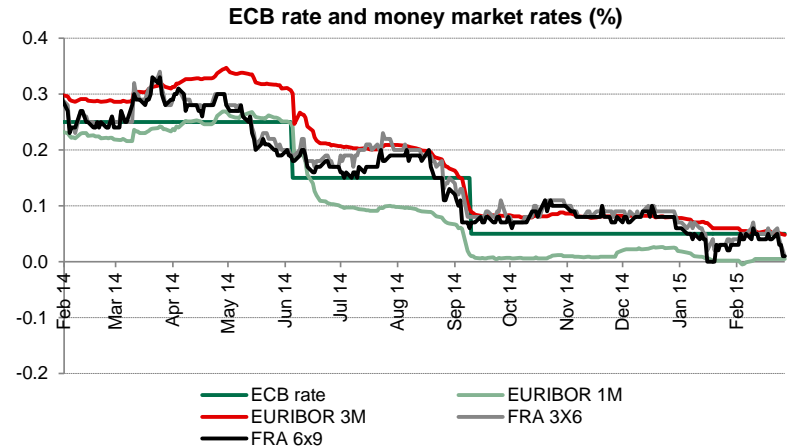
Auction date	Settlement date	Series	Planned offer (PLN m)
12 Mar 2015	16 Mar 2015	WZ0124/DS0725/WS0428	3,000 – 6,000

Auction / Settlement date	T-bonds to be offered	Source T-bonds	Outstanding (PLN m)
26 Mar 2015 / 30 Mar 2015	The choice depends on market conditions	PS0415	18,097
		OK0715	9,506
		DS1015	25,370

Source: Finance Ministry, BZ WBK.

International Money Market and IRS: More room for EUR rates to decline

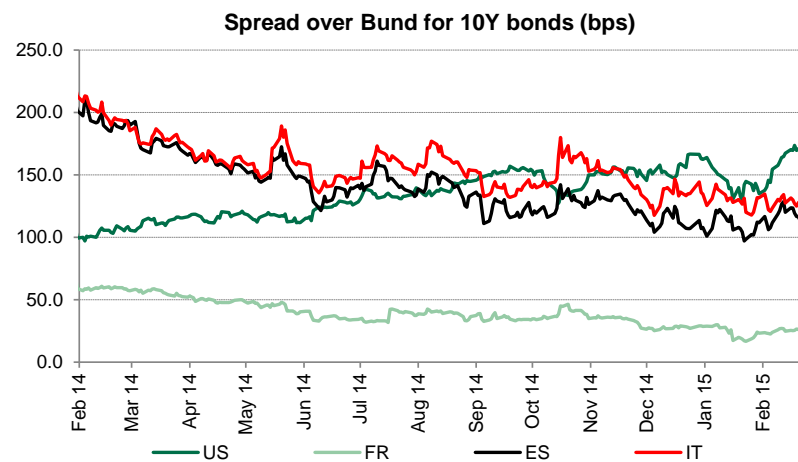
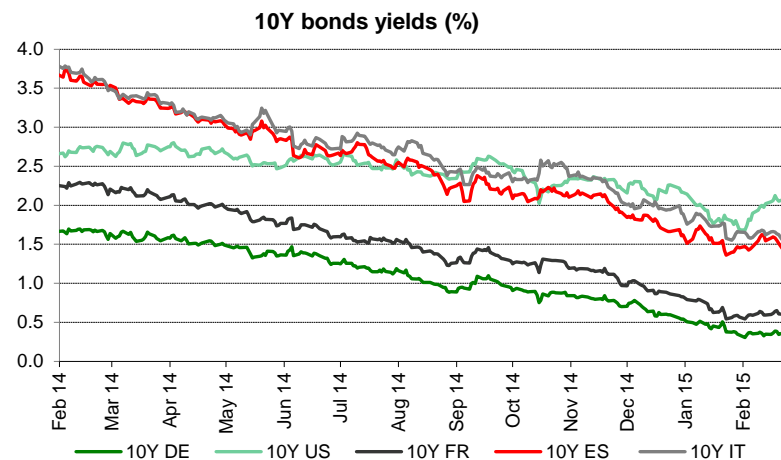
- In February EUR money market rates were roughly stable (shedding only 1.2-1.4bp across the curve on a monthly basis) and the decline in EUR IRS was muted (2-5bp). Minor downside in EUR rates could come from signals that Euro zone growth is gaining momentum, rather than the uncertainty generated by the situation in Greece.
- USD Libor rates were little changed, as in previous month, while USD IRS increased by 7-30bp, with the highest rise in the belly and long end of curve (10Y USD IRS briefly reached 2.23%, the highest level since the end of 2014). This was the result of better US macro data, which renewed expectations of earlier monetary tightening. However, the dovish tone of the FOMC minutes and the Fed governor's testimony before Congress helped IRS rates to rebound slightly.
- In our view, investors' focus will shift more towards macroeconomic data releases, which might weigh on future central bank decisions, in particular the Fed's. EUR rates (both money market and IRS) have a room for a gradual decline, supported by ECB action, while US rates should stabilise in the coming weeks, due to further strengthening of labour market data and solid economic activity. However, in 2Q15 USD IRS could resume an upward trend.



Source: Reuters, ECB, Fed, BZ WBK.

International Bond Market: Improving macro perspectives might put a brake on the downward trend

- In February, the yields of peripheral debt surged significantly, due to the uncertainty generated by the situation in Greece, while core markets remained relatively immune to these developments. Notwithstanding, the end of the month brought quite visible strengthening in the face of the dovish rhetoric of the Fed governor (confirming the tone of the FOMC minutes) and the upcoming launch of the ECB's QE programme. Consequently, 10Y Bunds fell below 0.3%, while 10Y UST stabilised below 2%.
- Peripheral debt also benefited from the improving global mood at the end of February, with the Irish 10-year government bond yield dropping below 1% for the first time. Spanish and Italian 10Y benchmarks also rebounded, with yields falling below 1.40% and 1.50%, respectively. The spread over Bunds also narrowed considerably, towards 100bp for Spain and to below 120bp for Italy.
- With the ECB pushing the QE button in March, we expect a further gradual decline in yields on both core and peripheral markets. However, the decline in UST yields is likely to be limited, especially if upcoming macro data continue to strengthen or the FOMC meeting shows that a Fed move is closer.
- In the medium to long term, we still think yields will start rising, in particular at the long end, as the global growth picture should improve quite considerably and inflation should rise. While the 2Y Bund yield is likely to remain negative until the year end, the 10Y Bund should be above 0.5% at the end of 2015E.

