RATES AND FX OUTLOOK

POLISH FINANCIAL MARKET

September 2014

Bank Zachodni WBK

Grupa Santander

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Summary

- The set of worrying signals that have appeared in the last two months, including disappointing data from Polish and European economies, plus possible effects of sanctions imposed on Russia and its retaliatory actions against European countries, convinced us to revise the economic scenario for Poland. **While Polish GDP growth slowdown in Q2 was very mild, we are worried that coming quarters may see a continuing deceleration, instead of the recovery predicted earlier. We currently predict GDP growth to reach 3.1% on average in 2014 and in 2015 (versus previous forecasts 3.5% and 3.7%, respectively), with a few coming quarters below the 3% mark.** Moreover, it seems that inflation will also be significantly lower – due to lower economic growth and the impact of Russian sanctions – and it will take longer until CPI growth rebounds from current sub-zero levels to the 2.5% target. We think the CPI may remain below zero even until the end of this year and will increase towards only 1.5% by the end of 2015E.
- **Significant change in outlook for economic growth and inflation creates room for monetary easing, in our view.** The Monetary Policy Council (MPC) will surely discuss a rate cut motion at the next decision-making meeting, the first after the holiday recess in August. Recent comments by several Council members suggested, however, that even though the number of arguments for policy easing is growing (and it would make sense to deliver a rate cut as early as this month) , they would rather not hurry with a decision in order to obtain even more evidence that an interest rate cut is needed. Therefore, **we assume there will be no majority to support a rate cut at September's meeting. Still, in our view, in October-November we may see cumulative rate cuts of 75bp.**
- Polish and European debt markets have rallied significantly in August, with yields falling to new all-time lows, supported by weak economic data, low inflation, and growing expectations that central banks will stimulate economies with more accommodative monetary policies. Despite a correction at the very end of August, triggered by rising geopolitical tension, as the Russia-Ukraine conflict escalated, **we predict further decline in yields, given the currently expected scenario of NBP rate cuts and scope for more monetary easing in the euro zone. We think that 10Y bond yield may even drop to c2.7% shortly after the MPC delivers 75bp easing in October-November.** After this happens, a gradual rebound is likely in the medium term, following trends in core markets.
- The zloty weakened vs. the main currencies in August as worries over the situation in Ukraine rose and odds for earlier rate hikes in the US increased. The medium-term outlook for the zloty has deteriorated in our view, due to a scenario of weaker GDP growth, fast and deep rate cuts, and higher geopolitical risk. **We still predict the zloty to appreciate gradually in 2015, but in coming months the currency is likely to fluctuate along a horizontal trend**.

Short- and Medium-term Strategy: Interest Rate Market

	Change (bp)		Level	Expected trend	
	Last 3M	Last 1M	end-August	1M	3M
Reference rate	0	0	**2.50**	→	↘↘
3M WIBOR	-13	-8	**2.59**	→	↘↘
2Y bond yield	-54	-28	**2.18**	↘	↘↘
5Y bond yield	-73	-40	**2.53**	↘	↘↘
10Y bond yield	-57	-30	**3.11**	↘	↘↘
2/10Y curve slope	-3	-2	**93**	↘	↘

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

PLN rates: our view and risk factors

Money market: FRA rates have been falling recently and currently they are pricing in interest rate cuts of c50bp on a 3-month horizon and an additional 25bp in the next 3 months. We predict that the main central bank rates will be trimmed by 75bp in October-November, so there is still potential for a drop in money market rates. However, a short-term correction is possible after the MPC decided to keep rates on hold in September.

Short end: the strong rally in European debt markets dragged yields of Polish bonds to new all-time lows and we believe there is still room for further decline. As in the case of money market rates, the lack of an interest rate cut at September's MPC meeting may trigger a short-term correction. However, it is unlikely to be substantial as the central bank will probably signal possible policy easing in coming months and upcoming data should support it.

Long end: We are bullish on Polish long-term bonds, as we believe the MPC will cut main interest rates by 75bp by November. Before that happens, the recent correction driven by geopolitical risk may even deepen, amid further escalation of the conflict in Ukraine, but also due to the lack of an interest rate cut at the MPC meeting in September. In our opinion, recent market weakening is a good opportunity to accumulate Polish bonds.

Risks to our view: The biggest risk factor for the Polish bond market seems to be the situation in Ukraine. The intrusion of Russia's armed forces into Ukraine and the intensification of the conflict signal a significant escalation. Additionally, rising chances of Fed's rate hike due to better than expected data from the US may create pressure on emerging markets' assets, especially when it is not offset by additional policy easing in the euro zone.

Short- and Medium-term Strategy: FX Market

	Change (%)		Level	Expected Trend	
	Last 3M	Last 1M	End-August	1M	3M
EURPLN	1.7	1.2	**4.21**	→	→
USDPLN	5.0	2.8	**3.20**	→	→
CHFPLN	3.0	2.3	**3.49**	→	↘
GBPPLN	4.2	1.2	**5.31**	↗	↗
EURUSD	-3.2	-1.6	**1.32**	→	→

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

PLN FX Market: Our view and risk factors

EUR: Despite various negative external and internal factors (higher geopolitical risk, slowing economic growth, expected interest rate cuts), the zloty has remained quite stable in recent weeks. The inflow of fresh capital to the domestic debt market may still provide some support for the zloty, but the room for EURPLN decrease seems very limited in the near term. We see scope for a gradual zloty appreciation in the medium run (yet slower than expected before), as Poland will remain the leader of growth in Europe with relatively high real interest rates.

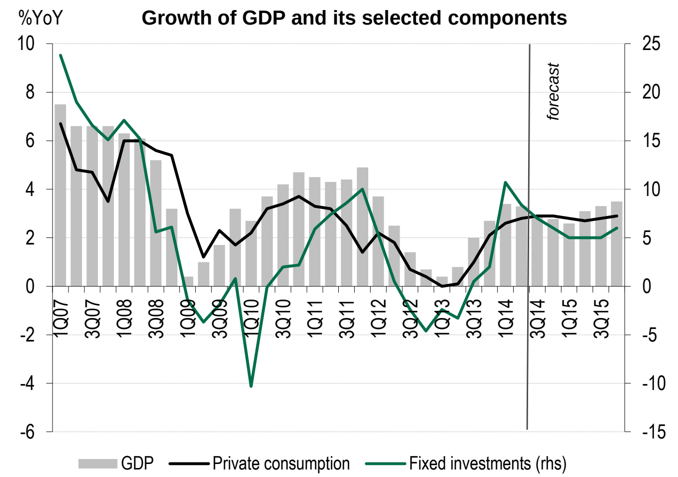
USD: Higher risk aversion and the strengthening of the US dollar pushed the USDPLN sharply up, to the highest level for more than a year (up c5% versus mid-July level). We think these elevated levels may be maintained in the near term, as the euro remains under pressure and market moods remain fragile. In the medium run, the USDPLN may drop faster than the USDPLN as we expect some rebound in the EURUSD rate.

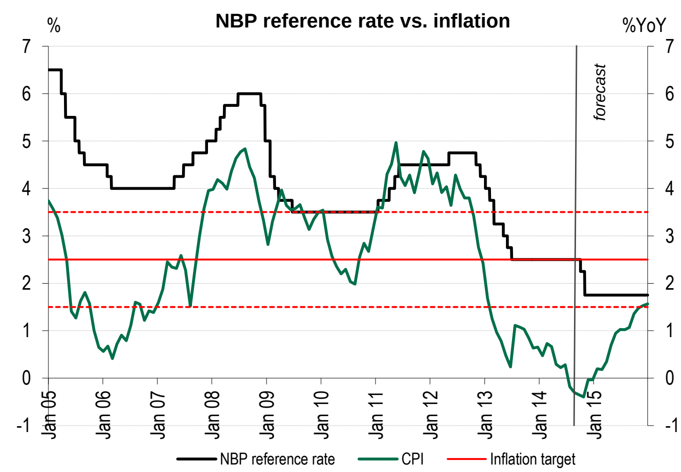
CHF: the Swiss franc remains overvalued, but the recent increase in geopolitical risk favours further strength amid a safe haven bid for the currency. We assume the CHFPLN may remain close to current levels in the short term, but on a longer horizon, the zloty should get stronger versus the CHF, as the EURCHF increases gradually.

Risks to our view: Although the Polish currency has remained relatively immune to geopolitical risk for the past several months, the escalation of the war in Eastern Ukraine may change investors' perception of CEE currencies, at least temporarily. On the other hand, the zloty could be stronger than we expect should upcoming data confirm that after a short-term soft patch both Poland and the euro zone are returning to faster economic growth.

