



2017 OUTLOOK: POLAND

MACRO, RATES AND FX

December 2016

ECONOMIC ANALYSIS DEPARTMENT
Bank Zachodni WBK S.A.

ekonomia@bzwbk.pl

(+48) 22 534 18 88



Bank Zachodni WBK

 Grupa Santander

In this issue:

■ Executive summary	p. 3
■ 2016 summary: Our expectations vs. outcome	p. 5
■ 2017 outlook: Our views and risks	p. 6
■ Growth story	p. 7
■ Investments	p. 9
■ Consumption	p. 15
■ Labour market	p. 17
■ Exports	p. 19
■ Inflation processes	p. 22
■ Monetary policy	p. 25
■ Fiscal policy	p. 28
■ Debt management	p. 30
■ Interest rate market	p. 35
■ Foreign exchange market	p. 36
■ Forecasts table	p. 42

Executive summary (macro)

- 2016 GDP growth in Poland was a disappointment on almost every front: the biggest in investments and exports, but consumption was also surprisingly meagre given the strong labour market and new, generous child benefits. We expect to see a V-shaped recovery in the coming quarters, with the bottom of the cycle at the end of 2016. Private consumption should be the main driver of growth in the near term, boosted by lagged effect of 500+ scheme, with stronger exports joining during the year and investment recovery gaining momentum in 2H17, as the absorption of EU funds speeds up. However, in general, GDP growth is expected to remain rather sluggish and should stay visibly below 3% in 1H17, with the entire year result estimated at 2.7%. With a record-low jobless rate and falling labour supply, we see the labour market as an increasing drag on the economic growth in Poland.
- After 28 months of deflation, CPI growth reached zero in November 2016 and is likely to jump to c.1.5% y/y at the start of 2017, mainly due to strong base effects and higher prices of oil, food and electricity. Despite the tightening labour market and less deflationary global environment, we do not expect to see a big increase in underlying price pressure in Poland (and see core inflation near 1% at the end of 2017), especially when GDP growth is subdued.
- The new Monetary Policy Council proved as conservative as the previous one and kept official rates on hold in 2016 despite persisting deflation and disappointing economic growth. Now, when deflation is over, monetary easing seems even less likely, as the Central Bank sees the GDP growth slowdown as temporary, and believes that rate cuts would harm financial stability. We think the MPC is likely to keep rates stable for the whole of 2017, with the next step being a hike, but not before 2018.
- On the fiscal front, we expect to see more good news (fiscal deficit in 2016 is going to be much lower than planned, possibly near 2% of GDP) long before things get a bit worse. Moreover, the main risk for the 2017 fiscal balance is on the local governments' side, as higher investments are likely to produce the deficit. Meanwhile, the central budget should remain under control, as any revenue slippage might be addressed by an adjustment on the spending side, and the Central Bank's profit is likely to be much higher than planned (while helping to keep the central budget in check and lowering financing needs, it would not count as revenue in the general government statistics, however). Overall, we estimate the general government balance might be slightly above 3% of GDP in 2017.

Executive summary (markets)

- A significant further slowdown of GDP growth at the turn of 2016/17 (GDP below 2% y/y) should anchor the front-end of the yield curve, even if we see a gradual increase in the headline inflation rate at the same time. Later during the year, the front-end may start pricing in hikes by the MPC that should materialise in 2018.
- We expect the long end of the Polish yield curve to remain under pressure from policies of the main central banks abroad. In our view, the Fed will continue its monetary tightening, delivering two more interest rate hikes of 25bp each in 2017. Consequently, the spill-over from higher US yields should result in some upward pressure on Bunds, but also on Poland's assets, particularly in the 10Y segment. Moreover, the long-term debt might be under pressure from the continued uncertainty tied to politics. All in all, we believe that the Polish curve will steepen further as the front end should outperform other tenors. In our view, the risk premium for Poland's assets should remain quite high, with the 10Y spread over Bunds oscillating slightly above 300bp. The main investor group buying Polish supply of Treasury securities will probably be local banks again (strong support from a difference in deposits and lending growth), but we also expect foreign investors to contribute positively in 2017.
- The PLN tends to be a cyclical currency, so we think the Polish currency is likely to gain next year, particularly in the second half of 2017 when economic growth revives. In the short term, the zloty may stay under pressure when the GDP hits the bottom. Apart from the pure economic cycle, we think that cash flows could also provide some support for the zloty – gradual revival of exports, sustained trade surplus and low current account-to-GDP ratio. Also, the inflow of EU funds will resume in 2017, giving the government more ammunition to stabilize the zloty in the event of any adverse market conditions.

2016 summary: Our expectations vs. the outcome

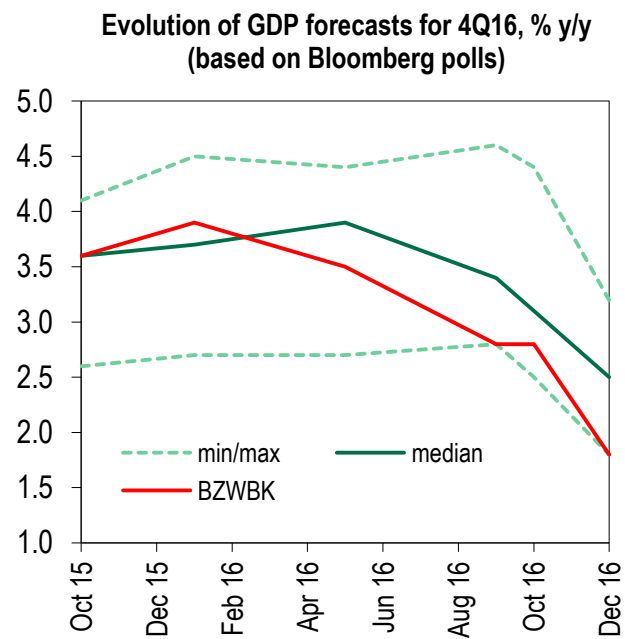
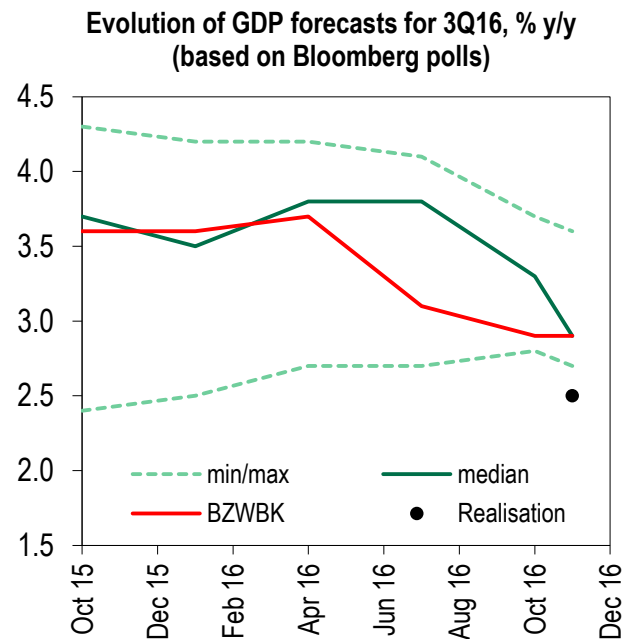
Indicator	Our view (12 months ago)	Outcome
GDP	Strong growth to continue in 3%-3.5% range throughout 2016. Any dip below 3% would be short-lived. Most of the risks are external.	Q1 surprised to the downside (investments and exports) and forced us to change forecasts for 2016-17 in mid-2016. Still, the scale of the slowdown during 2016 was an unpleasant surprise.
GDP breakdown	Consumption and investment growth rates similar to 2015. Any negative impact from net exports should be moderate. Upside risk for consumption, downside for investments.	We were right on consumption and net exports, but very wrong on investments (like the consensus). Public investment significantly in the red, private not growing despite high capacity utilisation.
Labour market	Continuation of job creation, though labour shortages should be more and more visible. Rising wage pressure.	Job creation has continued, though at slower pace. Wage pressure intensified, though it was still quite moderate.
Inflation	Upward trend to continue, but 12M CPI should remain way below target and slightly >1% at year end. Main downside risks: import of low inflation from abroad, supply-side shocks.	Upward trend during the year and end-2016 saw higher 12M CPI than end-2015. Still, on average, CPI surprised to the downside, mostly due to commodity prices decreasing at the start of 2016.
Monetary policy	Adjustment in the main policy rate in 1Q16 (-50bp) when the new MPC arrives. Risk of the MPC being extremely dovish.	The new MPC proved to be conservative and continued the policy of rates stabilisation (despite lower-than-expected) inflation.
Fiscal Policy	Fiscal deficit slightly above 3% of GDP. Risk of higher deficit amid increased spending.	Lower spending on public investments (mostly local governments) and improvement in revenues should take fiscal imbalance closer to 2% than 3% of GDP.
Interest rate market	Steeper curve: additional room for strengthening at the front-end thanks to monetary easing. Long end affected by local fundamentals (CPI/GDP). Rising yields in core markets and more fiscal risks (possible impact on rating).	No rate cut supporting front end (though the market tried to price in some cuts) and long end of the curve sharply up amid global factors. Fiscal risks did not materialise, though rating cut by S&P contributed to bonds weakening at the start of the year.
FX market	EURPLN range-trading without clear trend, as positive global factors offset by local risks (over-expansionary macro policy).	Range-trading, with a moderate trend towards weakening, which was mostly driven by global factors (Brexit, US elections).

2017 outlook: Our views and risks

Indicator	Our view (in a nutshell)	Risks
GDP	V-shaped recovery with a scratch in Q2 amid working days effect. The scale of recovery depends mostly on investment path, we see GDP growth in Q4 again above 3% y/y.	U-shaped recovery if EU funds' absorption is delayed until end of 2017. External risks for growth if global growth stagnates.
GDP breakdown	Strong consumption, at least in 1H17. Net exports neutral again, despite recovery in foreign trade. Investments picking up in 2H17 after EU funds' absorption speeds up.	Negative risk for exports if world trade fails to recover. Significant uncertainty about the timeframe of investment pickup.
Labour market	Unemployment already close to natural rate. Job creation limited by available labour supply. Wage acceleration.	If exports and investment weakening prove permanent, negative labour market trends might appear.
Inflation	Strong jump in 1Q17 to 1.5% due to spike in commodity prices. Stabilisation later in the year.	Higher commodity prices and demand-side pressure bringing inflation to around 2% at end-2017.
Monetary policy	Rates flat throughout the year. MPC under pressure at the turn of 2016/17 amid very low GDP growth, but they are likely to resist.	Downside risk for 1H17 (MPC cannot resist the pressure). Upside risk for 2H17 (GDP recovery and higher inflation).
Fiscal policy	Central budget deficit at c.3% of GDP is relatively safe amid favourable growth breakdown (driven by consumption). General government fiscal deficit slightly above 3%, however, amid deficit at local governments.	No acceleration of public investment creating risk for GDP growth (and budget revenues), but would also limit spending. If local governments spend more on investments, they would not show surplus anymore and GG deficit would exceed 3%.
Interest rates	In 2017, front end starting to price in hikes by the MPC (to materialise in 2018). Long-term yields under upward pressure from global markets.	Curve flattening amid weaker growth globally and less Fed rate hikes /more easing in Europe.
FX market	Cyclicality of the Polish zloty will not be supportive at the start of 2017, some improvement in sentiment in 2H17.	No recovery locally and global risks keeping EURPLN above 4.4 throughout the year.

GDP 2016: Surprising to the downside

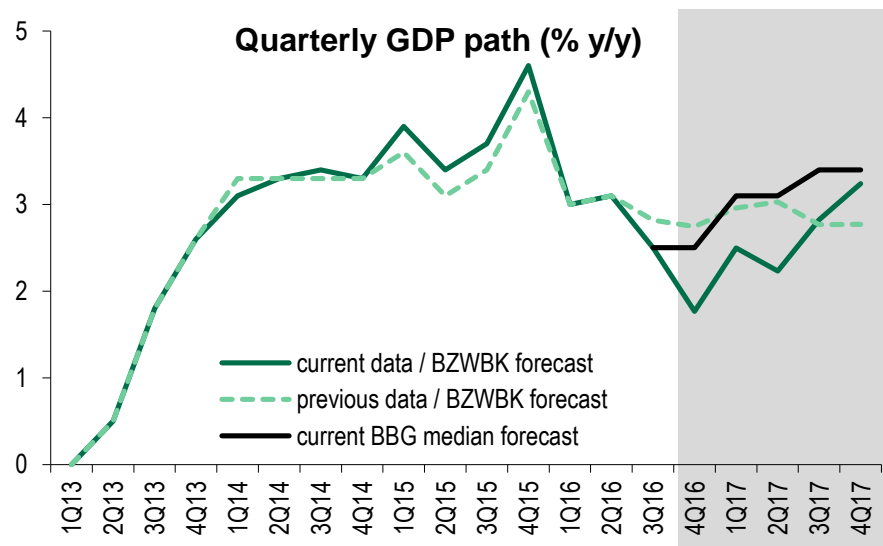
- In the middle of 2016 we lowered our growth forecasts for the following quarters (to c3% in 2H16 and below 3% in 2017), but it turned out that our revision was not significant enough. Though the consensus for Q3 had gradually adjusted lower, the final release was below even our pessimistic forecast – see charts below.
- The same is true, we think, for the last quarter of the year. We publish this document in the middle of December and the discrepancy in 4Q16 forecasts is still very wide, with ours being the lowest in the market.
- The following slides present our scenario for 2017, but it is worth noting that even the starting point (turn of 2016/17) brings huge uncertainty.



Sources: Bloomberg, BZ WBK.

GDP 2017: Below 3%, V-shaped recovery

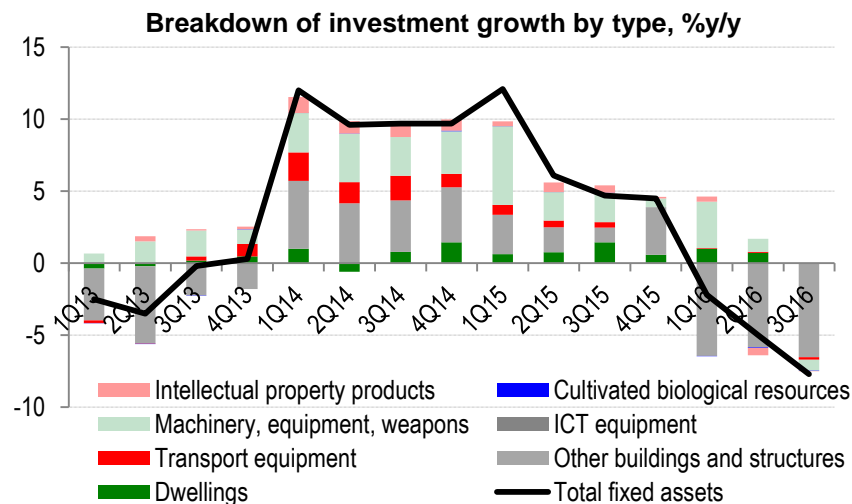
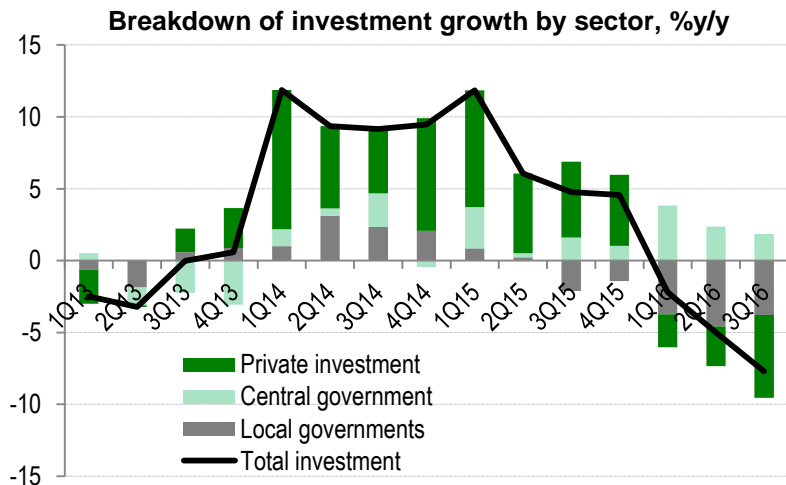
- Given the scale of surprise in the second half of 2016, it looks like the growth path for 2016-17 will have a completely different shape to that in the previous forecasts.
- While previously GDP growth was widely expected to fluctuate around 3% (a potential growth rate for Poland), now the path looks like a V-shaped recovery with the bottom of the cycle at the end of 2016. Some fluctuations driven by statistical effects (working days) are possible in 1H17 and a significant acceleration is expected in 2H17 (with the final quarter above 3% y/y). We see GDP growth in 2017 as a whole below our previous forecast, though not significantly (2.7% vs. 2.9%).
- The following slides show our scenario for the main components of growth: investments with a special focus on EU funds (pages 9-14), consumption and the labour market situation (pages 15-18), and exports in a global context (pages 19-20).



Sources: GUS, Bloomberg, BZ WBK.