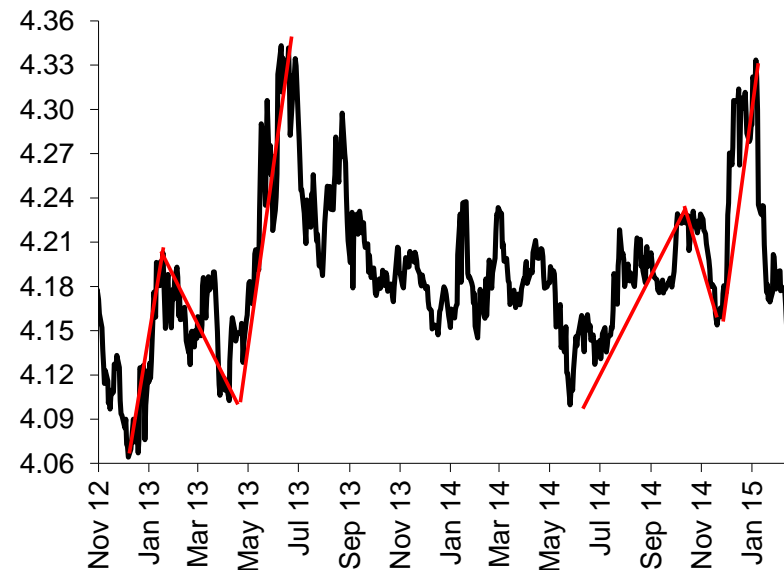


Source: Reuters, BZ WBK.

Foreign Exchange Market: Moving sideways with potential to appreciate

- We expect EUR/PLN to stay range-bound in the coming weeks. The likely interest rate reductions in the coming months (we anticipate two rate cuts, of 25bp each, in March-April) will probably have a negative effect on the currency. Even though the uncertainty about Greece diminished recently (at least for some time), which should be supportive for the zloty, there is mounting tension in Eastern Europe. Some NATO countries (including Poland) plan to send military personnel to Ukraine to train and advise the Ukrainian forces. This implies a risk of escalation of the conflict with Russia, which would weigh on CEE currencies.
- Another issue that may prompt investor concern is the potential conversion of CHF mortgage loans into zlotys, as proposed recently by the head of the financial regulator (KNF). Such a solution would imply financial losses for Polish banks and, theoretically, could introduce FX market volatility, as banks would have to buy CHF to cover loan conversions. However, at this stage, we think the risk for the currency is limited.
- The start of ECB's fully-fledged QE could potentially have a strong positive impact on the zloty, as it may spur flows to higher-yielding assets like Polish bonds. However, in the next few weeks, this may be mitigated, at least partly, by the NBP's expected cut in its main rate to 1.5% and by geopolitical risk.

EUR/PLN recovered faster than in 2H13



Source: Bloomberg, BZ WBK

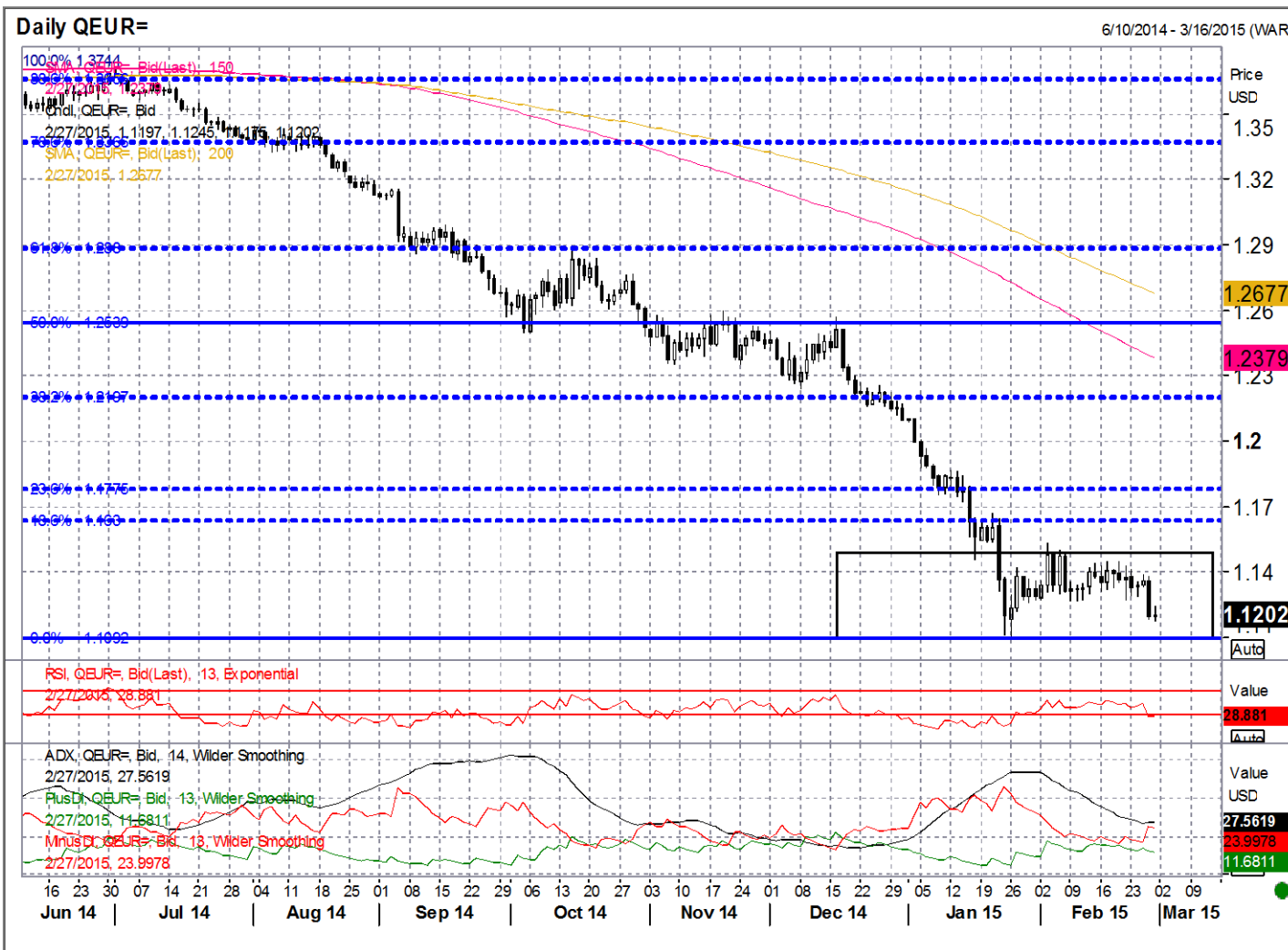
FX Technical Analysis Corner: EURPLN tested support at 4.146