Review of macroeconomic scenario

- GDP growth slowed only slightly in 2Q14, to 3.3% YoY from 3.4% in 1Q. However, recent weaker data from Poland and the disappointing performance of the euro zone economy, plus the possible negative impact of sanctions, suggest coming quarters will see further deceleration of economic growth. We forecast GDP growth to slow to below 3% in H2 2014E, with a possible dip to nearly 2.5% in 1Q15E.
- The labour market situation is still improving, although the pace of recovery has waned also in this area. Households' real income growth is still supporting quite decent consumption growth in coming quarters (of almost 3%YoY). Investment growth in the first two quarters was surprisingly strong (9.3% YoY on average in 1H14). While private firms may become more cautions in 2H14, cutting investment plans in response to rising global uncertainty, the public sector is likely to boost investment spending before the election using funds from the new EU financial perspective. Consequently, domestic demand may be to some extent stabilising economic growth in Poland, while the outlook for exports is becoming more challenging.
- Slower economic growth means it will take longer before the negative output gap closes, so we see no substantial rise of inflationary pressure in the near term. Additionally, the oversupply of food on the Polish and European markets will persist in coming months, dragging prices lower, due to the Russian ban on food exports. As a result, inflation may be notably lower than earlier assumed, with the CPI staying below zero until the end of 2014E and rising gradually towards 1.5% by the end of 2015E, significantly below the target of the central bank (2.5%).

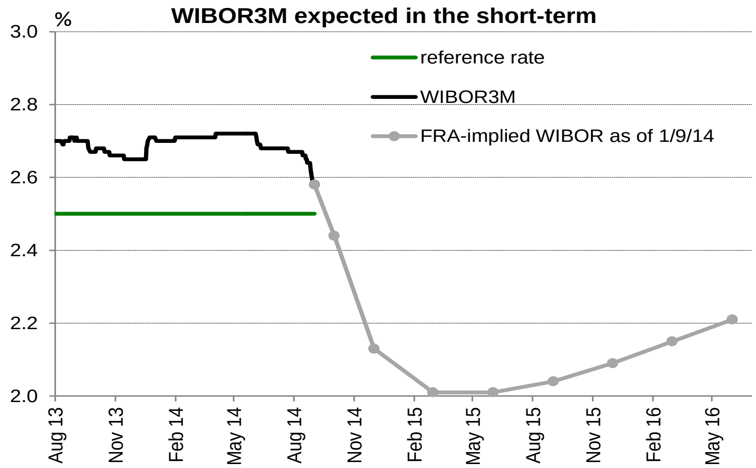


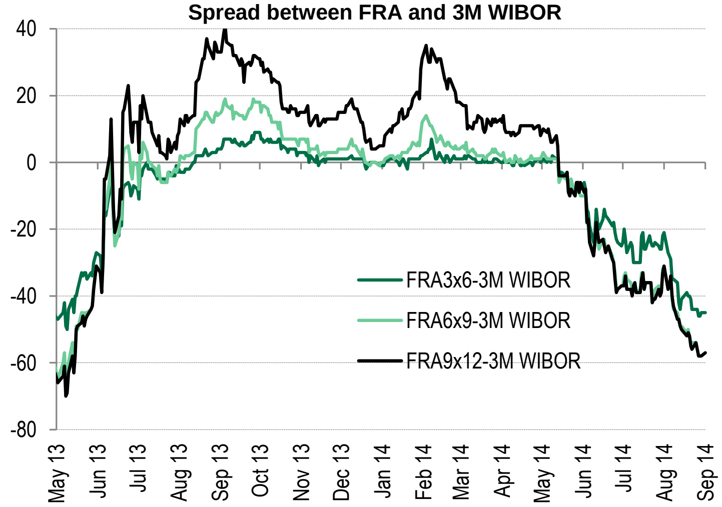


Source: GUS, NBP, BZ WBK

Domestic Money Market: Rate cut on the agenda, but timing is uncertain

- Over the past month, weak economic data (including the CPI declining to below zero) and rising concerns about the economic growth outlook for 2H14 strengthened expectations of a rate cut later this year. Consequently, WIBOR rates have declined by 1-11bp and have enforced a flattening of the curve as the 12M rate dropped the most. At the same time, FRA rates fell sharply across the curve (by 20-40bp in monthly terms), confirming the strong belief in a rate cut after the summer holiday. Currently, the FRA market is pricing in a rate cut of 50bp in 3 months' time and slightly more than 50bp in 6 months.
- Arguments supporting an interest rate cut this year have increased significantly. In our opinion, a decisive move in monetary policy looks a done deal and would be justified as early as September. However, recent comments by MPC members suggest there may be no majority to support such a decision at the next meeting and this may trigger a short-term correction. This month's data releases should confirm the economy is slowing and strengthen expectations for monetary easing next month (some MPC members suggest a decision in October, which is also our scenario).
- We revised downward our WIBOR forecasts for coming months after changing macro and monetary policy scenarios for upcoming quarters (see p.6). Currently, we expect WIBOR 3M to decline to 1.90% at the end of this year. Please find updated forecasts on page 17.



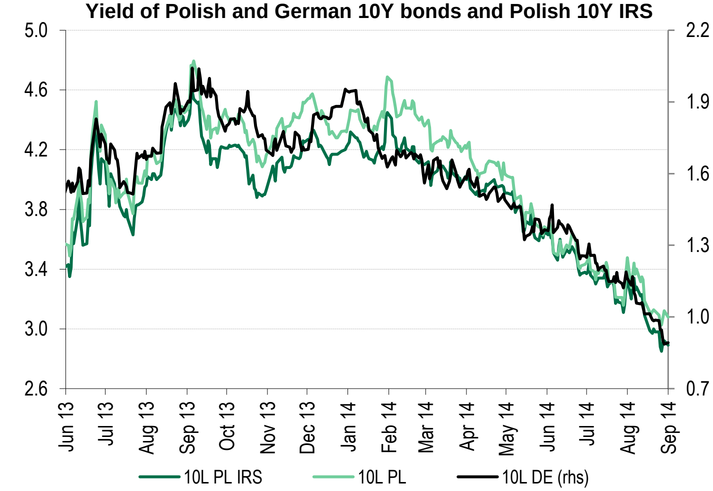


Source: Reuters, BZ WBK

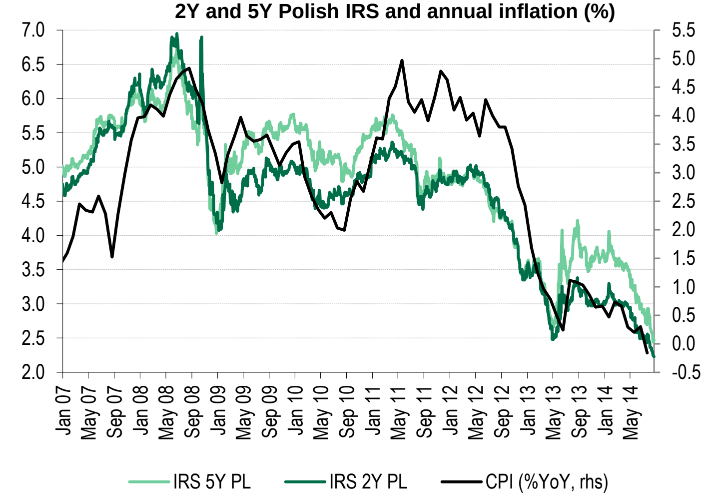
Domestic IRS and the T-Bond Market: Strong rally, but tension in Ukraine sours market mood

- Poland's T-bonds and IRS strengthened quite considerably in August after a relatively vulnerable beginning to that month. Yields and IRS rates reached new record low levels (the 10Y T-bond yield temporarily fell below 3%), as the domestic debt market was still being supported by expectations for rate cuts in Poland, more monetary policy easing in the euro zone, and further strengthening of German Bunds (the 10Y yield fell below 1%). However, at the end of August the Polish T-bonds and IRS suffered significantly, following EM weakness, due to investors' mood deteriorating in reaction to more negative news from Ukraine.
- Over the past month, longer ends of curves were prone to higher volatility due to their greater vulnerability to geopolitical risk. As a result, investors have been easily switching between flattening and steepening strategies.
- Despite a relatively deep correction in the last few days of August, we have a bullish view on Polish bonds, as we believe the Monetary Policy Council will cut the main interest rates by 75bp (in total) until November. Before that happens, the correction may even deepen, not only due to further escalation of the conflict in Ukraine, but also due to a lack of interest rate cuts at the MPC meeting this month (as some investors are expecting monetary policy to be relaxed in September). In our opinion, the recent market weakening is a good opportunity to accumulate Polish bonds. On a medium to long-term horizon we still expect domestic yields/IRS rates to edge higher as economic prospects should improve and US rates rise as the Fed may start hiking rates earlier than the market expects.

Yield of Polish and German 10Y bonds and Polish 10Y IRS



2Y and 5Y Polish IRS and annual inflation (%)

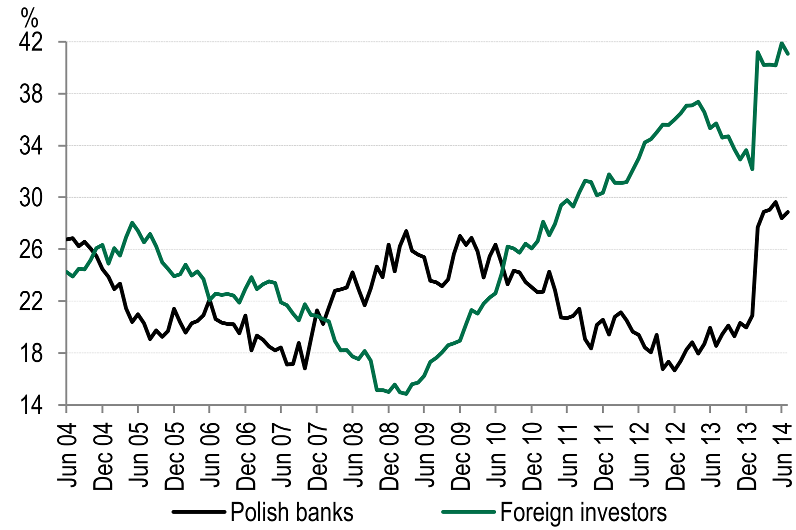


Source: Reuters, BZ WBK.