Investments 2016: A huge disappointment

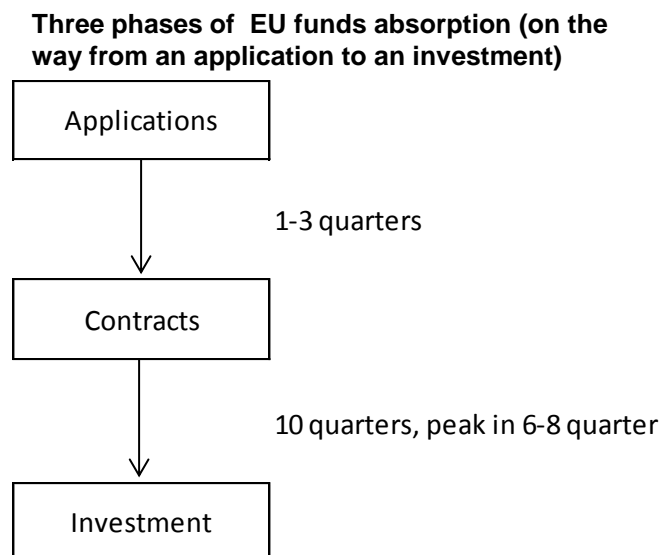
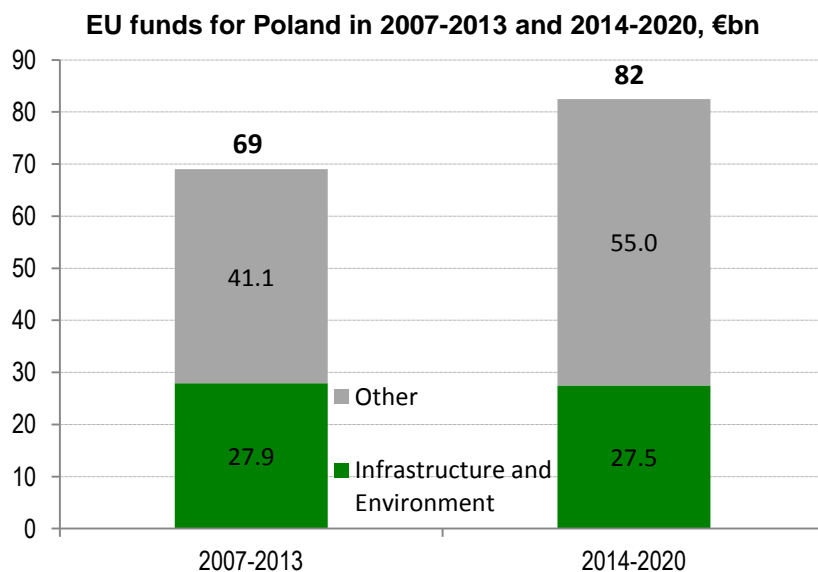
- Investment was very weak in 2016. After a disappointing start, the following quarters were even worse.
- One key reason behind the investment collapse was public investment, especially in local governments (-53.6% y/y in 1H16 and -36.6% y/y in 3Q). This can, to a large extent, be explained by the low spending of EU funds (a phenomenon present not only in Poland). That is why, on the following slides, we present the details of three phases of investments with EU funds (application, contracts, spending) with the implied scenario for the following quarters.
- However, EU funds do not explain everything, as private sector investments also showed a decline. It is worth mentioning that, in 1Q16, high military spending was responsible for the positive public investment reading.
- What is the most worrying is that 3Q16 saw investments fall across the board for the first time since comparable data are available (2005), with the decrease in machinery and equipment category being the first since 4Q12 (by 2.4% y/y). As the housing market does not actually use much EU financing, its 0.2% y/y decline supports our claim that low absorption of EU funds does not tell the whole story.



Sources: GUS, NBP, Eurostat, BZ WBK.

Slow start of new EU financial framework

- In 2016 we saw very low absorption of EU budget-related resources, despite the fact that the new financial framework is more generous than the previous one (€82bn of cohesion funds in 2014-2020 versus €69bn in 2007-2013).
- The scale of improvement in 2017 depends on the path of EU funds-related investment spending. Therefore, we investigated the three phases of using EU funds: 1) applications for EU funds, 2) signed contracts for EU financing and 3) investments. We based our analysis (next few slides) on available data for the new budget and with reference to the historical data from the 2007-2013 EU financial framework.
- Our model implies that applications are transformed into contracts within 1-3 quarters (about 40% in the first quarter). Then the contract becomes an actual investment, with outlays spread over 10 quarters, with peak between the 6th and 8th quarters.

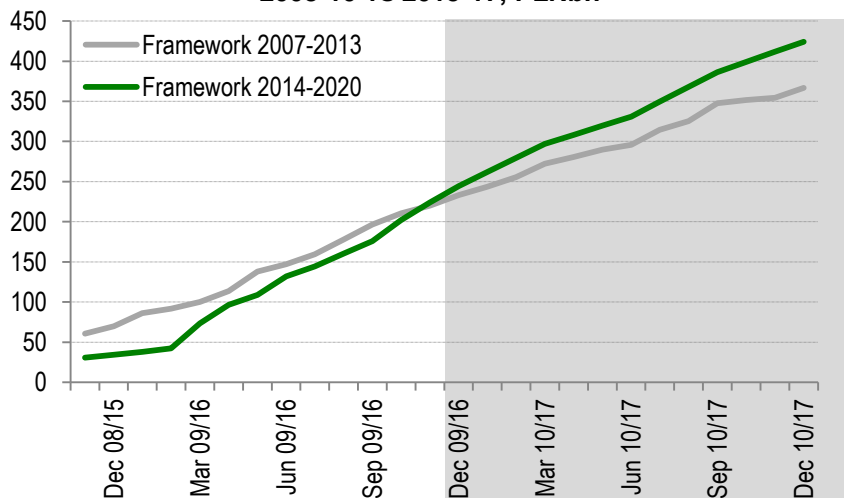


Source: Eurostat, BZ WBK

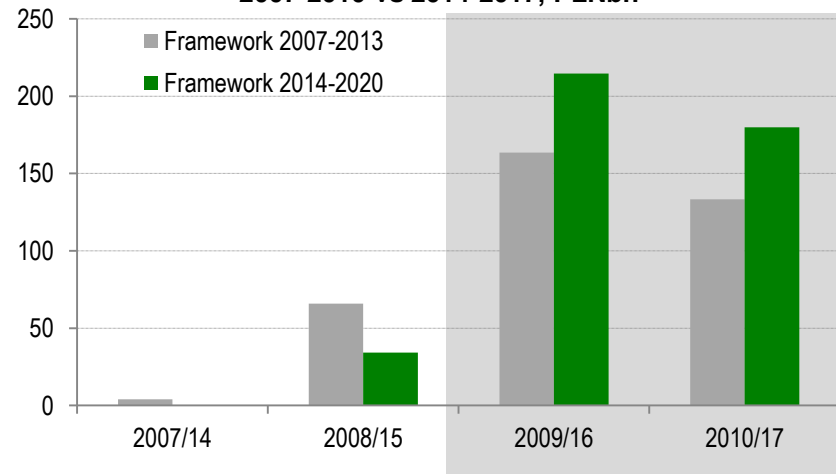
Phase 1: Applications – boost in 4Q16

- In the first two years of the new framework (2014 and 2015), Polish entities applied for resources (we look at the total value of projects, including both EU and domestic funding) worth PLN35bn as compared to PLN70bn in the first two years of the old framework (2007 and 2008). This sluggishness was not particularly surprising, given that in 2014 and 2015 funds from the previous budget were still available and it was quite natural to apply for these instead of the new ones.
- The number of applications recently jumped and currently (4Q16) we can see a really strong boost. According to our estimates, 4Q16 alone could see applications worth almost PLN70bn (we already have data for October and November). Note that Q4 is historically the weakest quarter, with only a 20%-share in the annual volume. In 2016, this number is likely to exceed 30%. However, in our view, it is unlikely that the “application frenzy” will last for long, as the gap versus the last framework is already closing. Given the larger EU budget as compared to the previous one, the growth rate of applications should accelerate further at the start in 1Q17, but should normalise in the remainder of 2017.

**Value of new applications (cumulative):
2008-10 vs 2015-17, PLNbn**



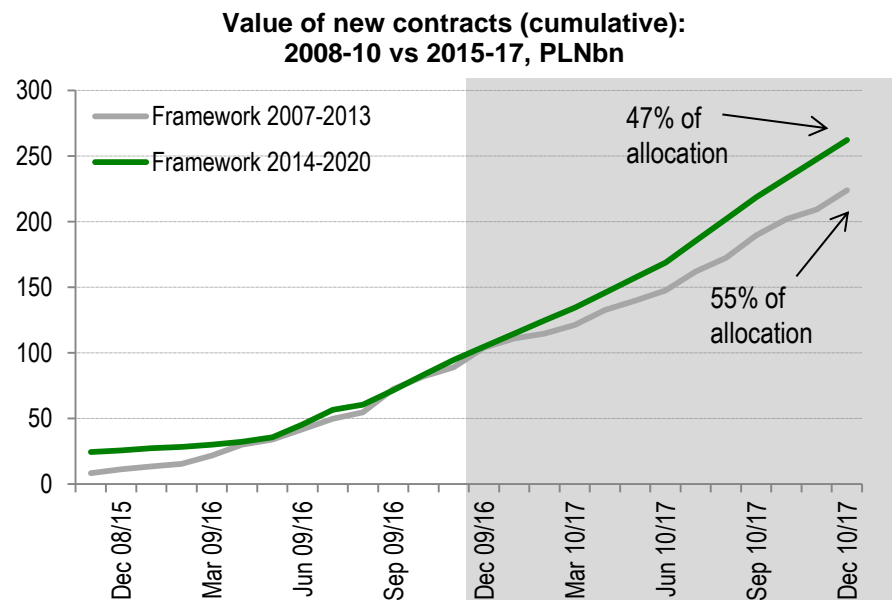
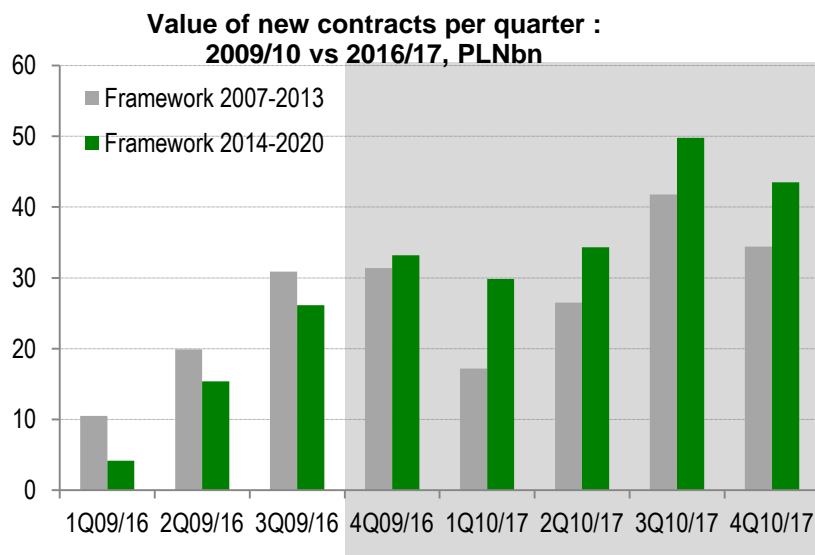
**Value of new applications per year:
2007-2010 vs 2014-2017, PLNbn**



Source: Eurostat, BZ WBK

Phase 2: Contracts – peak expected in 3Q17

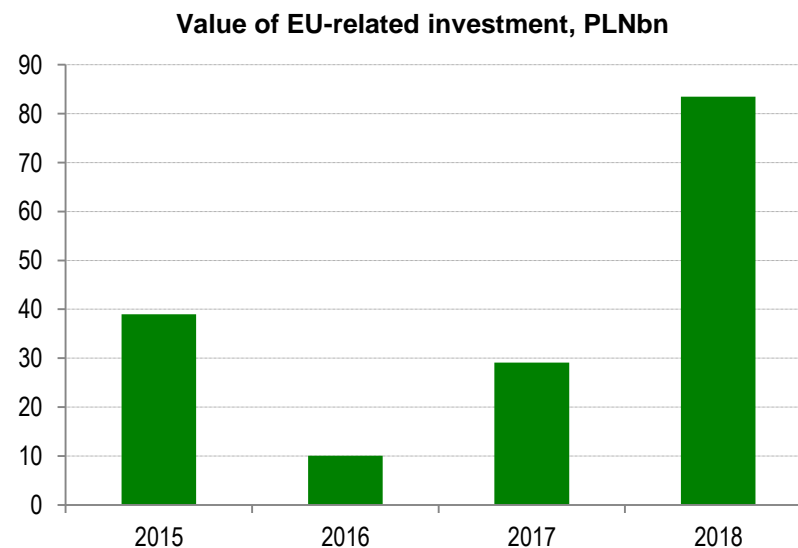
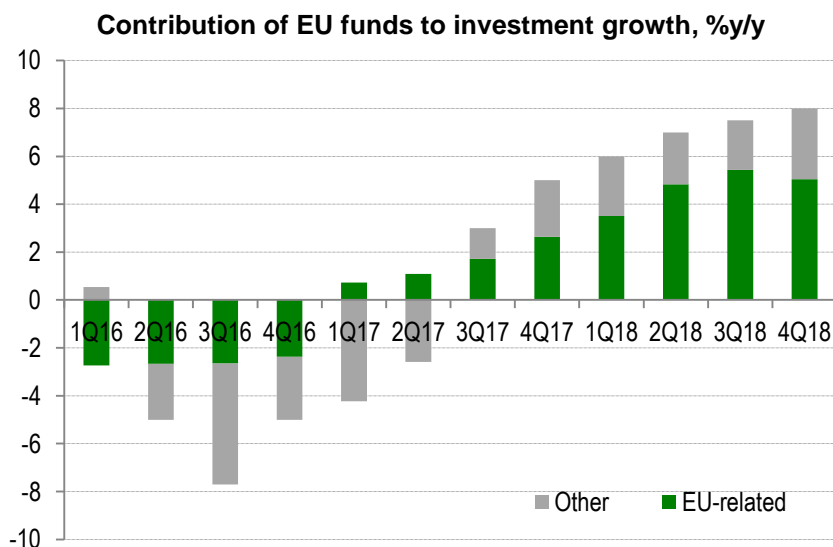
- Applications are only the first step and the next phase, signed contracts for EU financing, is key for the investment path. Of course, applications and contracts for EU financing is one side of the coin. On the other side, especially with big infrastructure projects, we have tenders and contracts between an investor (e.g. the General Directorate for National Roads and Motorways) and construction companies. There is always a risk of delays in tenders, protests etc.
- According to our estimates, around 65% of applications turn into actual contracts and this happens with a lag of around 1-3 quarters (about 40% of contracts in the first quarter). Thus, given the applications pattern presented in the previous slide, we expect a big accumulation of new contracts in 3Q17, with the volume surpassing PLN50bn and reaching an all-time high. The end of 2016 and the first half of 2017 should also be stronger than the corresponding periods of the previous framework, in our view, though the pace of growth should be slower.



Source: Eurostat, BZ WBK

Phase 3: Investment boom is coming... in 2018

- Contracts will transform into actual investment. However, in the case of most big infrastructure projects, signing the contract is followed by a planning phase lasting even a few quarters. These projects, including roads, railways, sewage treatment, make up about 55% of the contracts signed so far. Thus, we assume that investment outlays will be spread over 10 quarters, with the peak between the 6th and 8th quarters.
- In general, contracts from 2015 will translate into investments in 2017. However, the impact of EU funds on annual growth in investments might not be so significant in 2017, especially in the first half of the year. We think a positive contribution will become more visible only in 4Q17, and a really strong impact should take place in 2018.
- Our analysis suggests a strong rise in EU-related investment in the fifth year of the EU budget. Note that the same happened in the last framework, with 2011 being the first year of strong investment after a rather sluggish 2010.

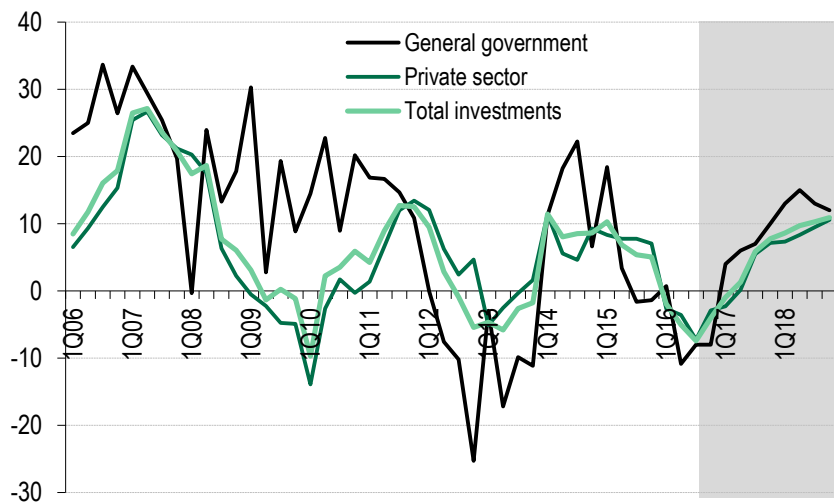


Source: Eurostat, BZ WBK

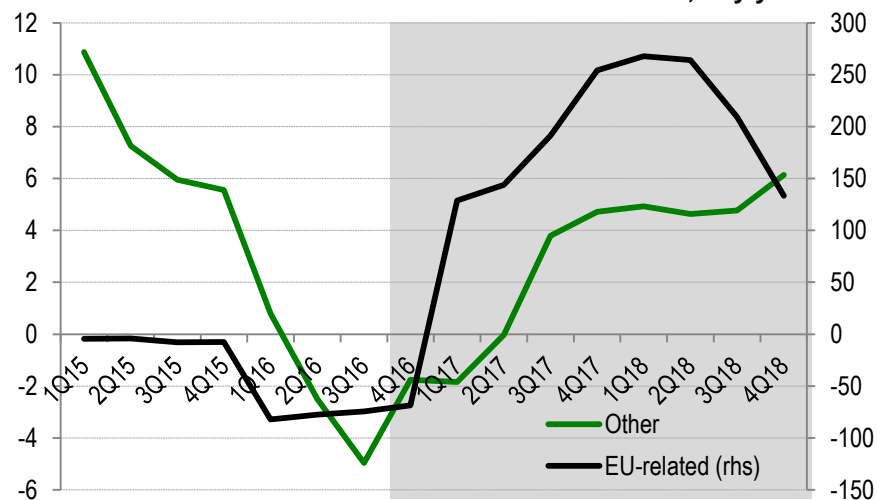
Investments 2017: Gradual recovery expected

- The scenario for EU fund absorption presented in the previous slides implies a considerable acceleration in 2017 (above 100% y/y), but from very low levels, so total contribution to investment growth will not be high. As regards other investment, in our view, high capacity utilization and low financing costs are favourable for growth. Recovery in EU-related investment will thus encourage other investment to grow as well, yet with some lag. Keep in mind, however, that the global and local uncertainties will remain.
- We expect the first half of the year to be still weak in terms of overall investment growth (we might actually see a continuation of decrease y/y) with the recovery expected in the second half. Really impressive investment growth should start in 4Q17 and continue in 2018.