- ▶ The EUR/PLN recovered quite visibly (as the risk of Grexit diminished and due to dovish comments from Fed) and it is trying to test the lower boundary of a consolidation channel between 4.146 (December's bottom) and 4.20.
- ▶ Recently, the EUR/PLN repeatedly tested 4.15, but failed to break it. If it succeeds, the rate may fall to 4.12 and then towards 4.08.
- ▶ There is strong resistance at 4.20 and at 4.22.

Source: Reuters, BZ WBK.

FX Technical Analysis Corner: EURUSD closer to this year's low



- ▶ EUR/USD once again tested support at c1.12, indicated by the 61.8% Fibonacci retracement of an up-wave created in 2001-08.
- ▶ If the rate breaks that support, it becomes very likely that it will reach the year-to-date low of 1.1098.
- ▶ In our view, breaking that level would mean the end of the ongoing consolidation channel, started in January, and a return to a downtrend.

Source: Reuters, BZ WBK.

Macroeconomic Forecasts

Poland		2012	2013	2014	2015E	1Q14	2Q14	3Q14	4Q14	1Q15E	2Q15E	3Q15E	4Q15E
GDP	PLNbn	1,615.9	1,662.1	1,724.7	1,782.6	403.1	418.4	426.8	476.4	412.2	431.7	440.6	498.2
GDP	%YoY	1.8	1.7	3.3	3.2	3.4	3.5	3.3	3.1	2.9	3.1	3.2	3.5
Domestic demand	%YoY	-0.4	0.2	4.7	4.6	3.4	5.6	4.9	4.6	4.4	4.7	4.4	4.8
Private consumption	%YoY	1.0	1.1	3.0	3.6	2.9	3.0	3.2	3.1	3.5	3.6	3.6	3.5
Fixed investment	%YoY	-1.5	0.9	9.5	8.4	11.2	8.7	9.9	9.0	9.0	9.0	8.0	8.0
Unemployment rate ^a	%	13.4	13.4	11.5	10.8	13.5	12.0	11.5	11.5	11.6	10.4	10.2	10.8
Current account balance	EURmn	-13,697	-5,245	-5,320	-7,868	-1,403	-808.0	-1777.0	-1332.0	-1,955	-1,312	-2,820	-1,782
Current account balance	% GDP	-3.5	-1.3	-1.3	-1.8	-1.1	-1.2	-1.3	-1.3	-1.4	-1.5	-1.8	-1.8
General government balance (ESA 2010)	% GDP	-3.9	-4.3	-3.4	-2.9	-	-	-	-	-	-	-	-
CPI	%YoY	3.7	0.9	0.0	-0.5	0.6	0.3	-0.3	-0.7	-1.3	-0.7	-0.5	0.4
CPI ^a	%YoY	2.4	0.7	-1.0	0.9	0.7	0.3	-0.3	-1.0	-1.2	-0.6	-0.3	0.9
CPI excluding food and energy prices	%YoY	2.2	1.2	0.6	0.8	0.8	0.8	0.5	0.4	0.5	0.6	0.7	1.2

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

Interest Rate and FX Forecasts

Poland		2012	2013	2014	2015E	1Q14	2Q14	3Q14	4Q14	1Q15E	2Q15E	3Q15E	4Q15E
Reference rate ^a	%	4.25	2.50	2.00	1.50	2.50	2.50	2.50	2.00	1.75	1.50	1.50	1.50
WIBOR 3M	%	4.91	3.02	2.52	1.68	2.71	2.71	2.59	2.06	1.90	1.61	1.60	1.63
Yield on 2-year T-bonds	%	4.30	2.98	2.46	1.48	3.01	2.76	2.26	1.80	1.57	1.44	1.44	1.48
Yield on 5-year T-bonds	%	4.53	3.46	2.96	1.73	3.71	3.35	2.67	2.11	1.84	1.68	1.63	1.78
Yield on 10-year T-bonds	%	5.02	4.04	3.49	2.04	4.38	3.82	3.18	2.58	2.16	1.98	1.96	2.08
2-year IRS	%	4.52	3.10	2.51	1.58	3.07	2.82	2.32	1.83	1.61	1.49	1.49	1.74
5-year IRS	%	4.47	3.51	2.92	1.66	3.70	3.31	2.63	2.02	1.72	1.56	1.53	1.82
10-year IRS	%	4.56	3.86	3.34	1.96	4.16	3.73	3.07	2.40	2.01	1.98	1.92	1.93
EUR/PLN	PLN	4.19	4.20	4.18	4.13	4.19	4.17	4.18	4.21	4.21	4.15	4.11	4.06
USD/PLN	PLN	3.26	3.16	3.15	3.60	3.06	3.04	3.15	3.37	3.69	3.67	3.57	3.47
CHF/PLN	PLN	3.47	3.41	3.45	3.87	3.42	3.42	3.45	3.50	3.93	3.91	3.87	3.76
GBP/PLN	PLN	5.16	4.94	5.19	5.55	5.06	5.11	5.26	5.33	5.63	5.57	5.51	5.49