Demand Corner: Slight reduction of nonresidents' holdings

- The portfolio of foreign investors contracted in July after three consecutive months of purchases. Non-residents sold debt with a PLN3.7bn nominal value, the highest monthly outflow since January. Foreigners still own c41% of the total, nominal, marketable, zloty-denominated bonds outstanding (PLN196.1bn out of PLN477.3bn).
- Polish investors bought bonds worth over PLN4bn with banks' making a contribution of PLN2.4bn. Among other domestic investors, only non-financial institutions reduced their holdings.

Share of foreign investors and Polish banks in total, PLN, marketable bonds



Source: Ministry of Finance, BZ WBK.

Supply Corner: Auctions in September will finance borrowing needs for 2015

- Poland's Ministry of Finance returns to the primary market in September after a one-month break. It will be a relatively busy month as the Ministry plans three auctions (see table). The supply on the outright auction is relatively low (only PLN1-3bn), therefore we do not expect any problems in selling the whole offer. However, market players reacted negatively to news that the ministry will offer long-term instruments (floating rate WZ0124 and a new series of 10Y bonds DS0725).
- The Ministry has not specified the offer on switch tender yet, saying that the selection of bonds depends on the market situation. However, we think that the bonds offered instead of buying back WZ0115 and PS0415 will be medium term instruments.
- Lastly, the Ministry of Finance also plans to buy back bonds denominated in USD maturing in July 2015 for USD400m.
- Summing up, auctions in September will finance borrowing needs for 2015. The market situation (further monetary easing by the MPC and the ECB) should support strong demand for Polish assets, which, in our opinion, remain attractive for investors.

Issuance plan for September 2014

T-bond auction

Auction date	Settlement date	T-bonds	Expected supply
4 Sep 2014	8 Sep 2014	DS0725 / WZ0124	PLN1.0-3.0bn

T-bond switching auction

Auction / Settlement date	T-bonds to be offered	Source T-bonds	Outstanding (PLN m)
18 Sep 2014 / 22 Sep 2014	the choice depends on market conditions, without bonds offered on the first auction	WZ0115	15,445
		PS0415	26,925

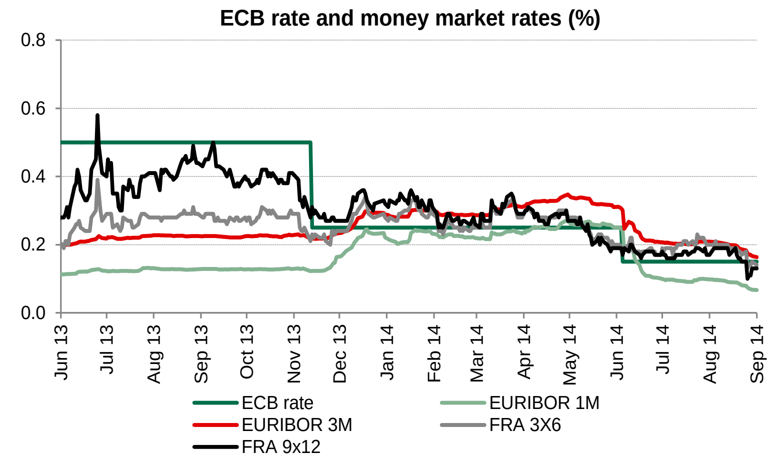
Buy-back auction of USD nominated T-bonds

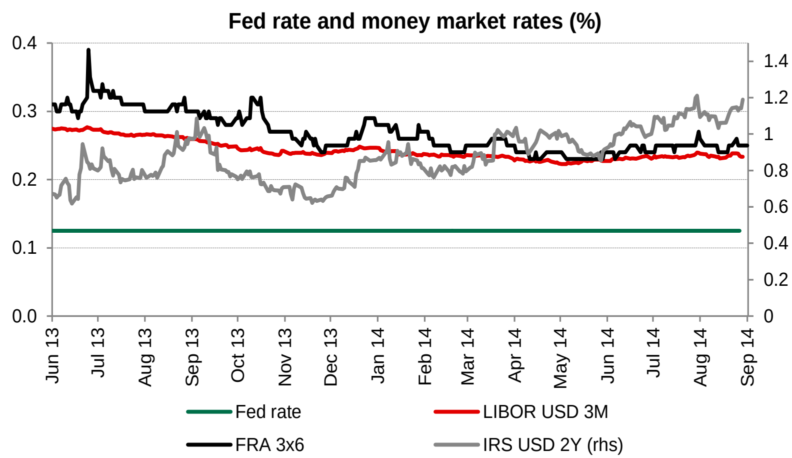
Auction / Settlement date	Buy-back T-bonds		Nominal value of buy-back (USD m)
	Series	Maturity date	
25 Sep 2014 / 29 Sep 2014	USD20150716	16 Jul 2015	Up to 400

Source: Ministry of Finance, BZ WBK.

International Money Market and IRS: Central banks meetings on agenda

- In August, EUR money market rates declined gradually (by 4-5bp in monthly terms) as markets have priced-in further monetary easing from the ECB. At the same time, USD money market rates increased again after a temporary drop, supported by strong macro data (FRA12x15 suggests rate hikes by 50bp in one year time).
- Contrary to the previous month, both EUR and USD IRS have come down by some 5-30bp as the situation in Ukraine has escalated and the markets have priced-in further easing from the ECB. Following the debt market, long-term IRS (both EUR and USD) reached all-time lows and performed better than the short-end of curves. This has resulted in significant curve flattening.
- The central banks' meetings are the key for the money market and IRS rates. The ECB seems to be waiting for the take on the first TLTRO in mid-September although it has intensified preparations for an ABS purchase programme. Moreover, the ECB continues to signal that it is ready to do broad-based QE if needed. Lack of the ECB decision may result in an upward move in EUR IRS in the short run. However, we see some room for a moderate decline in money market rates as expectations for monetary easing continue. At the same time, strong labour market data in the US should push USD IRS higher in the short run, while cautious Fed's rhetoric may result in a downward correction in the second part of the month.
- In the medium term we expect higher IRS rates (both EUR and USD) across the board as growth and inflation pick up.

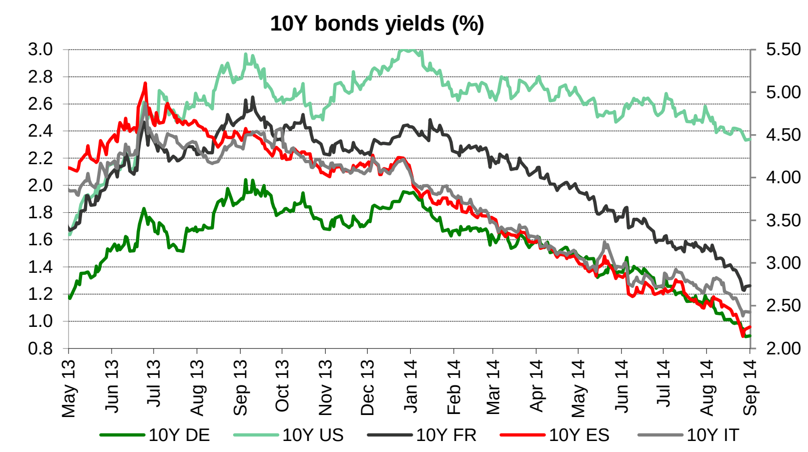


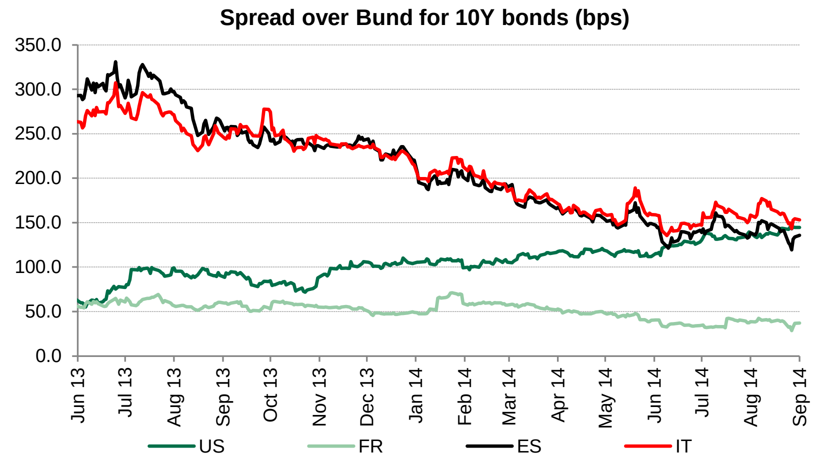


Source: Reuters, ECB, Fed, BZ WBK.