Fixed investment in public and private sectors, % y/y



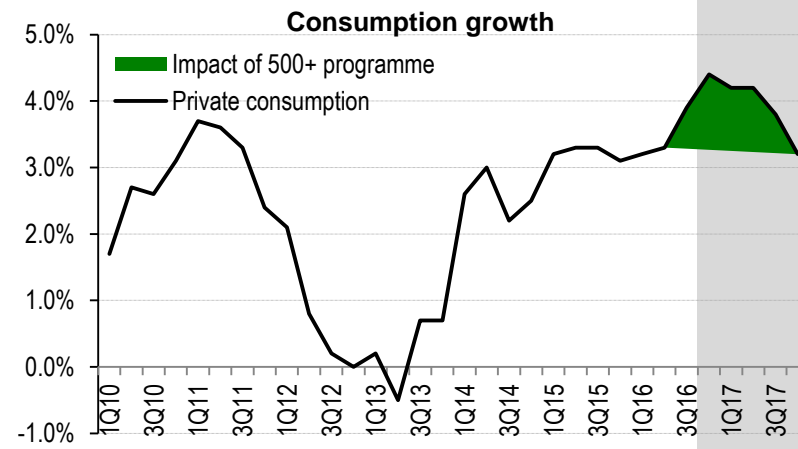
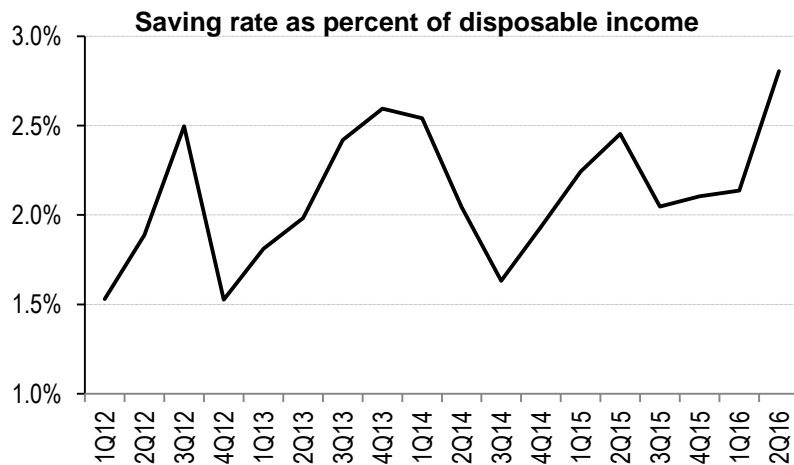
EU-related investments vs other investments, % y/y



Sources: GUS, NBP, Eurostat, BZ WBK.

Consumption: Effect of 500+ weaker than expected

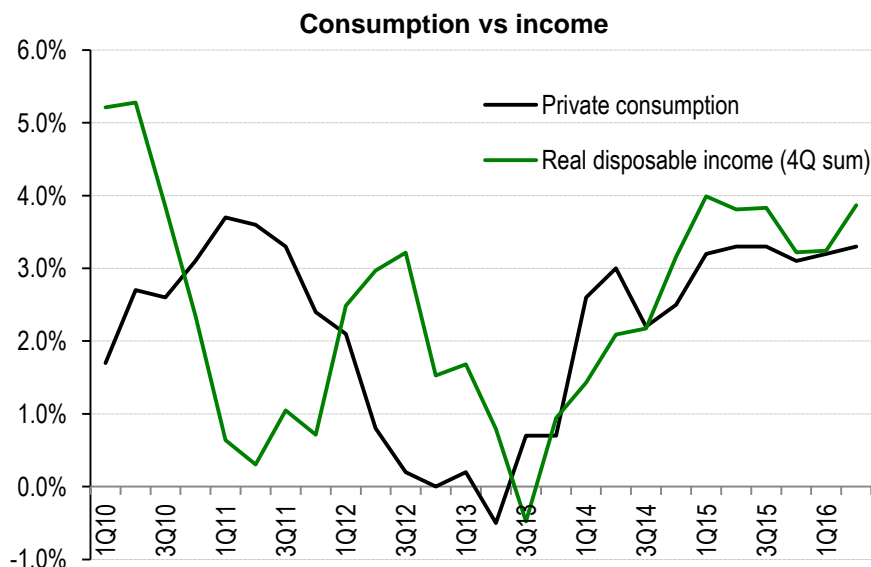
- The 500+ child-benefit programme was introduced in April 2016, with payments totalling PLN17.2bn until year-end. It was widely expected that the programme would translate into higher consumer spending (we had assumed that the private consumption growth might temporarily be close to 5% y/y). However, the impact has been quite muted so far: no visible acceleration of consumption in 2Q16 (despite the fact that as much as PLN4.9bn were paid out in April-June), while consumption growth accelerated to just 3.9% y/y in 3Q16 from 3.3% y/y in 2Q16 (or 1.4% q/q s.a. in 3Q16 vs 0.8% q/q s.a. in 2Q16). The back-of-the-envelope estimate of the 500+ consumption boost is thus equal to 0.6% of Q3 consumption.
- 0.6% of Q3 consumption equals PLN1.6bn, implying that only 14% of the payments were spent, way below expectations (we assumed around 50%). This can be explained as follows: 1) 500+ effects are lagged (hence no effect in 2Q16) and some consumers may have been reining in their spending to secure a richer Christmas, 2) low-earners cancelled small consumer loans (statistical data show that the poorest 20% of households consume more than they earn and finance consumption via small loans), so 500+ resulted in lower indebtedness but no significant boost to consumption.
- Assuming lagged effects of the programme and a possible Christmas-spending boost, we estimate that the consumption/payment ratio will rise to 25% in 2016 and 30% in 2017, adding 0.4 percentage points to consumption growth in 2016 and 0.3pp in 2017.



Sources: GUS, Eurostat, BZ WBK.

Consumption: Moderate acceleration in 2017, stronger in 1H

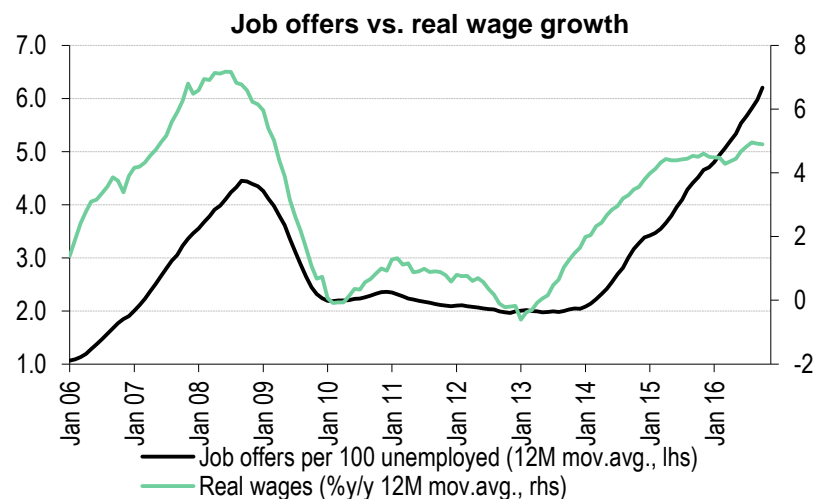
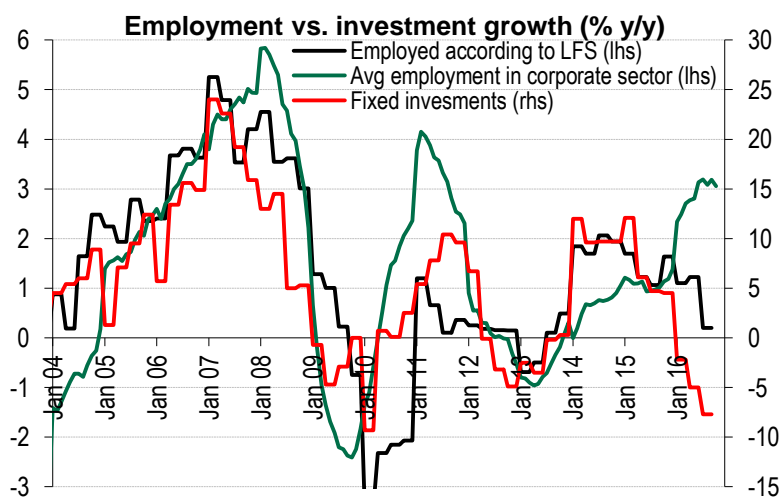
- Since 2014, consumption has been growing at c3.0% y/y on average. Even though real incomes from work and social benefit have been growing at about 5% y/y, the growth rate of consumption was generally consistent with real growth in gross disposable income (3.3% y/y in 2014-1Q16). The saving rate increased only slightly, as households were smoothing their consumption.
- In our view, the expected acceleration of nominal wage growth in 2017 will be absorbed by higher inflation (average CPI in 2017 2.0pp higher than in 2016), while social benefits will rise only slightly due to low indexation. So, the total growth in real gross disposable incomes in 2017 may be lower than in 2016, suggesting little room for consumption growth to accelerate.
- In fact, after accelerating at the start of 2017, consumption growth may slow in the second half of the year, once the impact of 500+ disappears.
- All in all, we estimate consumption growth at 3.9% y/y in 2017 versus 3.7% y/y in 2016.



Sources: GUS, Eurostat, BZ WBK.

Labour market: Approaching the limits

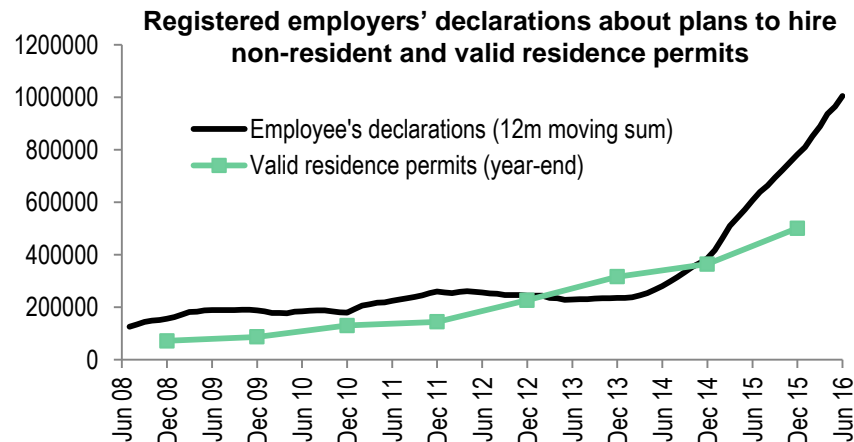
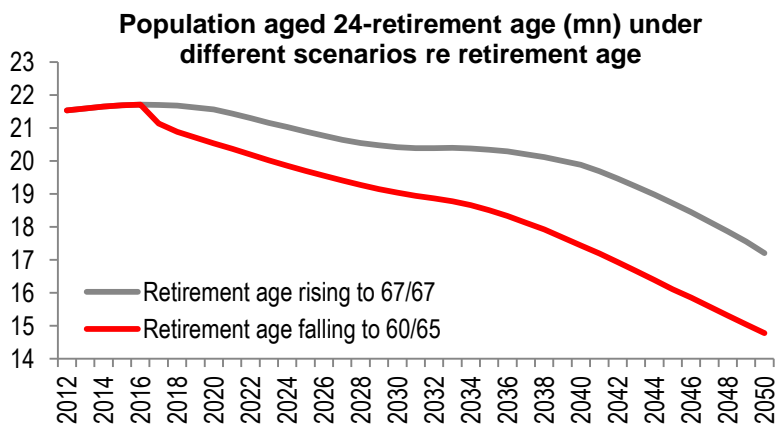
- The labour market situation has improved over the last year, with the unemployment rate declining to a record low of 5.7% in October 2016. The number of unemployed fell below 1 million for the first time in modern history.
- Companies' demand for labour remains high, as reflected in increasing new job offers and vacancies. However, the pace of employment growth seems to have decelerated. Corporate sector data show still solid employment growth, around 3% y/y in 3Q16, but we think they are misleading given that some companies offered their employees a change in the type of labour contract after recent legal changes (from civil law contracts to regular employment). Meanwhile, the Labour Force Survey (which should be immune to such effect, as it counts all employed regardless of contract type) suggests that the number of employed stalled in 3Q16. Yet, the LFS data were subject to population change at the start of 2016.
- We expect to see almost stable employment in 2017 – firstly, because of subdued investments that, until recently, were closely correlated with labour demand, and secondly due to a deepening shortage of labour supply. The latter, plus rising inflation, should trigger a strengthening of wage pressure. At the same time, we acknowledge that our worries about higher wage pressure, as expressed in last year's annual Outlook, proved excessive, with moderate wage growth so far.



Sources: GUS, NBP, Eurostat, BZ WBK.

Labour market: Risk factors ahead

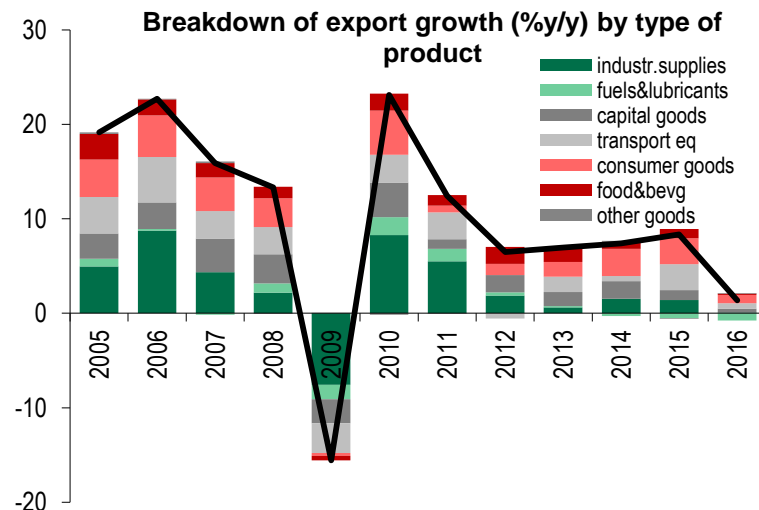
- We see three additional factors, which may affect the situation in the Polish labour market in coming quarters:
- **Lower retirement age.** As we wrote in our [research note](#) in July, the number of retired people may rise by c.480k in 4Q17 after the change is implemented, but some of them are likely to continue work after having retired. We estimate that the new regulations may reduce the labour force by 150k in the first year after implementation.
- **Impact of 500+ on labour activity.** The child subsidies programme launched in April 2016 may potentially trigger a drop in labour activity in low-income groups. It is still too early to judge the full effect of the programme, but the early signs (the Labour Force Survey flash results for 3Q16) suggest that some people could have been disincentivised: labour activity decreased slightly for women, people with lower education and those aged 35-44.
- **What next with workers from Ukraine?** There is a proposal to unblock visa-free travel for Ukraine by the EU. This change, if implemented, could potentially encourage some Ukrainians working in Poland to move further West, to other EU countries where wages are higher (although visa-free travel does not imply free access to labour markets!). But, at the same time, it could encourage even more people from Ukraine to come to Poland. The number of Ukrainians officially working in Poland was 500k at the end of 2015, while the number of Polish companies saying they want to hire a non-resident employee continues on an uptrend and soared to 1 million in mid-2016.



Sources: Eurostat, Ministry of Labour, BZ WBK.

Exports 2016: Broad-based slowdown

- Polish exports have slowed considerably in 2016, following a parallel move in foreign trade in Germany – our biggest trading partner. In fact, the export slowdown seemed to be a part of a global phenomenon as the turnover of international trade has stagnated over the last year.
- To some extent, the export weakness has probably reflected the fact that 2016 GDP growth in Western Europe was based mainly on strong consumption, rather than investments and exports. This was not an optimal situation for Poland as the bulk of Polish exporters are suppliers of intermediate goods for Western European industry.
- However, the breakdown by product type shows that the slowdown in Polish exports to the Euro zone was broad-based and affected all types of goods. In fact, it was even more severe in consumer goods and transport equipment than for industrial supplies.
- Looking at the breakdown by geography, exports to most of our key trading partners in the Euro zone have slowed sharply, but have grown at a decent pace to Asia and North America.

