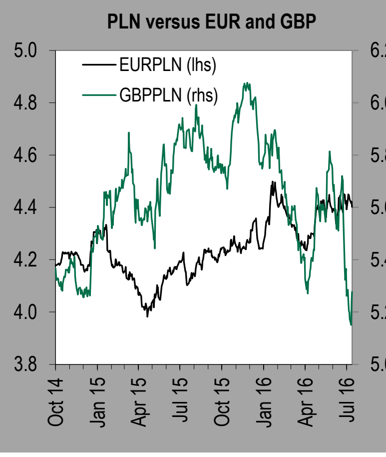
MACROscope

Even more uncertainty ahead



- The post-Brexit market turbulence did not last long. Growing hopes for more monetary stimulus by the main central banks triggered a rally in the bond markets with Polish bond yields falling to April lows and the spread vs the 10Y Bunds returning below 300bp. EM currencies also rebounded, although the zloty and the CEE region's currencies gained less than, for example, their Latam counterparts. They were probably held back by worries about the looming economic slowdown in Europe as well as some country-specific risk factors.

- In our view, the risk for Poland's growth outlook is indeed rising – GDP growth in 2017E-18E may be closer to 3% than to the government-envisaged 4%. 2016E may also be weaker, as recent data disappointed (1Q only at 3%) and high-frequency figures for 2Q have signalled that the 2nd quarter may not be much better. Additionally, Brexit poses a risk for the Polish economy due to a direct impact through the trade channel amid high exposure to the British market in foreign trade (c7% of the total exports and high trade surplus) and an indirect impact of a risk of the euro zone's slowdown. Overall, we have revised our GDP forecast for Poland by 0.3-0.4pp in 2016-17E.

- The Monetary Policy Council (MPC) kept rates on hold in July. More interestingly, the new NBP projection assumes that inflation will rise gradually with the mid-point of the projection for 12M CPI in 2018 at a mere 1.5%. This means the central bank expects inflation to be below the 2.5% target for more than two years going forward. Also, the GDP growth forecast was lowered by 0.6pp for 2016 and by 0.2pp for 2017. It seems MPC members have a more optimistic view of the GDP outlook than suggested by the NBP model. In our opinion, if the next economic data confirm that a significant acceleration of growth is not very likely, market expectations for rate cuts will grow, being positive for the front end of the curve. The FRA market has already started to price in a rising chance of rate cuts. The next MPC meeting in September will take place after the 2Q GDP data release but we do not think a change in interest rates is possible just after the summer break. In November, however, the new projection for the NBP will be available and if it confirms a weaker growth scenario (in line with our forecast), the MPC might consider an easing then, given the no-inflation environment. Historically, the Polish central bank has not been forward-looking in the decision-making process, but we believe a 50bp cut might be delivered at the turn of 2016/17.

- The MPC's decisions will be complicated further by the zloty's depreciation and the possibility of CHF-loans conversion. The latter issue is still alive and even if the head of PM Chancellery said recently that any project will require consultation with the KNF (limiting the risk of big losses for the sector), this would probably still prevent the zloty from strengthening in the following months. Also, lower economic growth and some fiscal risks (though higher tax-free income will not be increased starting 2017) are arguments in favour of a higher EURPLN path as compared to our previous forecasts.

- The government presented the plan for another overhaul of the pension system (see page 2). This caused some short-term negative market reaction, but it is certainly less harmful than expected by some market participants (risk of "nationalisation"). We believe it should be neutral for bonds and the zloty in the short term.

In this issue:

ECONOMIC ANALYSIS DEPARTMENT:

al. Jana Pawła II 17, 00-854 Warszawa fax +48 22 5868340

email: ekonomia@bzwbk.pl Website: skarb.bzwbk.pl

Maciej Reluga (chief economist)	+48 22 534 18 88
Piotr Bielski	+48 22 534 18 87
Agnieszka Decewicz	+48 22 534 18 86
Marcin Luziński	+48 22 534 18 85
Marcin Sulewski	+48 22 534 18 84

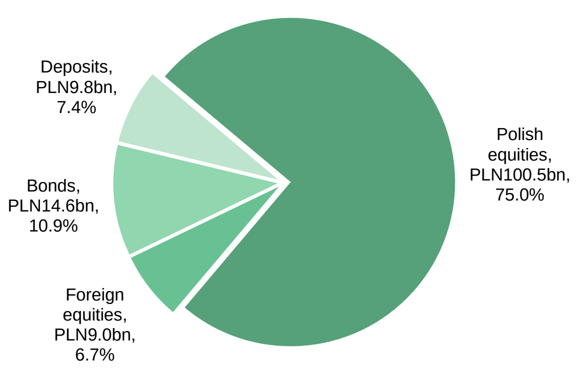
Financial market on July 13, 2016:

NBP deposit rate	0.50	WIBOR 3M	1.71	EURPLN	4.4016
NBP reference rate	1.50	Yield on 2-year T-bond	1.66	USDPLN	3.9809
NBP lombard rate	2.50	Yield on 5-year T-bond	2.21	CHFPLN	4.0324

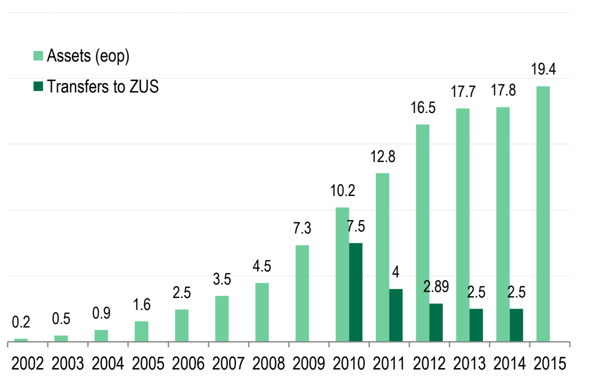
This report is based on information available until 13.07.2016.

OFE overhaul, part two

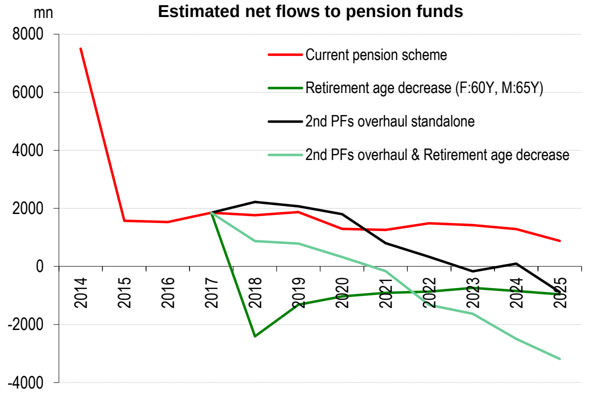
Structure of OFE portfolio as of June 30, 2016



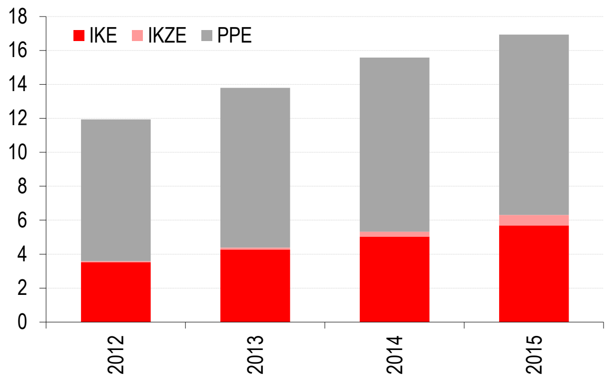
FRD - assets and transfers to ZUS



Estimated net flows to pension funds



Pension assets in 3rd pillar (eop)

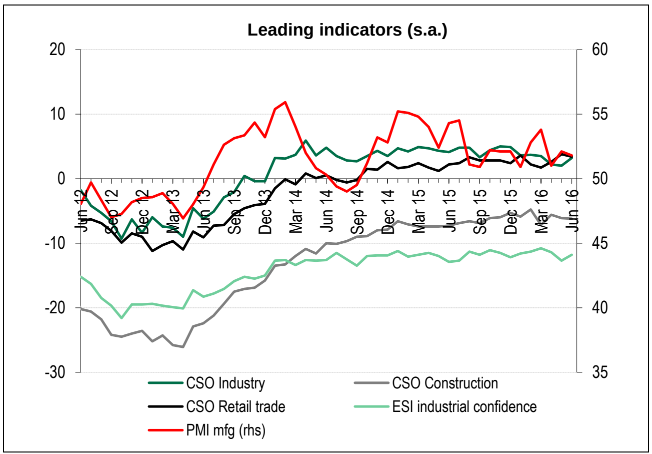


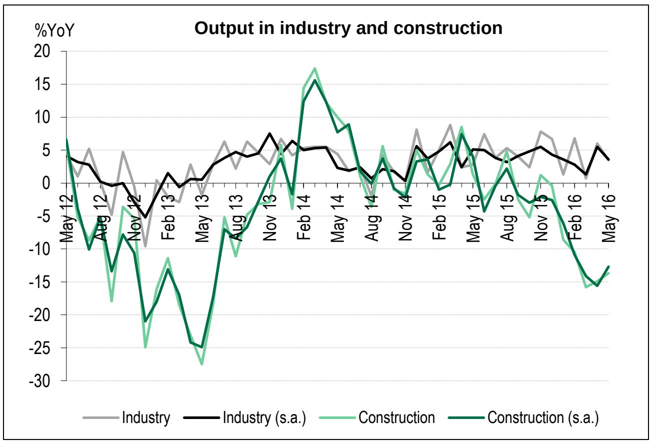
Source: KNF, ZUS, Ministry of Development, BZ WBK.

