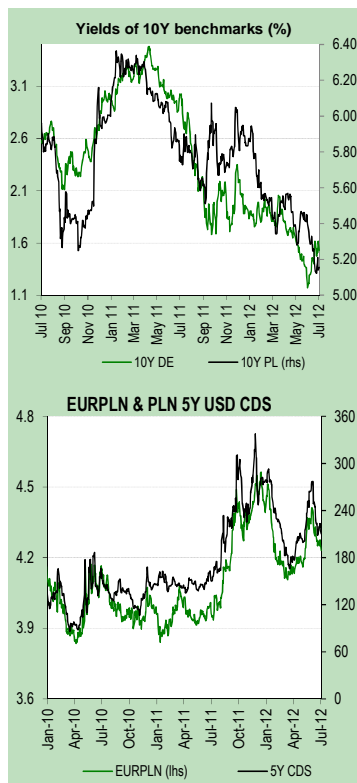


# Rates and FX Outlook

## Polish Financial Market

July 2012



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#### Maciej Reluga

Chief economist  
+48 22 586 8363

#### Piotr Bielski

+48 22 586 8333

#### Agnieszka Decewicz

+48 22 586 8341

#### Marcin Luziński

+48 22 586 8362

#### Marcin Sulewski

+48 22 586 8342

Email: ekonomia@bzwbk.pl

- **The announcements after the June's EU summit did not disappoint the markets.** Quite opposite, the agreement to allow the ESM to inject capital directly into banks and the fact that the EFSF/ESM could start acting in government debt markets led to rally in riskier assets. The Polish market benefited as well with the zloty appreciating significantly, to below 4.20 against the euro. The next few weeks will show how long the market optimism can last given comments from Finland and Netherlands that these countries could oppose using the existing bailout funds to buy peripheral debt in the secondary market. This shows that disparity of views within the euro area continues. Additionally, the leading indicators (PMI, ISM) are still very weak and expectations are growing that the central banks would deliver more monetary easing.
- **It is widely expected that the ECB will cut the refi rate at July's meeting.** As we know from the comments by ECB President Mario Draghi, some council members favoured the rate cut already at the previous meeting. As inflation rate has decreased and pressure from commodity prices has lowered, global monetary policy will probably continue to be very accommodative. One cannot exclude another round of LTRO by the ECB and if the US labour market data disappoint again there is good chance the Fed will announce more quantitative easing in August or September. If this is the case, some short-term improvement on the market is possible again.
- **The Polish central bank is still considering rate hike, as some MPC members suggested in their comments. We have been arguing for long time that monetary tightening (including hike delivered in May) in current environment is hard to justify.** The market participants seem to share our view as FRA started to price-in more than 25 bp rate cut in six months (FRA 6X9 at 4.85% against 3M WIBOR at ca. 5.15%) and even more monetary easing at the start of 2013 (FRA 9X12 at 4.65%). We continue to believe that rates will remain stable for some time, though we may see the environment for monetary easing in 2013 if we witness significant slowdown of the economy (currently we forecast GDP at 2.5% in 2013).
- **Nevertheless, the Polish inflation rate is still elevated and it seems that drop to 3.6% in May was only temporary phenomenon.** The figure to be released in mid-July may show another increase to above 4% (or even close to 4.5%), which would make the MPC members nervous again. Fortunately they will be on holidays (no meeting planned in August), so will not react with swift backward-looking rate hike. However, the high CPI reading may lead to correction of bond yields, especially at the short-end of the curve, after the recent rally. FRA and IRS should also increase as a result. As regards, foreign exchange market, we still see the risk of zloty depreciation in summer months, though it might be limited given market expectations for more monetary easing from global central banks.

*This report is based on information available until 2<sup>nd</sup> July*

## Short- and Medium-term Strategy

### Interest rate market

	Change (bps)		Level end-June	Expected trend	
	Last 3M	Last 1M		1M	3M
Reference rate	0.25	0.00	4.75	→	→
WIBOR 3M	19	2	5.13	→	→
2Y bond yield	3	-17	4.61	↗	→
5Y bond yield	-22	-31	4.71	↗	↗
10Y bond yield	-35	-31	5.14	→	↗
2/10Y curve slope	-38	-13	53	→	→

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

#### Rates: our view and risk factors

<b>PLN rates market</b>	<b>Money market:</b> After increase in 3M WIBOR to ca. 5.15% in reaction to rate hike by the MPC in May, we saw stabilisation. Market started to price-in more than 25 bp rate in 6M (FRA 6X9 at 4.85%) and even more monetary easing at the start of 2013 (FRA 9X12 at 4.65%). We see stable rates in 2012.
	<b>Short end:</b> Our view of low inflation reading and positive impact on the short-end of the curve has materialised with 2Y yield falling to almost 4.6%. This month we see the risk of higher inflation, which should bring front-end of the curve slightly up after recent rally.
	<b>Long end:</b> While last month we expected stabilisation in yields, they continued the downward trend with 10Y close to 5.10% during the month. We see 5Y yield higher as this segment might be vulnerable to high-inflation reading, while 10Y should stabilise around this year's record-lows.
	<b>Risk factors to our view:</b> We do not think it is justified, but recent comments of MPC members indicate risk of rate HIKE in July. If this materialises short-end of the curve would move sharply up. The risk for the long end is mostly connected with a possible weakening of the zloty due to global risk aversion.

### FX market

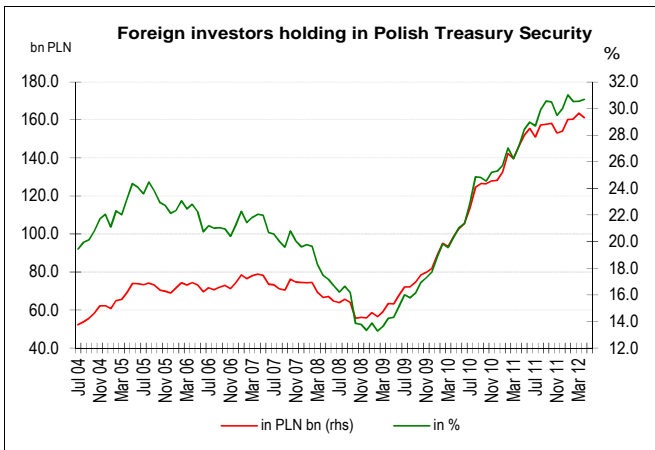
	Change (%)		Level end-June	Expected trend	
	Last 3M	Last 1M		1M	3M
EURPLN	2.4	-2.9	4.26	→	→
USDPLN	8.6	-4.2	3.39	→	↗
CHFPLN	2.7	-2.9	3.55	→	→
GBPPLN	6.0	-3.6	5.29	→	→
EURUSD	-5.7	1.4	1.26	→	→

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

#### FX: our view and risk factors

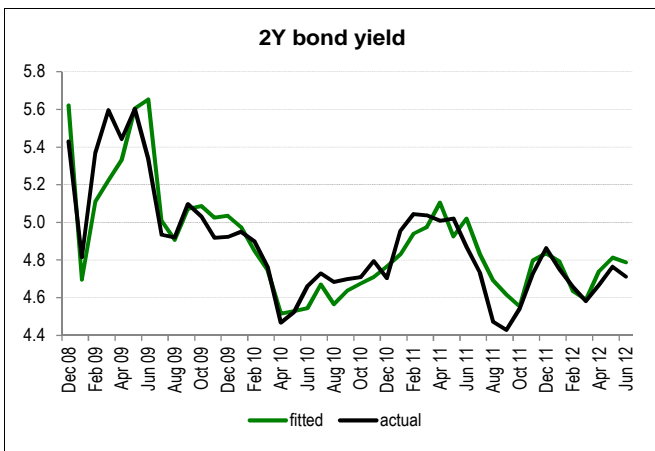
<b>PLN FX market</b>	<b>EUR:</b> June was positive month for the Polish currency and post EU summit positive mood drove EURPLN to ca. 4.20. We see the risk of zloty depreciation in summer months, though it might be limited given market expectations for more monetary easing from global central banks.
	<b>USD:</b> We assume stabilisation of EURUSD around 1.25 and thus any moderate movements in EURPLN would be reflected also in USDPLN rate.
	<b>CHF:</b> The same story as for USD, with EURCHF around 1.20.
	<b>Risk factors to our view:</b> If market optimism after EU summit proves short-lived, we can see EURPLN moving back to 4.40 and in this scenario depreciation of the zloty against USD would be even more significant (amid EURUSD going towards 1.20)

# Special focus – What drives Polish yields?



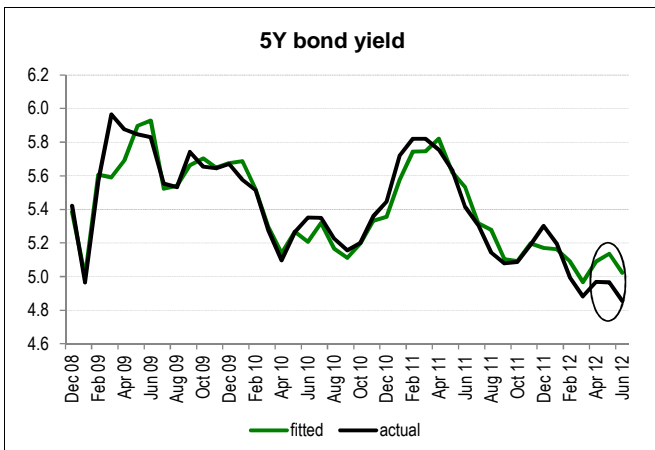
## What factors are important for Polish yields?

- Polish bonds have rallied strongly in H1 2012 due to heavy demand. As a consequence yield curve moved down by 17-74bps in comparison with the end of 2011, with the highest scope of fall in case of 10Y sector. Upward correction in yields were used to purchase bonds at more attractive price.
- It is interesting that Polish government securities have performed strongly this year despite Europe's debt problems. Therefore, using an econometric analysis of bond yields we tried to find which factors were the most important for the fixed income market (technical details about models on next page).
- Our analysis shows that FRA rates i.e. expectations regarding monetary policy strongly affected yields changes at the short-end and mid- of the yield curve. The exchange rate also put some pressure on the yields, with the highest impact on long-term bonds. In the same vain, long term bonds are more vulnerable to foreign investors holding than to changes in monetary policy. We also find out that impact of domestic business cycle condition (PMI index suggests economic activity perspectives) on yields increases together with yield maturity, showing the strongest influence in case of 10Y benchmark.
- As for spread vs. Bunds, the mid and the long end of the curve are the most vulnerable to this factor. It is also interesting that the variable representing percentage share of foreign investors' holding in Polish bonds proved to be significant. Non-residents have increased significantly their exposure to Polish assets, to the historical high at PLN167.7bn (or over 31% of total Polish marketable treasury securities).
- High completion of borrowing requirements (near 80% at the end of June) allows the MF to reduce issuance plan for Q3 and to refrain from offering T-bills until year-end. It will continue to be supportive for bonds market. However, we were not able to confirm the importance of this factor in our historical analysis.