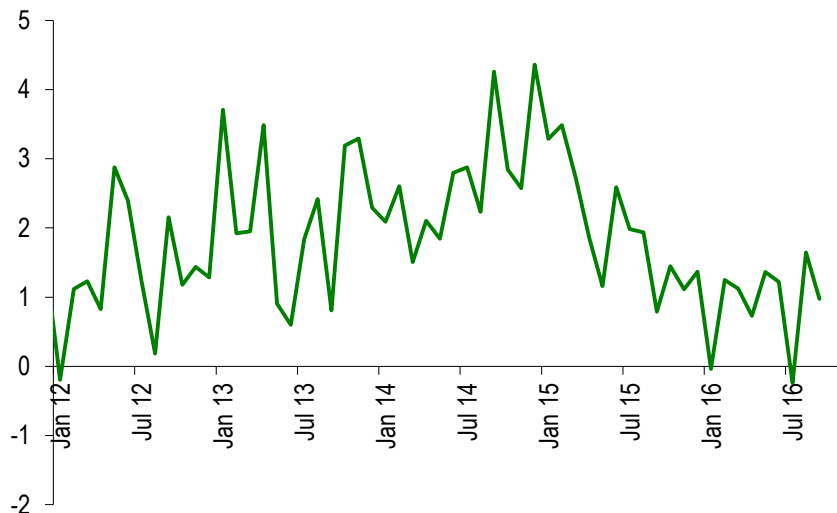


Sources: Eurostat, Bloomberg, BZ WBK.

Export: Gradual recovery expected

- We expect export growth to pick up in 2017, firstly because of the projected recovery in international trade and, secondly, thanks to the change in the Euro zone growth model (from consumption-driven to investment- and export-driven).
- The significant zloty weakening in recent months should help to boost Polish exports, increasing the country's international price competitiveness.
- Nevertheless, we do not expect to see an improvement in the foreign trade balance, as imports are also likely to pick up at a similar pace. As a result, net exports' contribution to GDP growth may remain close to zero next year, similar to in 2016. Also, the current account deficit should remain similar, at 0.8% of GDP.

Global trade turnover, % y/y



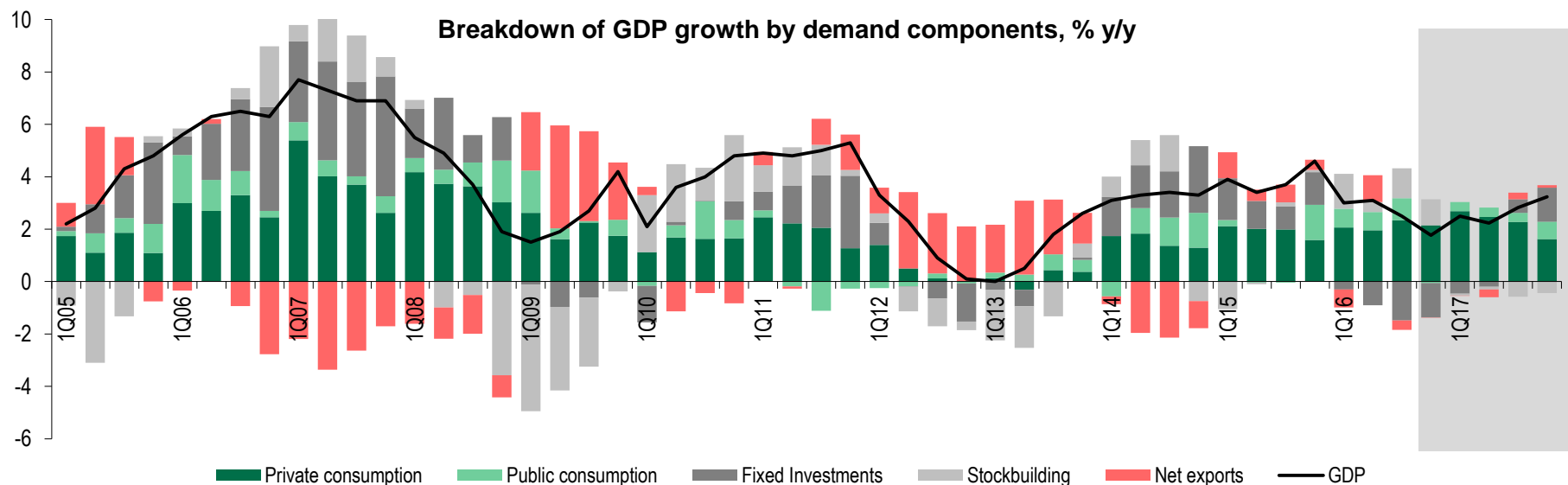
GDP and export forecasts for Poland's main trading partners

Country	GDP growth – our forecast (consensus)		Exports growth – our forecast (consensus)	
	2016E	2017E	2016E	2017E
Germany	2.0 (1.8)	2.1 (1.4)	2.6 (2.3)	4.8 (2.9)
Czechia	(2.5)	(2.6)	(5.1)	(4.4)
United Kingdom	2.0 (2.0)	0.9 (1.1)	2.9 (2.6)	3.0 (3.2)
France	1.3 (1.2)	1.5 (1.2)	1.3 (0.9)	4.6 (2.7)
Italy	0.9 (0.8)	1.3 (0.8)	2.3 (1.4)	4.4 (3.1)
Netherlands	(1.7)	(1.6)	(3.4)	(3.5)

Sources: Eurostat, Bloomberg, BZ WBK, CPB.

GDP breakdown 2017

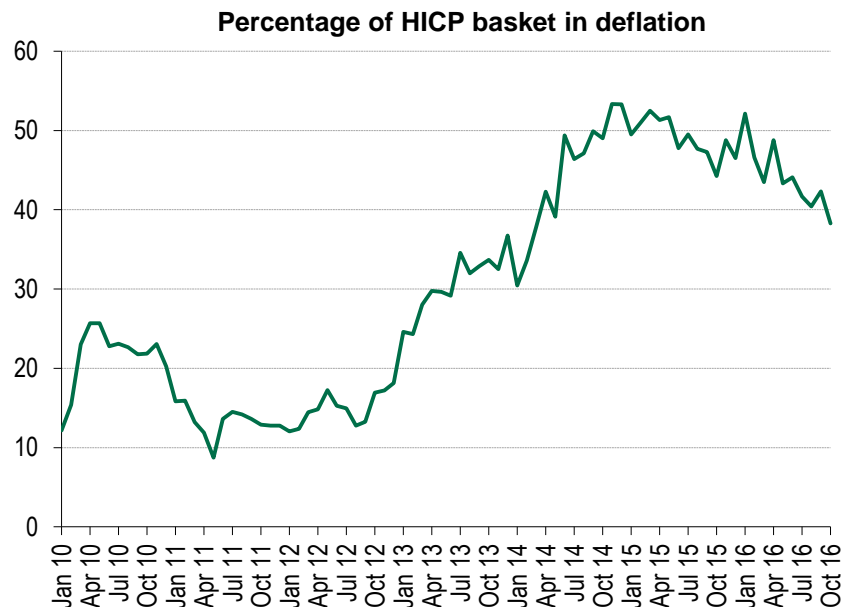
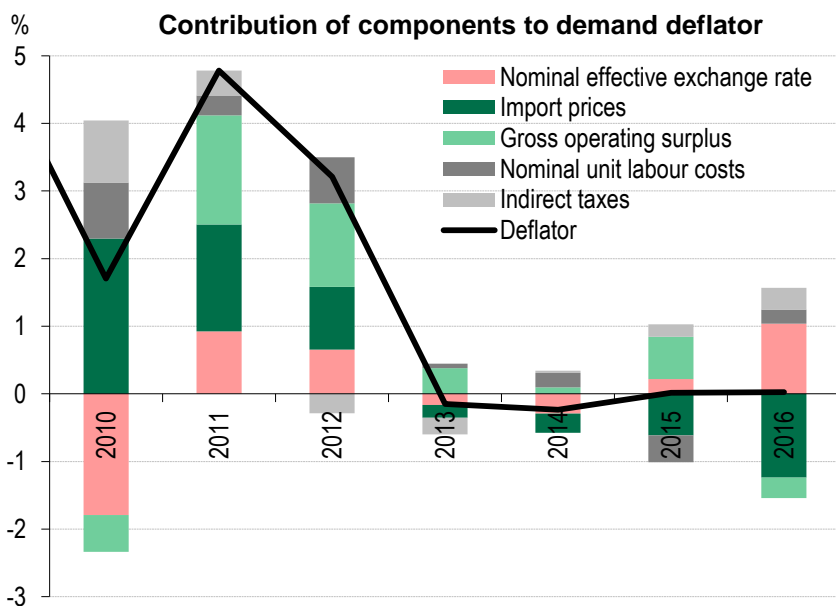
- Private consumption should be the main growth driver in the near term, boosted by the lagged effect of the 500+ scheme; however, it may decelerate slightly in 2H17.
- Net exports' contribution to GDP growth should remain near zero next year, despite gradual improving export growth during the year, as imports are also likely to pick up at a similar pace.
- Investments, while still in decline in the first two quarters, are likely to recover in 2H17, particularly in 4Q17, as the absorption of EU funds speeds up. However, their total contribution to GDP growth should remain small in 2017 but with a stronger impact possible in 2018.



Sources: GUS, BZ WBK.

Inflation 2016: Lower start, positive at year-end... finally!

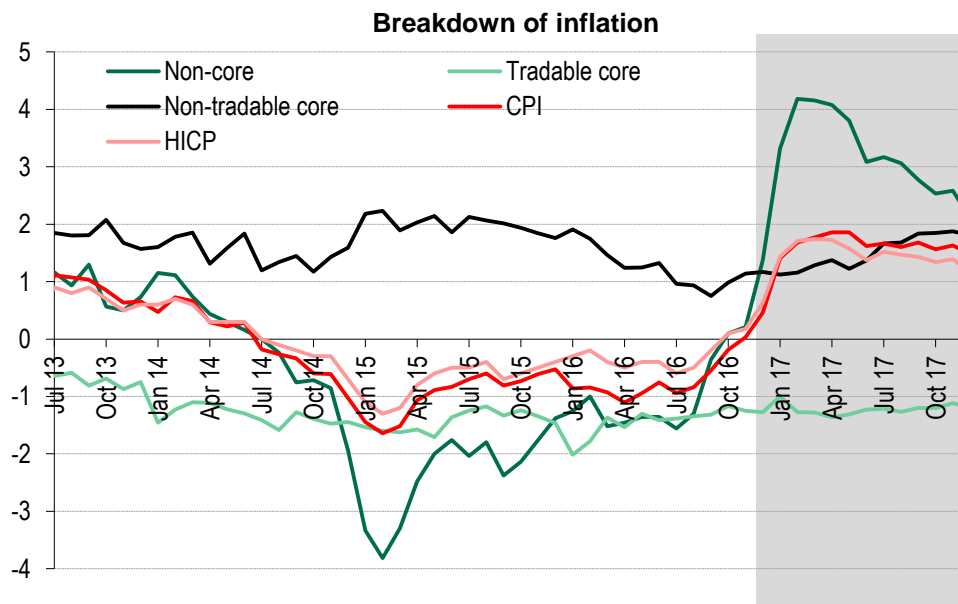
- 12M CPI inflation stayed in negative territory for most of 2016, against a wide consensus view from a year ago. This was, however, to a large extent the result of the commodity prices shock at the start of the year (imported deflation), with an upward path clearly visible during the year. Deflation ended in November and our forecast for year-end at “slightly above 1%” is very likely to materialize already in January 2017. Actually, January may see inflation well above 1% y/y.
- Still, despite relatively strong consumption growth and a weaker-than-expected zloty, core inflation showed very few signs of demand-side pressure on prices. On average, it was negative and at end-2016 should be merely above zero (against our forecast of a gradual increase towards 1%). This shows that inflationary processes failed to build in 2016, but also that deflationary pressure was easing throughout 2016.
- Nevertheless, there are already some signs (mostly global) which may prove inflationary already in 2017 (see next slide).



Sources: AMECO, Eurostat, NBP, BZ WBK.

Inflation 2017: Further increase, mostly supply-driven...

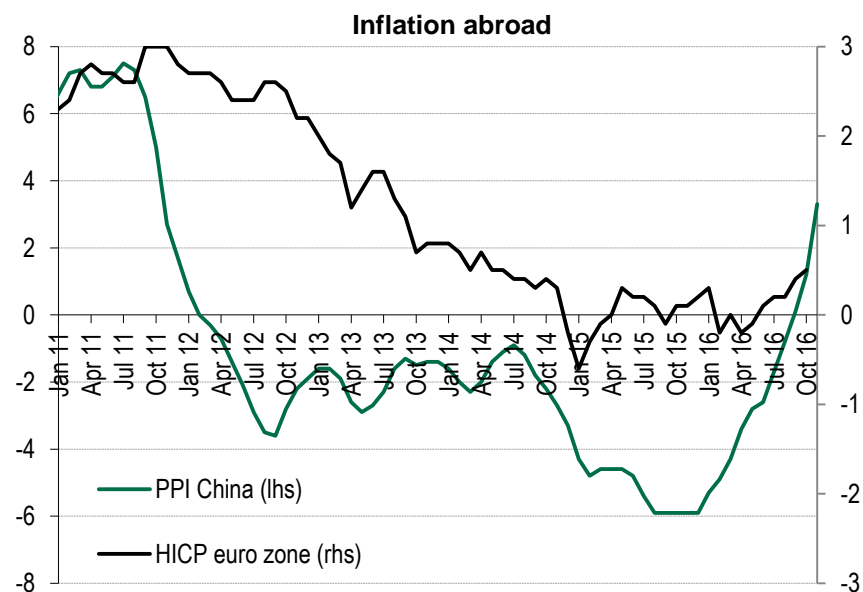
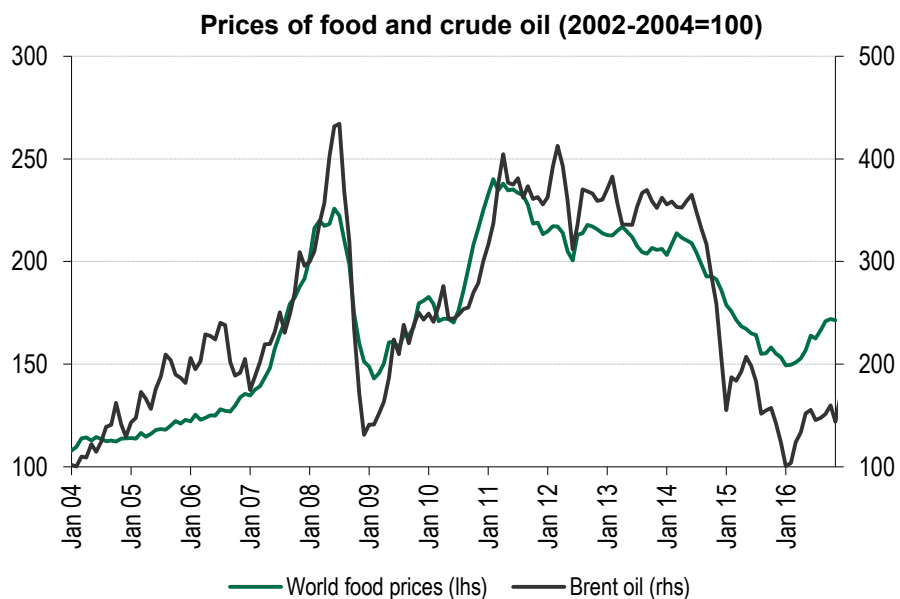
- The inflation pick-up at the end of 2016, driven by commodity price increase, will probably continue at the start of 2017. Needless to say, in Polish zloty the Brent price increase will amount to c70% y/y (effect of both oil price and higher USDPLN). Also, the trend in global food prices is quite clear. We expect food price inflation at 1.6% in 2017 on average, which would mean doubling the result from 2016. Energy prices will go up in January due to a hike of the distribution fee.
- On the other hand, we do not see a significant increase in core inflation (c1% at end-2016). The non-tradable part of core inflation will be supported by climbing car insurance prices and the fading effect of 2H16 cuts in drug prices, and should return to sub-2% growth, while the tradable part is expected to remain in deflationary mode.
- According to the central bank's projection, the output gap will not close till end-2018. Given that economic growth at the turn of 2016/17 will be well below the NBP's forecast, demand-side pressures on prices should not accelerate sharply.



Sources: GUS, Eurostat, NBP, BZ WBK.

Inflation 2017: ... but there are some risks

- It seems that the world is escaping deflation. Commodity prices are on the rise across the board, global food prices are also on the up, and CPI is edging higher in all major Euro zone countries. Poland has imported deflation in the 2013-2016 period, but it seems that this will no longer be the case in 2017.
- Moreover, some second-round effects from higher commodity prices are possible given the weak zloty and strong household disposable income. For example, November's PMI showed input prices rising at the fastest rate since 2012.
- In general, we see upside risks for inflation in 2017 and think it could even reach 2%.

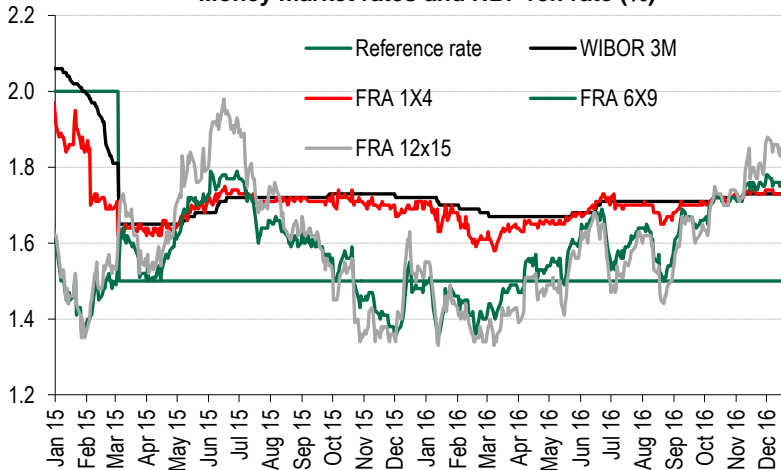


Sources: Eurostat, Reuters, FAO, Bloomberg, BZ WBK.