International Bond Market: Short-term correction likely

- A combination of disappointing growth data, ongoing deflation concerns and geopolitical risks have pushed yields of both core and peripherals debt to new all-time lows, with the German 10Y Bund yield falling to a fresh record low (0.87%) and the US 10Y Treasuries yield declining to 2.30% (the lowest level for more than one year). However, peripheral yields edged higher at the end of August as risk aversion sentiment favours safe-haven assets, i.e. German Bunds or the US Treasuries (despite further positive development in the US macro data). Notwithstanding this, in August a significant curve flattening has developed on core markets as the long-term bonds gain the most.
- In the short run the trend for lower core yields has continued amid rising geopolitical tensions and a view of lower central bank rates. Currently, the market is pricing-in further easing from the ECB this month. In our opinion, the ECB may abstain from such a decision, waiting for results of TLTROs, which start in mid-September. This, together with strong labour market data from the US, may push yields higher after the considerable strengthening over the last month.
- As geopolitical risks fade, investors should focus on growth prospects. Improving macro data and expected rate hikes in the US in 1H 2015 should result in growing yields. In the medium term, we expect a re-steepening of curves driven by higher long-end rates.





Source: Reuters, BZ WBK.

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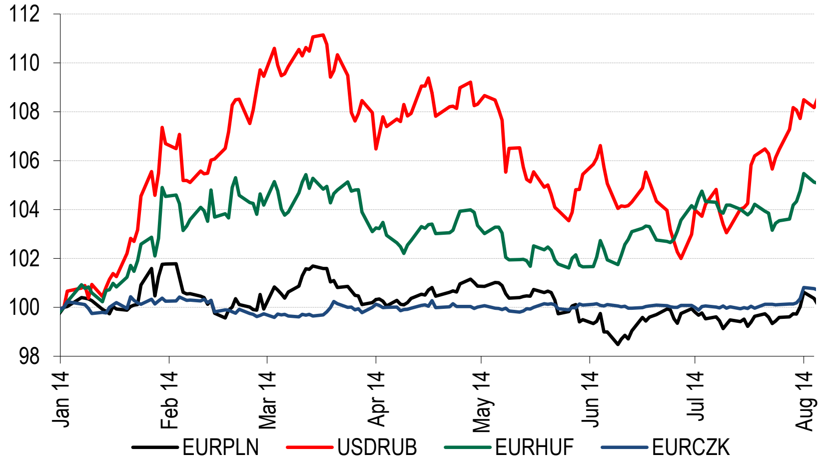
Foreign Exchange Market: Slower appreciation ahead

- The increase in geopolitical risk and global risk aversion had a noticeable impact on the zloty. Expectations for faster rate hikes in the US and worries over an escalation of the Ukraine-Russia conflict pushed the EUR/PLN to c4.233 at the end of August, its highest since March.
- The economic outlook for Poland has deteriorated in the course of the past month, in our view. Inflation is likely to be lower than previously expected, and we now expect interest rates in Poland to be reduced by 75bp over the next three months. This fast and significant easing is likely, in our view, to lead to a slower appreciation of the zloty compared to our earlier forecasts.
- However, it should be noted that both interest rates and GDP growth in Poland will most likely remain among the highest in Europe. That is why we still assume the Polish zloty should appreciate gradually in the medium term. In the short run, the inflow of foreign capital to the Polish debt market – given the speculation about further rate cuts – may help support the currency, while persisting geopolitical risks should prevent any significant appreciation. The zloty could potentially gain from a higher global appetite for risk if the ECB decides to launch a QE program in the Euro zone.

CEE currencies (1 January 2014 = 100)



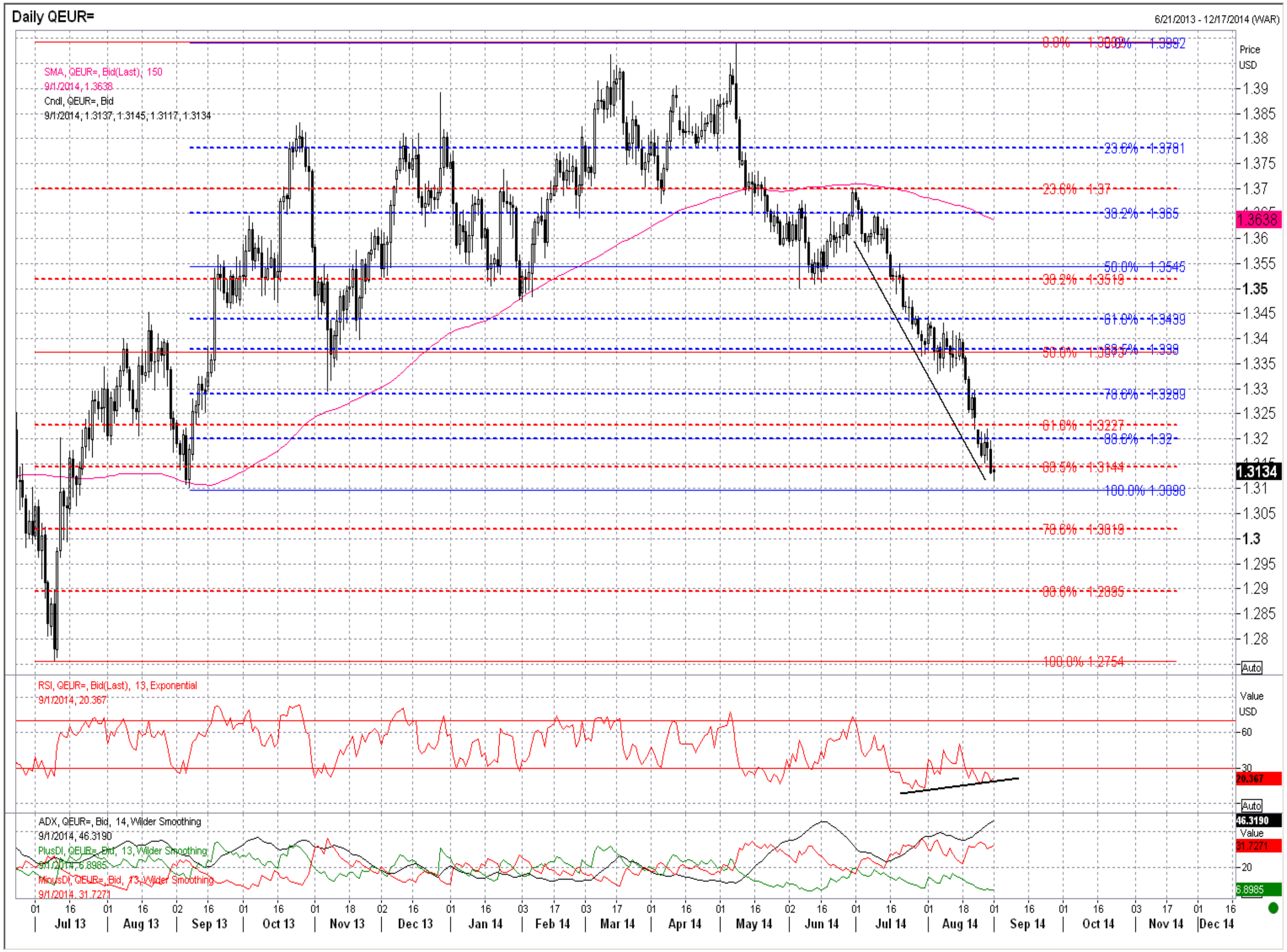
Source: Bloomberg, BZ WBK

FX Technical Analysis Corner: EURPLN – next ”upward” Shark

- Last week we presented a Shark-32 formation on the weekly chart and suggested that after breaking 4.17, EURPLN may rise further. Indeed, the exchange rate reached nearly 4.23 in the following days.
- In late August another Shark-32 appeared on the weekly chart and EURPLN broke 4.225, opening the door to a further increase in the following weeks.
- ADX is running low and starting to rebound indicating that a directional trend may gain strength in the coming weeks.

Source: Reuters, BZ WBK

FX Technical Analysis Corner: EURUSD keeps falling



- The EURUSD continues its downward path, the exchange rate is breaking next support levels.
- ADX is at very high level and we have a very clear divergence of the EURUSD with the RSI.
- This indicates that some correction may occur soon. However, only breaking 1.35-1.37 could suggest a trend reversal.

Source: Reuters, BZ WBK.