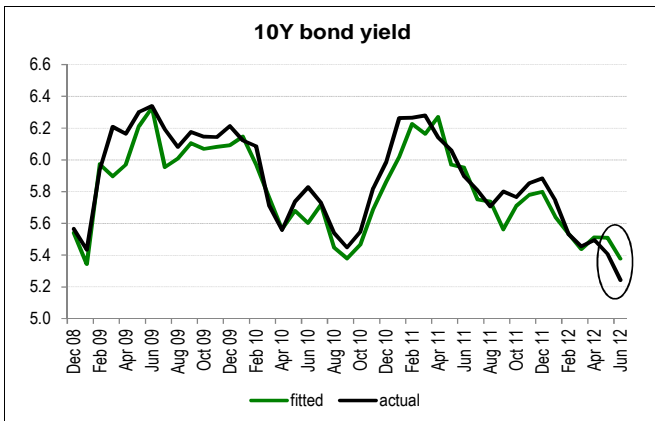
## Will the MPC unwind rate hike?

- The front end of the curve was under pressure of May's rate hike and the MPC's hawkish rhetoric. But renewed cuts expectations after dovish statements by two MPC's members (Chojna-Duch, Bratkowski) caused sharp fall of 2Y yield.
- Currently market prices in two cuts in 9 months horizon, with possible first easing in Q4 2012. Given MPC rhetoric it is hard to expect monetary easing unless GDP growth decelerates strongly, as CPI will remain near 4% till late autumn. We predict rates to be on hold till year-end.
- Taking into account our inflation forecasts we predict yield of 2Y benchmark to anchor near 4.70%, with possible more gradual decrease in Q4 2012 if CPI inflation descends towards NBP's target and economic activity slows more significantly.
- As for 5Y, the value fitted from the model overshoots actual yields in last three months. It was caused mainly by introduction of a new 5Y benchmark, which attracted a fresh demand. We expect yield of 5Y to remain between 4.70-4.80% in coming months, however if risk aversion increases, it will cause sell off in 5Y and yields growth towards even 5.00%.



## Long-term bonds still strong

- Long term bonds have performed much better than other sectors, supported by strong fundamentals, limited supply and global mood improvement. All these facts caused the fitted value to over shoot the actual ones recently.
- The June's EU summit brought some positive information for the market, however we do not exclude that market enthusiasm could turn into consolidation on the financial markets, including Polish bonds. Therefore we foresee 10Y benchmark to be traded horizontally between 5.10 and 5.35% till year-end.



Sources: Ministry of Finance, BZ WBK

## Technical annex

According to the financial and economic theory, bond yields depend upon several factors:

- (1) Interest rates expectations
- (2) Inflation expectations
- (3) Domestic fiscal risk
- (4) Exchange rate risk
- (5) Bond supply
- (6) Interbank liquidity
- (7) Expected gains from alternative investments
- (8) Cost of money on international market and global risk aversion

Taking into account these factors, we have chosen macroeconomic and financial variables which can serve as proxies for them. These variables were regressed against yields of 2, 5 and 10Y Polish bonds in order to choose these, which are statistically relevant. These are:

- Polish FRA3x6 and 6x9 rates (FRA3x6, FRA6x9), which reflect factor (1)
- CPI inflation (CPI), which reflects factor (2)
- Percentage share of foreign investors' holding in Polish bonds (FOREIGN\_HOLDING), reflecting factor (3)
- Polish PMI index for manufacturing (PMI), which reflects factor (3)
- EURPLN exchange rate, which reflects factor (4)
- WIG20 index (WIG20), which reflects factor (7)
- Yields of 2, 5 and 10Y German bonds (DE2Y, DE5Y, DE10Y), which reflect factor (8)
- VIX index (VIX), which stands for factor (8)

We failed to capture factors (5) and (6), but they surely remain important for Polish bond yields.

Bond yields were modelled using the error correction model framework, which is typical for this kind of problem. A typical error correction model consists of two equations: one describing the long-term equilibrium level of the endogenous variable and the other one describing the short-term volatility around the equilibrium. The estimated parameters of models are given in table 1. (all are statistically significant at 5% significance level, constants are omitted, D(.) operator stands for the first difference). All variables were standardised, so value of coefficient cannot

be interpreted in an usual manner, but they can be compared with each other.

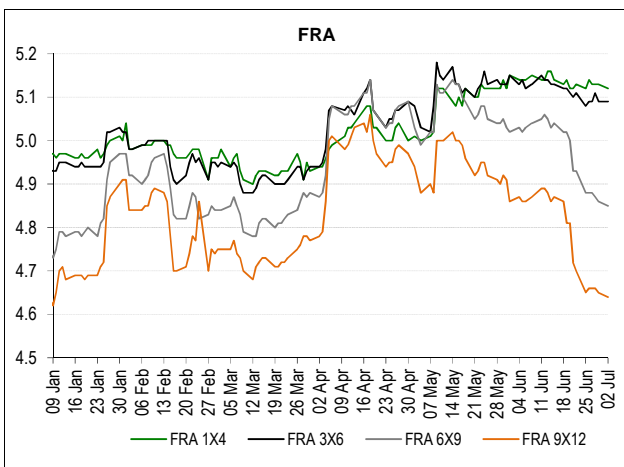
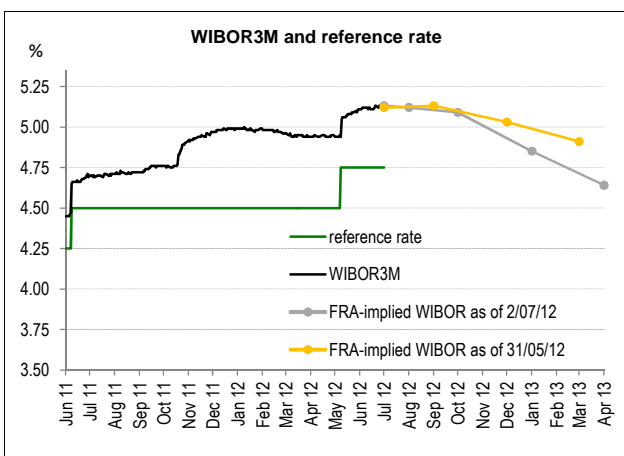
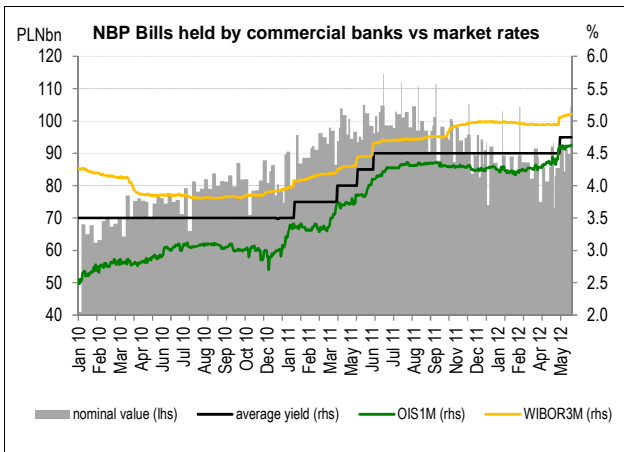
The estimated coefficients have expected signs (yields rise due to higher interest rates and inflation expectations, depreciation of the zloty, higher German yields, higher risk aversion and lower demand of foreign investors), except for PMI and WIG20. The former reflects current business climate. High economic activity is favourable for tax receipts, so should exert a downward pressure on yields. On the other hand, the latter stands for expected gains from alternative investments so flourishing stock market should deliver an upward impulse for yields. Still, these two variables are both treated as leading indicators of the economy and carry a similar message, so it is possible that they managed to capture opposite signals, with WIG20 promising high tax receipts and PMI showing good business climate with other investment prospects.

Moreover, our models captured an important theoretical relation: yields for longer tenors are less vulnerable to expected interest rate path, but depend more on global and risk aversion and foreign exchange developments.

**Table 1. Estimated coefficients**

Exogenous variable	Endogenous variable		
	PL2Y	PL5Y	PL10Y
<b>LONG-TERM EQUATION</b>			
FRA3x6/6x9	0.9379	0.8951	0.3499
CPI			0.6276
FOREIGN_HOLDING	-0.4156	-0.3577	-0.4500
PMI	0.2061	0.1617	0.3578
EURPLN	0.2448	0.3081	0.4387
WIG20	-0.1273	-0.1625	
DE2Y/5Y/10Y	0.1098	0.2532	0.2422
<b>SHORT-TERM EQUATION</b>			
ERROR TERM	-0.3018	-0.1782	-0.1252
D(FRA3x6/6x9)	1.0561	0.9025	0.7127
D(FOREIGN_HOLDING)	-0.1829	-0.2853	-0.4443
D(EURPLN)	0.2439	0.2473	0.3322
D(DE2Y/5Y/10Y)		0.2292	0.4564
D(VIX)		0.1888	0.2246

# Money Market



## Spread between reference rate and Polonia narrowed again

▪ Liquidity in banking sector has remained relatively high as commercial banks every week invest their money in NBP bills (average for June was at ca. PLN86bn). Despite this, cost of cash has remained at very high level. It was visible in Polonia rates. One should notice that spread between Polonia and reference level narrowed and currently it was 5bps on average in June (down from 16bps in previous month). It could result from NBP's activity on the interbank market. The most important question is if this trend is going to be extended in July. We do not exclude such scenario.

▪ As regards OIS, rates with maturity up to 3 months remained relatively stable. At the same time rates with longer maturity (6M+) fell significantly by 10-20bps, with the highest decline in case of 1Y. It clearly suggested that market has discounted the first rate cut in Q4 2012 and the next one in Q1 2013.

## FRA market has believed in interest rates cut this year

▪ June brought slight increase (by 1-2bps in monthly terms) in WIBOR rates with maturity between 3M and 1Y. Investors' activity on that market has remained subdued. Investors did not react to the dovish statement by two MPC's members (Chojna-Duch and Bratkowski).

▪ FRA market was more sensitive to the MPC's members view. Dovish statement presented firstly by E.Chojna-Duch and next by A.Bratkowski helped the market to strengthen as expectation for interest rates cuts renewed. FRA rates fell in all tenors. However, market optimism was reduced by other MPC's members (A. Zielińska-Głębocka, J. Winięcki, A. Kaźmierczak), who pointed out that inflation rate has remained at elevated level and therefore rate cuts should not be considered. As a consequence FRA 1x4 and FRA 3x6 slightly increased, ended the month at 5.13% and 5.09%, respectively. It shows that market players expect WIBOR 3M to stabilise at current level in coming months, while in 3 month horizon it could slightly decrease.

▪ As regards FRA 6x9 and FRA 9x12, rates decreased in monthly terms by 17bps and 26bps, respectively. It clearly suggested that FRA market has priced-in one interest rates cut in 6 month period and two cuts in 9 months period.