Monetary policy: Stabilisation and continuation

- The new Monetary Policy Council proved as conservative as the previous one and kept official rates stable despite continuing deflation and (much) lower-than-expected economic growth. Actually, the MPC sees the slowdown as a temporary phenomenon and deflation as driven mostly by external factors. Another argument against further monetary policy easing (which was important during the MPC discussions in 2016 and earlier) is stabilisation in the financial sector.
- As we see inflation higher and the GDP slowdown should indeed be temporary (above 3% in 4Q17), though at a lower level, the MPC is likely to keep rates stable for the whole of 2017. We think the next step could be a hike in 2018 .
- Overall, the new MPC showed a continuation of monetary policy. Risks of (too) expansionary monetary policy or diminished central bank independence did not materialise (see table below). It seems also that the role of NBP Governor Adam Glapiński was important in shaping the final solution regarding the bill for CHF loans (limiting the risk of the most controversial solutions).

Money market rates and NBP refi rate (%)



S&P comments on NBP independence

January 2016

The change in the rating outlook to negative reflects our view that there is potential for further erosion of the independence, credibility, and effectiveness of key institutions, especially the National Bank of Poland (NBP).

December 2016

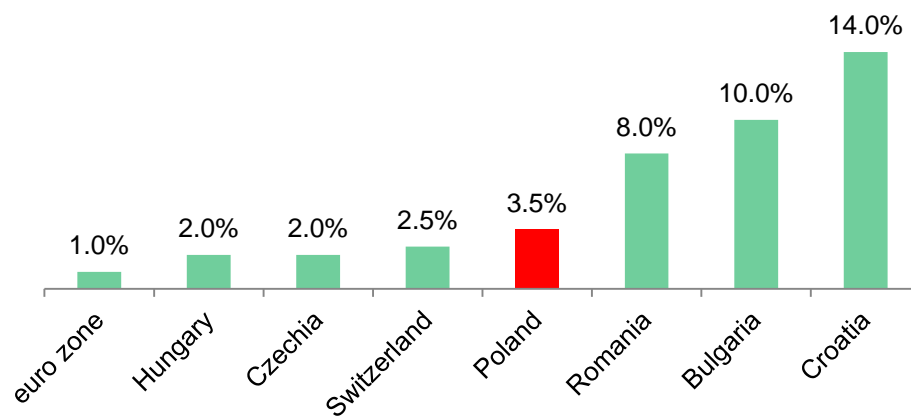
The outlook revision reflects the reduction in our near-term concerns over a further weakening of key institutions, most importantly Poland's central bank, caused by the government's efforts to change and control Poland's key independent institutions.
The Polish government is still mulling over potential changes that could directly and indirectly affect the NBP, including moving administrative control of the financial supervisor, KNF, back to the NBP or requiring banks to return foreign currency spreads gained by granting Swiss franc-denominated mortgages to households. However, we do not see that such efforts by the government would undermine the NBP's credibility and independence.

Sources: NBP, Reuters, S&P, BZ WBK.

Monetary policy: Any other policy moves than in rates?

- The Monetary Policy Council showed no signs of willingness to adopt non-standard measures in monetary policy (recall that, before the 2015 elections, some politicians called for QE in Poland). Quite the opposite, the Central Bank seems to be still proud to conduct a traditional policy. Our base-case scenario is that this will also continue in 2017. However, we think there is a possibility of a more active policy supporting public debt management if any problems arise on this front.
- As we show on page 32, commercial banks will have to play the key role in covering the government's large financing needs. Therefore, some incentives are possible in case of significant market stress. One possibility would be lowering the obligatory reserve requirement, from a relatively high level – see chart below comparing the rates in Poland and other countries. For example, a 1pp lower reserve requirement would boost banks' bond-buying capacity by PLN12bn, of which PLN4bn relate to three State-controlled banks (PKO BP, Pekao, BGK).
- Other possibilities would be connected with changes in open market operations.

Reserve requirement in selected countries



Sources: NBP, central banks, BZ WBK.

Regulatory measures: Is the CHF-loans issue still an issue?

- One of the PiS election promises was to deal with the FX loans issue. While the initial versions of the solution proposed by President Andrzej Duda assumed a forced conversion of FX loans into zlotys (which would trigger huge costs for the banking system, even up to PLN70bn, according to KNF estimates), in 2H16 the President submitted a new, much softened version of the plan, assuming no forced loan conversion but only a mandatory return of excessive FX spreads banks charged clients. The President's experts estimate the cost of this solution at PLN3-4bn, but it could go twice as high according to the Central Bank.
- Apart from President Duda's proposal, two alternative proposals have been submitted in the Polish Parliament: one by PO, and one by Kukiz'15. The PO's proposal is similar to that they proposed before 2015 election and assumes conversion based on bank-client agreements with the loss split 50:50. Kukiz'15 proposed the most extreme solution, as it assumes conversion of FX loans to PLN at the conversion rate from the loan origination, which would be the worst-case scenario for the banking system. One can suppose that the proposal submitted by the President is the most likely to be approved.
- While President Duda softened his proposal, he also suggested new regulatory measures should be adopted that would encourage banks to seek agreements with clients on "voluntary" loan conversion. These measures are still unknown. However, in early December, the KNF (the Polish Financial Supervision Authority) issued its recommendations for dividend pay-out ratios for 2016 profits, that show stricter criteria for banks with FX-loans exposure.

New criteria for dividend pay-out:

Banks meeting all criteria below would be able to pay out 50% of the profit:

- not implementing a recovery programme;
- received a positive score in the Supervisory Review and Evaluation Process – final score of no less than 2.5 ;
- have a Leverage Ratio (LR) above 5%;
- OSII¹ banks - minimum T1 ratio at 13.25% + 0.75%*add-on² + respective OSII buffer;
- other commercial banks - minimum T1 ratio at 11.25% + 0.75%*add-on
- minimum TCR of 13.25% + add-on+ OSII buffer.

To pay out 100% of profit, banks additionally would have to meet criteria below:

- minimum TCR of 16.25% + add-on+ OSII buffer

Additionally, banks with FX mortgages accounting for 5%+ of their books will have to adjust their pay-out ratios depending on the share of FX mortgages/total loan book and:

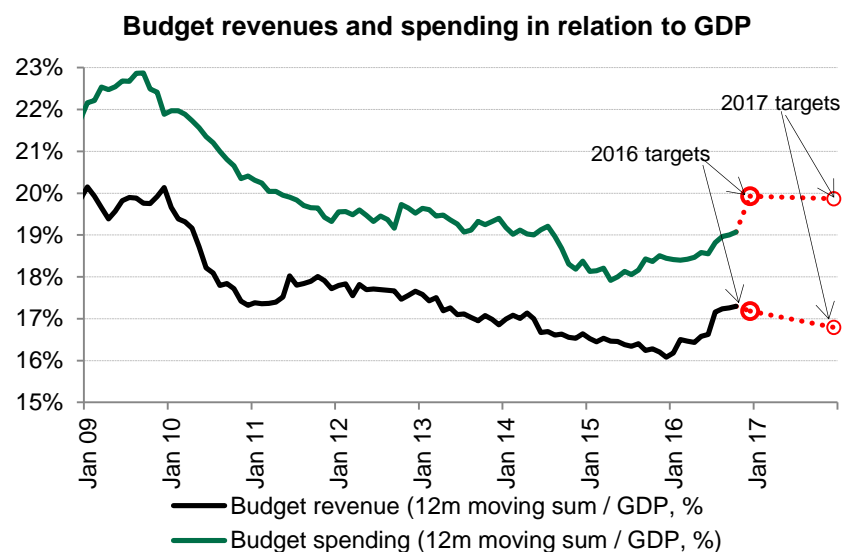
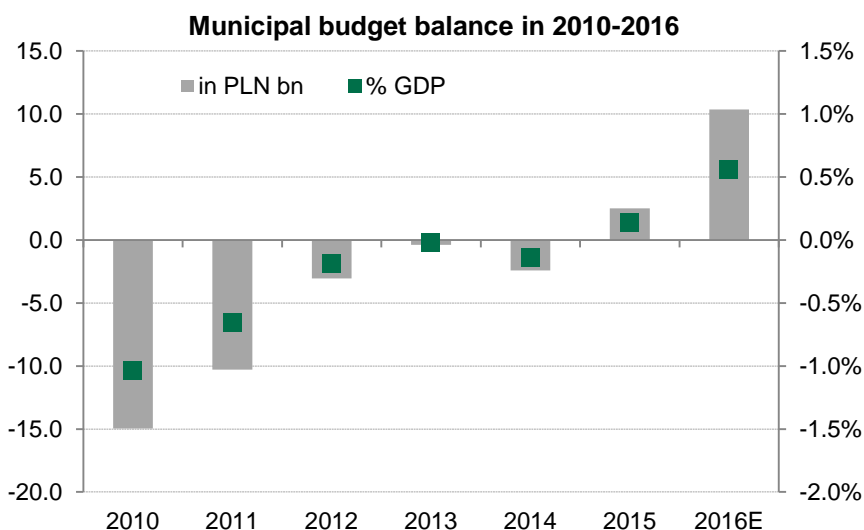
- $0% < x < 20%$ proportion would trigger a 20% lower dividend pay-out ratio,
- $20% < x < 30%$ a 30% adjustment while $> 30%$, a 50% adjustment.

Finally, the share of 2007/08 vintages in their books ($20% < x < 50%$) will result in an additional claw-back of 30%, while for those with $> 50%$ share a claw-back of 50%.

¹ OSII – Other Systemically Important Institutions; ² add-on – respective FX buffer determined for particular bank

Fiscal policy 2016: Deficit much lower than forecast

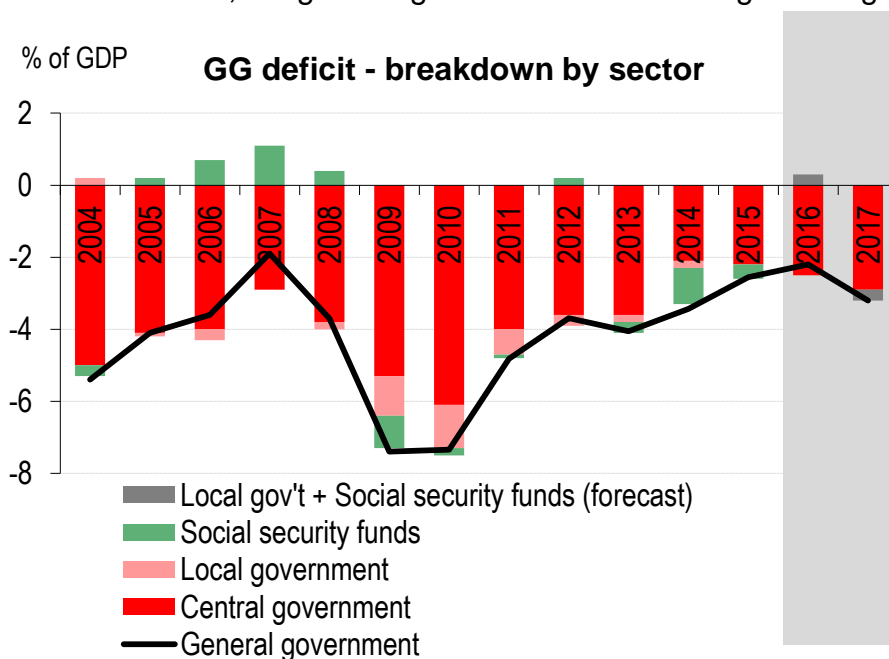
- As we have already written many times in previous reports, the 2016 central budget deficit will be much lower than planned and lower than forecast at the start of the year. Firstly, this was connected with improved budget revenues, with the growth breakdown favourable and some visible improvement in the effectiveness of tax collection (e.g. fuel market). Secondly, the expenditure ceiling, as in previous years, will not be reached and, according to our estimate, government spending might be at least PLN10bn lower than planned. The central budget deficit according to domestic methodology should amount to 2.1% of GDP in 2016. Please note, however, that it will be higher according to ESA2010 standards.
- Local governments show a significant surplus after the three quarters of the year. Even if this scale is not maintained at year-end, their surplus of c0.6% of GDP will bring the overall general government (GG) balance towards 2.2% of GDP.
- GG balance could even have achieved the 2% level, but we think that the government might decide to frontload some 2017 spending to smooth the fiscal deficit in 2016-17.



Sources: GUS, Ministry of Finance, BZ WBK

Fiscal policy 2017: Risk for GG deficit in local governments

- In September's edition of our [MACROscope](#), we described the government's budgetary plans for 2017. Even if the government's macroeconomic assumptions (GDP in real terms up by 3.7%) are far from conservative, the estimated budgetary revenues (excluding higher effectiveness of tax collection, of PLN10bn) do not seem excessive. We think that any risk of a revenue shortage might be addressed during the year with an adjustment on the spending side. What is more, the Central Bank's profit (practically, not planned in the budget) is likely to be very high amid the recent zloty weakening – the scale of transfer from the NBP will depend on the zloty's level at year-end, but it might be as high as PLN10bn. While helping to keep the central budget in check, this would not count as revenues in the general government statistics, however.
- The main risk we see driving the total fiscal deficit above 3% would be on the local government side, as higher investments are likely to produce the deficit. Therefore, the general government balance might be slightly above 3% of GDP in 2017.

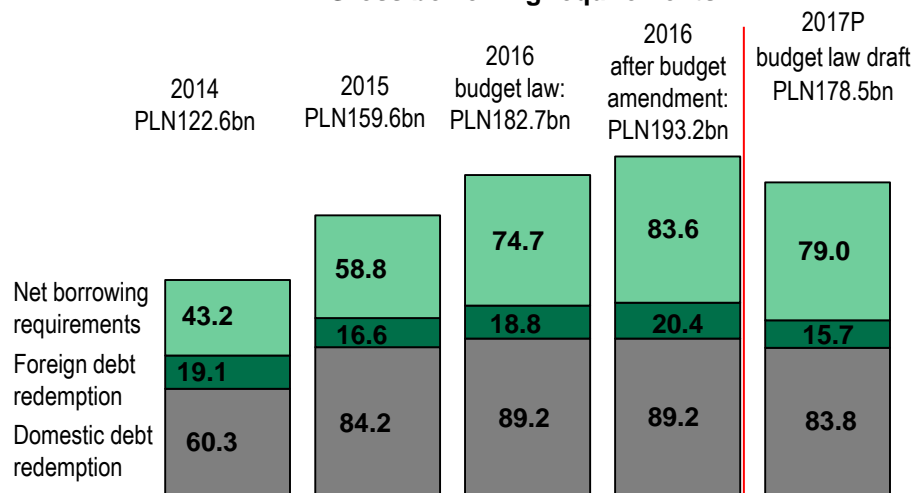


Sources: GUS, Eurostat, Ministry of Finance, BZ WBK

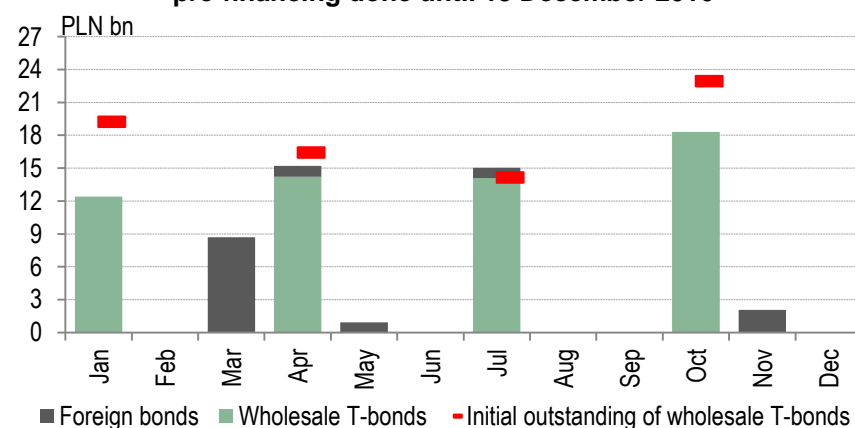
Local debt supply in 2017 similar to the 2016 level

- At the end of November, Poland fully financed the 2016 gross borrowing needs after amendment (i.e. PLN193.2bn). Also, the Ministry of Finance has started its pre-financing process through switch tenders, selling bonds worth cPLN14.5bn in September-December, which accounted for 8% of the 2017 borrowing target of PLN178.5bn assumed in the draft budget bill.
- This year's budget deficit will be cPLN10bn below target, we believe, implying the effective pre-financing rate is higher (at 15-20%, which is still lower than in previous years).
- Both net and gross borrowing needs for 2017 should not change significantly as compared to the initial assumptions (see left-hand chart). However, there are two factors, mentioned on the previous page, that could reduce the possible supply: central bank profits (possibly even cPLN10bn) and the possibility of the Social Security Fund transfer being reduced by PLN4bn (due to a one-off cash transfer from pension funds to ZUS, attributable to the adjustment of the 10-year pre-retirement scheme).
- Taking this into account, but also including a need to pre-finance the 2018 budgetary needs in 2H17, the average T-bonds supply on a monthly basis in the domestic market should be close to the average monthly offer of T-bonds in 2016 (cPLN10bn). In our view, FX funding should not exceed 15% of the total gross borrowing needs assumed in the budget law draft.