Macroeconomic Forecasts

Poland		2012	2013	2014E	2015E	1Q14	2Q14	3Q14E	4Q14E	1Q15E	2Q15E	3Q15E	4Q15E
GDP	PLNbn	1,596.4	1,635.7	1,692.7	1,765.8	397.4	413.46	415.6	466.2	409.0	430.6	435.1	491.1
GDP	%YoY	2.0	1.6	3.1	3.1	3.4	3.30	2.8	2.8	2.6	3.1	3.3	3.5
Domestic demand	%YoY	-0.1	0.0	3.9	4.0	3.0	5.10	3.9	3.6	3.5	3.9	4.2	4.3
Private consumption	%YoY	1.3	0.8	2.8	2.8	2.6	2.80	2.9	2.9	2.8	2.7	2.8	2.9
Fixed investment	%YoY	-1.6	-0.2	7.5	5.4	10.7	8.40	7.0	6.0	5.0	5.0	5.0	6.0
Unemployment rate [a]	%	13.4	13.4	12.3	11.8	13.5	12.00	11.8	12.3	12.5	11.3	11.2	11.8
Current account balance	EURm	-14,191	-5,328	-5,221	-8,435	-766	674.00	-2,135	-2,994	-1,448	-318	-2,956	-3,713
Current account balance	% GDP	-3.7	-1.4	-1.3	-2.0	-1.0	-0.90	-0.9	-1.3	-1.4	-1.7	-1.8	-2.0
General government balance	% GDP	-3.9	-4.3	5.7	-2.9	-	-	-	-	-	-	-	-
CPI	%YoY	3.7	0.9	0.1	1.0	0.6	0.26	-0.3	-0.2	0.2	0.9	1.2	1.5
CPI [a]	%YoY	2.4	0.7	0.0	1.6	0.7	0.28	-0.4	0.0	0.3	1.0	1.4	1.6
CPI excluding food and energy prices	%YoY	2.2	1.2	0.7	1.3	0.8	0.84	0.5	0.8	1.1	1.3	1.4	1.5

Source: CSO, NBP, Finance Ministry, BZ WBK estimates. [a] at the end of the period * without changes in the pension system

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Interest Rate and FX Forecasts

Poland		2012	2013	2014E	2015E	1Q14	2Q14	3Q14E	4Q14E	1Q15E	2Q15E	3Q15E	4Q15E
Reference rate [a]	%	4.25	2.50	1.75	1.75	2.50	2.50	2.50	1.75	1.75	1.75	1.75	1.75
WIBOR 3M	%	4.91	3.02	2.53	1.96	2.71	2.71	2.64	2.07	1.93	1.95	1.97	1.99
Yield on 2-year T-bonds	%	4.30	2.98	2.52	2.18	3.01	2.76	2.31	2.00	2.03	2.12	2.22	2.35
Yield on 5-year T-bonds	%	4.53	3.46	3.01	2.55	3.71	3.35	2.71	2.28	2.37	2.47	2.60	2.78
Yield on 10-year T-bonds	%	5.02	4.04	3.54	2.95	4.38	3.82	3.19	2.75	2.75	2.82	3.02	3.20
2-year IRS	%	4.52	3.10	2.63	2.42	3.07	2.82	2.42	2.23	2.32	2.38	2.43	2.55
5-year IRS	%	4.47	3.51	3.05	2.77	3.70	3.31	2.73	2.47	2.63	2.70	2.80	2.95
10-year IRS	%	4.56	3.86	3.38	2.88	4.16	3.73	3.06	2.55	2.65	2.80	2.95	3.10
EUR/PLN	PLN	4.19	4.20	4.17	4.09	4.19	4.17	4.18	4.16	4.12	4.10	4.07	4.05
USD/PLN	PLN	3.26	3.16	3.10	3.08	3.06	3.04	3.13	3.18	3.16	3.13	3.05	2.99
CHF/PLN	PLN	3.47	3.41	3.42	3.10	3.42	3.42	3.45	3.40	3.27	3.18	3.02	2.94
GBP/PLN	PLN	5.16	4.94	5.21	5.39	5.06	5.11	5.28	5.40	5.46	5.47	5.32	5.29

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

Economic Calendar and Events

Date		Event:	Note:
3-Sep	**PL**	**MPC Meeting – interest rate decision**	
4-Sep	**PL**	**Auction of WZ0114/DS0725**	**Offer: PLN1-3bn**
	EZ	ECB Meeting – interest rate decision	–
15-Sep	**PL**	**CPI for August**	**Our forecast: -0.3%YoY, the same as the market consensus**
16-Sep	**PL**	**Core CPI excluding food and energy prices for August**	**Our forecast: 0.4%YoY**
	PL	**Employment and wages for August**	**We expect employment to increase by 0.8%YoY and wages to grow 4.0% YoY. Our forecast for wage growth is above market consensus of 3.8%**
17-Sep	**PL**	**Industrial output and PPI for August**	**Our forecast for industrial output is -0.8%YoY (well below market consensus of 0.7%YoY). We predict PPI at -1.3%YoY**
	US	FOMC Meeting – interest rate decision	Meeting associated with a Summary of Economic Projections and a press conference by the Chair
18-Sep	**PL**	**Minutes from September's MPC meeting**	**-**
	PL	**Switching auction**	**Source T-bonds: WZ0115 and PS0415**
23-Sep	HU	NBH meeting - interest rate decision	-
25-Sep	**PL**	**Buy-back auction of USD nominated T-bonds**	**Nominal value of buy-back: up to USD400m**
TBA	**PL**	**Retail sales for August**	**Our forecast of 1.8% YoY is above market consensus of 1.9%YoY**
1-Oct	**PL**	**PMI manufacturing for September**	**-**
	EZ	PMI manufacturing for September	-
2-Oct	EZ	ECB Meeting – interest rate decision	–
8-Oct	**PL**	**MPC 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

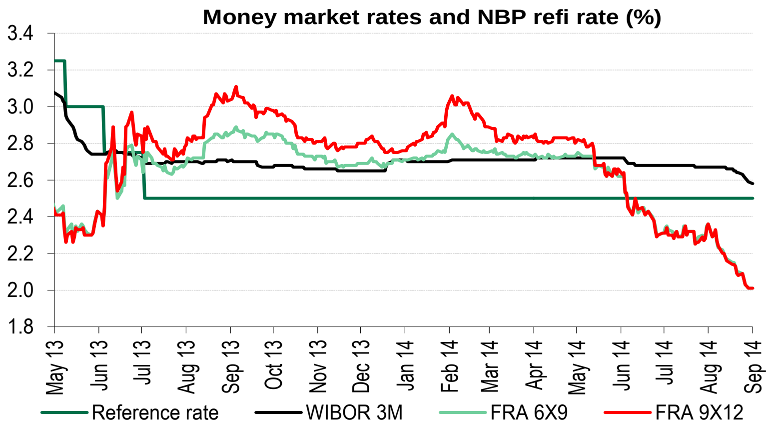
1. Domestic Market Performance

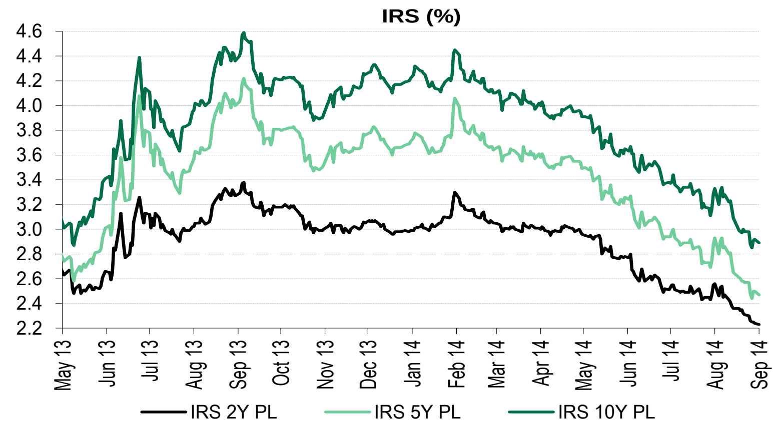
Money market rates (%)

	Reference rate (%)	Polonia (%)	WIBOR (%) 1M	WIBOR (%) 3M	WIBOR (%) 6M	WIBOR (%) 12M	OIS (%) 1M	OIS (%) 3M	OIS (%) 6M	OIS (%) 12M	FRA (%) 1x4	FRA (%) 3x6	FRA (%) 6x9	FRA (%) 9x12
End of August	**2.50**	**2.51**	**2.59**	**2.59**	**2.60**	**2.62**	**2.41**	**2.23**	**2.04**	**1.98**	**2.46**	**2.14**	**2.01**	**2.01**
Last 1M change (bp)	0	60	-1	-8	-9	-11	-6	-17	-22	-22	-18	-27	-26	-26
Last 3M change (bp)	0	0	-3	-13	-14	-18	-2	-19	-36	-42	-21	-52	-62	-62
Last 1Y change (bp)	0	2	-2	-12	-13	-15	-2	-20	-39	-60	-27	-60	-85	-105

Bond and IRS market (%)

	BONDS 2Y	BONDS 5Y	BONDS 10Y	IRS 2Y	IRS 5Y	IRS 10Y	Spread BONDS / IRS (bp) 2Y	Spread BONDS / IRS (bp) 5Y	Spread BONDS / IRS (bp) 10Y
End of August	**2.18**	**2.53**	**3.11**	**2.24**	**2.50**	**2.92**	**-6**	**3**	**19**
Last 1M change (bp)	-20	-19	-5	-19	-19	-19	-1	0	14
Last 3M change (bp)	-52	-69	-51	-53	-71	-69	1	2	18
Last 1Y change (bp)	-92	-132	-137	-106	-154	-150	14	22	13