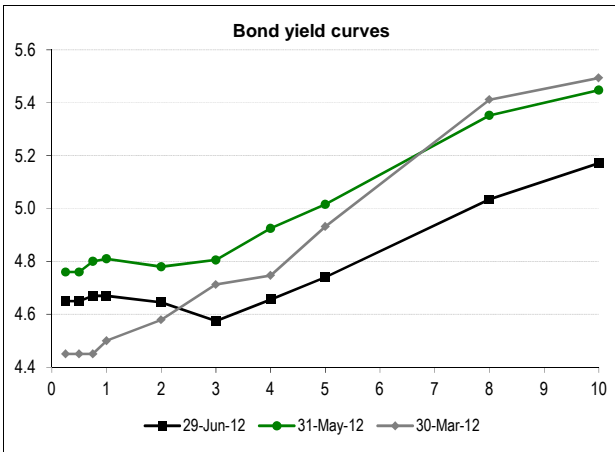
▪ We think that market too aggressively discounted monetary easing. In our opinion the MPC will keep interest rates stable in July and new CPI inflation and GDP projections will not bring additional factors to significantly change rhetoric of the MPC. We also uphold our stance that interest rates will remain stable till year-end. Therefore we do not change our view of WIBOR rates in coming months, assuming WIBOR 3M to stay in horizontal trend. In short-term the money market rates may be under influence of high reading of CPI inflation for June.

## Money market rates (%)

	Reference rate (%)	Polonia (%)	WIBOR (%)				OIS (%)				Spread WIBOR / OIS (bp)			
			1M	3M	6M	12M	1M	3M	6M	12M	1M	3M	6M	12M
<b>End of June</b>	<b>4.75</b>	<b>4.78</b>	<b>4.91</b>	<b>5.13</b>	<b>5.14</b>	<b>5.15</b>	<b>4.63</b>	<b>4.63</b>	<b>4.58</b>	<b>4.47</b>	<b>28</b>	<b>50</b>	<b>56</b>	<b>68</b>
<b>Last 1M change (bp)</b>	0	29	0	4	2	3	2	-1	-9	-20	-2	5	11	23
<b>Last 3M change (bp)</b>	25	46	19	19	18	18	39	40	35	23	-20	-21	-17	-5
<b>Last 1Y change (bp)</b>	25	106	30	43	39	29	41	42	32	9	-11	1	7	20

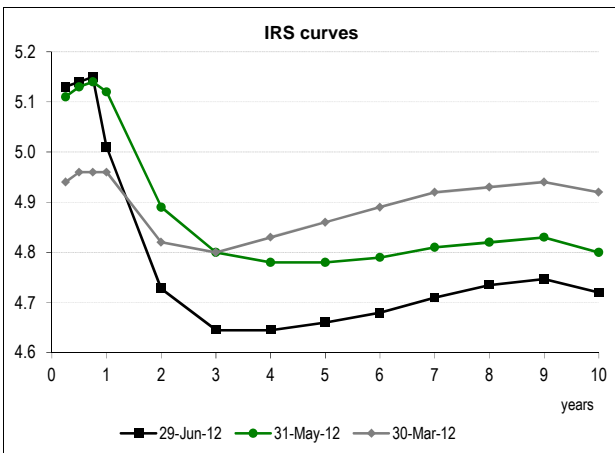
Sources: Reuters, BZ WBK

# IRS and T-Bond Market



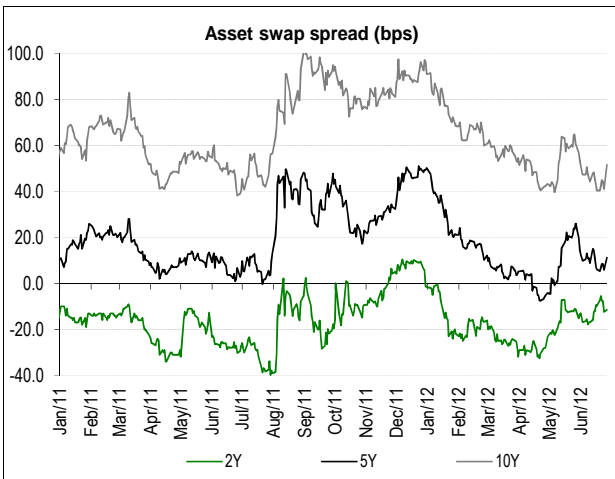
### Bond benchmark hit a new multiyear lows

- As expected the MPC kept interest rates unchanged in June, but in our opinion it shifted its rhetoric slightly towards less hawkish stance. Market reaction at the short-end of the curve was very limited and renewed expectations for interest rates cuts (even this year) appeared only after dovish statements by the MPC's members (Chojna-Duch, Bratkowski). They supported the front end of the curve and as a result yield of two-year benchmark fell to nearly 4.60% at the end June, reaching the lowest level since April.
- Bullish sentiment has prevailed on domestic FI market. Global mood improvement due to results of Greek election and official help for Spanish banks strongly supported the mid and the long-end of the Polish curve. Yields decreased sharply, reaching a new multiyear lows at 4.71% in case of 5Y and almost 5.10% for 10Y. However, the end of the month brought some profit taking on the long-end of the curve.
- All in all, in June the shape of a yield curve has changed moderately, with 5Y and 10Y bonds outperforming the 2Y benchmark. The yield curve has continued a bull flattener, with the slowest decrease in 2Y sector (by 17bps in June) and sharper fall in both 5Y and 10Y sectors (by 31bps).
- As regards IRS, rates have followed moves on the bond market. IRS curve also moved down (by 7-16bps), but the scope of fall was much lower than on bonds. Changes in monetary policy outlook (currently market prices in the first rates cut in 6 month perspectives) caused the significant decrease in 2Y sector (by 17bps in monthly terms). Asset swap spread narrowed sharply in case of 5Y and 10Y sectors.



### CPI reading and global mood important

- The key event for the front of the curve will be MPC meeting and the June inflation reading. We believe that the Council stance after July's meeting will not bring any significant changes in rhetoric compared to June's one. Therefore, we foresee it should stabilise yield of 2Y near current level. However, CPI inflation publication for June might negatively affect short-end of the curve and even 5Y benchmark. As a result we do not exclude some increase towards 4.70% in case of 2Y and towards 4.80% in case of 5Y.
- As regards 10Y sector yields are supported by low supply (this month investors can purchase long-term bonds only at switch tender). We think that investors will focus on data from real economy and situation on the global market. Some worsening of GDP prospects and global mood deterioration could result in higher premium of risk and put some pressure on long-end of the curve. We think that currently 5.10% is a strong support for 10Y benchmark and it should effectively stop downward trend. This month we foresee yield of 10Y between 5.10-5.25%.

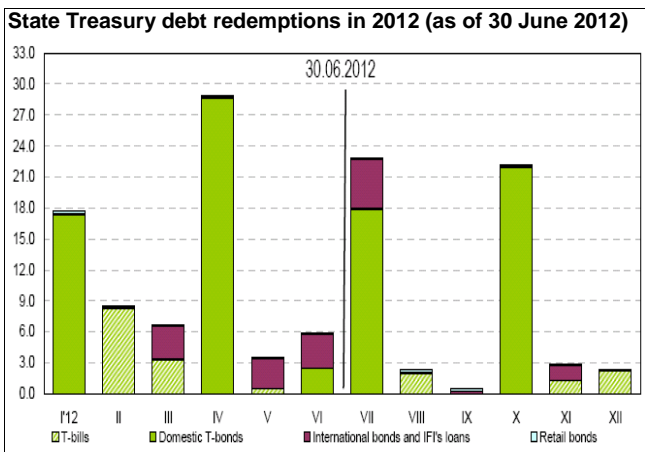
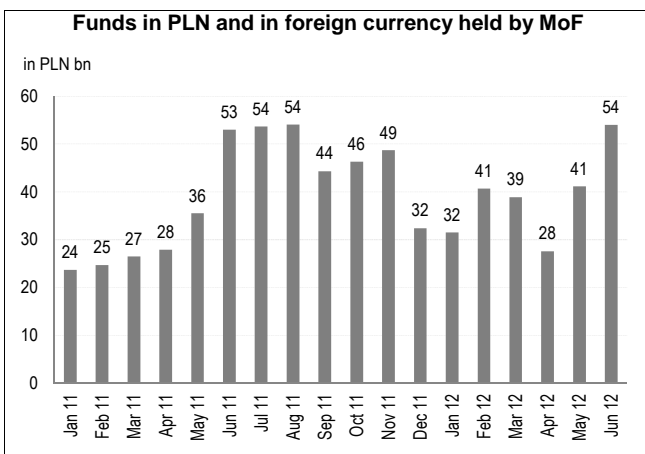
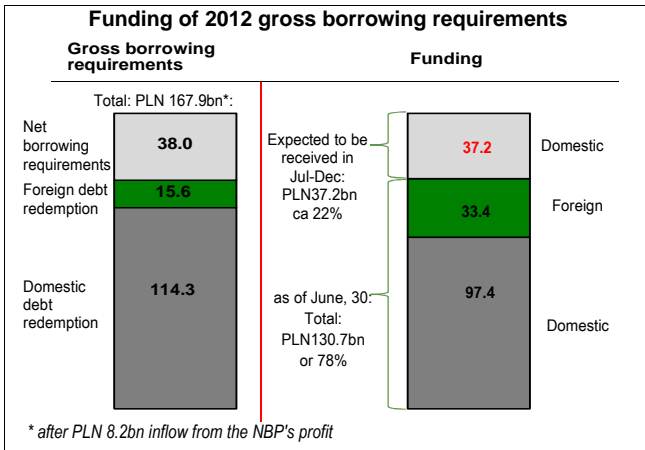


### Bond and IRS market (%)

	T-bills	BONDS			IRS			Spread BONDS / IRS (bp)		
	52-week	2Y	5Y	10Y	2Y	5Y	10Y	2Y	5Y	10Y
End of June	4.67	4.61	4.71	5.14	4.73	4.65	4.73	-12	6	41
Last 1M change (bp)	-11	-16	-29	-27	-16	-14	-9	0	-15	-18
Last 3M change (bp)	17	1	-24	-40	-11	-23	-21	12	-1	-19
Last 1Y change (bp)	4	-24	-64	-72	-37	-66	-64	13	2	-8

Sources: Reuters, BZ WBK

# Treasury Securities Supply Corner



**Auction calendar for Q3 2012**

Auction date	Settlement date	Series	Planned offer (PLN m)
19-07-2012	25-07-2012	OK0714	2,000 – 5,000
01-08-2012	03-08-2012	PS0417	2,000 – 4,000
12-09-2012 or 19-09-2012	14-09-2012 or 21-09-2012	PS / DS / WS / WZ / IZ*	2,000 – 4,000

*\*/ depends on market conditions*

**T-bond switching auction in July (data at the end of June)**

Auction/settlement date	Settlement bonds	Source bonds	Outstanding amount (PLN m)
05-07-2012 / 09-07-2012	PS0417 / DS1021	OK0712	17,899
		OK1012	21,873
06-09-2012 / 10-09-2012	depend on market conditions	OK1012	21,873
		OK0113	23,096

## Financing position after H1 2012 looks favorable

The central government financing position after June looks favorable. Poland has issued ca. PLN134bn (on both domestic and foreign markets), completing ca. 80% of its funding needs for this year. As compared to the previous years the ratio is higher – nearly 15bps more than the average over the last three years.