Gross borrowing requirements



Treasury security redemptions in 2017, including pre-financing done until 15 December 2016

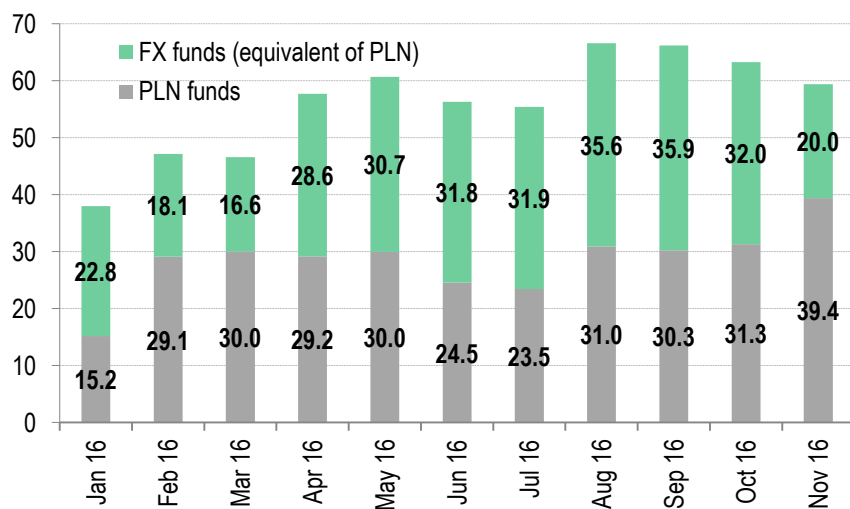


Source: Ministry of Finance, BZ WBK

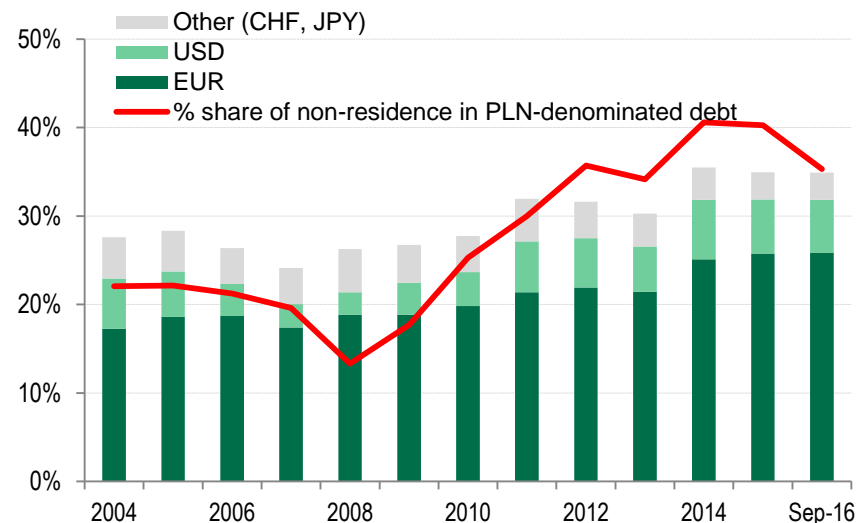
FX debt supply done for 2017, flexible approach expected

- 2016 was quite intense in the primary market. Poland successfully launched bonds denominated in euros (€4.75bn in total), US dollars (\$1.75bn) and Chinese yuan (“Panda” bonds worth RMB3bn). This way, the Ministry of Finance has secured all the FX needs for 2017. Despite higher-than-expected issuance in the international market this year, the share of FX-denominated debt in total debt decreased to below 34% at the end of September, down from nearly 35% at end-2015. Thus, Poland has consistently pursued the policy of reducing the share of foreign debt in total State Treasury debt (though at a slower-than-assumed pace).
- In our view, the structure of funding the 2017 borrowing needs will not change much compared to previous years. Still, PLN-denominated securities should play the main role. At the same time, issuance in international markets should depend on market conditions. It seems that the Euro zone market should still be attractive as regards issuing plans for 2017, given low interest rates and market liquidity. In our view, the Ministry will maintain its flexible approach to tapping bonds in both external and domestic markets, with demand from local banks likely to determine the structure of auction offerings in the latter case.

Funds in PLN and foreign currency in budgetary accounts
(funds financing the borrowing needs, month-end, PLN bn)



Structure of FX-denominated debt (share in total debt) and non-residents' holdings of PLN-denominated debt

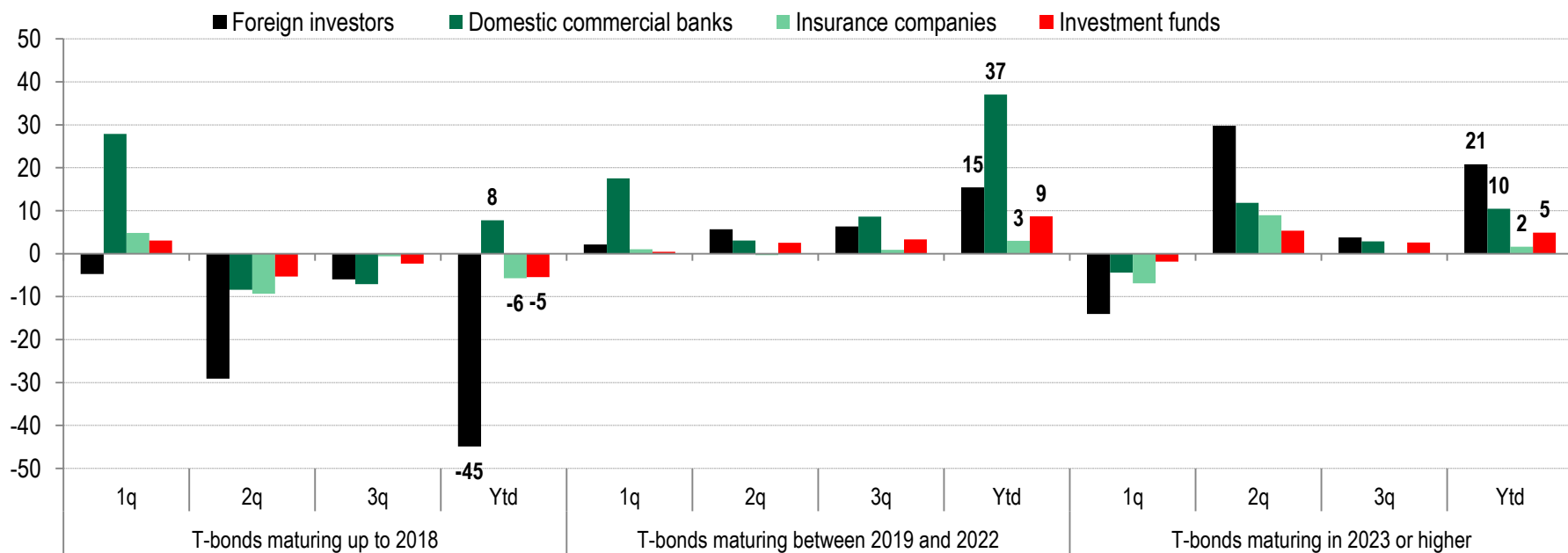


Source: Ministry of Finance, BZ WBK

Demand-side 2016: Local banks incentivized to buy

- In 2016, domestic banks strengthened their role in financing Poland's net borrowing needs. This resulted from a surplus of deposits over loans and the exemption of government papers from the banking tax base (tax introduced as of February 1, 2016) - local banks were incentivized to move from NBP bills to Polish Treasury Securities (in particular, the front end of the curve and floaters).
- In January-October their portfolio increased by cPLN57bn to PLN228.3bn, the highest level in history. Their share of domestic marketable debt increased to c39% at the end of October (c33% end-2015), with the weighted average portfolio duration at 2.1 years (same as end-2015). Local banks' exposure to the risk of Polish market rates (measured by DV01) did not change and amounted to 2.0.

Nominal changes in different segments of Poland's T-bonds in major investor groups' holdings (PLNbn)

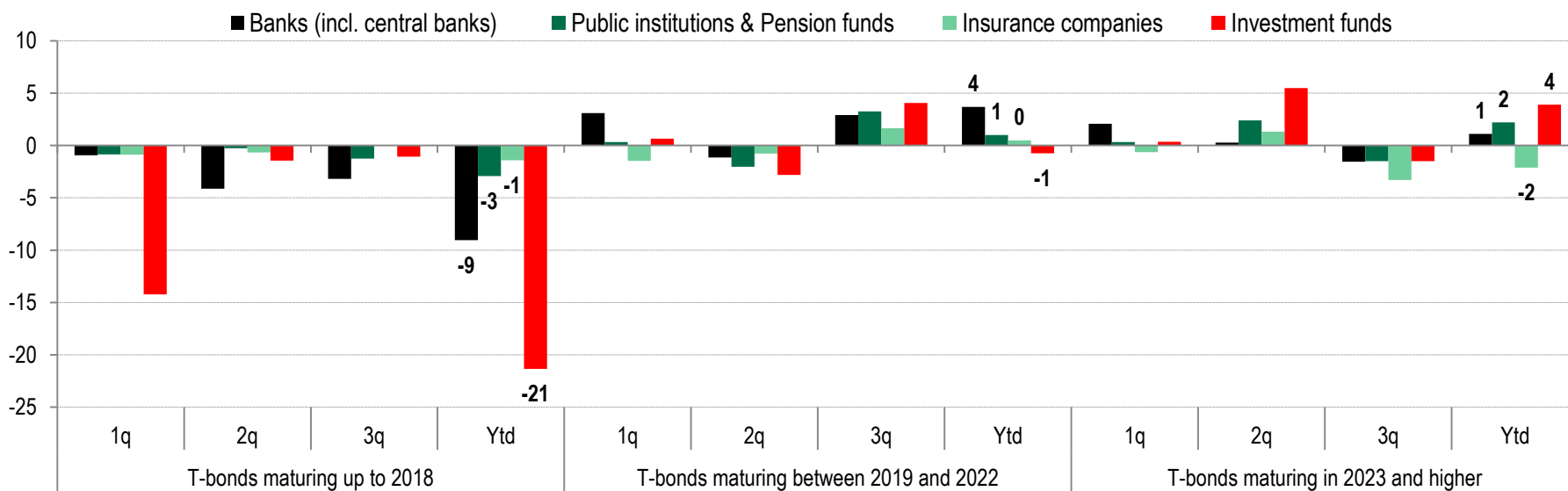


Sources: Ministry of Finance, BZ WBK

Demand-side 2016: Foreigners selling, but duration up

- 2016 brought negative foreign investors' contribution to financing net borrowing needs, for the first time since 2008. Non-resident outflows amounted to nearly PLN10bn in the first ten months. As a result, their portfolio fell to cPLN198bn, down from PLN206.7bn at end-2015.
- However, a clear pattern has been observed in terms of extending portfolio duration. Non-residents were sellers of bonds maturing in up to two years and were accumulating mid- and long-term debt, in particular 5Y and 10Y benchmarks. As a result, at the end of October their share in PS0721 and DS0726 outstanding were at 42% and 77%, respectively. The weighted average duration of foreign investors portfolio increased to 4.7 years (from 3.8 years at end-2015). The exposure of foreign investors to the risk of Polish market rates (measured by DV01) also inched up to 4.7 (from 4.0 at the end of 2015)
- At the end of October 2016, their share in domestic marketable debt amounted to nearly 35% (down from 40% at end-2015), which is still higher than in Hungary (c30%) and Czechia (c28%).

Nominal changes in different segments of Poland's T-bonds in major groups of non-resident holdings (PLN bn)

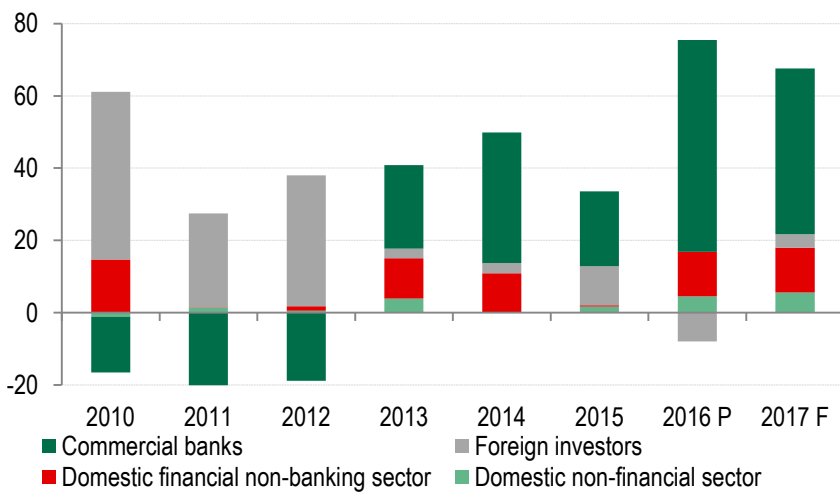


Sources: Ministry of Finance, BZ WBK

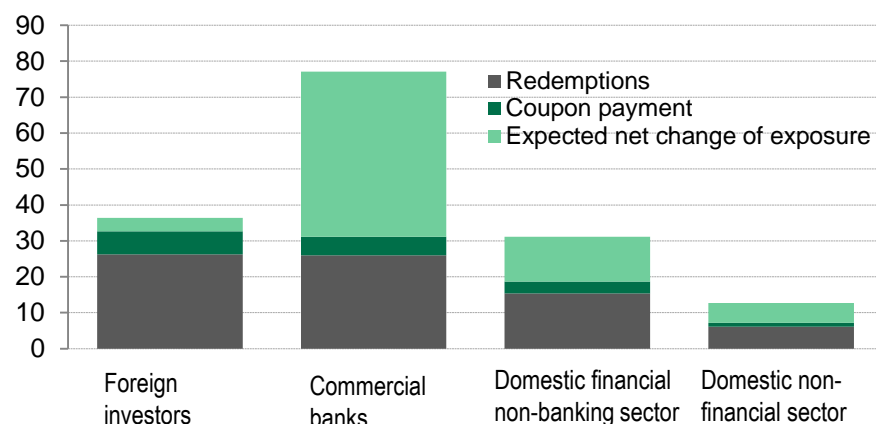
Demand-side 2017: Banks (and foreign investors) key again

- Two groups of investors should continue to play the key role in financing domestic needs in 2017. Domestic commercial banks are still likely to be the main purchasers of domestic bonds. Banking tax as an incentive will probably not change. Bonds worth cPLN35bn in their portfolio will mature in 2017 and are likely to be rolled over. What is more, next year coupon payments for commercial banks will total cPLN5bn. Additionally, according to our forecast loan/deposit ratio (much slower growth of loans than deposits), there should be an additional cPLN40bn of excess liquidity to be invested in T-bills.
- In our view, higher yields on Polish bonds should attract demand from non-residents as the global 'hunt for yield' by investors is still on. This was observed at the start of 2016, after the S&P's decision, as well as after the sell-off post the US election (at different levels, though, as the sell-off was global). Therefore, we expect foreign investors to contribute positively to covering the 2017 borrowing needs.
- Poland's Ministry of Finance will probably fit the auction offerings to demand from domestic banks. As a consequence, especially if global yields continue to rise, the supply of short-term instruments and floaters might increase. Other domestic institutions should maintain their interest in the government debt (net financing roughly the same as in 2016).

Domestic financing – demand side (PLNbn)



Flows to the main investor groups in Poland's T-bond market in 2017 (PLNbn)

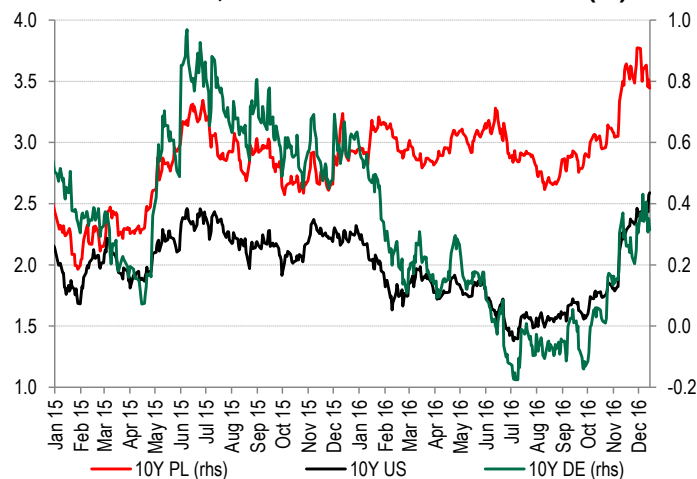


Sources: Ministry of Finance, BZ WBK

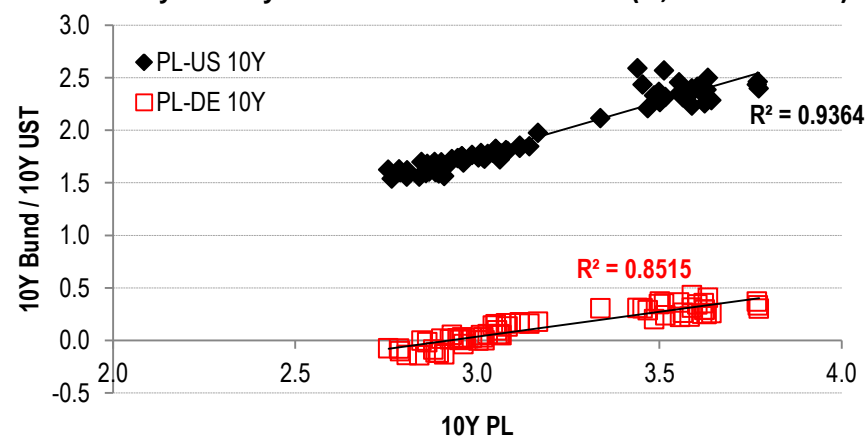
Global factors still the key for Poland's rates

- A further significant slowdown in GDP growth at the turn of 2016/17 (GDP below 2% y/y) should anchor the front-end of the yield curve, even if, at the same time, we see a gradual increase in the headline inflation rate. Later during the year, the front-end may start pricing in MPC hikes materializing in 2018.
- In 2016, external factors, in particular signals from the main central banks, continued as the main driver for the Polish interest rate market at the long-end of the curve. Consequently, the correlation between the 10Y Polish bond and UST (especially since the US presidential election) increased to c94%, while the figure for the Bund was around 85% (in the last 3 months). In our view, the Fed will continue its monetary tightening, delivering two more hikes of 25bp each in 2017, after the Fed rate rose 25bp in December 2016. Consequently, the spill-over from higher US yields should result in some upward pressure on Bunds, but also on Poland's debt, particularly in the 10Y segment. Moreover, Poland's long-term bonds might be under pressure from ongoing risks tied to politics, mainly loosening in fiscal policy.
- All in all, we believe that the Polish curve will steepen further, as the front end should outperform other sectors. In our view, the risk premium for Poland's assets should remain quite high, with the 10Y spread over the Bund oscillating slightly above 300bp.