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

Economic Calendar and Events

Date		Event:	Note:
2-Mar	PL	PMI manufacturing for February	We expect a slight decline to 54.8, close to market expectations
	EZ	PMI manufacturing for February	-
4-Mar	PL	MPC meeting – interest rate decision	We predict a rate cut of 25 bp, in line with market expectations
5-Mar	EZ	ECB meeting – interest rate decision	-
12-Mar	PL	Auction of long-term T-bonds WZ0124/DS0725/WS0428	Offer: PLN3.0-6.0bn
13-Mar	PL	M3 money supply for February	We expect 8.8%YoY
	PL	CPI inflation for February	We see a deepening of deflation to -1.5%YoY. This will most probably be the lowest point this year. We are below market consensus (-1.4%YoY)
16-Mar	PL	Current account for January	We expect weaker growth in both exports and imports and a deeper C/A account deficit
17-Mar	PL	Wages in the corporate sector for February	We expect a slowdown to 3.1%YoY, mainly on the back of weaker payments in mining, in line with expectations
	PL	Employment in the corporate sector for February	We expect a slight acceleration to 1.3%YoY, proving the labour market is in good shape, in line with expectations
18-Mar	PL	Industrial output for February	Our forecast assumes an acceleration to 5.6%YoY and we are more optimistic than the market (4.0%YoY)
	PL	Retail sales for February	We predict retail sales up 1.0%YoY, above market consensus (0.0%YoY)
	US	FOMC meeting – interest rate decision	-
TBA	PL	Unemployment rate	Likely to stay flat at 12.0%, in line with market consensus
24-Mar	EZ	Flash PMI manufacturing for March	-
	HU	MNB meeting – interest rate decision	-

Source: CB, Markit, CSO, Finance Ministry

Annexe

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

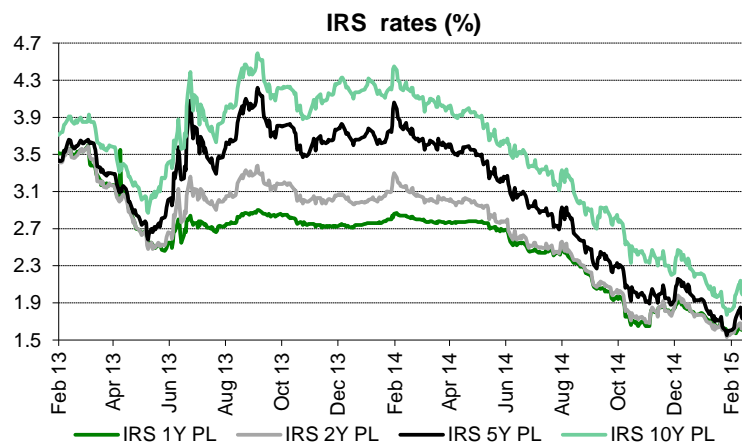
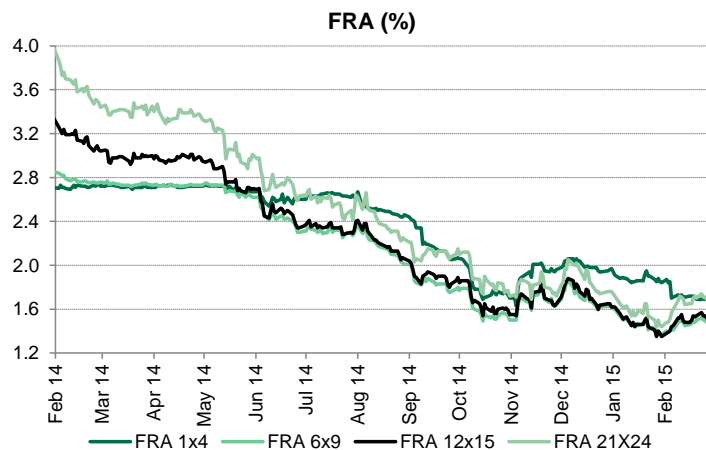
1. Domestic Market Performance

Money market rates (%)

	Reference	Polonia	WIBOR (%)				OIS (%)				FRA (%)			
	rate (%)	(%)	1M	3M	6M	12M	1M	3M	6M	12M	1x4	3x6	6x9	9x12
End of February	2.00	1.80	1.89	1.81	1.80	1.79	1.76	1.60	1.49	1.46	1.69	1.55	1.50	1.50
Last 1M change (bp)	0	6	-13	-20	-20	-20	1	3	2	3	-16	-2	14	16
Last 3M change (bp)	0	-20	-19	-25	-25	-24	-3	-15	-19	-19	-25	-23	-13	-13
Last 1Y change (bp)	-50	1	-72	-90	-94	-99	-66	-82	-94	-106	-106	-117	-125	-139

Bond and IRS market (%)

	BONDS			IRS			Spread BONDS / IRS (bp)		
	2Y	5Y	10Y	2Y	5Y	10Y	2Y	5Y	10Y
End of February	1.59	1.86	2.15	1.65	1.76	2.00	-6	10	15
Last 1M change (bp)	9	19	16	12	21	23	-3	-2	-7
Last 3M change (bp)	-14	-10	-25	-12	-12	-22	-2	2	-3
Last 1Y change (bp)	-143	-180	-223	-140	-188	-210	-3	8	-13



Source: Reuters, BZ WBK

2. Polish Bonds: Supply Recap

Total issuance in 2015 by instruments (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	5,000	15,000	5,000	4,000	8,000		5,000	15,000	6,000		85,112
T-bill auctions													0
Retail bonds	100	100	100	150	150	150	150	150	150	150	150	150	1,650
Foreign bonds/credits					4200		1700						5,900
Pre-financing and financial resources at the end of 2014	38,700												38,700
Total	50,004	11,008	5,100	15,150	9,350	4,150	9,850	150	5,150	15,150	6,150	150	131,362
Redemption	6,071	159	98	18,191	5,273	110	14,244	1,452	431	28,764	213	241	75,249
Net inflows	43,932	10,849	5,002	-3,041	4,077	4,040	-4,394	-1,302	4,719	-13,614	5,937	-91	56,112
Rolled-over T-bonds													0
Buy-back of T-bills/ FX-denominated bonds													0
Total	43,932	10,849	5,002	-3,041	4,077	4,040	-4,394	-1,302	4,719	-13,614	5,937	-91	56,112
Coupon payments from domestic debt	1,416			4,204			2,810		1,298	7,910			17,638

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	18,097		95	18,191	0	18,191
May	0		116	116	5,157	5,273
June	0		110	110	0	110
July	9,506		136	9,642	4,602	14,244
August	0		184	184	1,267	1,452
September	0		162	162	269	431
October	25,370		146	25,516	3,248	28,764
November	0		213	213	0	213
December	0		241	241	0	241
Total 2015	58,995		1,710	60,705	14,544	75,249
Total 2016	87,607		2,034	89,641	13,808	103,449
Total 2017	64,134		1,032	65,166	10,687	75,853
Total 2018	66,317		1,103	67,420	10,040	77,460
Total 2019+	63,863		972	64,835	20,336	85,171
Total 2020+	162,703		2,383	165,087	110,914	276,001

Source: MF, BZ WBK.