One of the key aspects, especially in June, was strong demand for Polish debt. The Ministry of Finance successfully sold eurobonds worth €1.5bn, maturing on 19 January 2023. One should notice that demand recorded during book-building reached the level of €4bn. The issue was priced with a yield of 3.77% i.e. 195bps over the interpolated mid-swap rate. The bonds were placed among investors mainly from Germany (25%). As regards the institutional distribution, it was dominated by asset managers (43%), while central banks purchased ca. 7% of total sales. June's eurobond issue finished this year FX financing needs. We believe that the MF will come back on the foreign markets, probably in Q4 2012, just to pre-finance next year's borrowing.

Auctions on the domestic market also attracted healthy demand. In June the MF sold 5Y benchmark PS0417 worth ca. PLN5.0bn, with a bid-cover ratio at 2.22 (vs. 2.06 in previous month). Auction yield at 4.784% was the lowest since the beginning of 2006.

The MF also announced that at the end of June liquidity cushion denominated in PLN and FX amounted to some PLN54bn. It allowed the ministry to significantly reduce debt offer in Q3 2012.

## Subdued offer of Treasury Securities in Q3 2012

As expected, the Ministry of Finance significantly reduced supply of Treasury Securities in Q3, limiting both the number of auction and value of supply. The Ministry will offer PLN6.0-13.0bn in T-bonds at three regular auctions (one per each month). It will also hold two switching tenders, buying back papers maturing from July 2012 to January 2013. Moreover, the ministry decided to refrain from offering T-bills in Q3.

As regards plan of foreign financing, the MF will get €0.75bn loan from the World Bank and could get "additional financing by structured coupon bonds' issuance in the private placement system".

As in a previous months, the structure of offer is well diversified, showing elasticity of the ministry to the market conditions. In Q3 investors could purchase all fixed-income benchmarks and eventually floating-rate and inflation-linked bonds.

In July the Ministry will offer only 2Y benchmark OK0714 worth of PLN2.0-5.0bn. Supply is relatively small taking into account bonds redemption later this month. In July the MF will redeem OK0712 worth ca. PLN18bn. Market liquidity will be increased by coupon payments from WZ series (ca. PLN1.5bn). We believe that due to liquidity situation the MF will not have any problems to launch bonds on the primary market with auction yield closed to the level on the secondary market (or even a bit lower).

During switch tender the MF will buy back OK0712 and OK1012, offering in exchange bonds from mid and long end of the curve, i.e. 5Y benchmark PS0417 and 10Y benchmark DS1021. Switch tender results could allow the Ministry to further reduce this year redemption amount. One should notice that starting from April 2012 the MF has reduced redemption of OK0712 by ca. 28% (or by PLN6.9bn) and OK1012 by 18% (or by PLN4.9bn).

Sources: Ministry of Finance, BZ WBK

## Treasury Securities Supply Corner

### Total issuance in 2012 by instruments (in PLNm, nominal terms)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
T-bonds auction	10,820	11,503	10,560	9,012	8,341	4,974	5,000	4,000	4,000	4,000	2,000	0	74,209
T-bills auction	2,223	5,778	3,000										11,001
Retail bonds	216	248	212	210	210	210	150	156	160	150	150	150	2,221
Foreign bonds/credits	7,979	2,200	0	5,390	1,251	9,675							26,494
Refinancing and financial resources at the end of 2011	31,600												31,600
<b>Total</b>	<b>52,837</b>	<b>19,729</b>	<b>13,772</b>	<b>14,611</b>	<b>9,802</b>	<b>14,859</b>	<b>5,150</b>	<b>4,156</b>	<b>4,160</b>	<b>4,150</b>	<b>2,150</b>	<b>150</b>	<b>145,526</b>
Redemption	11,297	3,981	5,275	20,795	4,906	2,778	24,017	3,191	1,122	23,038	2,256	2,368	105,024
<b>Net inflows</b>	<b>41,540</b>	<b>15,749</b>	<b>8,496</b>	<b>-6,183</b>	<b>4,896</b>	<b>12,080</b>	<b>-18,867</b>	<b>965</b>	<b>3,038</b>	<b>-18,888</b>	<b>-106</b>	<b>-2,218</b>	<b>40,502</b>
Rolling over T-bonds	6,309			7,966		2,459							16,733
Buy-back of T-bills													0
<b>Total</b>	<b>47,848</b>	<b>15,749</b>	<b>8,496</b>	<b>1,782</b>	<b>4,896</b>	<b>14,539</b>	<b>-18,867</b>	<b>965</b>	<b>3,038</b>	<b>-18,888</b>	<b>-106</b>	<b>-2,218</b>	<b>57,235</b>
Coupon payments	1,451			7,211			1,497		1,455	7,413			19,026

Note: Our forecasts – shaded area

### Schedule Treasury Securities redemption by instruments (in PLNm)

	Bonds	Bills	Retail bonds	Total domestic redemption	Foreign Bonds/Credits	Total redemptions
January	10 946	0	351	11 297		11 297
February		3 799	182	3 981		3 981
March		1 997	129	2 125	3 150	5 275
April	20 663		132	20 795		20 795
May		2 223	117	2 339	2 567	4 906
June			112	112	2 666	2 778
July	17,899	0	218	18,117	5,900	24,017
August	0	1,997	248	2,245	946	3,191
September	0	0	176	176	946	1,122
October	21,873	0	265	22,138	900	23,038
November	0	1,332	208	1,540	716	2,256
December	0	2,223	146	2,368	0	2,368
<b>Total 2012</b>	<b>71,380</b>	<b>13,571</b>	<b>2,283</b>	<b>87,234</b>	<b>15,891</b>	<b>103,124</b>
Total 2013	82,468	6,110	1,698	90,276	14,825	105,102
Total 2014	53,116	0	628	53,743	17,448	71,192
Total 2015	78,880	0	485	79,365	14,329	93,694
Total 2016	59,378	0	91	59,469	16,871	76,340
Total 2017+	201,187	0	3,288	204,475	134,966	339,442

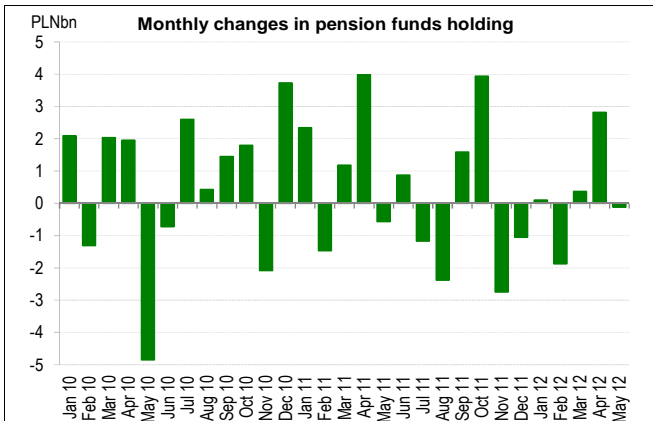
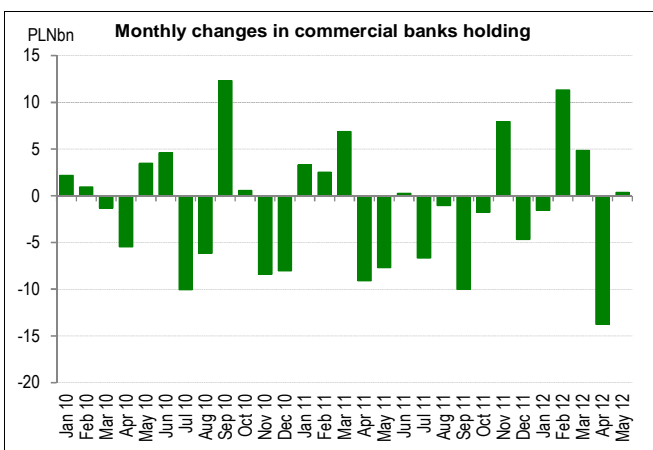
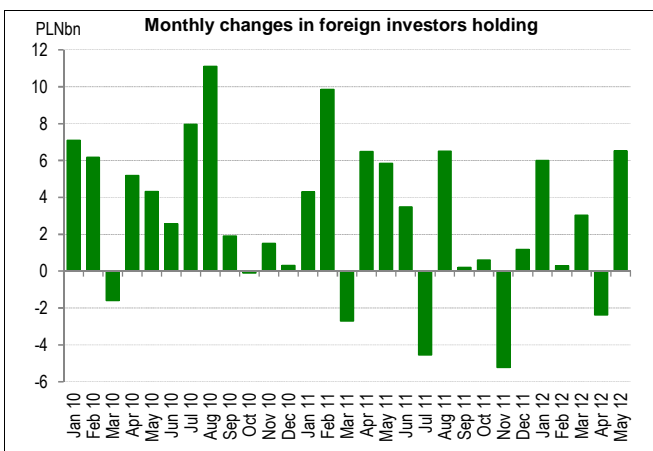
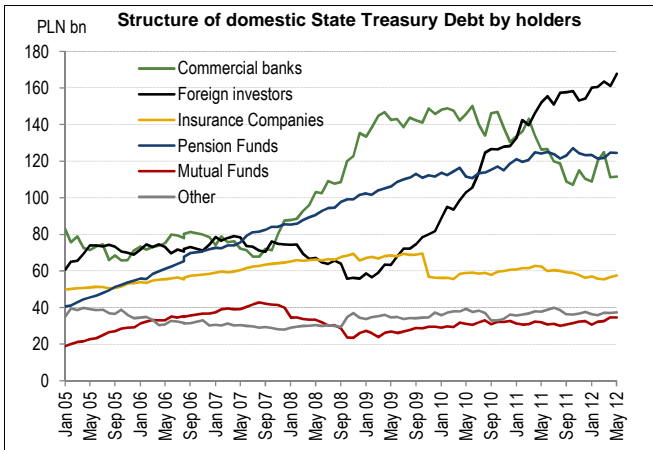
### Schedule wholesales bonds redemption by holders (data at the end of May 2012, in PLNm)

	Foreign investors	Domestic banks	Insurance Funds	Pension Funds	Mutual Funds	Individuals	Non-financial sector	Other	Total
Q1 2012	0	0	0	0	0	0	0	0	0
Q2 2012	0	0	0	0	0	0	0	0	0
Q3 2012	7,837	6,045	1,731	1,828	727	121	36	1,403	19,729
Q4 2012	10,566	5,000	1,132	2,585	1,143	80	30	2,085	22,620
<b>Total 2012</b>	<b>18,402</b>	<b>11,045</b>	<b>2,864</b>	<b>4,413</b>	<b>1,870</b>	<b>201</b>	<b>66</b>	<b>3,488</b>	<b>42,350</b>
	<b>43%</b>	<b>26%</b>	<b>7%</b>	<b>10%</b>	<b>4%</b>	<b>0%</b>	<b>0%</b>	<b>8%</b>	<b>100%</b>
Total 2013	36,044	13,040	12,436	12,607	3,342	477	117	4,540	82,602
	44%	16%	15%	15%	4%	1%	0%	5%	100%
Total 2014	22,236	10,075	4,434	8,803	3,790	412	124	3,530	53,406
	42%	19%	8%	16%	7%	1%	0%	7%	100%
Total 2015	22,779	23,115	7,370	14,977	5,320	191	615	4,583	78,951
	29%	29%	9%	19%	7%	0%	1%	6%	100%
Total 2016	12,477	8,461	5,151	27,103	5,734	48	411	3,166	62,549
	20%	14%	8%	43%	9%	0%	1%	5%	100%
Total 2017+	55,503	36,694	24,041	55,821	12,965	272	812	8,482	194,591
	29%	19%	12%	29%	7%	0%	0%	4%	100%

Sources: Ministry of Finance, BZ WBK



# Treasury Securities Holders



## Foreign investors portfolio hit a new record high

According to recent update of the statistics on marketable debt and on holders of Polish debt, the total outstanding of PLN denominated marketable debt at the end of May was PLN533.3bn. Non-residents held PLN167.7bn in Polish securities (up PLN7bn from April), which accounted for nearly 32% of the total. It is the highest level in history.