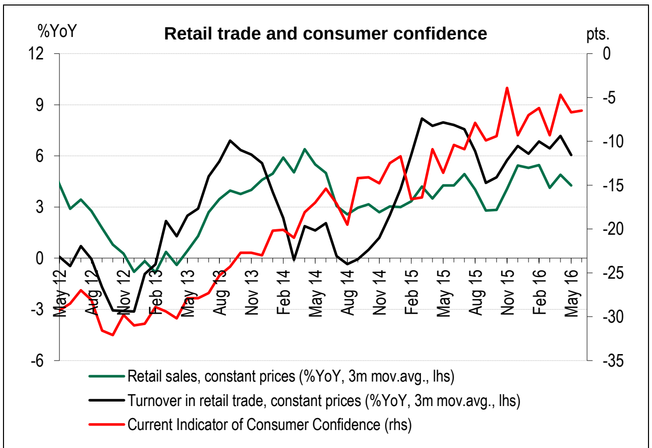
Government proposed another change in pension system

- The Development Ministry presented its plan for the pension system overhaul, which is planned to come into force at the turn of 2017/2018. This plan envisages a relocation of money currently held within open pension funds (OFE) – PLN133.9bn at the end of June 2016.
- 75% (PLN100bn) of OFE-held assets – specifically these invested in Polish stocks – will be transferred to individual pension accounts (IKE). IKE is a voluntary and private pension system, as opposed to OFE (public system). IKE has not proved very popular to date and its assets total less than PLN6.0bn. In our view, this change is positive, as households will gain more control of their future pensions and they will be given greater flexibility in choosing investment options (although they will be unable to cash in their savings before reaching retirement age). Moreover, thanks to this solution, there is no risk of a dreaded stock nationalisation. There will be no obligatory contribution to IKE and all the current pension contributions will flow into ZUS. Some analysts interpreted that the government wants to transfer to IKE an equal sum of money for every saver, but this is false –75% of each person's individual savings in OFE will be transferred.
- 25% (PLN33bn) of OFE assets – specifically these invested in bonds, cash and foreign stocks – will be transferred to the government-controlled Demographic Reserve Fund (FRD) and recorded in individual sub-accounts within ZUS. FRD is an entity securing funds for future pension payments to mitigate changes in the demographic structure (a higher number of pensioners and lower number of workers). We think it quite logical that the government wants to secure the pension system's liquidity after transferring PLN100bn from the public to the private system, but on the other hand we see a risk that FRD funds will be transferred to ZUS (leaving more room for spending in the central budget) earlier than actually needed (FRD assets were already used by the ZUS – see chart alongside). This is a risk, which should somehow be addressed in legislation.
- We do not expect this operation to have an immediate impact on ESA 2010 general government deficit and debt. However, as we argue above, transfers from FRD to ZUS will allow central budget spending (the subsidy for ZUS) and gross borrowing needs to be lowered in the following years.
- The pension contribution, currently amounting to 19.52% of gross salary and divided into ZUS and OFE (for those who applied for OFE), will be directed entirely towards ZUS. None of this obligatory contribution will go to IKE, which will be supplied only by voluntary contributions. However, there will be no "safety buffer"/"zipper" (gradual transfer of OFE assets to ZUS starting 10 years before pension age), so we estimate that the net impact on flows to the capital market will be negligible in 2018-2020 assuming no changes in the retirement age. Moreover, the lack "of a safety buffer" solution will mitigate the impact of lowering the retirement age on the capital market in 2018-2020.
- There are also some additional new measures, like tax incentives for long-term savings and new voluntary pension programmes (employees capital programme - PPK). The government assumes that the new PPK programme can generate up to PLN22.0bn annual inflows to the 3^{rd} pillar (for comparison, the total assets of the third pillar amounted to c.PLN17bn at the end of 2015).
- In general, we are quite positive about the proposed changes, as they could support private savings and increase the inflow of money to the capital market. However, there are also some risks, as the government may be tempted to use FRD funds too early.

Economic update







Source: Markit, Eurostat, CSO, BZ WBK.

Worse outlook for GDP growth…

- We see an increasing risk for Poland's growth outlook and a declining probability of growth acceleration in 2H2016E. Growth in Q1 was weaker than expected (3.0% y/y) and high-frequency figures for Q2 have signalled that this period may not be much better. Additionally, Brexit poses a risk for the Polish economy due to a direct impact through the trade channel amid high exposure to the British market in foreign trade (c7% of the total exports and high trade surplus) and an indirect impact of a risk of the euro zone's slowdown. Overall, we have revised our GDP forecast for Poland by 0.3-0.4pp: in 2016 to 3.1% from 3.4% and in 2017 to 2.9% from 3.3%.

… leading indicators suggest no improvement

The PMI for the Polish manufacturing sector slid in June to 51.8pts from 52.1pts in May. The most important sub-indices, like new orders, new export orders, employment and output, were quite stable or even up, with the fall in the headline index caused by suppliers' delivery times. Other important business climate indices were more or less stable. In general, leading indicators are signalling a stabilization of economic growth in Poland.

Weak performance of industry and construction

- Industrial output rose 3.5% y/y in May, below forecasts. Construction and assembly output contracted 13.7% y/y and disappointed as well. After the seasonal adjustment the output in industry rose 3.6% y/y and fell 12.7% y/y in construction.

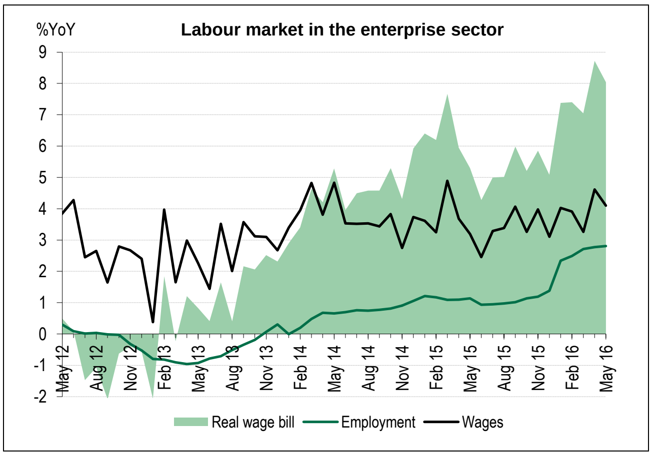
- We find these numbers disappointing. On the one hand, industry was undermined by the larger number of holidays and 'long weekends' in May. On the other hand, however, the underperformance of industry might have been due to the structural weakness of external demand. The pace of economic growth in Germany and the whole euro zone remains decent, which should support Polish companies with external market exposure. However, we are not happy with the breakdown of this growth – it is based mainly on internal demand while foreign trade volumes remain subdued. It is worth remembering that the bulk of Polish exporters are producers of intermediate goods and suppliers for exporters from Western Europe. Nevertheless, in May, those sectors focused largely on exports continued to rise faster than the other categories (two-digit growth in textiles, computers, automobiles, furniture) so maybe these concerns are somewhat exaggerated and output will revive in the months to come. We estimate that June's results for industry were considerably better. This forecast was supported by Samar's information about the high output in the automotive sector in June (+23.9% y/y).

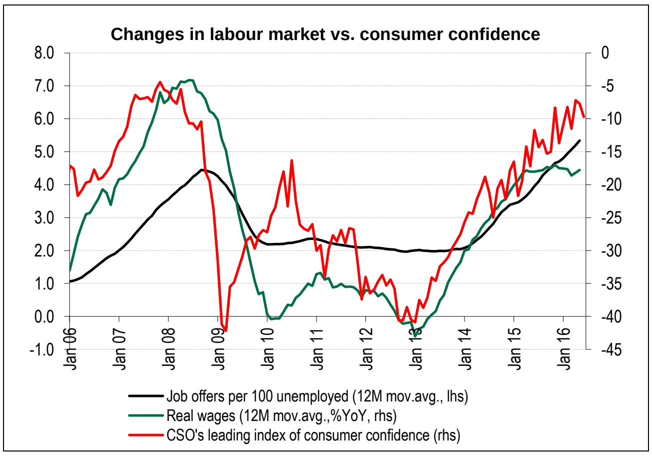
- Significant contraction in construction does not bode well for investments. However, we expect this sector will recover later in the year due to the launch of more projects co-financed with EU funds.