2. Polish Bonds: Supply Recap (cont.)

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

	Foreign investors	Domestic banks	Insurance funds	Pension funds	Mutual funds	Individuals	Non-financial sector	Other	Total
Q1 2015	0	0	0	0	0	54	9	7	71
Q2 2015	10,048	4,108	1,960	145	372	39	37	1,388	18,097
Q3 2015	2,919	3,360	1,069	128	527	63	9	1,430	9,506
Q4 2015	10,802	5,680	4,408	101	2,015	27	224	2,113	25,370
Total 2015	23,768	13,148	7,437	374	2,914	183	280	4,938	53,043
	45%	25%	14%	1%	5%	0%	1%	9%	100%
Total 2016	44,986	20,397	7,440	681	8,623	120	184	6,191	88,624
	51%	23%	8%	1%	10%	0%	0%	7%	100%
Total 2017	21,947	18,572	6,058	528	6,676	72	178	4,512	58,543
	37%	32%	10%	1%	11%	0%	0%	8%	100%
Total 2018	20,129	27,397	4,643	382	8,555	81	590	4,541	66,317
	30%	41%	7%	1%	13%	0%	1%	7%	100%
Total 2019+	19,061	28,007	5,097	503	7,551	72	174	3,399	63,863
	30%	44%	8%	1%	12%	0%	0%	5%	100%
Total 2020+	71,192	37,866	21,017	794	13,435	159	662	5,579	150,704
	47%	25%	14%	1%	9%	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 January			Share of total in January (%)
	End Jan'15	End Dec'14	End Nov'14	End 3Q 2014	End 2Q 2014	End 2013	MoM	3-mth	YoY	
Domestic investors	294.5	295.9	294.6	283.2	277.2	381.2	-0.46	2.09	-24.98	59.3 (-0.9pp)
Commercial banks	150.0	150.8	151.0	140.9	135.4	114.7	-0.52	1.67	24.13	30.2 (-0.5pp)
Insurance companies	51.8	52.8	52.2	53.4	53.1	52.0	-1.95	-2.51	-1.15	10.4 (-0.3pp)
Pension funds	3.3	3.3	3.4	3.5	3.3	125.8	-1.83	-3.27	-97.53	0.7
Mutual funds	48.5	46.9	46.5	44.1	44.8	46.7	3.49	5.68	4.82	9.8 (0.2pp)
Others	40.9	42.0	41.5	41.2	40.6	42.0	1.3	2.0	0.0	8.2 (-0.3pp)
Foreign investors*	202.5	196.0	196.6	197.5	199.8	193.2	3.34	3.83	8.72	40.7 (0.9pp)
Banks	13.3	9.9	9.9	12.1	12.6	n.a.	0.4	-17.6		2.7 (0.7pp)
Central banks	17.4	16.4	15.6	19.3	18.0	n.a.	5.4	-15.0		3.5 (0.2pp)
Public institutions	8.1	8.1	8.8	0.5	0.7	n.a.	-8.3	1369.4		1.6
Insurance companies	10.6	10.7	10.5	10.9	9.5	n.a.	1.9	-2.0		2.1 (-0.1pp)
Pension funds	12.7	13.0	12.8	12.7	12.3	n.a.	1.9	2.2		2.6 (-0.1pp)
Mutual funds	81.1	78.1	78.8	80.8	83.4	n.a.	-0.8	-3.3		16.3 (0.4pp)
Hedge funds	0.7	0.8	0.6	0.1	0.1	n.a.	25.7	808.0		0.1
Non-financial sector	11.6	11.6	12.1	12.1	12.2	n.a.	-3.7	-4.8		2.3
Others	15.8	14.3	14.8	17.7	16.5	5.2	-3.6	-19.2		3.2 (0.3)
TOTAL	497.0	491.8	491.2	480.7	477.0	574.3	1.1	0.9	-14.1	100

*Total for foreign investors does not match 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	6
Belgium	31.8	102.2	28.1	32.5	15
Finland	10.0	119.6	7.6	11.4	-
France	173.0	117.4	116.5	187.0	13
Germany	161.0	100.0	155.0	147.0	12
Greece	-	-	-	-	-
Ireland	10.0	117.5	2.3	7.5	30
Italy	235.4	111.8	205.2	252.9	10
Netherlands	50.0	101.7	39.9	48.0	10
Portugal	16.7	101.7	7.2	13.9	42
Spain	129.3	105.4	86.4	130.0	13
Total	841.9	108.1	661.5	847.3	12

*/ YTD (year calendar) data for 2015

Source: European Commission, EZ 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)	
	2014	2015	2014	2015	2014	2015	2014	2015	2014	2015
Poland	3.0	2.9	0.2	1.1	-2.0	-2.4	-3.4	-2.9	49.1	50.2
Czech Republic	2.5	2.7	0.5	1.4	-1.3	-0.9	-1.4	-2.1	44.4	44.7
Hungary	3.2	2.5	0.1	2.5	4.3	4.3	-2.9	-2.8	76.9	76.4
EU	1.3	1.1	0.6	1.0	1.4	1.5	-3.0	-2.7	88.1	88.3
Euro zone	0.8	1.1	0.5	0.8	2.5	2.6	-2.6	-2.4	94.5	94.8
Germany	1.3	1.5	0.9	1.2	7.1	7.1	0.2	0.0	74.5	72.4

Main market indicators (% , end of period)