The bulk of non-residents portfolios of Polish assets is invested in bonds with maturity up to 3 years. This asset class made up ca. 60% of the total portfolio (or nearly PLN100bn). Only in May foreign investors increased their holding mainly in 10Y benchmark DS1021 (by 2.7bn), PS0414 (by PLN1.8bn) and OK1012 (by 0.8bn).

On the demand side it was mainly foreign non-bank financial sector. In May it increased its holding of Polish bonds by PLN8.2bn to PLN138.7bn. As a consequence, foreign non-bank financial sector has strengthened its position on Polish debt market, keeping in its hands nearly 27% of total marketable debt.

As regards foreign banks, they cut slightly their involvement in Polish bonds by PLN0.9bn. They reduced their position across the board, though foreign banks slightly increased share in OK1012 (by 0.7bn), OK0114 (by PLN0.5bn) and DS1021 (by PLN0.3bn).

Commenting Q3 issuance plan Piotr Marczak, the MF public debt director, said that "in June foreign investors' appetite for Polish bonds has not decreased".

## Domestic investors were relatively passive in May

The share of total Polish securities in hands of domestic investors was more or less relatively stable in May compared with previous month. Domestic banks slightly increased their position in debt assets (by PLN0.4bn to PLN111.6bn) thanks to buy-sell back transactions with the Ministry of Finance, which worth PLN2.9bn.

As for banks one should notice that they were very active on the auction of a new 5Y benchmark PS0417. Banks purchased PS0417 worth PLN1.6bn, which accounted for 38% of total sale in May. Domestic banks beside pension funds have played the main role on the debt market among residents.

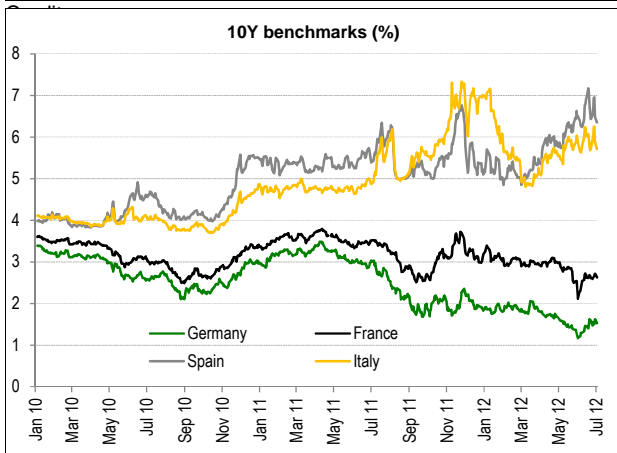
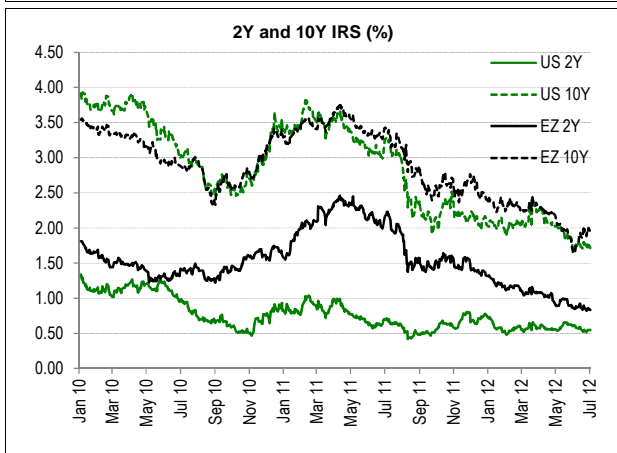
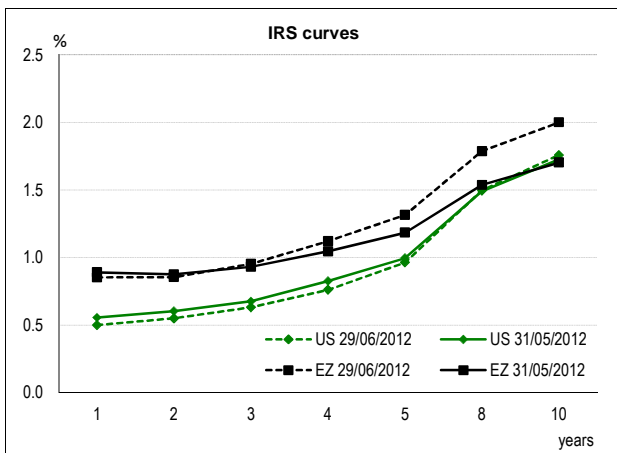
On the demand side, insurance companies increased their holding by PLN0.9bn compared to previous month to PLN57.6bn. Insurance firms increased their holding in PS series by PLN1.5bn in net and in floating-rate instruments by PLN0.5bn in net, cutting mainly share in OK series (by ca. PLN1bn in net). One should notice that insurance companies bought nearly 20% of a new 5Y benchmark during May's auction.

While mutual funds held PLN34.6bn in Polish securities (flat compared with previous month), the pension funds slightly reduced their portfolio. At the end of May pension funds holding amounted to PLN124.5bn, which accounted for 23.3% of total marketable debt. Pension funds have kept their leader position on the Polish debt market among domestic investors. However, as we mentioned in previous reports their position will probably weaken in medium terms as contribution to pension funds significantly lowered compared with previous years.

In our opinion, domestic investors were also active on the debt market in June. We do not exclude that they increased their holding in T-bonds, however at the lower pace compared with non-residents.

Sources: Ministry of Finance, BZ WBK

# International Bond Markets



## Bunds underperformed the US Treasuries

- Bonds on core markets performed well in context of growing risk aversion and also series of weaker macro data from the largest economies. At the beginning of June yield on 10Y German benchmark reached a new record low at 1.127% and 1.44% in case of UST. 2Y Bunds were quoted with negative yield, what happened earlier for example on the Swiss curve.
- The following weeks core markets have remained volatile strongly depended on news flows. All in all June was not successful for holders of long-term Bunds and the US Treasuries. Rising risk appetite supported stock markets and limited safety-bids. The German yield curve steepened and rose by 15-40bps (with the highest increase in case of 10Y benchmark) in monthly terms. As regards the US, curve moved up by 6-10bps over the month, although fresh supply during the month limited demand on Treasuries at the end of June.

- The US Treasuries spread to 10Y Bunds narrowed to 17bps in June (on average, down from 33bps in May). It came mainly from continuation of re-allocation between these markets. As a consequence Bunds underperformed the US Treasuries. We do not exclude this trend to continue also in July.

## The June's EU summit has supported peripheries

- During June Spanish government bonds have been under selling pressure as investors have become particularly negative on Spain. It came mainly from downgrading credit rating not only for Spain, but also Spanish banks and information about a sizeable decline in demand on Spanish government bonds from domestic banks. As a consequence yield of 10Y bonds reached a new record high of 7.28%.

- Investors concerns about situation in Spain put negative pressure on other peripheries' countries, especially Italy. 10Y Italian benchmark increased to 6.33%. However, information about implementation reforms by the Italian government helped the market to slightly rebound.

- The key event for the euro zone peripheries was the June's EU summit. Its results positively surprised investors and changed situation on markets. Agreement to create a common financial supervision in the euro area (the first step towards banking union), concept of recapitalization banks with emergency funds (EFSF and EMS), as well as opening way to purchase bonds from these resources (on primary/secondary market), brought a wave of optimism. Spreads to Bunds narrowed (by ca. 40-50bp) and peripheral curves sharply tighten.

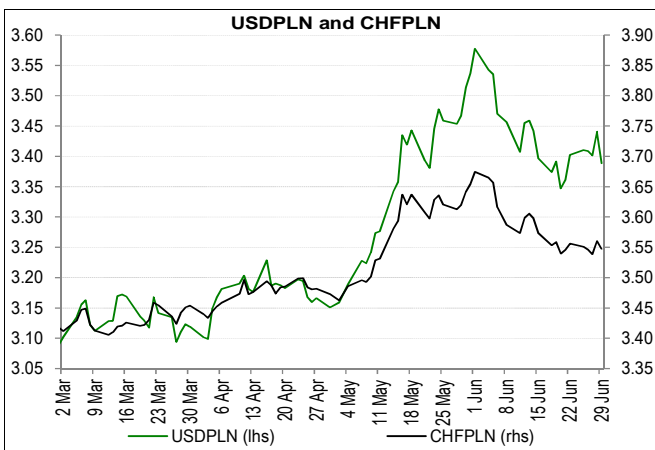
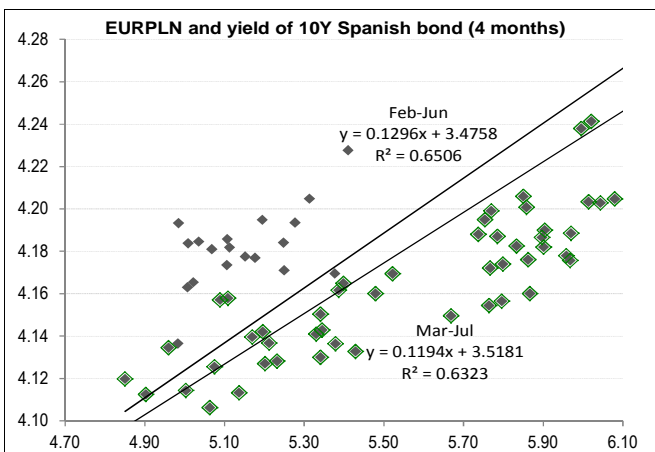
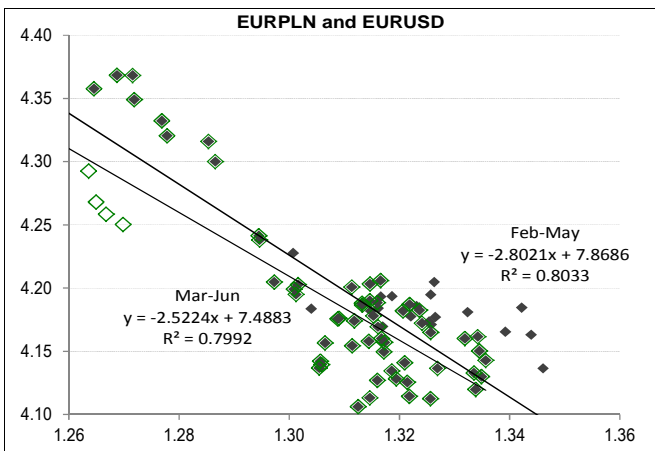
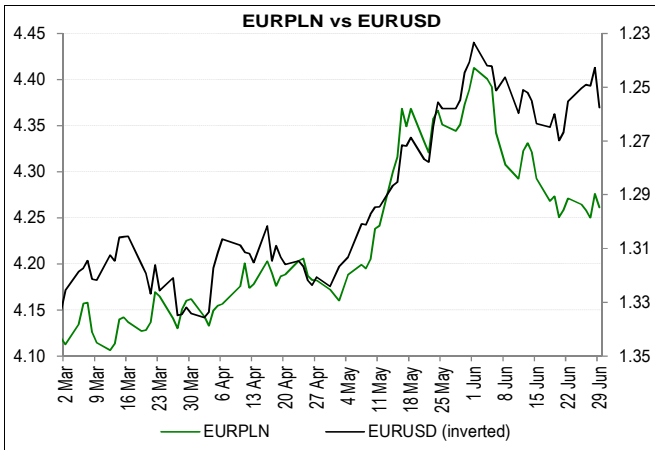
- The EU summit outcome was better than expected, but the devil is in the details. Therefore after sharp fall of yields we foresee some stabilisation ahead of coming news flow from real economy (and politics).