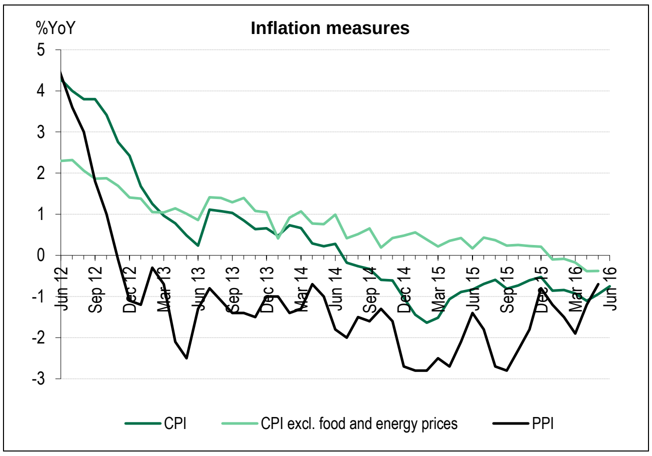
Retail sales below expectations, but still solid

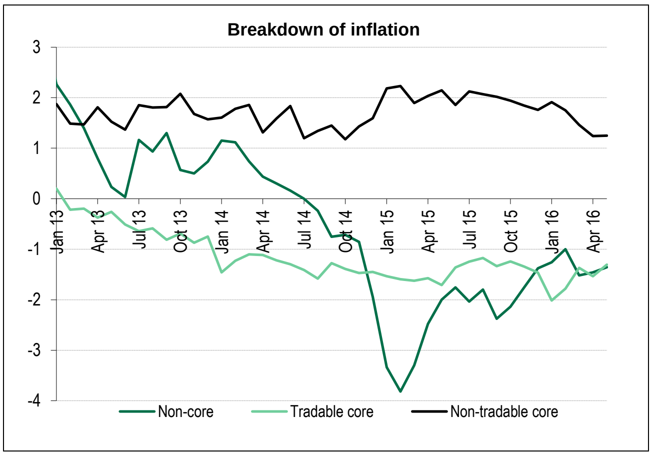
- Retail sales in real terms rose in May by 4.3% y/y, slightly slower than expected (we and consensus: 5.6% y/y), but this was still a solid reading. We think that the growth rate for food sales (5.4% y/y) and in other non-specialised stores (8.2% y/y) returned to the underlying trend after the March/April shifts connected to the Easter holidays. Sales in other categories were weaker than our expectations and we think that this may be due to two long weekends in May, which undermined the propensity to shop in malls. Hence the slowdown in categories like furniture and household appliances (6.8% y/y) or clothing and footwear (18.6% y/y). Strong sales of fuel (+6.0% m/m versus +2.5% m/m in May 2015) suggest that this may be the case and Poles preferred to spend their time on travel instead of on shopping.

Economic update









Source: CSO, NBP, Eurostat, BZ WBK.

Wage pressure building up

- In May, employment in the corporate sector reached 5734k (+2.8% y/y, in line with expectations). On a monthly basis, employment rose 3.9k, the best result in May since 2010. Data confirmed that demand for labour remains strong.
- At the same time, data on wages disappointed – salaries rose 4.1% y/y, below expectations. In our view, deceleration in wage growth was mostly due to a lower number of working days, which affected mainly manufacturing. However, wages in trade increased by a strong 7.0% y/y, confirming that the good result in May (6.6% y/y) was not a one-off, but proof of strengthening wage pressure. In general, wage growth in May was above average growth in 2015 (3.5% y/y) and in 1Q2016 (3.7% y/y) and we expect that it will continue to accelerate in the following months given the fact that the Polish economy is approaching a state of full-employment.
- Registered unemployment fell to 8.8% in June, according to the Labour Ministry's estimate. Our estimate of seasonally adjusted unemployment rate fell to 9.0% - the lowest level since the early 90s. We do not have detailed data for June, but earlier statistics for May show a deceleration in the growth of the number of people removed from unemployment rolls after taking up non-subsidised jobs, suggesting a strengthening tensions in the labour market.
- The wage bill in the corporate sector increased in May by 7.0% y/y in nominal terms and by 8.0% y/y in real terms. High growth in income will be supportive for private consumption throughout 2016. We assume that data for June and following months are likely to show the first effect of the 500+ programme.

Deflation caused mostly by global price developments

- In June, the headline CPI reached -0.8% y/y, in line with our forecast and the flash reading. On a monthly basis, the inflation rate increased by 0.2% m/m. Core inflation excluding food and energy prices amounted to -0.2% y/y.
- Changes in particular categories were in line with our expectations. It is worth noting the rise in food prices (+0.2% m/m), that was larger than in previous years. This was mainly the result of higher sugar (0.7% m/m) and meat (0.6% m/m) prices. A significant rise was also recorded for fruit (2.3% m/m) but this was in line with the seasonal pattern). An increase above our forecasts was recorded for fuels (2.8% m/m). Price hikes were recorded also in recreation and culture (0.7% m/m, in line with the seasonal pattern) and healthcare (0.2% m/m). At the same time, prices fell in clothing and footwear (-0.6% m/m) and telecommunications (-0.3% m/m). In the remaining categories prices remained roughly stable.
- We expect the headline CPI will stay below zero in coming months and will increase into positive territory at the end of this year. June's data do not change our monetary policy outlook.
- A deeper look at detailed data on the inflation basket breakdown shows a few interesting phenomena. It seems that – even though deflation is visible in many products – it is affecting mostly tradables: non-core inflation (i.e. food and energy) and the tradable part of the core basket (mostly goods). Moreover, the tradable part of the inflation basket (core and non-core) is highly correlated with corresponding measures in the euro zone, confirming that deflation is mostly caused by global movements. The non-tradable part of core inflation (mostly services – about 35% of the whole basket, theoretically not dependent on prices in other countries), is rising rather steadily at 1.5-2.0% y/y. Though recently a slowdown in non-tradable prices was visible, it was mostly connected with falling drug prices due to changes in the reimbursement system, so it does not reflect weakening price developments in non-tradable inflation.

Monetary policy watch

Excerpts from the MPC's official statement after its July meeting

Global economic growth remains moderate. At the same time, uncertainty remains about future economic conditions in the global economy, associated additionally with the implications of the referendum on the United Kingdom's membership in the European Union. The result of the referendum has increased risk aversion in the global financial markets, which was reflected in a depreciation of currencies and a decline in asset prices in many countries.

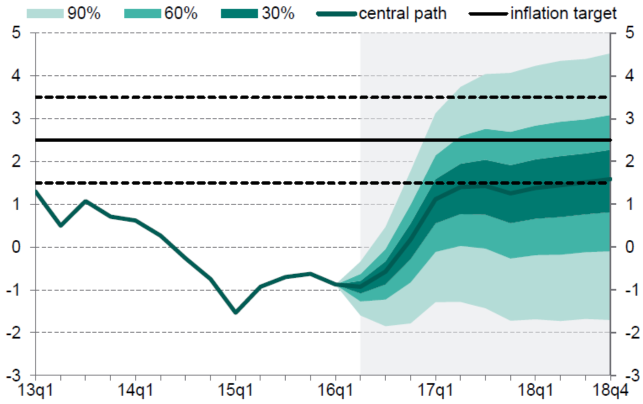
In Poland, incoming data shows that economic activity has accelerated after a GDP slowdown in 2016 Q1. A relatively strong increase in the wage bill and favourable consumer sentiment as well as a sound financial position of enterprises and their high capacity utilisation have a positive influence on domestic economic conditions. This is accompanied by a stable growth of credit to the non-financial sector. An increase in disposal income of households resulting from the "Family 500+" programme will contribute to GDP growth in the coming quarters. Yet, the uncertainty about economic conditions abroad, including the effects of the UK referendum, is a risk factor for domestic economic activity.

With negative output gap and a moderate growth of average nominal wages, currently there is no inflationary pressure in the economy. Annual consumer price growth and producer price growth remain negative. External factors – particularly the earlier sharp fall in the global commodity prices and the low price growth in the environment of the Polish economy – continue to be the main sources of deflation. This is accompanied by low inflation expectations. The persisting deflation has not adversely affected decisions taken by economic agents so far.

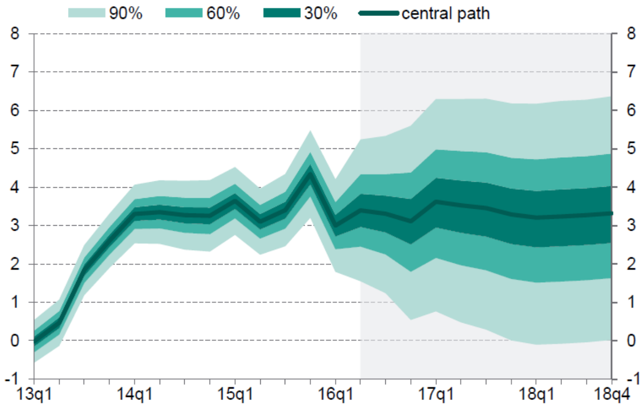
In the Council's assessment, the CPI growth will remain negative in the coming quarters due to the earlier substantial decline in the global commodity prices. At the same time, GDP growth is expected to remain stable in the coming quarters, following a temporary deceleration at the beginning of the year. Consumer demand will continue to be the main driver of economic growth, supported by rising employment, the forecasted acceleration of wage growth and an increase in social benefits. This notwithstanding, the downside risks to the global economic conditions, aggravated by the uncertainty about the effects of the UK's EU referendum, and the volatility of commodity prices, remain the sources of uncertainty for the economy and the price developments.

The Council confirms its assessment that – given the available data and forecasts – the current level of interest rates is conducive to keeping the Polish economy on the sustainable growth path and maintaining macroeconomic balance.

Inflation projection (%YoY)



GDP projection (%YoY)



Sources: NBP, BZ WBK.

First meeting chaired by Adam Glapiński

▪ At the first meeting chaired by the new NBP governor Adam Glapiński, the Monetary Policy Council kept interest rates on hold. The new NBP projection assumes lower inflation and GDP growth, with inflation not reaching the target within the forecast horizon (details below).