Source: Reuters, BZ WBK

2. Polish Bonds: Supply Recap

Total issuance in 2014 by instruments (in PLN mn, nominal terms)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
T-bonds auction	18,143	8,821	6,573	17,503	5,694	4,990	8,418		3000	5,000	3,000	2300	85,442
T-bills auction													0
Retail bonds	256	475	190	170	170	170	170	180	170	175	185	176	2,487
Foreign bonds/credits	16,724	1,150								3200			21,074
Prefinancing and financial resources at the end of 2013	25,000												25,000
Total	**60,123**	**10,445**	**6,763**	**17,673**	**5,864**	**5,160**	**8,588**	**180**	**5,170**	**8,375**	**3,185**	**2476**	**134,002**
Redemption	16,497	5,613	2,230	16,035	116	60	9,470	1,793	2,796	83	816	91	55,599
Net inflows	**43,626**	**4,832**	**4,533**	**1,638**	**5,749**	**5,100**	**-882**	**-1,613**	**2,374**	**8,292**	**2,369**	**2,385**	**78,403**
Rolling over T-bonds			4,807			6,117							**10,924**
Buy-back of T-bills/ FX-denominated bonds													**0**
Total	**43,626**	**4,832**	**9,340**	**1,638**	**5,749**	**11,216**	**-882**	**-1,613**	**2,374**	**8,292**	**2,369**	**2,385**	**89,327**
Coupon payments from domestic debt	1,546			5,596			2,775		1,298	7,910			19,125

Note: our forecasts = shaded area

Source: MF, BZ WBK

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2. Polish Bonds: Supply Recap (cont.)

Schedule of Treasury securities redemption by instruments (in PLN m)

	Bonds	Bills	Retail bonds	Total domestic redemption	Foreign Bonds/Credits	Total redemptions
January	13,660		155	**13,815**	2,681	**16,497**
February			171	**171**	5,442	**5,613**
March			117	**117**	2,113	**2,230**
April	15,968		66	**16,035**		**16,035**
May			116	**116**		**116**
June			60	**60**		**60**
July	8,145		89	**8,234**	1,236	**9,470**
August			198	**198**	1,594	**1,793**
September			359	**359**	2,438	**2,796**
October			83	**83**		**83**
November			171	**171**	645	**816**
December			91	**91**		**91**
Total 2014	37,773		1,677	**39,450**	16,149	**55,599**
Total 2015	78,037		1,710	**79,747**	14,789	**94,536**
Total 2016	84,347		1,273	**85,621**	17,262	**102,882**
Total 2017	58,543		917	**59,460**	12,566	**72,026**
Total 2018	66,317		911	**67,228**	14,396	**81,624**
Total 2019+	179,098		3,233	**182,332**	135,784	**318,116**

Source: MF, BZ WBK

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2. Polish Bonds: Supply Recap (cont.)

Scheduled wholesale bond redemption by holders (data at the end of June 2014, in PLN mn)

	Foreign investors	Domestic banks	Insurance Funds	Pension Funds	Mutual Funds	Individuals	Non-financial sector	Other	Total
Q1 2014	0	0	0	0	0	0	0	0	0
Q2 2014	0	0	0	0	0	0	0	0	0
Q3 2014	5,012	1,000	1,532	14	455	129	10	90	8,243
Q4 2014	0	0	0	0	0	56	7	14	77
Total 2014	**5,012**	**1,000**	**1,532**	**14**	**455**	**185**	**16**	**104**	**8,319**
	60%	**12%**	**18%**	**0%**	**5%**	**2%**	**0%**	**1%**	**100%**
Total 2015	30,508	25,030	8,626	522	6,017	237	301	6,831	78,071
	39%	32%	11%	1%	8%	0%	0%	9%	100%
Total 2016	42,741	18,106	7,982	724	9,600	106	404	5,744	85,406
	50%	21%	9%	1%	11%	0%	0%	7%	100%
Total 2017	24,269	15,978	6,179	610	7,291	56	188	3,971	58,543
	41%	27%	11%	1%	12%	0%	0%	7%	100%
Total 2018	18,160	31,067	3,524	385	8,700	70	171	4,239	66,317
	27%	47%	5%	1%	13%	0%	0%	6%	100%
Total 2019+	79,116	44,199	25,302	1,021	12,699	212	336	8,256	171,141
	46%	26%	15%	1%	7%	0%	0%	5%	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 June			Share in TOTAL (%) in June
	End Jun'14	End May'14	End Apr'14	End 1Q 2014	End 4Q 2013	End 3Q 2013	MoM	3-mth	YoY	
Domestic investors	277.2	282.4	278.7	277.9	381.2	377.3	-1.84	2.63	-24.97	58.1 (-1.7pp)
Commercial banks	135.4	139.9	135.4	134.3	114.7	116.2	-3.24	0.83	18.86	28.4 (-1.3pp)
Insurance companies	53.1	52.7	53.2	52.9	52.0	52.8	0.89	0.44	0.09	11.1
Pension funds	3.3	3.3	3.5	3.5	125.8	122.7	-1.79	-6.33	-97.21	0.7
Mutual funds	44.8	46.2	46.0	45.8	46.7	46.1	-3.18	-2.33	-3.73	9.4 (-0.4pp)
Others	40.6	40.2	40.5	41.4	42.0	39.5	1.0	-1.8	6.1	8.5
Foreign investors*	199.8	189.7	187.6	186.9	193.2	200.6	5.36	6.91	-0.97	41.9 (1.7pp)
Banks	12.6	10.5	11.9	30.5	29.1	32.1	20.63	n.a.	n.a.	2.6 (0.4pp)
Central banks	18.0	17.3	14.4	150.6	156.0	159.7	4.21	n.a.	n.a.	3.8 (0.1pp)
Public institutions	0.7	0.7	0.7	n.a.	n.a.	n.a.	3.81	n.a.	n.a.	0.2
Insurance companies	9.5	9.4	9.1	n.a.	n.a.	n.a.	1.70	n.a.	n.a.	2.0
Pension funds	12.3	12.2	11.9	n.a.	n.a.	n.a.	1.08	n.a.	n.a.	2.6
Mutual funds	83.4	80.2	79.1	n.a.	n.a.	n.a.	3.97	n.a.	n.a.	17.5 (0.5pp)
Hedge funds	0.1	0.1	0.1	n.a.	n.a.	n.a.	0.48	n.a.	n.a.	0.0
Non-financial sector	14.2	12.6	12.1	n.a.	n.a.	n.a.	13.13	n.a.	n.a.	3.0 (0.3pp)
Others	16.5	15.9	18.0	4.5	4.7	5.2	3.88	n.a.	n.a.	3.5 (0.1pp)
TOTAL	477.0	472.0	466.3	464.8	574.3	577.9	1.05	-0.24	-16.49	100

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

Source: MF, BZ WBK

4. Euro Zone Bonds: Supply Recap

Euro zone planned and completed issuance in 2014 (€ bn)

	Total redemptions	Deficit	Borrowing needs	Expected bond supply	% of completion (YtD*)
Austria	23.4	4.3	27.7	24.7	53
Belgium	21.8	9.8	31.6	30.0	80
Finland	6.9	4.8	11.7	11.7	55
France	105.0	70.2	175.2	174.0	81
Germany	144.0	-	144	144.0	60
Greece	16.8	5.6	-	-	-
Ireland	6.9	7.7	14.6	14.6	70
Italy	187.8	27.6	235.4	235.4	75
Netherlands	32.0	15.9	47.9	45.9	76
Portugal	11.4	7.4	18.8	7.2	94
Spain	68.2	36.7	141.3	141.3	75
Total	**624.2**	**189.9**	848.2	**828.8**	**73**

Source: Eurostat, BZ WBK.