## Euro zone's issuance plans and completion in 2012 (€bn)

	Total redemptions	Deficit	Borrowing needs	Expected bond supply	% of completion (YtD)
Austria	14	8.3	22.3	22.3	73
Belgium	27.9	7	34.9	26.0	74
Finland	6.3	7.5	13.8	13.8	44
France	101.7	78.7	180.4	178	65
Germany	157	26.6	183.6	170	55
Greece	33.2	16.2	49.4	-	-
Ireland	5.5	13.7	19.2	-	-
Italy	192.2	41.1	233.3	233.3	48
Netherlands	29.7	12.3	42	60.0	64
Portugal	12.9	17.4	30.3	-	-
Spain	50.1	36.2	86.3	85.9	61
<b>Total</b>	<b>630.5</b>	<b>265.0</b>	<b>895.5</b>	<b>789.2</b>	<b>58</b>

Source: Reuters, BZ WBK

# Foreign Exchange Market



## EURPLN gradually lower and lower

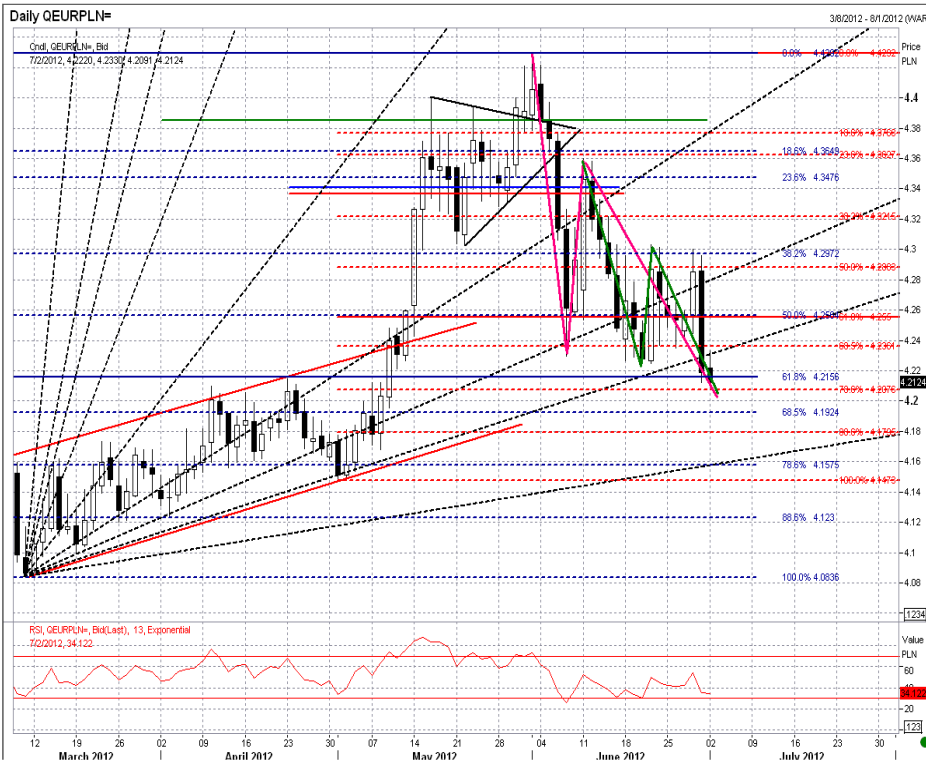
- Despite intensified pressure from the euro zone peripheries the zloty appreciated versus main currencies in June. Domestic currency gained 3.4% versus the euro, 5.3% versus the dollar and 3.5% versus Swiss franc.
- During the past month the zloty was less dependent on what was happening on the euro zone peripheral debt market while its relationship with the EURUSD remained relatively high (see charts). In early June the number of short euro bets reached all time high at 214k. A rebound of the EURUSD from 1.23 to 1.275 was not driven by any new positive factor.. As investors started to adjust their positions before the Greek election date in mid-June, the euro regained ground versus the dollar and that provided support for the zloty. Also due to expectations for central banks' actions, the domestic currency resisted negative pressure from surging yields of Spanish and Italian bonds and the EURPLN retreated back from 4.36 to nearly 4.22.
- Just before the EU summit the trading range of the EURPLN narrowed considerably, temporarily even to ca. 0.02PLN (4.24-4.26) and in case of the USDPLN intraday changes hardly exceeded 0.03PLN. That was accompanied by relatively stable EURUSD.
- During the EU summit volatility on the global market clearly increased. First, the EURPLN surged to 4.29, but as it occurred that European leaders reached an agreement on supporting Spanish and Italian bonds and direct recapitalization of banks via the ESM, so the zloty recovered fast. At the end of the month the EURPLN was close to 4.26, well below 4.40 seen at the beginning of June.

## Beware of high volatility in July

- Monthly data since 1999 indicate that in July average trading range of the EURPLN is the highest in a year (PLN0.22 versus the annual average of PLN0.19). Having said that, it is worth to notice that economic calendar is not full of many breaking events as it was the case in June.
- The rally of the euro versus the dollar after the EU summit (EURUSD surged from 1.24 to 1.27) was quite a rapid one, but halted after two days. Even better than anticipated final PMI indexes for German and euro zone's manufacturing did not trigger its continuation, while US ISM was much below expectations. Well, the PMI levels clearly indicate that economic problems of the euro zone are far from over.
- Short bets in euro had been cut considerably to ca. 160k from record levels and the potential for further upward move fuelled by stop loss orders is currently limited. That means that some more positive information – for example from the ECB – have to emerge to prevent profit taking from dragging the EURUSD down again.
- As regards the EURPLN, in early July the local minimum at 4.22 was successfully tested. Another wave of market optimism brought the EURPLN below 4.20. The next few weeks will show how long the market optimism can last given comments from Finland and Netherlands that these countries could oppose using the existing bailout funds to buy peripheral debt in the secondary market. This shows that disparity of views within the euro area continues. Additionally, the leading indicators (PMI, ISM) are still very weak and global growth prospects are rather gloomy. Therefore, we still see the risk of zloty depreciation in summer months, though it might be limited given market expectations for more monetary easing from global central banks. We see some upward trend in EURPLN in July with the forecast for the end of the month at 4.28.

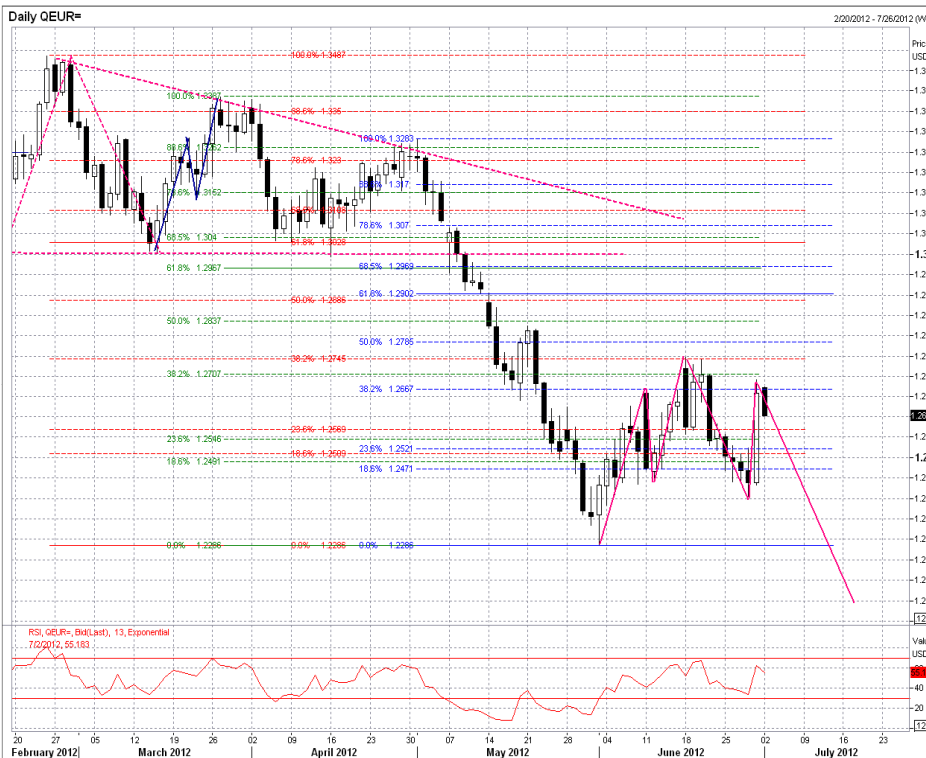
Sources: Reuters, BZ WBK

# FX Technical Analysis Corner



## EURPLN

- EURPLN did not manage to break resistance at ca. 4.43 and the level of 4.47 (projection from the triangle pattern) was not reached.
- The downward trend dragged the EURPLN to 4.22 and then the rate stayed in the range of 4.22-4.30.
- In late June the EURPLN declined below 4.22 and below the angle of the Gann fan.
- At the beginning of July the exchange rate has tested support area combined of two Fibon retracement. Additionally, just below current levels 2 movements (from peak at nearly 4.43 and from 4.36) market on the chart have nice Fibon proportions.
- Furthermore, there is a divergence with RSI and that is another factor making a scenario of a rebound of the EURPLN more likely than more zloty's appreciation.



## EURUSD

- Just like we had suggested last month, the EURUSD increased significantly. After it broke first resistance at ca. 1.25 (that was pointed as rather not too strong one) the exchange rate continued to advance and nearly touched next resistance at 1.275 named as more important.
- As the EURUSD did not manage to break 1.275 it is likely the exchange rate will restart the downward trend. On the weekly chart on the way to the south there is no vital support.
- Furthermore, on daily bars we see some chances for a "head and shoulders" pattern. If that proves to be right, then in coming weeks the EURUSD may reach 1.215.