▪ As regards GDP growth, the NBP head underscored that all the MPC members have a more optimistic view on GDP outlook than suggested by the NBP model. Glapiński said the UK referendum creates some uncertainty, which in theory might be negative for direct foreign investments in Poland, but in his view the impact of Brexit on Poland is "nearly zero" and there are no significant threats for economic growth on the horizon. At the same time, the official communique states that: "uncertainty about economic conditions abroad, including the effects of the UK referendum, is a risk factor for domestic economic activity". The MPC still believes that 'wait and see' is the best policy option. The NBP governor emphasized the MPC is unanimous in this regard, which was confirmed during the press conference, as the most dovish MPC member Jerzy Żyżyński said that there were no reasons to change policy until there are signs of economic slowdown or acceleration of growth.

▪ The MPC is downplaying risks stemming from the UK's Brexit vote and it repeated in the statement that GDP growth slowdown in 1Q16 was temporary. Meanwhile, we argue that the economic outlook for the next quarters was deteriorating already before the UK referendum (recent monthly data suggested that GDP growth in 2Q16 could be not much better than 1Q16) and the Brexit vote created additional negative impulse. We have just revised our GDP forecasts for Poland downwards. If the next economic data confirm that a significant acceleration of growth is not very likely, market expectations for rate cuts will grow. The next MPC meeting in September will be after the 2Q GDP data release but we do not think a change in interest rates is possible just after the summer break. In November, however, the new projection of the NBP will be available and if it confirms a weaker growth scenario (in line with our forecast), the MPC might consider an easing then, given the no-inflation environment. This will also depend on the situation in the FX market, especially in the context of a great unknown connected with the CHF-loans.

Downward revision of GDP and CPI projection

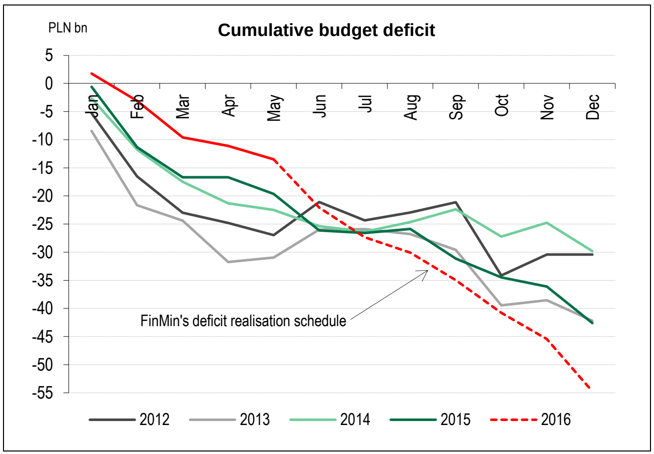
▪ The NBP revised its central growth projections for Poland to 3.2% from 3.8% in 2016 and to 3.5% in 3.8% in 2017. This was due to three factors: 1) lower GDP growth in Q1, 2) Disappointing data on EU funds utilization, 3) Rising global uncertainty and lower growth forecasts in foreign economies due to Brexit.

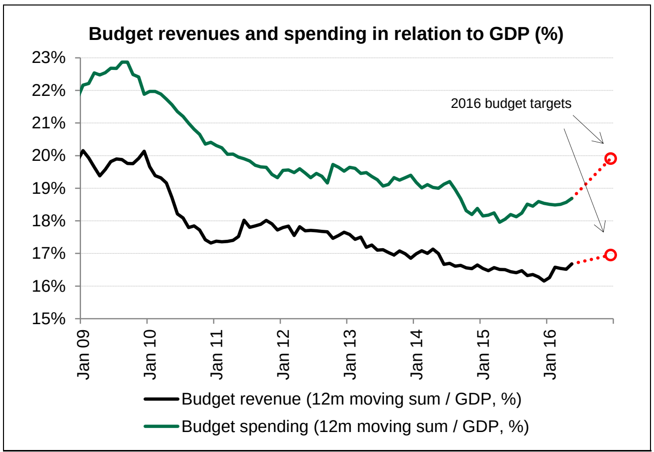
▪ Downward revision was mostly applied to fixed investments, which are lower than in March's projection in the whole forecast horizon (to 2018). Investment is expected to grow by a mere 1.2% in 2016 (5.1% expected in March), 4.1% in 2017 and 4.4% in 2018. Investment is undermined by a low inflow of EU funds, high uncertainty and stricter lending criteria. On the other hand, there are some positive factors: positive financial situation of companies, low energy commodities prices and positive labour market situation.

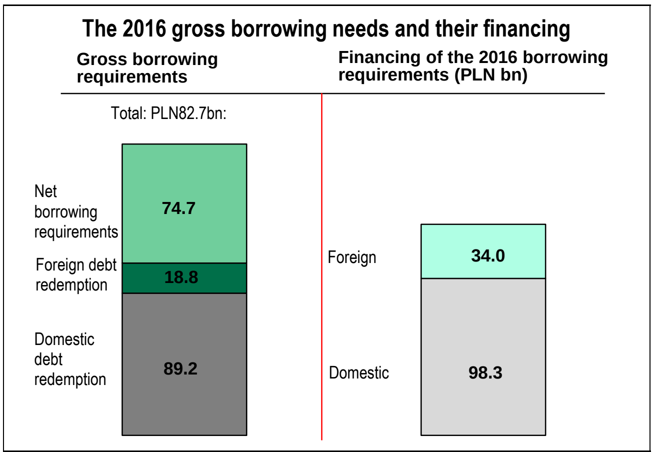
▪ Economic growth will be driven mostly by private consumption (growth by 4% in 2016 and 2017), supported by new social transfers, a positive labour market situation, improving consumer confidence and low interest rates.

▪ The inflation path also declined, but considerably less than GDP, averaging -0.5% in 2016, 1.3% in 2017 and 1.5% in 2018. Core inflation was revised down, while energy prices went up. The NBP expects inflation to turn positive in 4Q2016, but forecasts that the CPI will not reach the target (2.5%) within the whole forecast horizon. Moreover, the NBP sees a 20% chance of deflation in 2017 and 2018. The probability of reaching the target in 4Q2018 is c30%.

Fiscal policy watch







	Spread vs. Bunds (10Y) in bp			CDS (5Y USD)		
	13.07	Change since 10.06.16	Change since 31.12.15	13.07	Change since 10.06.16	change since 31.12.15
Poland	298	-10	68	98	13	23
Czech R.	53	7	57	41	0	-9
Hungary	308	-26	29	152	13	-12
Greece	806	61	35	916	90	-75
Spain	129	-15	14	85	-8	-2
Ireland	57	-16	4	68	8	31
Portugal	323	10	133	283	26	123
Italy	135	4	38	131	7	41
France	29	-8	-6	36	2	13
Germany	-	-	-	19	0	6

Source: Ministry of Finance, Reuters, Eurostat, CSO, BZ WBK.

Ambitious macro assumption in the 2017 budget draft

- May's data on the central budget were quite optimistic – the deficit amounted to PLN13.5bn versus PLN19.3bn in the plan. This was mostly due to lower spending, which amounted to PLN142.6bn vs the plan at PLN149.1, while revenues (PLN129.1bn) were more or less in line with the plan. Revenues from PIT rose by an astonishing 33.1% y/y, but in our view this is simply a shift from April (this year the deadline for annual tax settlement was May 2nd instead of April 30th due to the calendar effect). Also, VAT revenues recorded a strong jump, by 16.6% y/y.
- At the end of May revenues from the tax on certain financial institutions, which include bank tax amounted to cPLN1.1bn or 19.4% of the annual plan for this year. On a monthly basis it increased by less than PLN340mn, below previous inflows worth cPLN363mn on average in March-April. According to Poland's Financial Supervision Authority (KNF), lower inflows stemmed from banks' base reduction as one of the banks was covered by a restructuring programme, which exempts it from paying tax. Lower than assumed revenues from bank tax should be compensated by inflows from NBP's profit. Therefore we think that the state budget is under control this year.
- In mid-June the Polish government adopted macroeconomic assumptions for the 2017 budget, including GDP growth of 3.9%, CPI of 1.3%, an unemployment rate of 8.1% at the end of the year and nominal wage growth of 4.4%. Taking into account the current macro situation abroad and also in Poland we see these macro assumptions as too optimistic. Therefore we do not rule out that these forecasts may change in further work on the budget for 2017.