Yield of Polish, German and US 10Y bonds (%)



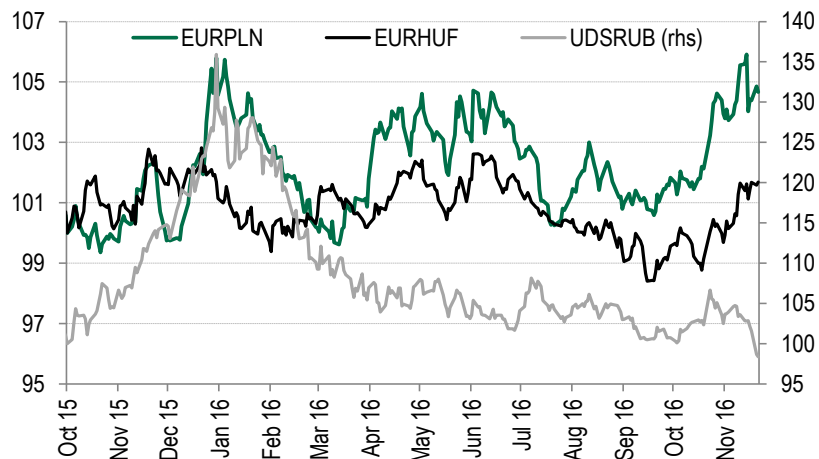
PLN 10Y yield vs yields on 10Y Bund and UST (% , last 3 months)



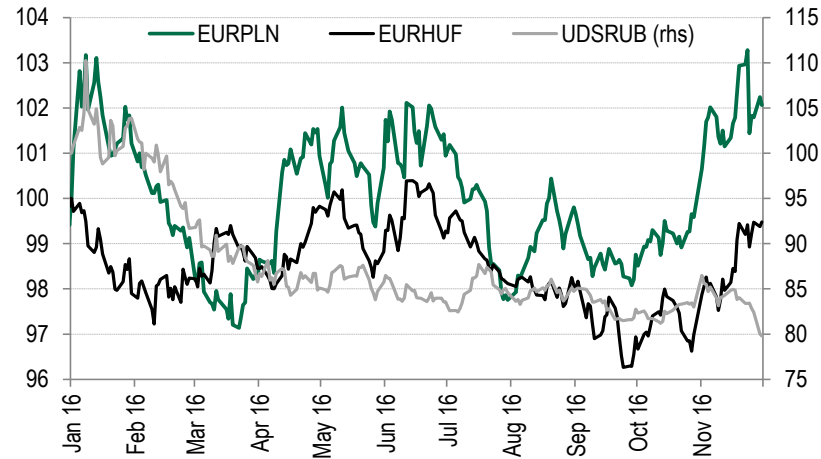
Sources: Reuters, BZ WBK

CEE currencies and big local/global events of 2015/2016

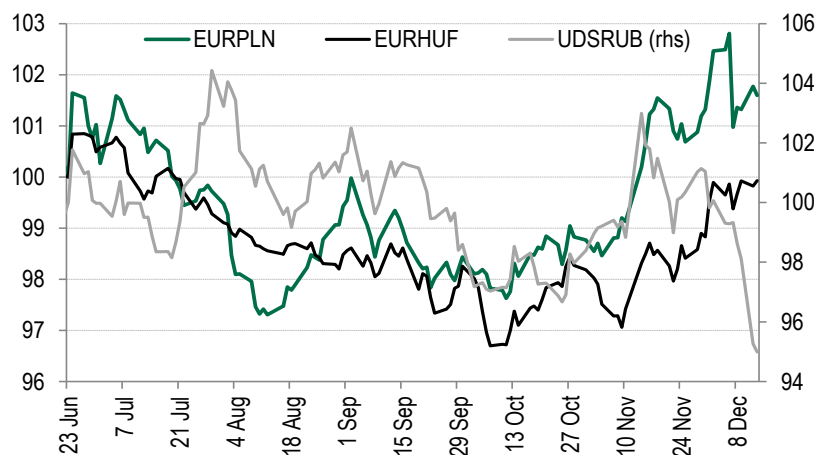
EUR/PLN, EUR/HUF and USD/RUB since the day before Poland's parliamentary elections (23 Oct 2015 = 100)



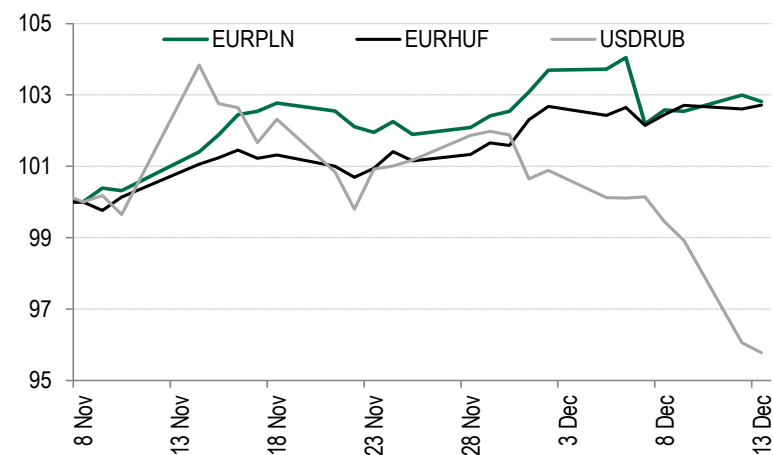
EUR/PLN, EUR/HUF and USD/RUB since the day before Poland's downgrade by S&P (14 Jan 2016 = 100)



EUR/PLN, EUR/HUF and USD/RUB since the day before UK's EU membership referendum (23 June 2016 = 100)



EUR/PLN, EUR/HUF and USD/RUB since the day before US presidential elections (8 Nov 2016 = 100)

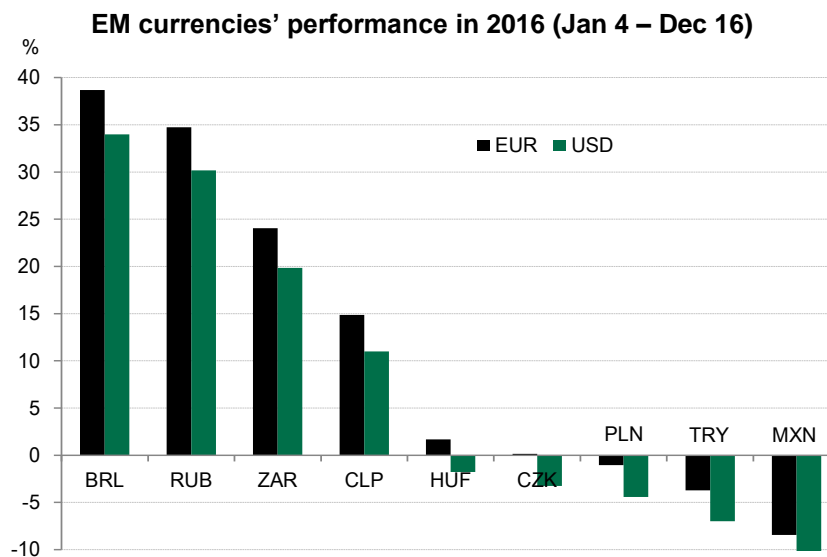


Sources: Reuters, BZ WBK.

Zloty underperformed due to local factors in 2016

In our 2016 Outlook we titled the PLN section “Little room for stronger zloty” and this proved pretty correct. The zloty was also under depreciation pressure from a few one-off events, which deteriorated market sentiment. Already in January the Polish currency was hit by S&P’s unexpected and quite controversial decision to downgrade Poland’s rating. In the following months, EUR/PLN corrected from c4.50 to nearly 4.20 amid hopes of more monetary policy easing from the ECB/BoJ. But concerns about the Polish banking sector, driven by uncertainty of the final shape of the CHF mortgage bill, as well as tensions ahead of the next rating reviews after S&P’s downgrade, continued to generate downside pressure on the zloty. Global political events –UK and Italian referendums, US presidential elections– added to the pressure on risky assets.

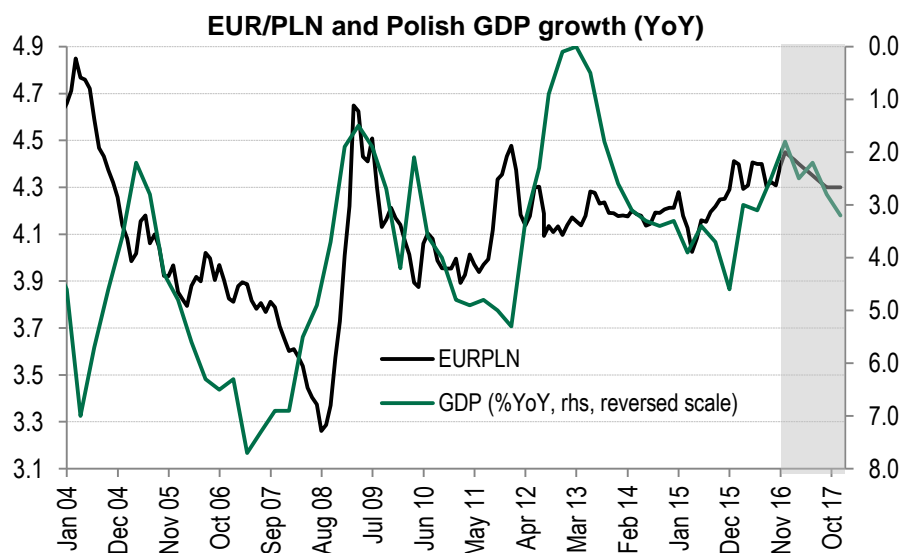
However, although the EM currencies as a general group of assets have performed quite well, the zloty has lagged its CEE peers and has been the third-weakest EM currency vs the euro, dollar and Swiss franc in 2016 (after the Mexican peso and Turkish lira). According to Bloomberg, only three of the main EM currencies lost ground vs the euro and five vs the franc until mid-December, suggesting that their underperformance could actually have been due to country-specific factors.



Sources: Bloomberg, BZ WBK.

Internal factors 2017: economic cycle supportive for zloty

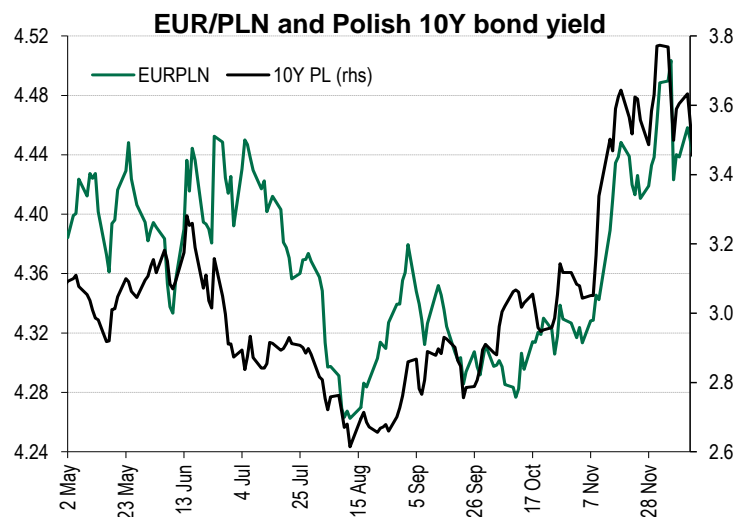
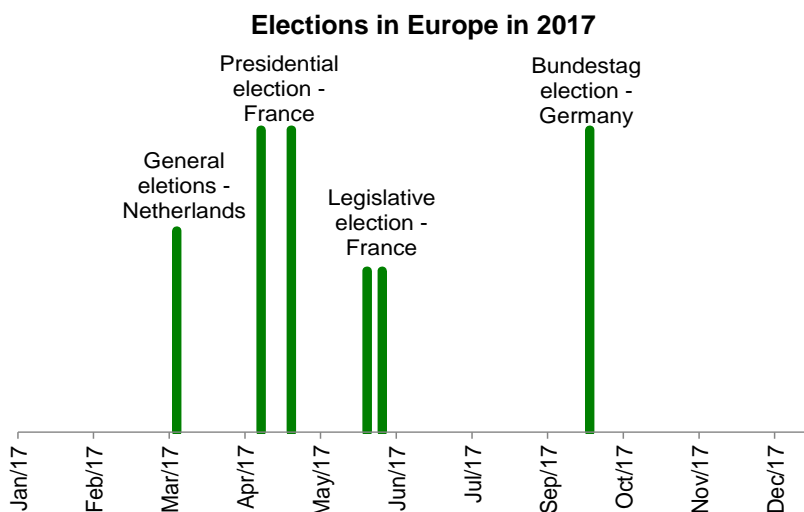
- 2016 saw a sharp deceleration in the pace of GDP growth in Poland. On earlier pages of this report we explain that 2017 should see a gradual rebound, especially in the second half. And this should be supportive for the zloty. On numerous occasions, we have shown that the zloty is a cyclical currency that is likely to gain during an economic revival, and this should be the main driver for the PLN's gradual appreciation in 2017 that we expect.
- Next to the pure economic cycle, we think cash flows could also provide some support for the zloty. We assume that exports will revive over the course of 2017 and that Poland will sustain the trade surplus. The current account to GDP ratio will remain low. Also, the inflow of EU funds will resume in 2017, giving more ammunition to stabilize the zloty in the event of adverse market conditions.
- Prospects of the so-called "re-polonisation" of the banking sector was one of risk factors that could weigh on the zloty. However, this issue has recently lost importance as payment for Pekao SA shares will be settled outside the FX market. Also, Poland's Alior Bank said that it was no longer interested in purchasing Raiffeisen Polbank.



Sources: Bloomberg, BZ WBK.

External factors 2017: politics and central banks

- In 2016, political events had a notable impact on the market and next year's elections scheduled in the Netherlands, France and Germany, as well as possible elections in Italy, are likely to attract investors' attention. Also, any follow-up on Brexit and more details on the new US President's policy might be important.
- As regards monetary policy, the market is pricing two rate hikes from the Fed next year, which is in line with our scenario of two 25bp hikes being delivered in 2Q and 4Q, respectively. We believe the FOMC will only hike rates when it is confident that the US and global economies are performing well and strong demand for risky assets (likely during economic expansion) should diminish concerns about the possible impact on the EMs of a less accommodative monetary policy in the US.
- Yields should rise in the US, and this may generate a negative pressure on Polish assets. Since the US presidential elections, the correlation between EUR/PLN and Poland's 10Y yield has been as high as that between 10Y Polish and US yields (94%). This suggests that the US market became more important for Polish debt than Germany and that part of the zloty's depreciation in late 2016 was fueled by non-residents selling Polish bonds. However, we think that pace of the recent jump in yields also played an important role. If market adjustment is rather gradual next year, weakening bonds should not weigh on the zloty. Actually, long-term investors may find higher yields (and coupons) attractive and cash may flow into the Polish market. Also, the Euro zone's monetary policy should be accommodative even with smaller monthly asset purchases.



Sources: Reuters, BZ WBK, BZ WBK Brokerage.

Global FX: EUR/USD to rebound *

- EUR/USD has stayed below Santander's forecast path throughout 2016, moving gradually down from 1.16 to 1.04. Contrary to our expectation, the euro did not manage to recover the losses suffered in 2014, while it got hit by more monetary policy easing in the Euro zone, the UK voting for Brexit, sound US GDP growth, expectations of Fed rate hikes and Donald Trump's victory in the US presidential elections.
- We expect EUR/USD to hold in the abovementioned range in 2017. In our view, the dollar could remain well bid in 1Q17 thanks to Fed monetary policy and expectations for a fiscal boost from the new US president's economic policy. At the same time, the political uncertainty in Europe and extension of the ECB's asset purchase program should weigh on the single currency in early 2017.
- Later in the year, we assume the exchange rate will start to rebound from the lower band of the range. The sentiment indexes from the Euro zone remained robust despite June's UK referendum and, in our base scenario, we assume a further rebound in economic growth in Europe over next year. This should drive inflation higher, meaning less room for monetary policy easing.
- We expect EUR/USD to rise gradually to 1.11 at the end of 2017, after staying near 1.05 in 1Q17.