Sources: Reuters, BZ WBK

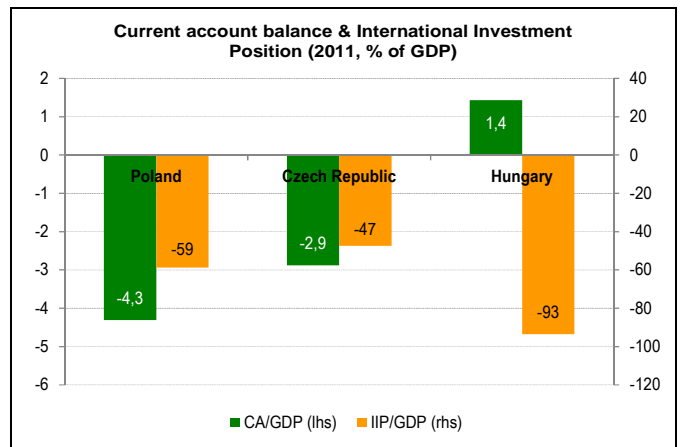
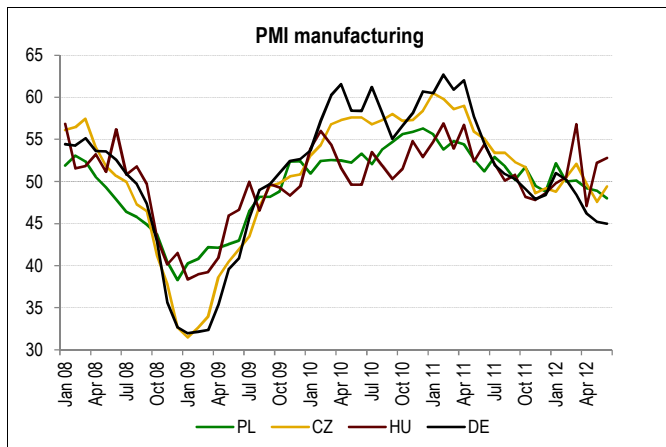
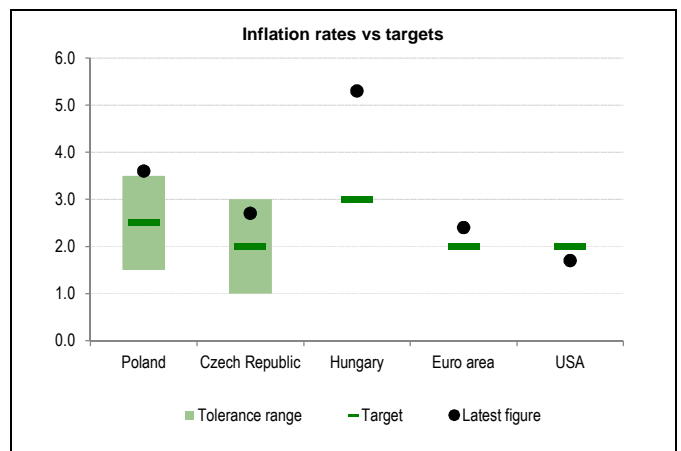
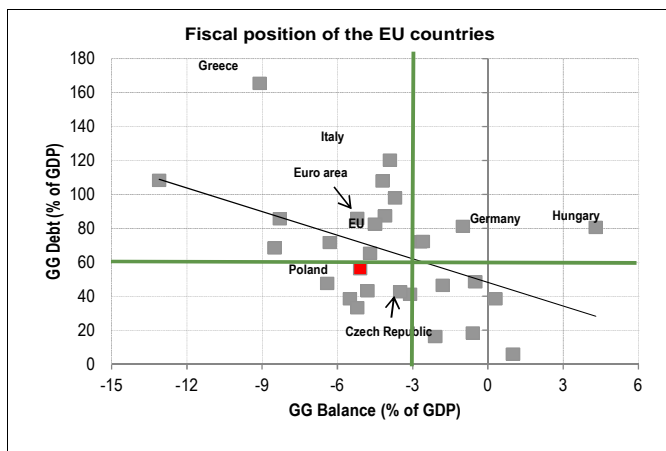
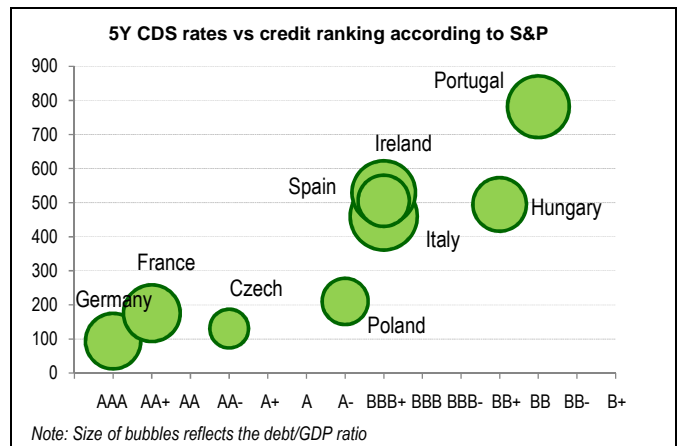
# Poland vs other countries - economy

Main macroeconomic indicators (European Commission's forecasts)

	GDP* (%)		Inflation* (HICP, %)		C/A balance (% of GDP)		Fiscal Balance (% of GDP)		Public Debt (% of GDP)	
	2011	2012F	2011	2012F	2011	2012F	2011	2012F	2011	2012F
<b>Poland</b>	<b>4.3</b>	<b>2.7</b>	<b>3.9</b>	<b>3.7</b>	<b>-4.3</b>	<b>-3.9</b>	<b>-5.1</b>	<b>-3.0</b>	<b>56.3</b>	<b>57.1</b>
Czech Republic	1.7	0.0	2.1	3.3	-3.6	-3.2	-3.1	-2.9	41.2	41.9
Hungary	1.7	-0.3	3.9	5.5	0.9	2.2	4.3	-2.5	80.6	76.5
EU	1.5	0.0	3.1	2.6	0.0	0.3	-4.5	-3.6	82.5	84.9
Euro area	1.5	-0.3	2.7	2.4	0.1	0.6	-4.1	-3.2	87.2	90.4
Germany	3.0	0.7	2.5	2.3	5.3	4.7	-1.0	-0.9	81.2	82.2

Note: \* European commission – May 2012

	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+	negative	Ba1	negative	BB+	negative
Germany	AAA	stable	Aaa	stable	AAA	stable
France	AA+	negative	Aaa	negative	AAA	negative
UK	AAA	stable	Aaa	negative	AAA	negative
Greece	CCC	stable	C	---	CCC	stable
Ireland	BBB+	negative	Ba1	negative	BBB+	negative
Italy	BBB+	negative	A3	negative	A-	negative
Portugal	BB	negative	Ba3	negative	BB+	negative
Spain	BBB+	negative	Baa3	negative	BBB	negative

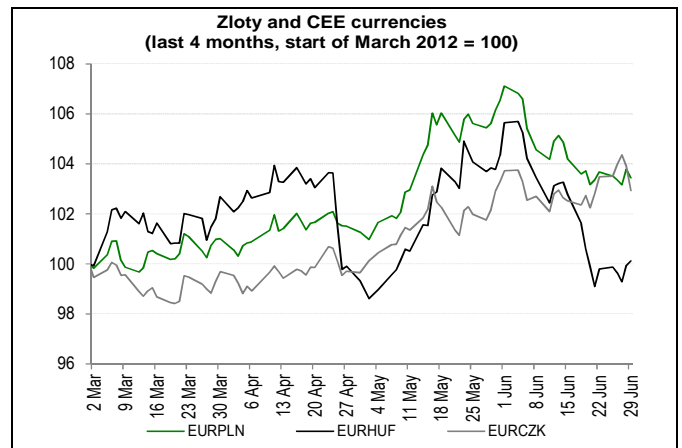
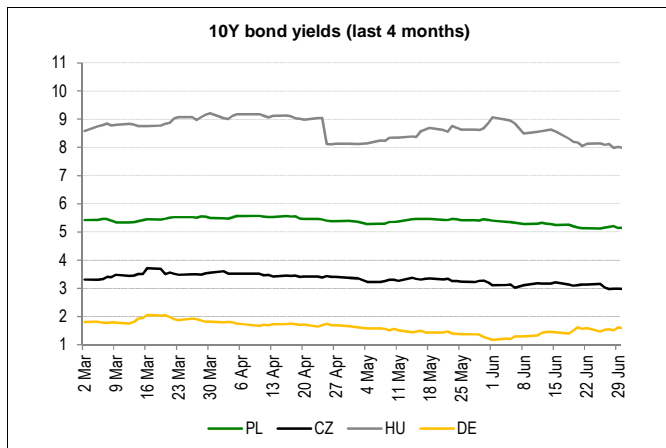
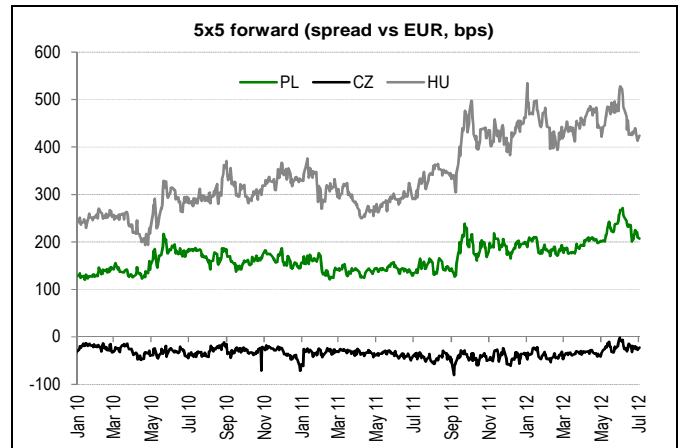
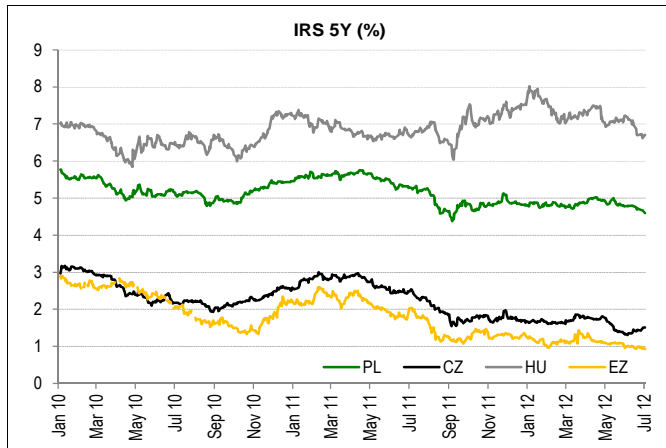
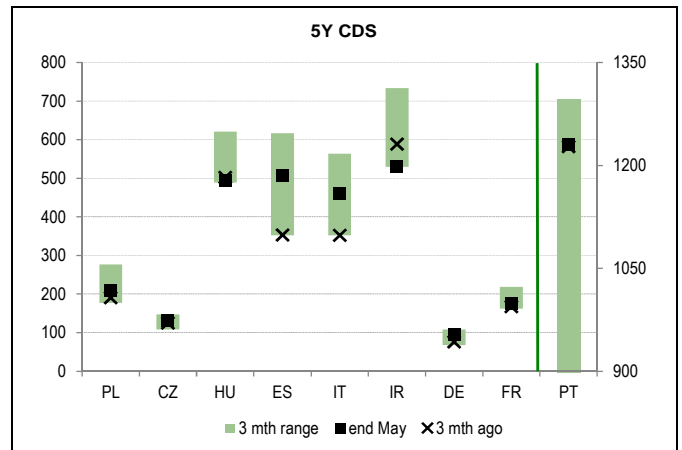
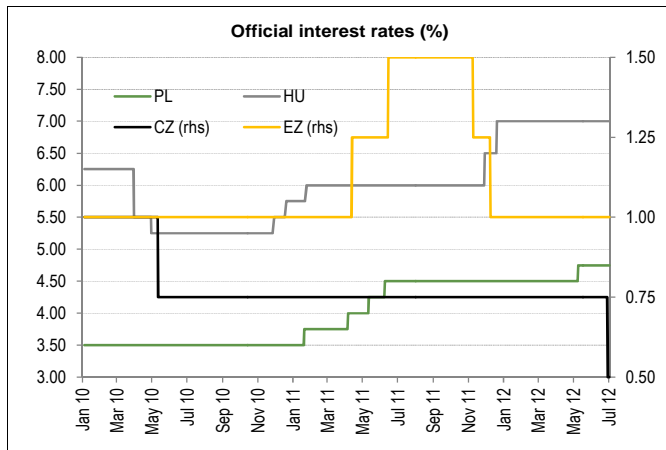