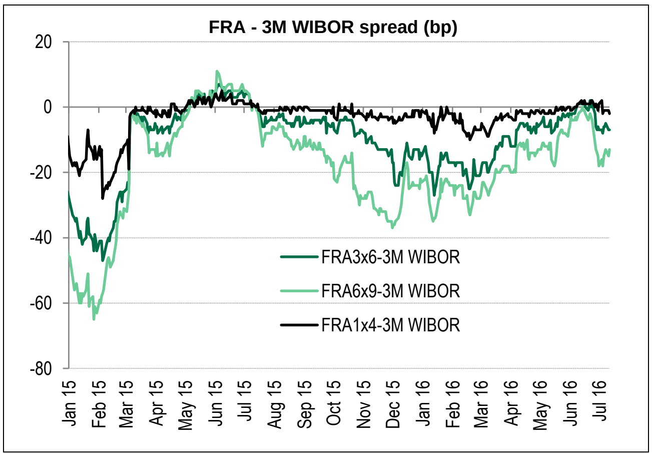
Limited offer of T-bonds in 3Q16

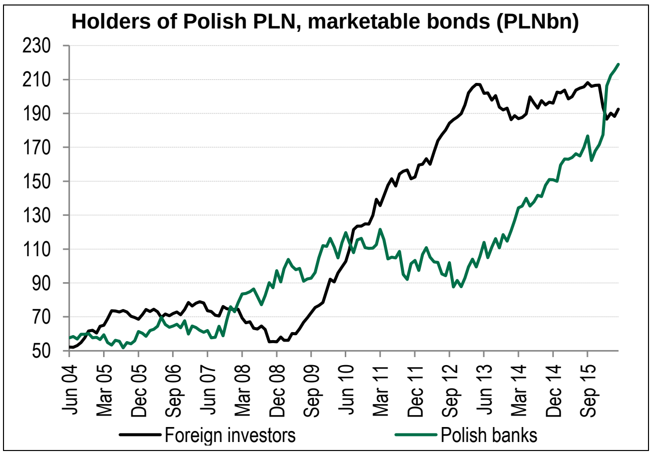
- T-bond auctions on the primary market proved successful in 2Q16. Poland's bond market has attracted healthy demand from both domestic and non-residents investors, who submitted purchase offers worth over PLN47bn on both regular and top-up tenders. The ministry sold bonds for a total amount of PLN28.7bn, above the upper limit of the planned offer on tenders in April-June. All in all Poland has financed over 70% of this year's gross borrowing needs and held a PLN56bn liquidity cushion at the end of June.
- The high level of this year's borrowing needs financing allows the Ministry to limit T-bond supply in 3Q16 to PLN15-25bn at four auctions. We see no problem with launching debt on the primary market in coming months given the liquidity situation. In July-September, flows from both redemptions (OK0716, IZ0816) and interest payments (WZ, PS, DS and WS series) will amount to PLN19.4bn in total, PLN14.4bn of which in July alone.

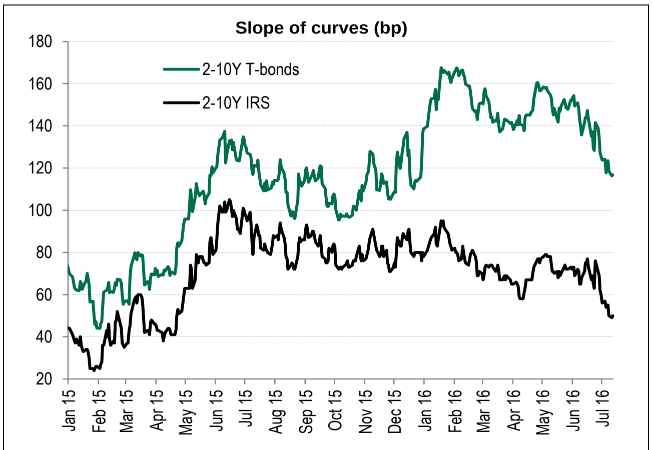
The downward pressure on global yields remains

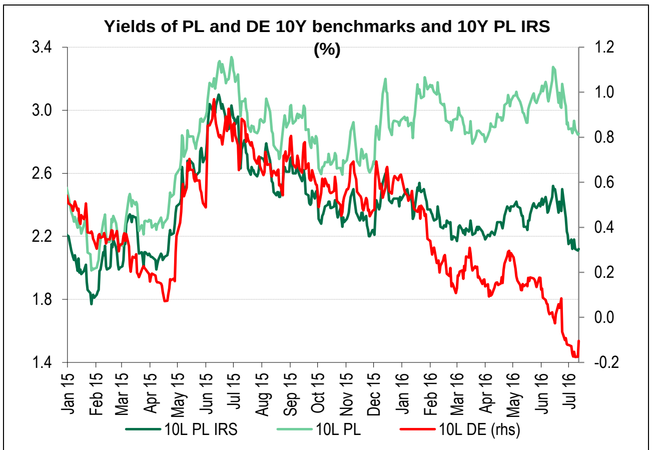
- In June, safe-haven flows dominated global trading, with the Bund the biggest gainer. The 10Y Bund yield reached nearly -0.20% for a while. The outcome of the UK referendum proved disappointing. However, market expectations that central banks might announce more monetary easing helped the global debt market to revive at the end of June-July.
- The downward pressure on global rates and yields should continue in the coming months. Despite the healthy US economy, the Fed may decide to delay the next hike as a consequence of uncertainty about the global economy and financial markets following Brexit. This should keep US yields on a horizontal trend. As regards the euro zone debt market (both core and peripheral), we expect yields to stay low for an even longer period. We think that further ECB intervention is likely and its adjustments might be presented at the earliest at the July meeting. The ECB is likely to concentrate on longer maturities and that suggests curve flattening.

Interest rate market









Source: Finance Ministry, Reuters, Bloomberg, BZ WBK.

Market sees rate cuts, yields at lowest level since April

▪ Early July WIBORs remained stable after a gradual increase in June. On a monthly basis, rates inched up 3-6bp across the board in June. Contrary to this, FRAs climbed quite visibly (by 1-5bp) at the start of July after a significant fall in June (by 5-15bp, with the biggest decline in rates for longer tenors). This stemmed from relatively hawkish rhetoric by the MPC, which pointed out that a ‘wait-and-see’ mode is appropriate for Poland’s economic situation.

▪ The interest rate market strengthened sharply in the second half of June and early July. Domestic curves followed global trends, where bonds and IRSs gained significantly, fuelled by speculation that more monetary easing may be needed to minimise the negative effects of Brexit on the global economy. As a result, yields and IRS rates reached their lowest levels since April, except the 10Y IRS, which fell to nearly 2.10%, the lowest level since April 2015.

▪ An additional factor behind the decline in yields was the strong demand from both domestic and foreign investors in primary market auctions. Poland yields were still attractive to investors hunting for yield. It should be noted that in May foreign investors bought bonds for almost PLN4.3bn, which was the biggest monthly increase since January 2015. On the other hand, commercial banks were the most active among all the domestic players (PLN3.6bn), as their bond holdings rose to a record level of cPLN219bn.

▪ Both yield and IRS curves shifted down and flattened visibly. The 2-10Y spread narrowed significantly to below 120bp for T-bonds in early July (down from 125bp at the end of June and from c150bp at the end of May) and to 50bp for IRSs (down from 60bp and 72bp, respectively). At the same time, the spread with the Bund for the 10Y sector has remained relatively wide, at slightly above 300bp.

Global factors are still key for market direction

▪ FRA rates are currently well below WIBOR 3M (by 7-20bp, depending on tenor), and this suggests that the market is pricing in a 60% chance rates will be cut by 25bp before year-end. What is more, the market assumes NBP rates remain low over the next two years (FRA21x24 at 1.55% on average). Given the MPC’s suggestion that NBP rates should remain stable at least until year-end, we expect a horizontal trend in WIBORs in the coming months.

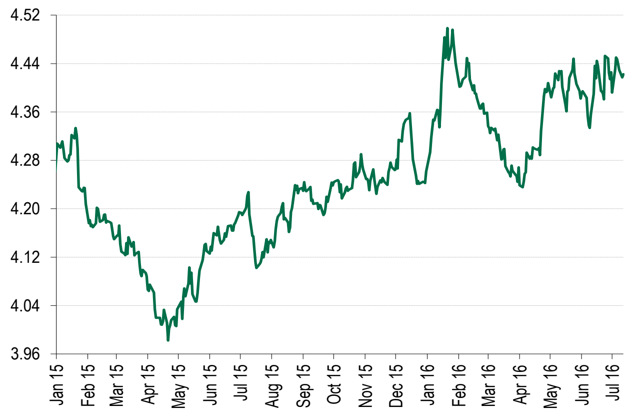
▪ In our view, FRA rates will be more vulnerable to macro data releases. We forecast that GDP growth in 2Q16 will only be marginally above that of 1Q16, as recently released monthly data were quite disappointing. If this scenario is confirmed, we see room for a further decline in FRA rates, in particular as the market may overreact if the main central banks announce further adjustments in their monetary policy due to Brexit. We expect the market to price in at least a 50bp cut in Poland within the next few months.

▪ Global trends are still key for Polish rates in the months to come with a focus on the growing probability of more accommodative monetary policies around the world (delayed interest rate hikes by the Fed, more stimulus from the ECB, BoE and others). In this new environment, yields in core Euro zone markets should stay lower for longer. Thus, we see limited scope for an increase in Polish yields in the coming months. Moreover, there may be a bull steepening of the curve if expectations for NBP interest rate cuts start building, given the lower GDP growth.

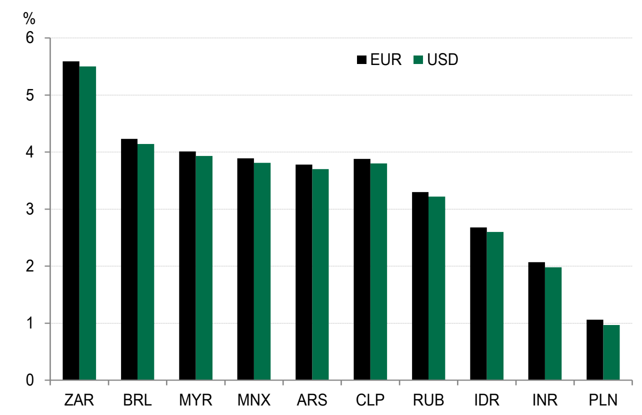
▪ Domestic factors should remain in the background for long-term bonds. Still, the most important risk factor is uncertainty about the final shape of the FX-loan conversion proposal. This could limit gains at the long end of the yield curve, keeping the spread with the Bund (and EURPLN) quite high.