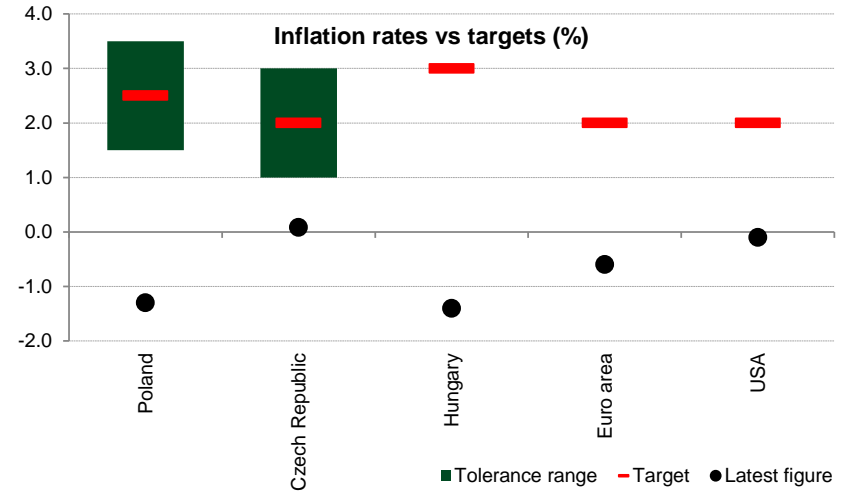
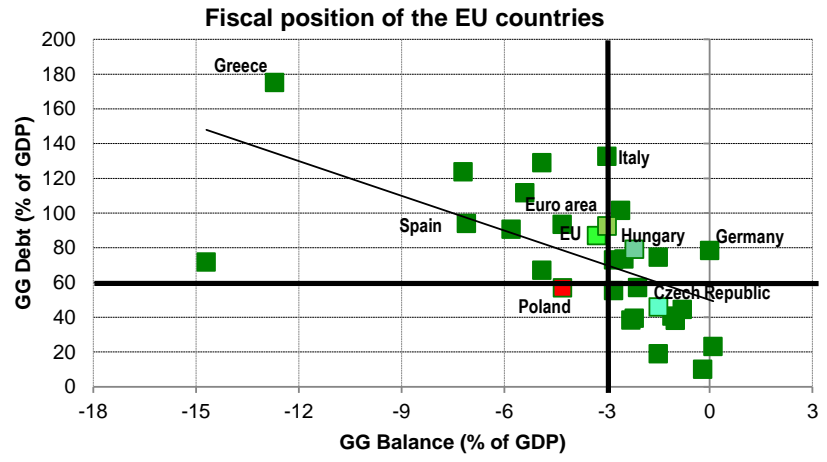
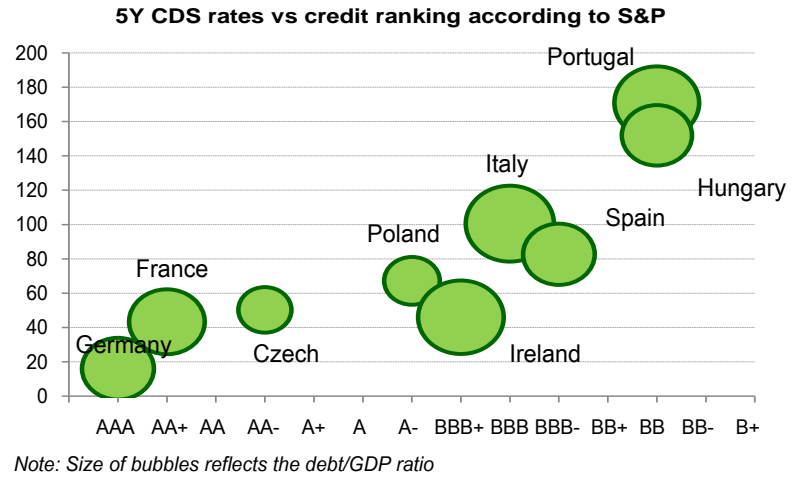
	Reference rate (%)		3M market rate (%)		10Y yields (%)		10Y spread vs Bund (bp)		CDS 5Y	
	2014	end-Feb 2015	2014	end-Feb 2015	2014	end-Feb 2015	2014	end-Feb 2015	2014	end-Feb 2015
Poland	2.00	2.00	2.06	1.81	2.51	2.15	197	183	71	60
Czech Republic	0.05	0.05	0.04	0.04	0.75	0.64	2	32	55	48
Hungary	2.10	2.10	2.10	2.10	3.69	3.01	315	269	178	119
Euro zone	0.05	0.05	0.08	0.04						
Germany					0.54	0.32			17	16

Source: EC – Autumn 2014, statistics offices, central banks, Reuters, BZ WBK.