**/ YTD (year calendar) data for 2014*

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)	
	2013	2014	2013	2014	2013	2014	2013	2014	2013	2014
Poland	**1.6**	**3.2**	**0.8**	**1.1**	**-1.6**	**-1.7**	**-4.3**	**5.7**	**57.0**	**49.2**
Czech Republic	-0.9	2.0	1.4	0.8	-1.2	-0.4	-1.5	-1.9	46.0	44.4
Hungary	1.1	2.3	1.7	1.0	3.1	3.0	-2.2	-2.9	79.2	80.3
EU	0.1	1.6	1.5	1.0	1.6	1.8	-3.0	-2.5	88.9	89.5
Euro area	-0.4	1.2	1.3	0.8	2.6	2.9	-3.3	-2.6	95.0	96.0
Germany	0.4	1.8	1.6	1.1	7.4	7.3	0.0	0.0	78.4	76.0

Main market indicators (%)

	Reference rate (%)		3M market rate (%)		10Y yields (%)		10Y Spread vs Bund (bp)		CDS 5Y	
	2013	end of August	2013	end of August	2013	end of August	2013	end of August	2013	end of August
Poland	**2.50**	**2.50**	**2.71**	**2.59**	**4.32**	**3.11**	**238**	**222**	**79**	**63**
Czech Republic	0.05	0.05	0.05	0.04	2.53	1.22	58	32	60	45
Hungary	3.00	2.10	2.99	2.14	5.71	4.55	377	366	256	165
Euro area	0.25	0.15	0.29	0.16						
Germany					1.94	0.89			26	20

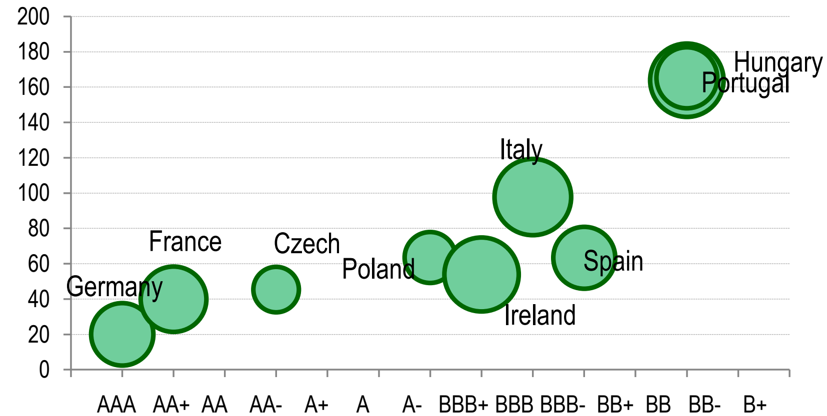
Source: EC – Spring 2014, stat offices, central banks, Reuters, BZ WBK.

5. Poland vs Other Countries (cont.)

Sovereign ratings

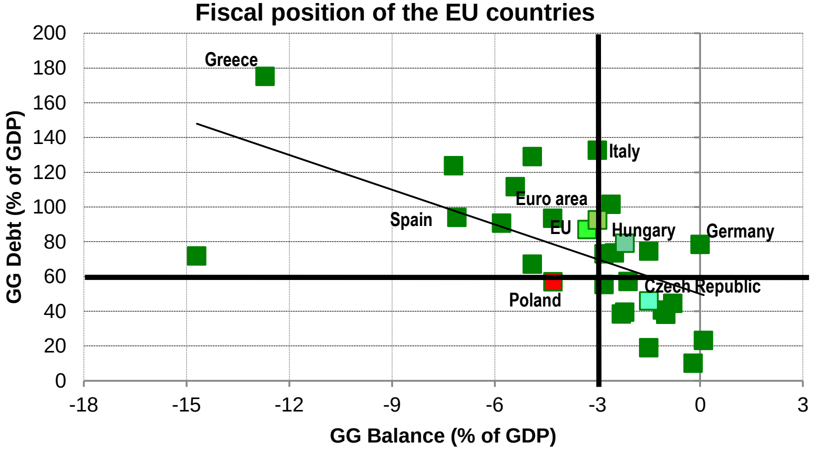
	S&P		Moody's		Fitch	
	rating	outlook	rating	outlook	rating	outlook
Poland	A-	stable	A2	stable	A-	stable
Czech	AA-	stable	A1	stable	A+	stable
Hungary	BB	stable	Ba1	negative	BB+	stable
Germany	AAA	stable	Aaa	negative	AAA	stable
France	AA	stable	Aa1	negative	AA+	negative
UK	AAA	negative	Aa1	negative	AA+	stable
Greece	B-	stable	Caa1	stable	B	stable
Ireland	BBB+	positive	Baa3	positive	A-	stable
Italy	BBB	negative	Baa2	stable	BBB+	negative
Portugal	BB	stable	Ba1	stable	BB+	negative
Spain	BBB	stable	Baa3	stable	BBB	stable

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

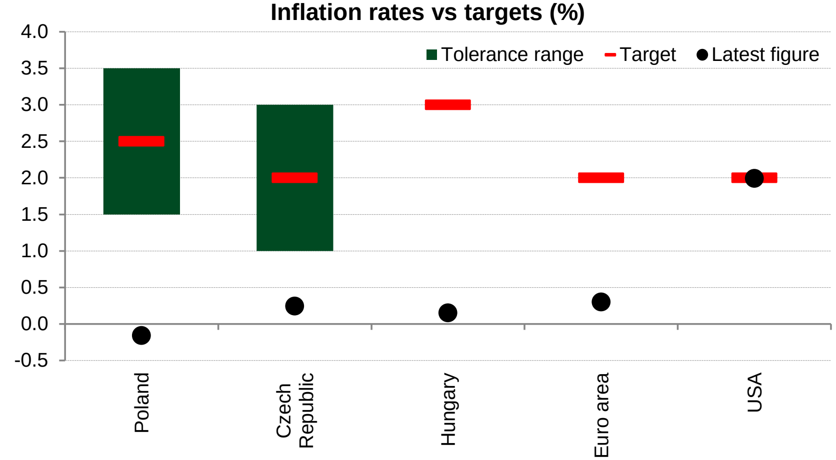


Note: Size of bubbles reflects the debt/GDP ratio

Fiscal position of the EU countries



Inflation rates vs targets (%)



Source: rating agencies, Reuters, EC, BZ WBK

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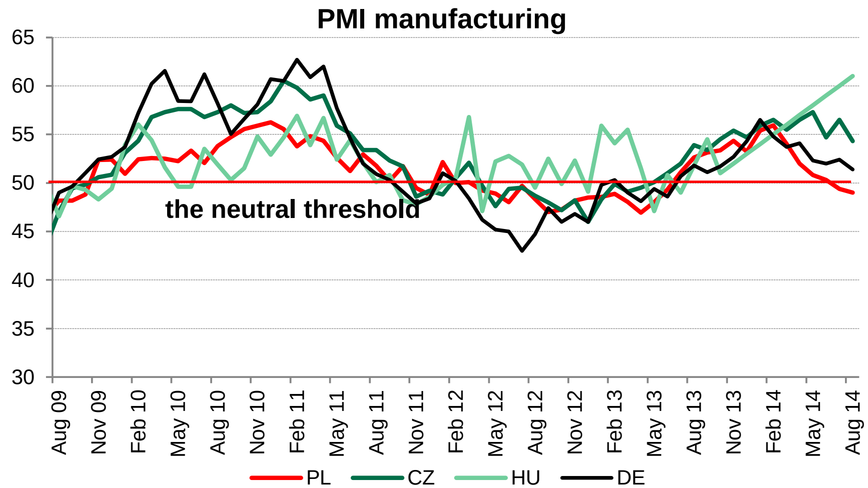
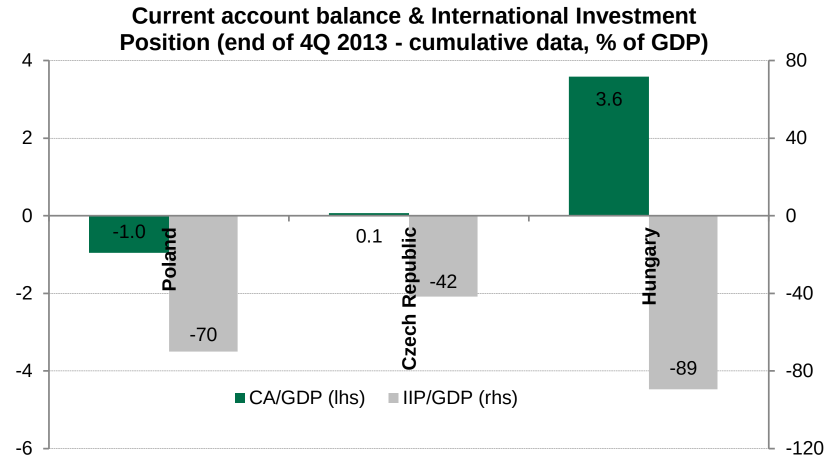
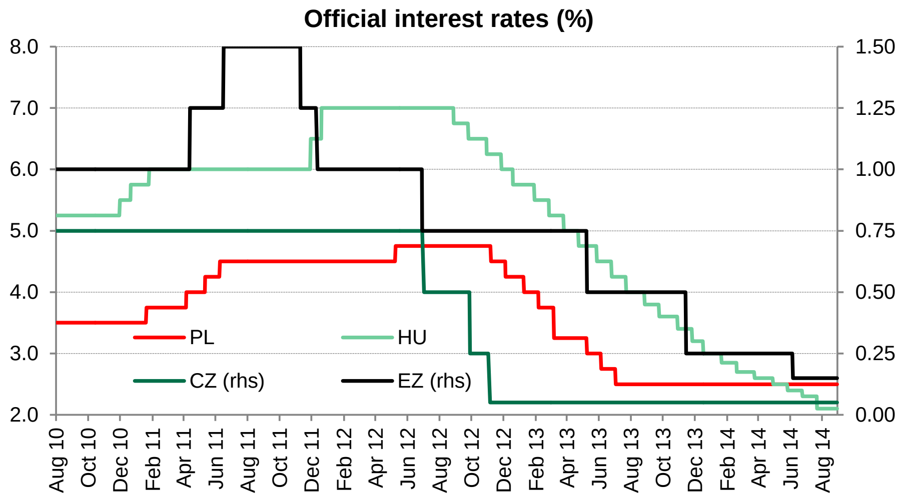
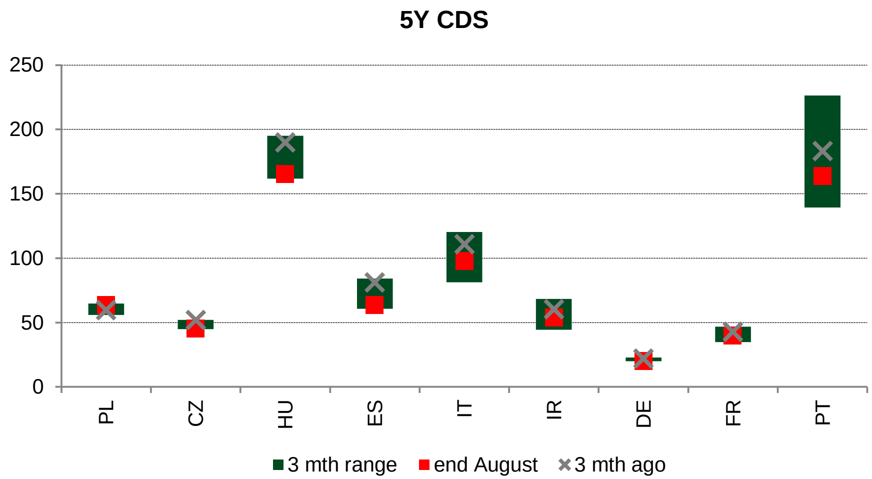
5. Poland vs Other Countries (cont.)