Foreign exchange market

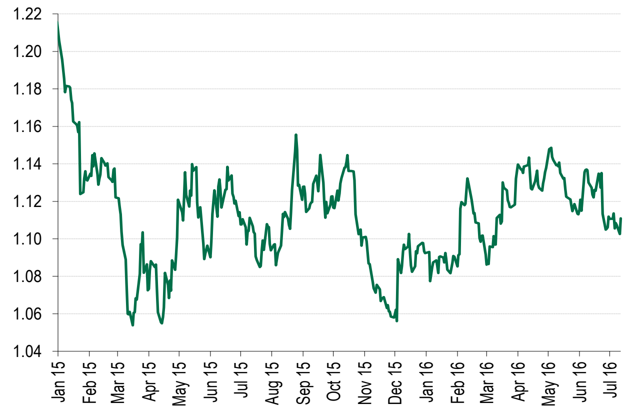
EUR/PLN exchange rate



EM currency performance (Jun 24 – Jul 14)



EUR/USD exchange rate



USD/RUB

Sources: Reuters, Bloomberg, Markit, BZ WBK.

Little room for the zloty to gain

▪ The zloty weakened sharply in response to the outcome of the UK referendum, with the EUR/PLN rising to 4.55, the USD/PLN to 4.13 and the CHF/PLN to 4.25, but the rates quickly corrected. We see growing upside risk for the EUR/PLN, as the zloty is more exposed to potential post-Brexit market turbulence than other CEE currencies. At the same time, we expect a weaker zloty vs the dollar and Swiss franc (as the USD and CHF may remain stronger for a while given the big uncertainty surrounding the Brexit consequences) and stronger vs Sterling in the months to come.

▪ Since the day the outcome of the UK referendum was announced, LatAm and Asian currencies have outperformed their CEE peers, suggesting that the zloty may gain less with fewer hikes in the US and further monetary policy easing in Europe. This could stem from the risk of a slowdown in Europe due to Brexit and the Polish economy's exposure to the UK market (c7% of total Polish exports). There are also other risk factors on the horizon that could weigh on the Polish currency in the coming months: decisions on FX loan conversions and a reduction in retirement age; and the pace of GDP growth in the coming quarters, which could disappoint, fuelling speculation on NBP rate cuts.

▪ Recall that, statistically, the summer period is not very positive for the zloty. In the last ten years the zloty has only gained vs the euro in the month of August in 2009 and 2010 and, given the above-mentioned risk factors, we think this vacation period could be rather negative for the Polish currency again.

Dollar and Swiss franc may stay strong in the short term

▪ We have revised our EUR/USD and EUR/CHF forecasts downwards following the Brexit vote. The heightened uncertainty regarding global economic growth, lower demand for risky assets and lower chances of Fed rate hikes later this year imply a stronger USD and CHF than we had previously expected. We still expect the EUR/USD to rise in the months to come, but our year-end target has been revised to 1.10 from 1.16.

▪ The chances of Fed rate hikes have fallen substantially after the Brexit vote, and for a couple of days the market has even been giving a 40% probability of cuts this year, according to Bloomberg. June nonfarm payrolls surprised on the upside, and the significant recovery from May's 38k suggests that this very weak number was largely due to one-off factors and that the US labour market is still strong. However, the chances of a 25bp hike in the US this year are still below 30%, so this is unlikely to support the dollar in the near future.

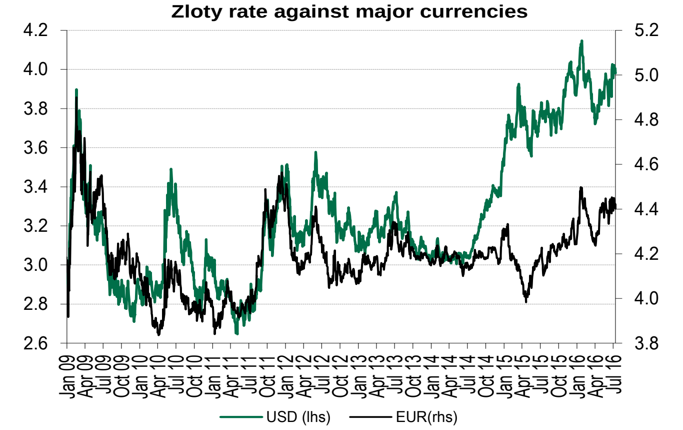
Risk factors for RUB still alive

▪ The USD/RUB has been moving sideways, with a slight downward tilt in the past few weeks as the Brent oil price stabilized below the local peak.

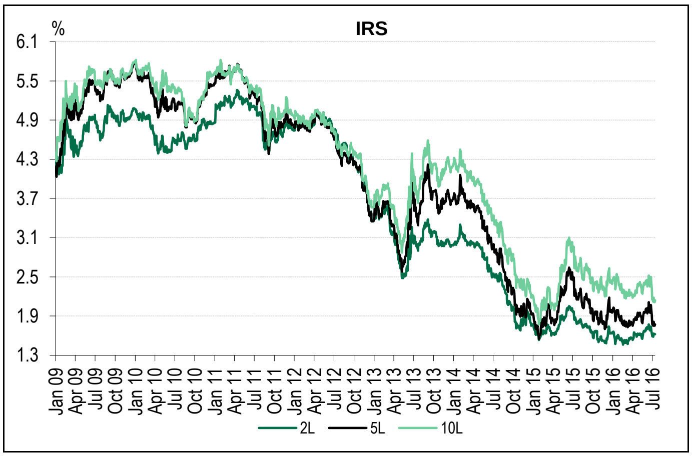
▪ Following the change in its rhetoric introduced in April, in June the Central Bank of Russia (CBR) cut interest rates by 50bp, lowering the main refi rate to 10.50%. The bank said that more cuts may come, provided inflation trends remain in line with its forecasts. This was the first rate cut since July 2015, and we think that, to some extent, it was motivated by the rouble's appreciation in the last few months.

▪ We think that the risk for a correction in commodity prices, the outlook for more rate cuts in Russia and the extension of EU/US sanctions generate upside risk for the USD/RUB.

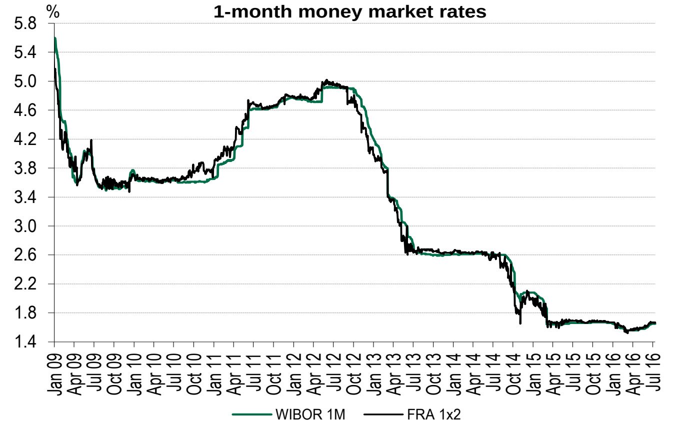
Market monitor



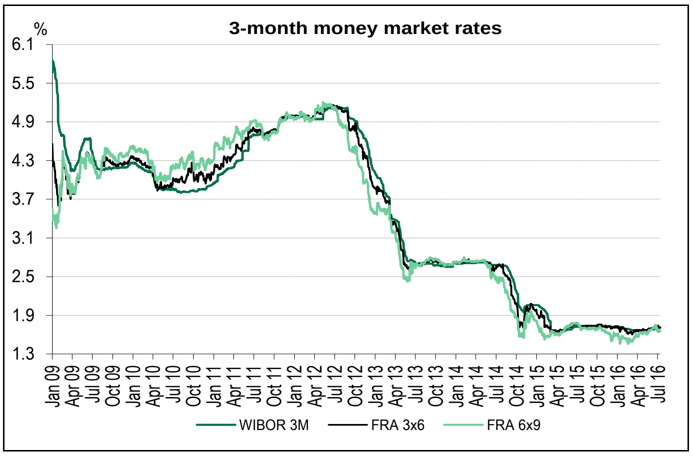
Zloty rate against major currencies



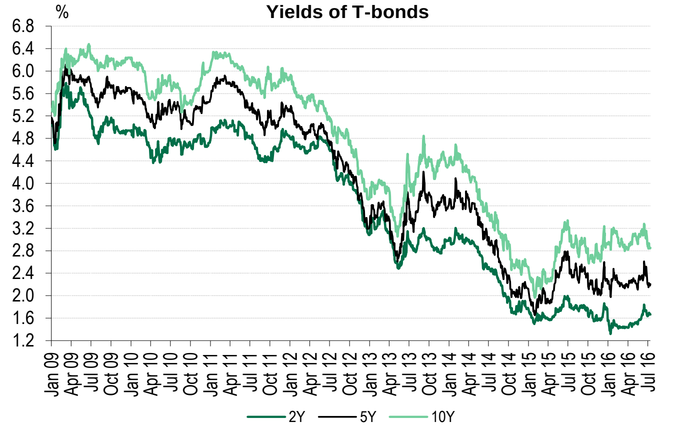
IRS



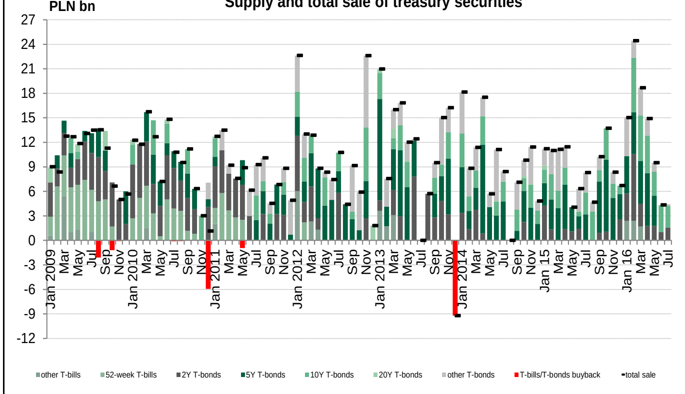
1-month money market rates



3-month money market rates



Yields of T-bonds



Supply and total sale of treasury securities

Treasury bond auctions in 2015/2016 (PLN mn)