5. Poland vs. Other Countries (cont.)

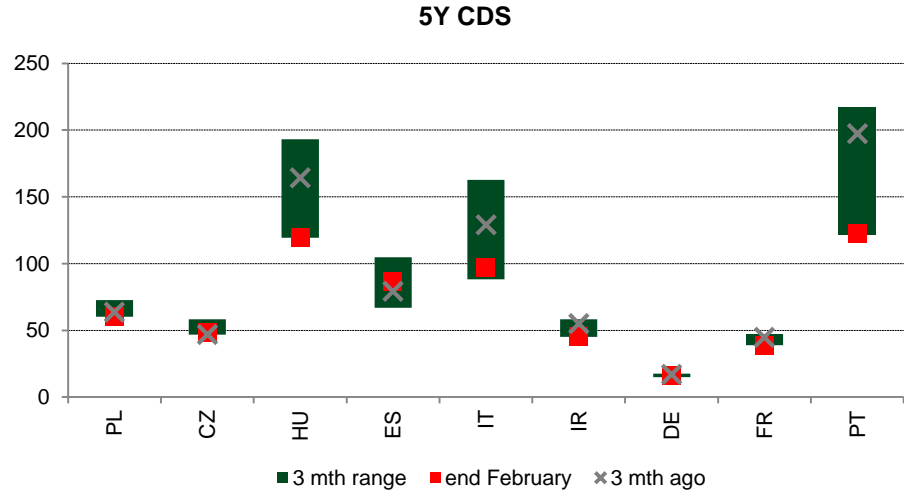
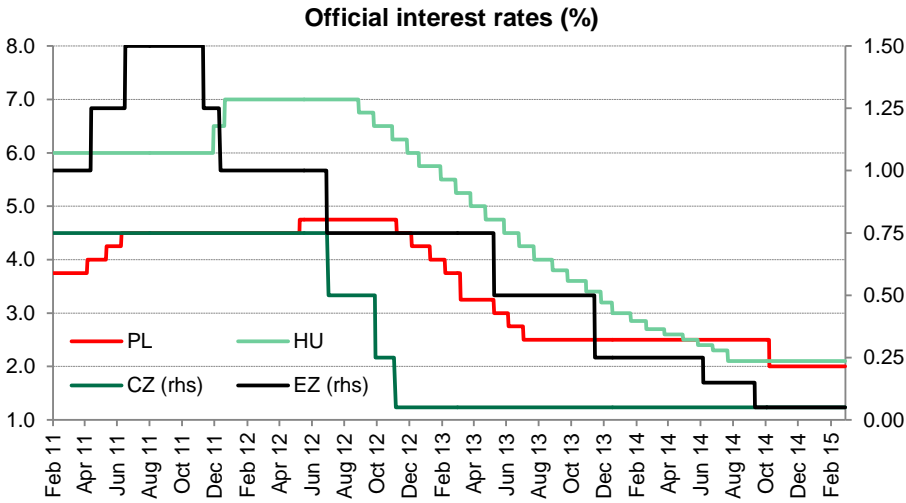
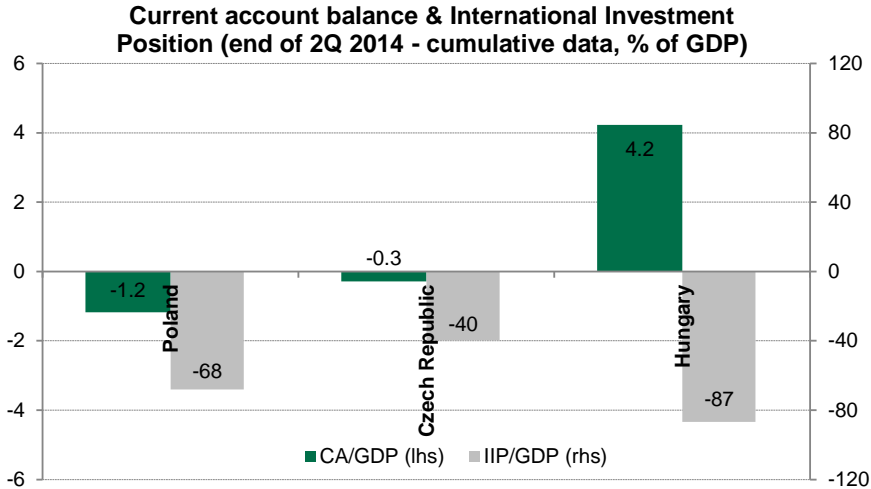
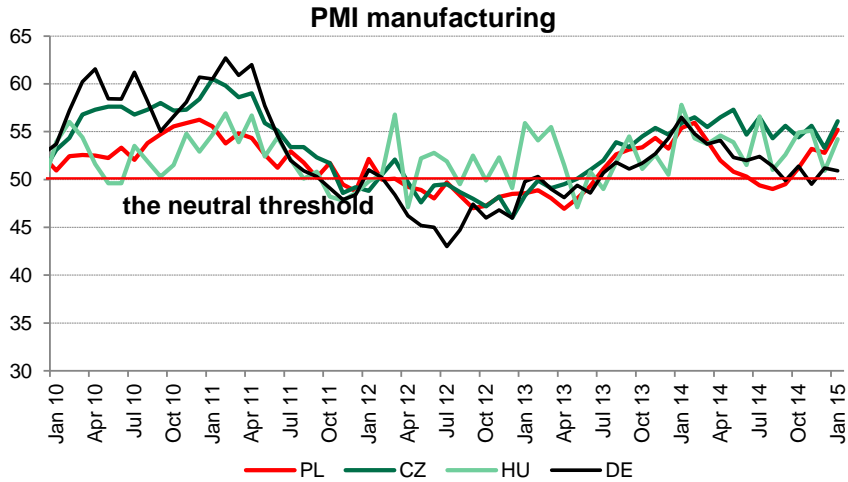
Sovereign ratings

	S&P		Moody's		Fitch	
	rating	outlook	rating	outlook	rating	outlook
Poland	A-	positive	A2	stable	A-	stable
Czech	AA-	stable	A1	stable	A+	stable
Hungary	BB	stable	Ba1	negative	BB+	stable
Germany	AAA	stable	Aaa	stable	AAA	stable
France	AA	negative	Aa1	negative	AA+	negative
UK	AAA	negative	Aa1	negative	AA+	stable
Greece	B-	negative	Caa1	stable	B	stable
Ireland	A	stable	Baa1	stable	A-	stable
Italy	BBB	stable	Baa2	stable	BBB+	negative
Portugal	BB	stable	Ba1	stable	BB+	negative
Spain	BBB	stable	Baa2	positive	BBB+	stable