Source: stat offices, central banks, Reuters. BZ WBK, EC

# Poland vs other countries - market

## Main market indicators (%)

	Reference rate (%)		3M market rate (%)		10Y yields (%)		10Y Spread vs Bund (bps)		CDS 5Y	
	2011	2012F	2011	end of June	2011	end of June	2011	end of June	2011	end of June
<b>Poland</b>	<b>4.50</b>	<b>4.75</b>	<b>4.99</b>	<b>5.13</b>	<b>5.88</b>	<b>5.14</b>	<b>405</b>	<b>352</b>	<b>279</b>	<b>215</b>
Czech Republic	0.75	0.50	0.78	0.73	3.59	2.98	176	137	173	133
Hungary	7.00	7.00	7.24	7.20	9.90	8.02	807	640	610	501
Euro area	1.00	0.50	1.36	0.65						
Germany					1.83	1.62			100	99



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

## Central Bank Watch

		Last	2011	2012F	Expected changes (bps)			Risks
					1M	3M	6M	
Euro	Forecast	1.00	1.00	0.50				It is expected the ECB to cut rates in July. However, it could adopt wait and see stance, waiting for more information from real economy
	Market implied »				-9	-14	-17	
UK	Forecast	0.50	0.50	0.50				Rates on hold, but market still awaits for a further round of QE.
	Market implied »				-5	-13	-16	
US	Forecast	0-0.25	0-0.25	0.25				Rates on hold. However, expectations on QE3 are still alive. However, Fed after announcement of extending its "twist operation" could bring wait and see stance
	Market implied »				0	3	5	
Poland	Forecast	4.75	4.50	4.75				The MPC might shift its rhetoric to more dovish due to new projections of CPI and GDP
	Market implied »				0	-4	-27	
Czech	Forecast	0.50	0.75	0.50				The CNB trimmed interest rates by 25bps at its June's meeting to an all-time low.
	Market implied »				31	27	24	
Hungary	Forecast	7.00	7.00	7.00				Possibility of deal between Hungary's government and IMF could result in rates cut earlier than previously expected
	Market implied »				-8	-28	-48	

Note: Market implied expectations show implied changes in 3M market rates based on FRA rates

## Economic Calendar and Events

Date	Event:	Note:
4-Jul	PL MPC Meeting – interest rate decision	<b>Our forecast and market consensus: the MPC will keep interest rate unchanged, focus on new projection</b>
5-Jul	DE Auction of 5Y bonds	Offer: €4.0bn
	EZ ECB Meeting – interest rate decision	Our forecast and market consensus: 0.75%
	PL <b>Switch tender</b>	<b>Offer: PS0417, DS1021; Buy back: OK0712, OK1012</b>
11-Jul	FR Auction of long term bonds	Offer: €7.0-8.0bn
	SP Auction of 3Y, 5Y and 10Y bonds	Offer: €2.0-3.0bn
11-Jul	DE Auction of 10Y bonds	Offer: €5.0bn
13-Jul	PL <b>CPI for June</b>	<b>Our forecast: 4.4%YoY (above consensus)</b>
	IT Auction of 3Y, 15Y or 30Y	-
17-Jul	PL <b>Employment and wages for June</b>	<b>We foresee a slight decrease in employment (to 0.1%YoY) and moderate growth in wages (3.8%)</b>
18-Jul	PL <b>Industrial output for June</b>	<b>We expect industrial output growth below 2%YoY, below market consensus (3.9%YoY)</b>
19-Jul	DE Auction of 2Y bonds	Offer: €5.0bn
	PL <b>Auction of 2Y OK0714</b>	<b>Offer: PLN2.0-5.0bn</b>
	SP Auction of medium terms bond	-
20-Jul	PL <b>Core inflation measures for June</b>	<b>We expect core inflation exc. food &amp; energy prices at 2.7%YoY</b>
24-Jul	HU NBH Meeting – interest rate decision	Our forecast: 7.00%
25-Jul	DE Auction of 30Y bonds	Offer: €3.0bn
26-Jul	PL <b>Retail sales for June</b>	<b>We foresee moderate growth at 9%YoY, which is in line with market consensus</b>
30-Jul	IT Auction of medium-term bonds	-
31Jul – 1 Aug	US FOMC meeting	Our forecast: rates on hold
1-Aug	PL <b>Auction of 5Y bonds PS0417</b>	<b>Offer: PLN2.0-4.0bn</b>
2-Aug	EZ ECB Meeting – interest rate decision	
	CZ CNB Meeting – interest rate decision	Our forecast: 0.50%

Source: stat offices, central banks, Reuters, BZ WBK

## Economic and market forecasts

Poland		2009	2010	2011	2012	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12
GDP	PLNbn	1,344.4	1,416.4	1,524.7	1,618.7	349.4	369.8	376.1	429.4	370.5	393.3	400.0	455.0
GDP	%YoY	1.6	3.9	4.3	2.7	4.6	4.2	4.2	4.3	3.5	2.6	2.4	2.4
Domestic demand	%YoY	-1.1	4.6	3.7	1.2	4.3	4.2	2.9	3.2	2.7	0.7	0.8	0.9
Private consumption	%YoY	2.1	3.2	3.1	1.9	3.7	3.6	3.0	2.1	2.1	1.7	1.8	2.0
Fixed investments	%YoY	-1.2	-0.2	8.3	4.9	5.4	6.8	8.1	9.7	6.7	7.0	5.0	3.0
Unemployment rate <sup>a</sup>	%	12.1	12.4	12.5	13.4	13.3	11.9	11.8	12.5	13.3	12.3	12.5	13.4
Current account balance	EURm	-12,152	-16,493	-15,917	-12,214	-3,135	-3,359	-4,459	-5,021	-4,344	-1,665	-2,671	-3,534
Current account balance	% GDP	-3.9	-4.7	-4.3	-3.2	-4.8	-4.9	-4.6	-4.3	-4.7	-4.2	-3.7	-3.2
General government balance	% GDP	-7.4	-7.8	-5.1	-3.0	-	-	-	-	-	-	-	-
CPI	%YoY	3.5	2.6	4.3	4.0	3.8	4.6	4.1	4.6	4.1	4.0	4.2	3.5
CPI <sup>a</sup>	%YoY	3.5	3.1	4.6	3.2	4.3	4.2	3.9	4.6	3.9	4.4	4.3	3.2
CPI excluding food and energy prices	%YoY	2.7	1.6	2.4	2.5	1.7	2.3	2.6	3.0	2.5	2.6	2.5	2.3
EUR/PLN	PLN	4.33	3.99	4.12	4.26	3.94	3.96	4.15	4.42	4.23	4.26	4.31	4.24
USD/PLN	PLN	3.12	3.02	2.96	3.37	2.88	2.75	2.94	3.28	3.23	3.32	3.45	3.48
GBP/PLN	PLN	4.86	4.66	4.75	5.23	4.62	4.48	4.73	5.16	5.07	5.21	5.30	5.23
Reference rate <sup>a</sup>	%	3.50	3.50	4.50	4.75	3.75	4.50	4.50	4.50	4.50	4.75	4.75	4.75
WIBOR 3M	%	4.42	3.94	4.54	5.07	4.10	4.43	4.72	4.91	4.97	5.04	5.14	5.15
Yield on 52-week T-bills	%	4.54	3.96	4.51	4.64	4.37	4.62	4.54	4.50	4.50	4.69	4.75	4.62
Yield on 2-year T-bonds	%	5.17	4.72	4.81	4.69	5.01	4.97	4.54	4.71	4.66	4.71	4.72	4.66
Yield on 5-year T-bonds	%	5.65	5.31	5.44	4.88	5.79	5.60	5.17	5.19	5.02	4.93	4.80	4.75
Yield on 10-year T-bonds	%	6.11	5.74	5.98	5.40	6.27	6.03	5.77	5.83	5.58	5.38	5.27	5.35

Source: CSO, NBP, Finance Ministry, BZ WBK own estimates; <sup>a</sup> at the end of period



This analysis is based on information available until 2<sup>nd</sup> July 2012 and has been prepared by:

## **ECONOMIC ANALYSIS DEPARTMENT**

ul. Marszałkowska 142. 00-061 Warszawa. fax +48 22 586 83 40

Email: ekonomia@bzwbk.pl Web site (including Economic Service page): <http://www.bzwbk.pl>

**Maciej Reluga** – Chief Economist

tel. +48 022 586 83 63. Email: [maciej.reluga@bzwbk.pl](mailto:maciej.reluga@bzwbk.pl)

**Piotr Bielski** +48 22 586 83 33

**Agnieszka Decewicz** +48 22 586 83 41

**Marcin Luziński** +48 22 586 83 62

**Marcin Sulewski** +48 22 586 83 42

## **TREASURY SERVICES DEPARTMENT**

### **Poznań**

pl. Gen. W. Andersa 5  
61-894 Poznań  
tel. +48 61 856 58 14/30  
fax +48 61 856 44 56

### **Warszawa**

ul. Marszałkowska 142  
00-061 Warszawa  
tel. +48 22 586 83 20/28  
fax +48 22 586 83 40

### **Wrocław**

ul. Rynek 9/11  
50-950 Wrocław  
tel. +48 71 369 94 00  
fax +48 71 370 26 22

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