Month	First Auction				Second Auction				Switch Auction		
	Date	T-bonds	Offer		Date	T-bonds	Offer		Date	T-bonds	Offer
July '15	9.07	WZ0120/WZ0124	1000-2000	2430.3	23.07	PS0420/DS0725	3000-6000	5852.7			
August	6.08	DS0725/WZ0126	1000-4000	4655.9							
September	10.09	WZ0126/DS0726	2000-4000	3019.0	24.09	OK0717/PS0420	4000-6000	7214.0			
October	29.10	OK/PS/DS	5000-8000	8082.0					8.10	DS1015/OK0116	PS0421/DS0726
November	26.11	EUR20160201**	Up to €1bn	€730m					19.11	OK0116/PS0416	WZ0120/PS0421/DS0726
December									10.12	OK0116/PS0416	OK0717/PS0421/DS0726
January '16	7.01	PS0421	2500-4500	4555.0	28.01	OK1018/WZ0120/WZ0126	5000-8000	8074.0			
February	4.02	OK1018/DS0726	4500-7500	9011.2	18.02	WZ0120/PS0421	4000-6000	7210.0			
March	3.03	OK1018/DS0726	4000-7000	8387.5					24.03	PS0416/OK0716/PS1016	WZ0120/PS0721/WZ0126
April	7.04	OK1018/DS0726	3000-6000	6356.6	28.04	WZ0120/PS0721/WZ0126	5000-8000	8534.7			
May	5.05	OK1018/DS0726	2500-4500	4703.9	25.05	PS0721/IZ0823	2000-4000	4801.7			
June	9.06	OK1018/DS0726	3000-4000	4321.7					27.06	OK0716/IZ0816/PS1016	Cancelled
July	7.07	OK/DS/WS	3000-6000	4431.9	28.07	To be announced	4000-9000				

** with supplementary auction, ** buy-back auction, *** demand/sale.*

Source: Finance Ministry, Reuters, BZ WBK.

Economic calendar

MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY
11 July ***PL: CPI (Jun)***	**12** ***PL: Core inflation (Jun)*** CZ: CPI (Jun)	**13** EZ: Industrial output (May) US: Fed Beige Book	**14** ***PL: Balance of payments (May)*** ***PL: Money supply (Jun)***	**15** ***PL: Fitch decision on rating*** EZ: HICP (Jun) US: Retail sales (Jun) US: CPI (Jun) US: Industrial output (Jun) US: Flash Michigan (Jul)
18 ***PL: Wages and employment (Jun)***	**19** ***PL: Industrial output (Jun)*** ***PL: PPI (Jun)*** ***PL: Retail sales (Jun)*** DE: ZEW index (Jul) US: House starts (Jun) US: Building permits (Jun)	**20**	**21** EZ: ECB decision US: Philly Fed index (Jul) US: Home sales (Jun)	**22** DE: Flash PMI – manufacturing (Jul) EZ: Flash PMI – manufacturing (Jul)
25 ***PD: Unemployment rate (Jun)***	**26** US: Consumer confidence index (Jul) US: New home sales (Jun) HU: Central bank decision	**27** US: Durable goods orders (Jun) US: Pending home sales (Jun) US: FOMC decision	**28**	**29** ***PL: Inflation expectations (Jul)*** EZ: Flash HICP (Jul) EZ: Flash GDP (Q2) US: Advance GDP (Q2) US: Michigan index (Jul)
1 August ***PL: PMI – manufacturing (Jul)*** CN: PMI – manufacturing (Jul) DE: PMI – manufacturing (Jul) EZ: PMI – manufacturing (Jul) US: ISM – manufacturing (Jul)	**2** US: Personal income (Jun) US: Consumer spending (Jun)	**3** DE: PMI – services (Jul) EZ: PMI – services (Jul) US: ISM – services (Jul) US: ADP report (Jul)	**4** US: Industrial orders (Jun) CZ: Central bank decision	**5** DE: Industrial orders (Jun) US: Non-farm payrolls (Jul) US: Unemployment rate (Jul)
8 CZ: Industrial output (Jun) DE: Industrial output (Jun)	**9** DE: Exports (Jun) CZ: CPI (Jul) HU: CPI (Jul)	**10**	**11**	**12** ***PL: Flash GDP (Q2)*** ***PL: Balance of payments (Jun)*** ***PL: CPI (Jul)*** ***PL: Money supply (Jul)*** DE. EZ. HU: Flash GDP (Q2) EZ: Industrial output (Jun) US: Retail sales (Jul) US: Flash Michigan (Aug)
15	**16** ***PL: Core inflation (Jul)*** CZ: Flash GDP (Q2) DE: ZEW index (Aug) US: House starts (Jul) US: Building permits (Jul) US: CPI (Jul) US: Industrial output (Jul)	**17** ***PL: Wages and employment (Jul)*** US: FOMC minutes	**18** ***PL: Industrial output (Jul)*** ***PL: PPI (Jul)*** ***PL: Retail sales (Jul)*** EZ: HICP (Jul) US: Philly Fed index (Aug)	**19**
22	**23** HU: Central bank decision US: New home sales (Jul)	**24** DE: GDP (Q2) DE: Flash PMI – manufacturing (Aug) EZ: Flash PMI – manufacturing (Aug) US: Home sales (Jul)	**25** ***PL: MPC minutes*** DE: Ifo index (Aug) US: Durable goods orders (Jul)	**26** US: Preliminary GDP (Q2) US: Michigan index (Aug)
29 US: Personal income (Jul) US: Consumer spending (Jul)	**30** ***PL: GDP (Q2)*** US: Consumer spending (Aug)	**31** ***PL: Inflation expectations (Aug)*** EZ: Flash HICP (Aug) US: ADP report (Aug) US: Pending home sales (Jul)	**1 September** ***PL: PMI – manufacturing (Aug)*** CN: PMI – manufacturing (Aug) DE: PMI – manufacturing (Aug) EZ: PMI – manufacturing (Aug) US: ISM – manufacturing (Aug)	**2** CZ: GDP (Q2) US: Non-farm payrolls (Aug) US: Unemployment rate (Aug) US: Industrial orders (Jul)
5 DE: PMI – services (Aug) EZ: PMI – services (Aug)	**6** DE: Industrial orders (Jul) CZ: Industrial output (Jul) HU: GDP (Q2) EZ: GDP (Q2) US: ISM – services (Aug)	**7** ***PL: MPC decision*** DE: Industrial output (Jul) US: Fed Beige Book	**8** EZ: ECB decision HU: CPI (Aug)	**9** ***PL: Moody's decision on rating*** DE: Exports (Aug) CZ: CPI (Aug)
12 ***PL: CPI (Aug)***	**13** ***PL: Core inflation (Aug)*** DE: ZEW index (Sep)	**14** ***PL: Money supply (Aug)*** EZ: Industrial output (Aug)	**15** EZ: HICP (Aug) US: Retail sales (Aug) US: Philly Fed index (Sep) US: Industrial output (Aug)	**16** ***PL: Wages and employment (Aug)*** US: CPI (Aug) US: Flash Michigan (Sep)

Source: CSO, NBP, Bloomberg.