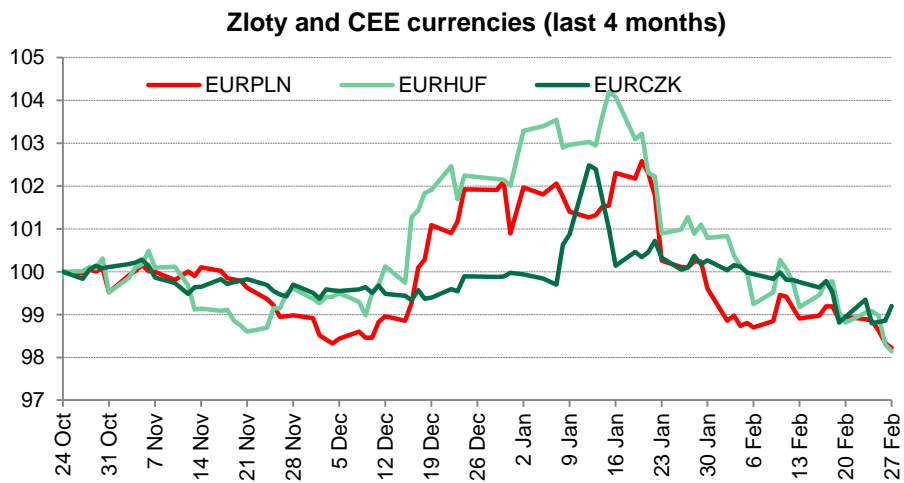
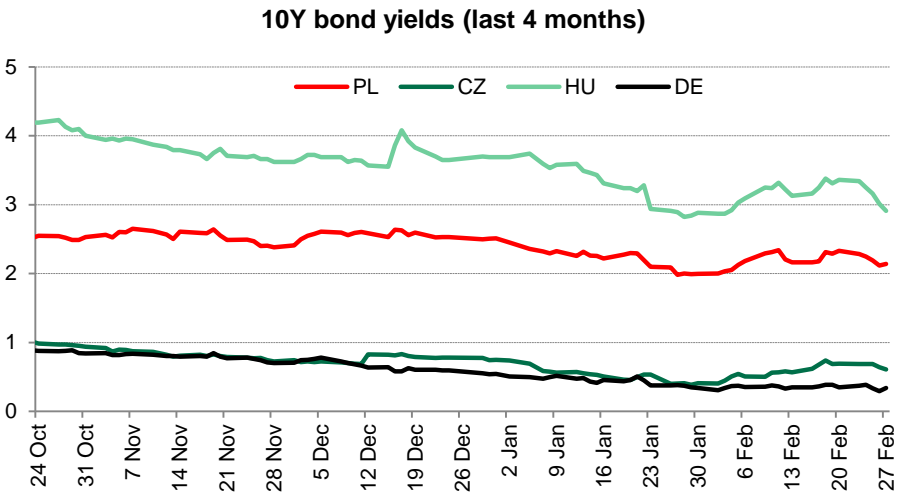
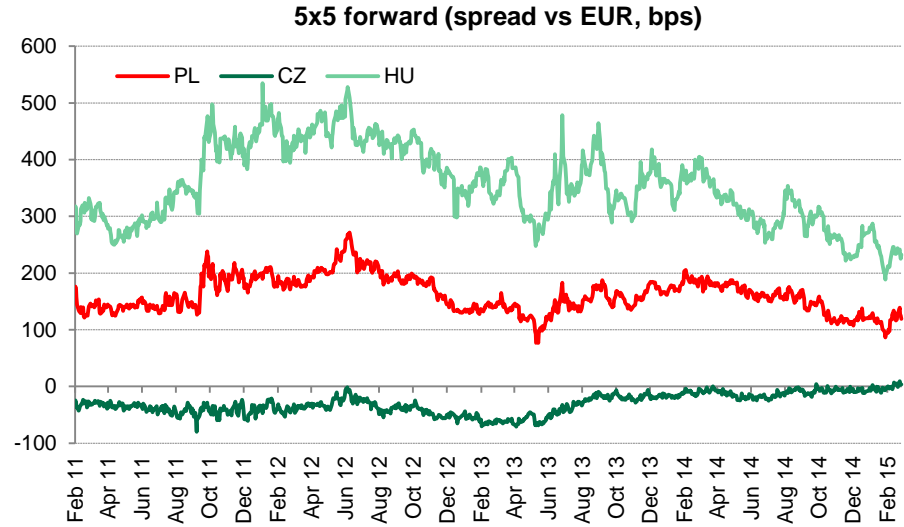
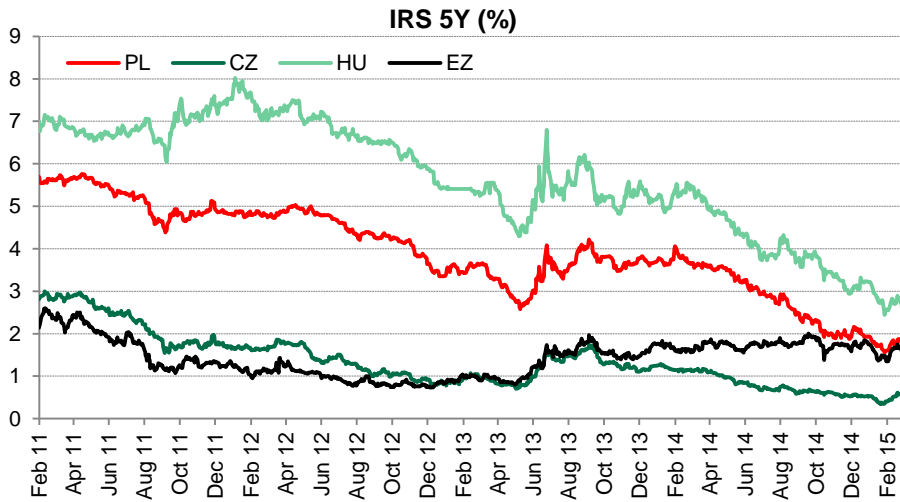
Source: Rating agencies, Reuters, EC, BZ WBK.

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				We expect the ECB to not change its monetary policy in March as it prepares to implement the quantitative easing programme . However, investors will focus on new macro projections. In our view ,GDP growth for the Euro zone could shift up a gear, while inflation is likely to remain negative for the most of this year.
	Market implied »				1	-1	-1	
UK	Forecast	0.50	0.50	1.00				We expect the BoE to leave the reference rate unchanged at 0.50% and maintain the stock of purchased assets at £375bn. Moreover, in its February <i>Inflation Report</i> , the BoE signalled that it intends to 'look through' the first-round effects of lower commodity prices on the CPI.
	Market implied »				2	4	9	
US	Forecast	0-0.25	0-0.25	0.50				Both the FOMC minutes and Yellen's testimony sounded a bit more dovish. Yellen suggested that if there is a change in the FOMC's communication, i.e. the Committee drops its declaration to remain patient, then the hike may be implemented at any subsequent meeting. In March investors will focus on new forecasts.
	Market implied »				17	25	36	
Poland	Forecast	2.00	2.00	1.50				The change in the MPC's rhetoric, larger-than-expected QE in the Euro zone and the recent policy easing by other central banks around the world have convinced us that Polish interest rates could come down 50bp this year, with a cut of 25bp in March.
	Market implied »				-12	-41	-59	
Czech Republic	Forecast	0.05	0.05	0.05				As expected ,monetary conditions in the Czech Republic remained unchanged. However, the CNB suggested that it may adjust the EUR/CZK floor upwards if deflationary pressures strengthen in the long term. The floor might even be lifted, but not in the next few months, in our view.
	Market implied »				27	27	23	
Hungary	Forecast	2.10	2.10	2.00				In line with expectations, the NBH kept official rates unchanged at its February meeting. However, the wording of the statement released after the rate announcement changed, revealing a dovish bias. Taking into account the inflation outlook we expect the NBH to cut rates in March.
	Market implied »				-3	-22	-33	

Source: Reuters, BZ WBK.

This analysis is based on information available through February 27, 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.

Important Disclosures (cont.)

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