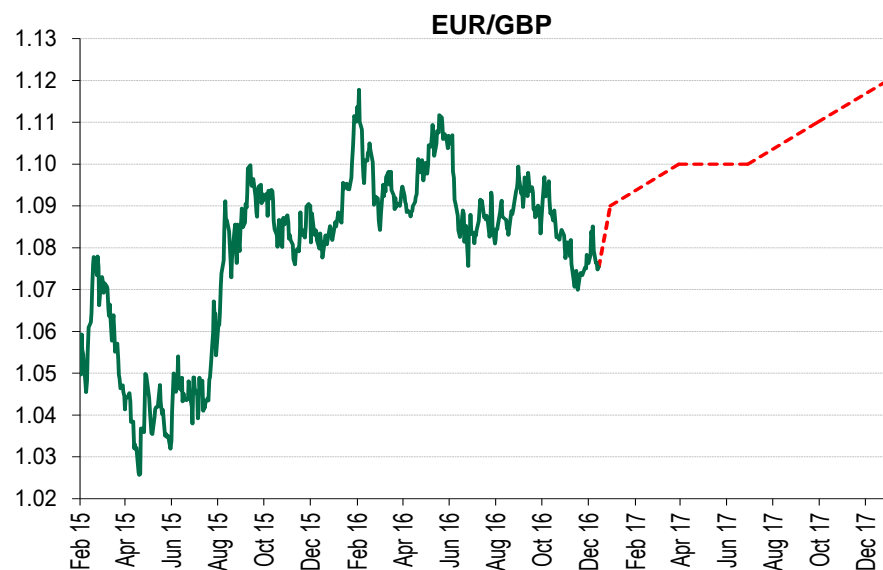
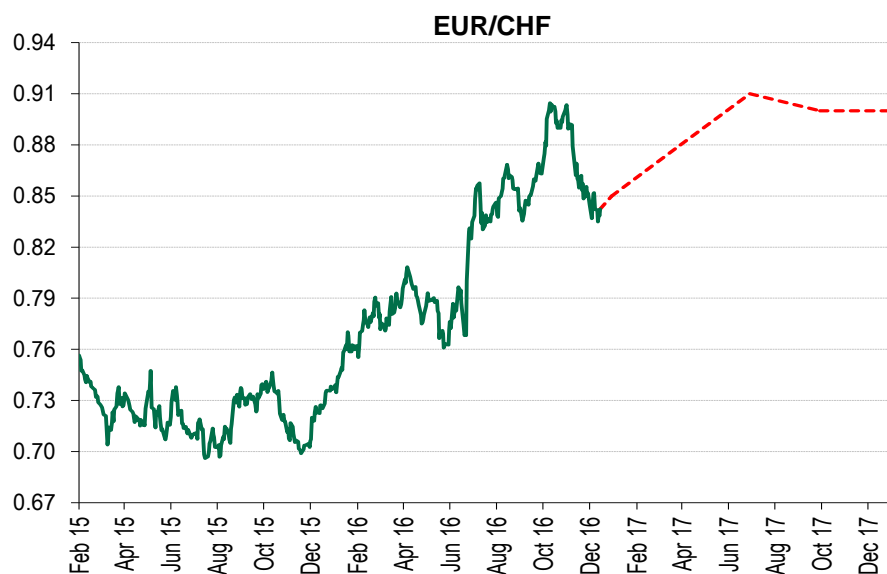
Sources: BZ WBK, Santander, Bloomberg.

* Based on Santander Global FX Strategy's FX Compass published on November 24, 2016

Global FX: EUR/GBP flat; EUR/CHF higher *

■ The UK's late-June decision to leave the EU pushed the pound to multi-year lows vs the euro and dollar. We assume that, in 2017, EUR/GBP will remain roughly stable at around 0.90, while GBP/USD could rise gradually to 1.24. On the one hand, uncertainty about Brexit conditions should obviously weigh on the pound. On the other hand, the market is already very short the GBP, implying that more negative news would have to emerge to push the British currency lower. Apart from the conditions under which the UK will leave the EU, investors will focus on the Supreme Court ruling on whether the British Parliament will have to agree to trigger Article 50. If Parliament's involvement is required, this could increase the chances of a "soft Brexit", boosting the pound.

■ The Swiss Central Bank still perceives the franc as significantly overvalued but has been unable to weaken the currency so far. We continue to see an upward profile for EUR/CHF but the euro's appreciation pace should be rather slow due to major political events in Europe next year. Also, the Swiss economy is expected to perform better next year than in 2016 (1.8% vs 1.5%), so the SNB should not be under excessive pressure to weaken the CHF. We expect EUR/CHF to be near 1.14 at the end of 2017.



* based on Santander Global FX Strategy's FX Compass published on November 24, 2015

Sources: BZ WBK, Bloomberg.

Macroeconomic Forecasts

Poland		2014	2015	2016E	2017E	1Q16	2Q16	3Q16	4Q16E	1Q17E	2Q17E	3Q17E	4Q17E
GDP	PLNbn	1,719.7	1,798.3	1,846.3	1,929.4	428.3	449.4	453.4	515.1	446.2	468.0	473.2	542.0
GDP	%YoY	3.3	3.9	2.6	2.7	3.0	3.1	2.5	1.8	2.5	2.2	2.8	3.2
Domestic demand	%YoY	4.7	3.4	2.7	2.8	3.9	2.2	2.9	1.8	2.6	2.7	2.6	3.2
Private consumption	%YoY	2.6	3.2	3.7	3.9	3.2	3.3	3.9	4.4	4.2	4.2	3.8	3.2
Fixed investment	%YoY	10.0	6.1	-5.1	1.8	-2.2	-5.0	-7.7	-4.8	-3.5	-1.2	3.0	5.0
Unemployment rate ^a	%	11.4	9.7	8.4	7.5	9.9	8.7	8.3	8.4	8.5	7.6	7.3	7.5
Current account balance	EURmn	-8,534	-2,653	-3,360	-3,399	-186	988	-2,641	-1,521	-557	691	-2,133	-1,400
Current account balance	% GDP	-2.1	-0.6	-0.8	-0.8	-0.8	-0.6	-0.7	-0.8	-0.9	-0.9	-0.8	-0.8
General government balance	% GDP	-3.4	-2.6	-2.2	-3.2	-	-	-	-	-	-	-	-
CPI	%YoY	0.0	-0.9	-0.6	1.7	-0.9	-0.9	-0.8	0.1	1.6	1.8	1.6	1.6
CPI ^a	%YoY	-1.0	-0.5	0.5	1.5	-1.1	-0.8	-0.5	0.5	1.8	1.6	1.7	1.5
CPI excluding food and energy prices	%YoY	0.6	0.3	-0.2	0.6	-0.1	-0.3	-0.4	-0.2	0.1	0.5	0.7	1.0

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

Interest Rate and FX Forecasts

Poland		2014	2015	2016E	2017E	1Q16	2Q16	3Q16	4Q16E	1Q17E	2Q17E	3Q17E	4Q17E
Reference rate ^a	%	2.00	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
WIBOR 3M	%	2.52	1.75	1.70	1.75	1.69	1.68	1.71	1.73	1.75	1.75	1.75	1.75
Yield on 2-year T-bonds	%	2.46	1.70	1.62	1.84	1.45	1.57	1.66	1.80	1.80	1.80	1.83	1.92
Yield on 5-year T-bonds	%	2.96	2.21	2.33	2.68	2.23	2.29	2.22	2.61	2.62	2.60	2.67	2.83
Yield on 10-year T-bonds	%	3.49	2.69	3.04	3.71	2.98	3.04	2.82	3.34	3.60	3.67	3.77	3.80
2-year IRS	%	2.51	1.72	1.67	1.83	1.54	1.64	1.68	1.81	1.75	1.77	1.83	1.95
5-year IRS	%	2.92	2.02	1.94	2.29	1.85	1.92	1.84	2.16	2.15	2.18	2.30	2.52
10-year IRS	%	3.34	2.41	2.39	3.12	2.32	2.34	2.19	2.71	2.95	3.05	3.20	3.28
EUR/PLN	PLN	4.18	4.18	4.37	4.35	4.37	4.37	4.34	4.38	4.42	4.37	4.32	4.30
USD/PLN	PLN	3.15	3.77	3.95	4.03	3.96	3.87	3.89	4.07	4.21	4.08	3.94	3.89
CHF/PLN	PLN	3.45	3.92	4.00	3.95	3.98	3.99	3.99	4.05	4.05	3.97	3.91	3.86
GBP/PLN	PLN	5.19	5.77	5.34	4.88	5.67	5.55	5.11	5.04	5.11	4.88	4.77	4.78

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

Important Disclosures

ANALYST CERTIFICATION:

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

EXPLANATION OF THE RECOMMENDATION SYSTEM

DIRECTIONAL RECOMMENDATIONS IN BONDS		DIRECTIONAL RECOMMENDATIONS IN SWAPS	
	Definition		Definition
Long / Buy	Buy the bond for an expected average return of at least 10bp in 3 months (decline in the yield rate), assuming a directional risk.	Long / Receive fixed rate	Enter a swap receiving the fixed rate for an expected average return of at least 10bp in 3 months (decline in the swap rate), assuming a directional risk.
Short / Sell	Sell the bond for an expected average return of at least 10bp in 3 months (increase in the yield rate), assuming a directional risk.	Short / Pay fixed rate	Enter a swap paying the fixed rate for an expected average return of at least 10bp in 3 months (increase in the swap rate), assuming a directional risk.
RELATIVE VALUE RECOMMENDATIONS			
	Definition		
Long a spread / Play steepeners	Enter a long position in a given instrument vs a short position in another instrument (with a longer maturity for steepeners) for an expected average return of at least 5bp in 3 months (increase in the spread between both rates).		
Short a spread / Play flatteners	Enter a long position in a given instrument vs a short position in other instrument (with a shorter maturity for flatteners) for an expected average return of at least 5bp in 3 months (decline in the spread between both rates).		
FX RECOMMENDATIONS			
	Definition		
Long / Buy	Appreciation of a given currency with an expected return of at least 5% in 3 months.		
Short / Sell	Depreciation of a given currency with an expected return of at least 5% in 3 months.		

NOTE: Given the current volatility in the financial markets, the recommendation definitions are only indicative until further notice. We generally review our Rates/FX recommendations monthly, in the regular MACROscope and FX Compass publications, and when market events/moves so warrant.

Important Disclosures (cont.)

This report has been prepared by Bank Zachodni WBK S.A. and is provided for information purposes only. Bank Zachodni WBK S.A. is registered in Poland and is authorised and regulated by The Polish Financial Supervision Authority.

This report is issued in the United States by Santander Investment Securities Inc. ("SIS"), in Poland by Bank Zachodni WBK S.A. ("BZ WBK"), in Spain by Banco Santander, S.A., under the supervision of the CNMV and in the United Kingdom by Banco Santander, S.A., London Branch ("Santander London"). SIS is registered in the United States and is a member of FINRA. Santander London is registered in the UK (with FRN 136261) and subject to limited regulation by the FCA and PRA. SIS, BZ WBK, Banco Santander, S.A. and Santander London are members of Grupo Santander. A list of authorised legal entities within Grupo Santander is available upon request.

This material constitutes "investment research" for the purposes of the Markets in Financial Instruments Directive and as such contains an objective or independent explanation of the matters contained in the material. Any recommendations contained in this document must not be relied upon as investment advice based on the recipient's personal circumstances. The information and opinions contained in this report have been obtained from, or are based on, public sources believed to be reliable, but no representation or warranty, express or implied, is made that such information is accurate, complete or up to date and it should not be relied upon as such. Furthermore, this report does not constitute a prospectus or other offering document or an offer or solicitation to buy or sell any securities or other investment. Information and opinions contained in the report are published for the assistance of recipients, but are not to be relied upon as authoritative or taken in substitution for the exercise of judgement by any recipient, are subject to change without notice and not intended to provide the sole basis of any evaluation of the instruments discussed herein.

Any reference to past performance should not be taken as an indication of future performance. This report is for the use of intended recipients only and may not be reproduced (in whole or in part) or delivered or transmitted to any other person without the prior written consent of BZ WBK.

Investors should seek financial advice regarding the appropriateness of investing in financial instruments and implementing investment strategies discussed or recommended in this report and should understand that statements regarding future prospects may not be realised. Any decision to purchase or subscribe for securities in any offering must be based solely on existing public information on such security or the information in the prospectus or other offering document issued in connection with such offering, and not on this report.

The material in this research report is general information intended for recipients who understand the risks associated with investment. It does not take into account whether an investment, course of action, or associated risks are suitable for the recipient. Furthermore, this document is intended to be used by market professionals (eligible counterparties and professional clients but not retail clients). Retail clients must not rely on this document.

To the fullest extent permitted by law, no Santander Group company accepts any liability whatsoever (including in negligence) for any direct or consequential loss arising from any use of or reliance on material contained in this report. All estimates and opinions included in this report are made as of the date of this report. Unless otherwise indicated in this report there is no intention to update this report.

BZ WBK and its legal affiliates (trading as Santander and/or Santander Global Corporate Banking) may make a market in, or may, as principal or agent, buy or sell securities of the issuers mentioned in this report or derivatives thereon. BZ WBK and its legal affiliates may have a financial interest in the issuers mentioned in this report, including a long or short position in their securities and/or options, futures or other derivative instruments based thereon, or vice versa.

BZ WBK and its legal affiliates may receive or intend to seek compensation for investment banking services in the next three months from or in relation to an issuer mentioned in this report. Any issuer mentioned in this report may have been provided with sections of this report prior to its publication in order to verify its factual accuracy.

Bank Zachodni WBK S.A. (BZ WBK) and/or a company in the Santander Group is a market maker or a liquidity provider for EUR/PLN.

Bank Zachodni WBK S.A. (BZ WBK) and/or a company of the Santander Group has been lead or co-lead manager over the previous 12 months in a publicly disclosed offer of or on financial instruments issued by the Polish Ministry of Finance or Ministry of Treasury.

Bank Zachodni WBK S.A. (BZ WBK) and/or a company in the Santander Group expects to receive or intends to seek compensation for investment banking services from the Polish Ministry of Finance or Ministry of Treasury in the next three months.

Important Disclosures (cont.)

ADDITIONAL INFORMATION

BZ WBK or any of its affiliates, salespeople, traders and other professionals may provide oral or written market commentary or trading strategies to its clients that reflect opinions that are contrary to the opinions expressed herein. Furthermore, BZ WBK or any of its affiliates' trading and investment businesses may make investment decisions that are inconsistent with the recommendations expressed herein.

No part of this report may be copied, conveyed, distributed or furnished to any person or entity in any country (or persons or entities in the same) in which its distribution is prohibited by law. Failure to comply with these restrictions may breach the laws of the relevant jurisdiction.

Investment research issued by BZ WBK is prepared in accordance with the Santander Group policies for managing conflicts of interest. In relation to the production of investment research, BZ WBK and its affiliates have internal rules of conduct that contain, among other things, procedures to prevent conflicts of interest including Chinese Walls and, where appropriate, establishing specific restrictions on research activity. Information concerning the management of conflicts of interest and the internal rules of conduct are available on request from BZ WBK.

COUNTRY & REGION SPECIFIC DISCLOSURES

U.K. and European Economic Area (EEA): Unless specified to the contrary, issued and approved for distribution in the U.K. and the EEA by Banco Santander, S.A. Investment research issued by Banco Santander, S.A. has been prepared in accordance with Grupo Santander's policies for managing conflicts of interest arising as a result of publication and distribution of investment research. Many European regulators require that a firm establish, implement and maintain such a policy. This report has been issued in the U.K. only to persons of a kind described in Article 19 (5), 38, 47 and 49 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (all such persons being referred to as "relevant persons"). This document must not be acted on or relied on by persons who are not relevant persons. Any investment or investment activity to which this document relates is only regarded as being provided to professional investors (or equivalent) in their home jurisdiction. **United States of America (US):** This report is being distributed to US persons by Santander Investment Securities Inc ("SIS") or by a subsidiary or affiliate of SIS that is not registered as a US broker dealer, to US major institutional investors only. Any US recipient of this report (other than a registered broker-dealer or a bank acting in a broker-dealer capacity) that would like to effect any transaction in any security or issuer discussed herein should contact and place orders in the United States with the company distributing the research, SIS at (212) 692-2550, which, without in any way limiting the foregoing, accepts responsibility (solely for purposes of and within the meaning of Rule 15a-6 under the US Securities Exchange Act of 1934) under this report and its dissemination in the United States. US recipients of this report should be advised that this research has been produced by a non-member affiliate of SIS and, therefore, by rule, not all disclosures required under FINRA 2241 apply. **Hong Kong (HK):** This report is being distributed in Hong Kong by a subsidiary or affiliate of Banco Santander, S.A. Hong Kong Branch, a branch of Banco Santander, S.A. whose head office is in Spain. The 1% ownership disclosure satisfies the requirements under Paragraph 16.5(a) of the Hong Kong Code of Conduct for persons licensed by or registered with the Securities and Futures Commission, HK. Banco Santander, S.A. Hong Kong Branch is regulated as a Registered Institution by the Hong Kong Monetary Authority for the conduct of Advising and Dealing in Securities (Regulated Activity Type 4 and 1 respectively) under the Securities and Futures Ordinance. The recipient of this material must not distribute it to any third party without the prior written consent of Banco Santander, S.A. **Japan (JP):** This report has been considered and distributed in Japan to Japanese-based investors by a subsidiary or affiliate of Banco Santander, S.A. - Tokyo Representative Office, not registered as a financial instruments firm in Japan, and to certain financial institutions defined by article 17-3, item 1 of the Financial Instruments and Exchange Law Enforcement Order. Some of the foreign securities stated in this report are not disclosed according to the Financial Instruments and Exchange Law of Japan. There is a risk that a loss may occur due to a change in the price of the shares in the case of share trading and that a loss may occur due to the exchange rate in the case of foreign share trading. **China (CH):** This report is being distributed in China by a subsidiary or affiliate of Banco Santander, S.A. Shanghai Branch ("Santander Shanghai"). Santander Shanghai or its affiliates may have a holding in any of the securities discussed in this report; for securities where the holding is greater than 1%, the specific holding is disclosed in the Important Disclosures section above. **Poland (PL):** This publication has been prepared by Bank Zachodni WBK S.A. for information purposes only and it is not an offer or solicitation for the purchase or sale of any financial instrument. All reasonable care has been taken to ensure that the information contained herein is not untrue or misleading. But no representation is made as to its accuracy or completeness. No reliance should be placed on it and no liability is accepted for any loss arising from reliance on it. Information presented in the publication is not an investment advice. Resulting from the purchase or sale of financial instrument, additional costs, including taxes, that are not payable to or through Bank Zachodni WBK S.A., can arise to the purchasing or selling party. Rates used for calculation can differ from market levels or can be inconsistent with financial calculation of any market participant. Conditions presented in the publication are subject to change. Examples presented in the publication is for information purposes only and shall be treated only as a base for further discussion.

Grupo Santander © 2016. All Rights Reserved