Bank Zachodni WBK
Grupa Santander

Economic data and forecasts for Poland

Monthly economic indicators

		Jun 15	Jul 15	Aug 15	Sep 15	Oct 15	Nov 15	Dec 15	Jan 16	Feb 16	Mar 16	Apr 16	May 16	Jun 16E	Jul 16E
PMI	pts	54.3	54.5	51.1	50.9	52.2	52.1	52.1	50.9	52.8	53.8	51.0	52.1	51.8	52.0
Industrial production	% YoY	7.4	3.8	5.3	4.0	2.4	7.8	6.7	1.3	6.8	0.7	6.0	3.5	6.4	1.3
Construction production	% YoY	-2.5	-0.1	4.8	-2.5	-5.2	1.2	-0.4	-8.6	-10.5	-15.8	-14.9	-13.7	-10.9	-13.9
Retail sales [a]	% YoY	3.8	1.2	-0.3	0.1	0.8	3.3	4.9	0.9	3.9	0.8	3.2	2.2	3.7	4.4
Unemployment rate	%	10.2	10.0	9.9	9.7	9.6	9.6	9.8	10.3	10.3	10.0	9.5	9.1	8.8	8.6
Gross wages in corporate sector	% YoY	2.5	3.3	3.4	4.1	3.3	4.0	3.1	4.0	3.9	3.3	4.6	4.1	4.8	4.4
Employment in corporate sector	% YoY	0.9	0.9	1.0	1.0	1.1	1.2	1.4	2.3	2.5	2.7	2.8	2.8	2.9	2.8
Exports (€)	% YoY	10.6	5.2	8.1	3.0	4.5	12.6	11.5	-0.9	5.9	0.8	4.8	1.4	6.3	2.8
Imports (€)	% YoY	10.3	7.3	6.7	5.2	0.2	6.7	3.8	0.6	7.7	1.1	0.4	4.6	5.7	3.5
Trade balance	EUR mn	-165	-727	-150	19	252	574	294	441	316	444	520	75	-100	-861
Current account balance	EUR mn	-963	-1,174	-574	-608	-305	405	-573	771	-529	54	594	352	-855	-1,240
Current account balance	% GDP	-0.4	-0.5	-0.3	-0.4	-0.4	-0.3	-0.2	0.0	-0.1	-0.4	-0.5	-0.6	-0.6	-0.6
Budget deficit (cumulative)	PLN bn	-26.1	-26.6	-25.9	-31.1	-34.5	-36.1	-42.6	1.8	-3.1	-9.6	-11.1	-13.5	-22.1	-27.4
Budget deficit (cumulative)	% of FY plan	56.7	57.7	56.1	67.6	74.8	78.4	92.5	-3.2	5.7	17.5	20.3	24.6	40.3	50.0
CPI	% YoY	-0.8	-0.7	-0.6	-0.8	-0.7	-0.6	-0.5	-0.9	-0.8	-0.9	-1.1	-0.9	-0.8	-1.0
CPI excluding food and energy	% YoY	0.2	0.4	0.4	0.2	0.3	0.2	0.2	-0.1	-0.1	-0.2	-0.4	-0.4	-0.2	-0.3
PPI	% YoY	-1.4	-1.8	-2.7	-2.8	-2.3	-1.8	-0.8	-1.2	-1.5	-1.9	-1.2	-0.7	-1.1	-0.8
Broad money (M3)	% YoY	8.2	8.5	7.2	8.3	8.9	9.3	9.1	10.2	10.1	9.1	11.6	11.5	11.6	11.1
Deposits	%YoY	8.7	8.8	7.7	8.9	9.2	9.7	9.1	9.9	10.4	9.4	11.6	11.8	11.7	11.6
Loans	%YoY	7.9	7.9	7.6	7.9	7.7	7.0	6.9	6.2	5.8	4.4	6.7	5.0	5.0	4.8
EUR/PLN	PLN	4.16	4.15	4.19	4.22	4.25	4.25	4.29	4.41	4.40	4.29	4.31	4.41	4.40	4.40
USD/PLN	PLN	3.71	3.78	3.77	3.75	3.78	3.96	3.95	4.06	3.96	3.87	3.80	3.90	3.92	3.97
CHF/PLN	PLN	3.98	3.96	3.89	3.86	3.91	3.92	3.96	4.03	3.99	3.93	3.94	3.99	4.04	4.04
Reference rate [b]	%	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
3M WIBOR	%	1.70	1.72	1.72	1.72	1.73	1.73	1.72	1.71	1.69	1.67	1.67	1.67	1.69	1.70
Yield on 2-year T-bonds	%	1.91	1.82	1.79	1.79	1.65	1.58	1.71	1.46	1.46	1.44	1.48	1.54	1.70	1.69
Yield on 5-year T-bonds	%	2.68	2.45	2.40	2.43	2.18	2.10	2.28	2.24	2.26	2.18	2.25	2.24	2.38	2.20
Yield on 10-year T-bonds	%	3.20	3.00	2.88	2.91	2.66	2.73	2.93	3.04	3.03	2.88	2.95	3.04	3.11	3.00

Note: [a] in nominal terms, [b] at the end of the period.
Source: CSO, NBP, Finance Ministry, BZ WBK estimates.

Quarterly and annual economic indicators

		2013	2014	2015	2016E	1Q15	2Q15	3Q15	4Q15	1Q16	2Q16E	3Q16E	4Q16E
GDP	PLN bn	1,656.3	1,719.1	1,790.1	1,850.7	413.1	431.0	437.1	508.4	426.2	443.3	451.7	529.6
GDP	% YoY	1.3	3.3	3.6	3.1	3.6	3.1	3.4	4.3	3.0	3.1	3.1	3.2
Domestic demand	% YoY	-0.7	4.9	3.3	3.5	2.9	3.0	3.0	4.5	4.1	2.9	3.5	3.6
Private consumption	% YoY	0.2	2.6	3.1	4.0	3.1	3.1	3.1	3.0	3.2	3.5	4.6	4.8
Fixed investments	% YoY	-1.1	9.8	6.1	0.5	11.8	5.8	4.4	4.4	-1.8	-0.5	0.5	2.0
Industrial production	% YoY	2.3	3.4	4.8	4.7	5.3	3.9	4.3	6.0	3.0	5.3	6.2	4.4
Construction production	% YoY	-10.3	4.3	0.3	-7.4	1.4	1.9	0.5	-1.5	-12.2	-13.1	-9.8	1.0
Retail sales [a]	% YoY	2.6	3.1	1.5	4.0	0.7	1.4	0.4	3.2	1.9	3.2	5.7	5.0
Unemployment rate [b]	%	13.4	11.4	9.8	8.6	11.5	10.2	9.7	9.8	10.0	8.8	8.4	8.6
Gross wages in the national economy [a]	% YoY	3.4	3.6	3.3	3.8	4.1	3.1	3.0	3.2	3.1	4.4	3.7	4.2
Employment in the national economy	% YoY	-1.1	0.2	0.9	1.9	0.8	0.8	0.9	1.0	1.9	2.0	2.0	1.8
Exports (€)	% YoY	5.7	6.4	8.3	4.1	9.8	9.0	5.3	9.3	2.0	4.2	4.8	5.4
Imports (€)	% YoY	0.2	8.3	4.9	4.3	3.5	6.2	6.4	3.4	3.2	3.5	4.5	6.0
Trade balance	EUR mn	-335	-3,255	2,135	1,848	1,651	216	-852	1,120	1,200	495	-765	918
Current account balance	EUR mn	-5,031	-8,303	-1,059	-1,839	900	864	-2,348	-475	296	91	-2,243	17
Current account balance	% GDP	-1.3	-2.0	-0.2	-0.4	-1.3	-0.4	-0.4	-0.2	-0.4	-0.6	-0.6	-0.4
General government balance	% GDP	-4.0	-3.3	-2.6	-2.8	-	-	-	-	-	-	-	-
CPI	% YoY	0.9	0.0	-0.9	-0.7	-1.5	-0.9	-0.7	-0.6	-0.9	-0.9	-0.9	0.0
CPI [b]	% YoY	0.7	-1.0	-0.5	0.4	-1.5	-0.8	-0.8	-0.5	-1.1	-0.8	-0.6	0.4
CPI excluding food and energy	% YoY	1.2	0.6	0.3	-0.1	0.4	0.3	0.3	0.2	-0.1	-0.3	-0.2	0.3
PPI	% YoY	-1.3	-1.5	-2.2	-0.6	-2.7	-2.1	-2.4	-1.6	-1.5	-1.0	-0.1	0.4
Broad money (M3) [b]	% oY	6.2	8.2	9.1	7.8	8.7	8.2	8.3	9.1	9.1	11.6	11.2	7.8
Deposits [b]	%YoY	6.6	9.0	9.1	7.3	9.2	8.7	8.9	9.1	9.4	11.7	11.3	7.3
Loans [b]	%YoY	3.5	7.2	6.9	4.2	7.8	7.9	7.9	6.9	4.4	5.0	4.3	4.2
EUR/PLN	PLN	4.20	4.18	4.18	4.39	4.20	4.09	4.19	4.26	4.37	4.37	4.42	4.40
USD/PLN	PLN	3.16	3.15	3.77	3.97	3.72	3.70	3.77	3.90	3.96	3.87	4.01	4.02
CHF/PLN	PLN	3.41	3.45	3.92	4.00	3.93	3.93	3.90	3.93	3.98	3.99	4.04	4.00
Reference rate [b]	%	2.50	2.00	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
3M WIBOR	%	3.02	2.52	1.75	1.70	1.87	1.67	1.72	1.73	1.69	1.68	1.71	1.74
Yield on 2-year T-bonds	%	2.98	2.46	1.70	1.59	1.61	1.75	1.80	1.65	1.45	1.57	1.67	1.65
Yield on 5-year T-bonds	%	3.46	2.96	2.21	2.23	1.90	2.35	2.43	2.19	2.23	2.29	2.18	2.23
Yield on 10-year T-bonds	%	4.04	3.49	2.69	3.02	2.24	2.79	2.93	2.77	2.98	3.04	2.99	3.07

Note: [a] in nominal terms, [b] at the end of period. Source: CSO, NBP, Finance Ministry, BZ WBK estimates.

This analysis is based on information available until 13.07.2016 has been prepared by:

ECONOMIC ANALYSIS DEPARTMENT

Al. Jana Pawła II 17, 00-854 Warszawa fax (+48) 22 586 8340

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

Maciej Reluga* – Chief Economist

tel. (+48) 22 534 1888. Email: maciej.reluga@bzwbk.pl

Piotr Bielski*	(+48) 22 534 1887
Agnieszka Decewicz*	(+48) 22 534 1886
Marcin Luziński*	(+48) 22 534 1885
Marcin Sulewski*	(+48) 22 534 1884

TREASURY SERVICES DEPARTMENT

Poznań

pl. Gen. W. Andersa 5
61-894 Poznań

tel. (+48) 61 856 58 14/30

fax (+48) 61 856 4456

Warszawa

al. Jana Pawła II 17
00-854 Warszawa

tel. (+48) 22 586 83 20/38

fax (+48) 22 586 8340

Wrocław

ul. Rynek 9/11
50-950 Wrocław

tel. (+48) 71 369 9400

fax (+48) 71 370 2622

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