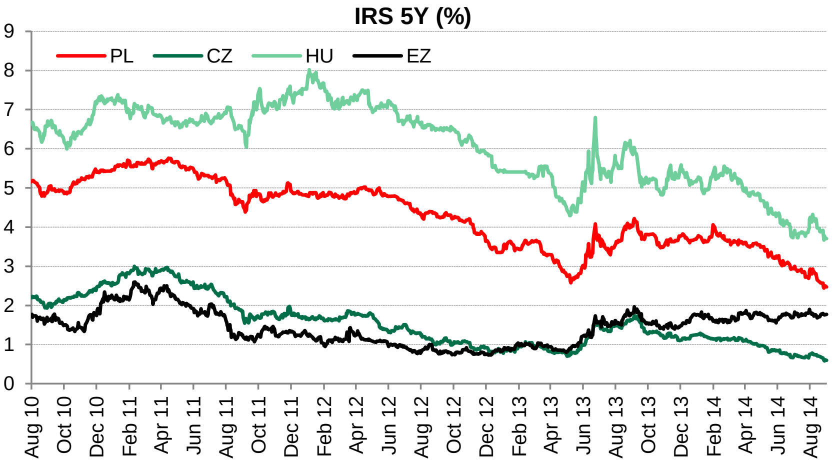


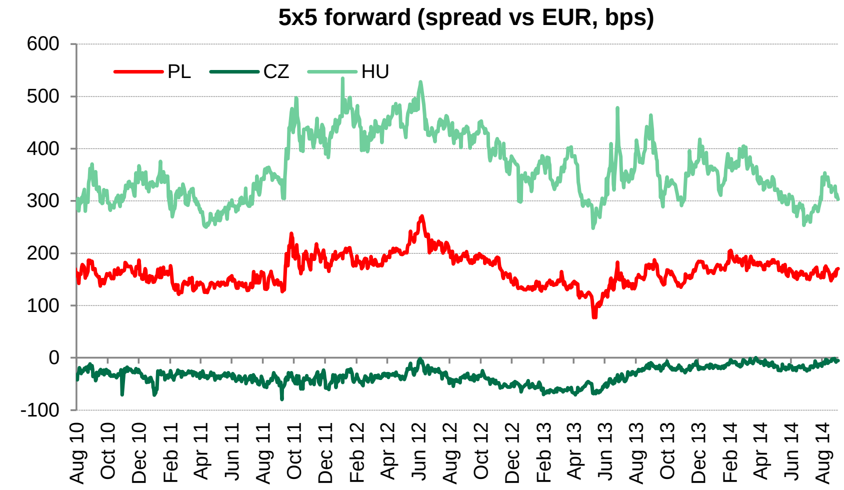


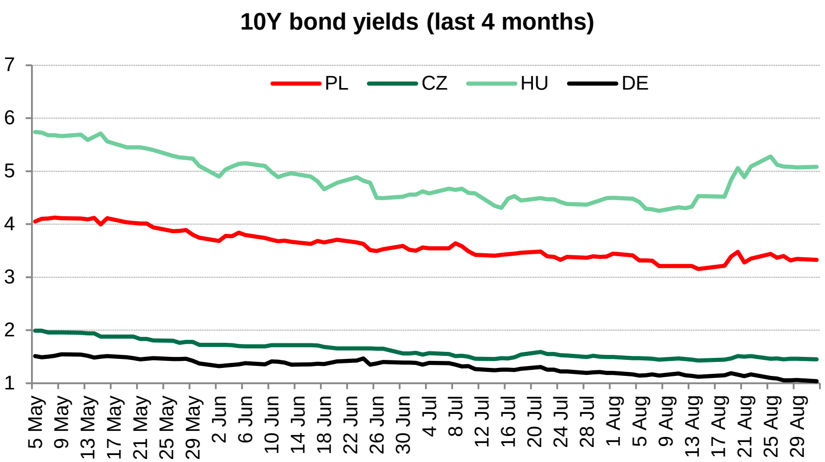


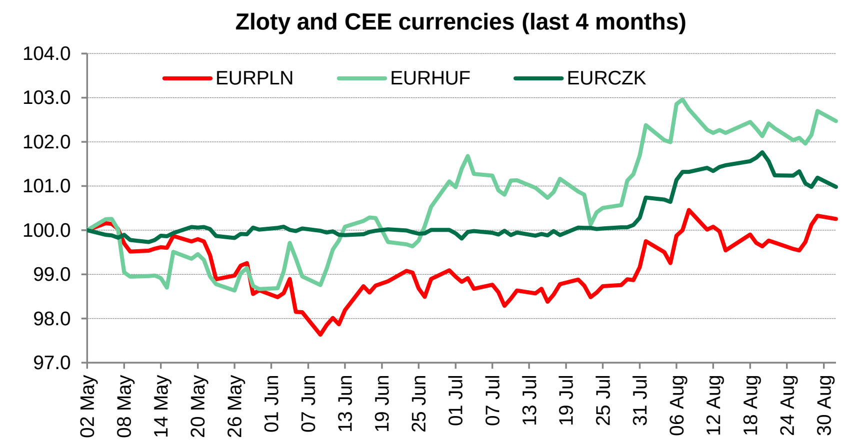
Source: Markit, Eurostat, central banks, Reuters, BZ WBK, EC

5. Poland vs Other Countries (cont.)









Source: Reuters, BZ WBK

6. Central Bank Watch

		Last	2013	2014	Expected changes (bp) 1M	3M	6M	Comments
Euro zone	Forecast	0.15	0.25	0.15				The market is pricing-in further easing from the ECB this month. In our opinion the ECB may abstain from such a decision, waiting for the results of TLTROs, which start in mid-September. The ECB seems to be intensifying preparations for an ABS purchase programme and signalling its readiness to do QE if needed.
	Market implied »				16	14	12	
UK	Forecast	0.50	0.50	0.75				In line with expectations, the BoE kept official interest rate unchanged. However, BoE minutes show that the labour market situation remains an important factor in respect of the timing of the first rate hike. Given the weak development in wage growth, the likelihood of a rate hike in 2014 has declined substantially.
	Market implied »				3	11	29	
US	Forecast	0-0.25	0-0.25	0-0.25				Fed Chair Janet Yellen reaffirmed that if the labour market continues to improve more quickly than anticipated by the FOMC, then the rate hike would likely occur sooner, but if the economic situation worsens then it would be later. We expect the first hike in 2H 2015.
	Market implied »				15	23	33	
Poland	Forecast	2.50	2.50	1.75				In our opinion, a decisive move in monetary policy looks like a done deal and would be justified as early as September. However, recent comments by MPC members suggest there may not be a majority to support such a decision at the next meeting. We expect a 75bp rate cut in total in October-November.
	Market implied »				-13	-45	-58	
Czech Republic	Forecast	0.05	0.05	0.05				We expect monetary policy to remain unchanged till year-end. The exchange rate is still important for the central bank. Despite the gradual slowdown in 2Q 2014 the FX intervention regime should stay stable until 2016E.
	Market implied »				30	28	27	
Hungary	Forecast	2.10	3.00	2.10				As expected, the NBH kept official rates unchanged at its August meeting. As macroeconomic data show a gradual improvement we predict that the base rate will stay unchanged till-year end.
	Market implied »				5	9	14	

Source: Reuters, BZ WBK

This analysis is based on information available through September 1, 2014 and has been prepared by:

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

EXPLANATION OF THE RECOMMENDATION SYSTEM

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

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

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

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

Important Disclosures (cont.)

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