RATES AND FX OUTLOOK

POLISH FINANCIAL MARKET

October 2014

Bank Zachodni WBK
Grupa Santander

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Summary

- Recently-released data confirmed that **economic activity in Poland is slowing down and that GDP growth in 3Q14 probably slid below 3%YoY**. While the deceleration in industrial production, construction output and retail sales in recent months was quite significant, export performance in the first half of the year was still relatively decent, showing only a mild slowdown overall and a continued expansion on EU markets. On a positive note, the labour market is still improving (falling jobless rate, growing real labour income), which should support private consumption, and a recovery in investment is probably under way (no sign of weakness in corporate demand for investment loans, companies are hiring new people). **We stick to our forecasts of 3.1% average GDP growth in 2014E and 2015E.**
- Meanwhile, **inflation is falling further (-0.3%YoY in August) and will most likely remain below zero until year-end**, under pressure from low food and commodity prices and subdued economic growth. The coming quarters should see a rebound in CPI growth, but a very gradual one, with inflation probably staying below the 2.5% official target until 2H 2016E.
- The Monetary Policy Council (MPC) decided to keep rates on hold in September, but clearly suggested re-opening its monetary easing cycle in October. We think that, given the recent change in the macroeconomic scenario, **the MPC will cut rates by 75bp between now and the end of this year and will probably do it in gradual steps of 25bp a month in 4Q**. Recent disappointing data increase the chances of a deeper, 50bp rate cut in October, but the latest comments by the MPC members make us think the Council is more likely to move in smaller, cautious steps.
- The Polish fixed-income market strengthened further, with yields falling to new lows as investors bet on larger MPC rate cuts and prices supported by stronger Euro zone debt after the ECB's policy easing. **While the MPC decision to cut rates by 25bp in October may trigger some correction, it could be very short-lived (possibly just a few hours), and we still see room for a further decline in both yields and IRS rates.** The market should be supported by: the ECB liquidity injection and the resulting hunt for yield; the prospect of lower MPC rates ahead; and by still-uninspiring economic data (with the exception of industrial output growth, which may rebound in September, but mainly due to a calendar effect).
- The zloty remained extremely stable versus the euro, but weakened substantially against the dollar in September. **We think the currency may hold steady in the near term and appreciate slightly in the medium run.**
- The biggest risk factor for both FI and FX markets is Federal Reserve policy. Should investors start worrying about faster interest rate hikes in the US, the Polish currency and bonds may suffer, as they did in the middle of 2013 when market started panicking about Fed tapering.

Short- and Medium-term Strategy: Interest Rate Market

	Change (bp)		Level	Expected trend	
	Last 3M	Last 1M	end-September	1M	3M
Reference rate	0	0	**2.50**	↘↘	↘↘
3M WIBOR	-40	-31	**2.28**	↘↘	↘↘
2Y bond yield	-51	-20	**1.98**	↘	↘
5Y bond yield	-65	-17	**2.37**	↘	↘
10Y bond yield	-46	-14	**2.97**	↘	↘
2/10Y curve slope	4	7	**99**	→	→

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

PLN rates: our view and risk factors

Money market: Money market and FRA rates declined further on market expectations of sharper-than-previously-forecast monetary easing in the coming months. A rate cut of "only" 25bp in October may trigger a short-term correction, but we expect WIBOR to fall further before year-end, based on a NBP rate cut of a total of 75bp in the next three months, weak macro data and a prolonged period of sub-zero inflation.

Short end: Yields fell to new all-time lows, aggressively pricing-in the expected scale of future monetary easing. A cut of 25bp in October may bring a brief correction, but, in our view, there is still some room for yields to decline at the short end of the curve.

Long end: Even though a cautious rate cut in October may trigger some correction, it may be very short-lived (even several hours long) and we still see room for further decline in both yields and IRS rates. This would be supported by anticipated accommodative ECB policy – as the search for yield will continue to help shrink risk premiums – by the anticipation of lower MPC rates in the coming months and by still-uninspiring economic data.

Risks to our view: Divergence between monetary policies in the Euro zone and US creates a risk of higher volatility in emerging market assets, in our view. If investors start worrying about faster interest rate hikes in the US, Polish bonds may suffer, as they did in the middle of 2013 when the market started panicking about Fed tapering.

Short- and Medium-term Strategy: FX Market

	Change (%)		Level	Expected Trend	
	Last 3M	Last 1M	end-September	1M	3M
EURPLN	0.4	-0.9	**4.18**	→	→
USDPLN	8.2	3.2	**3.30**	→	↘
CHFPLN	1.6	-0.7	**3.47**	→	↘
GBPPLN	3.2	1.0	**5.36**	↗	↗
EURUSD	-7.3	-3.9	**1.27**	→	→

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

PLN FX Market: Our view and risk factors

EUR: The zloty is extremely stable versus the euro, with the range of monthly fluctuations in September at the lowest level since 1998. We see the currency remaining range-bound near its current levels in the short term, as the positive impact of the ECB's liquidity injection may be offset by investors' worries about looming rate hikes in the US and geopolitical risk. On the longer-term horizon, we could see a gradual appreciation of the zloty as the Polish economy looks set to keep growing faster than its peers, with real interest rates still among the highest in the region.

USD: The sharp appreciation of US dollar triggered a more than 3% rise in the USDPLN in September, taking its gain to c.10% in the last six months. While, in the short term, we see a risk of a further drop of the EURUSD, which could push the USDPLN even higher, in the medium run the zloty may trim some of its losses versus the dollar, assuming some rebound in the EURUSD.

CHF: The Swiss franc remains overvalued against the euro, in our view, but negative EUR sentiment should keep the EURCHF hovering around its 1.20 floor. Consequently, we expect the CHFPLN to stay in a horizontal trend in the near term, just like the EURPLN. In medium term we still see scope for a faster zloty appreciation versus the franc than versus the euro, due to the expected rise in the EURCHF.

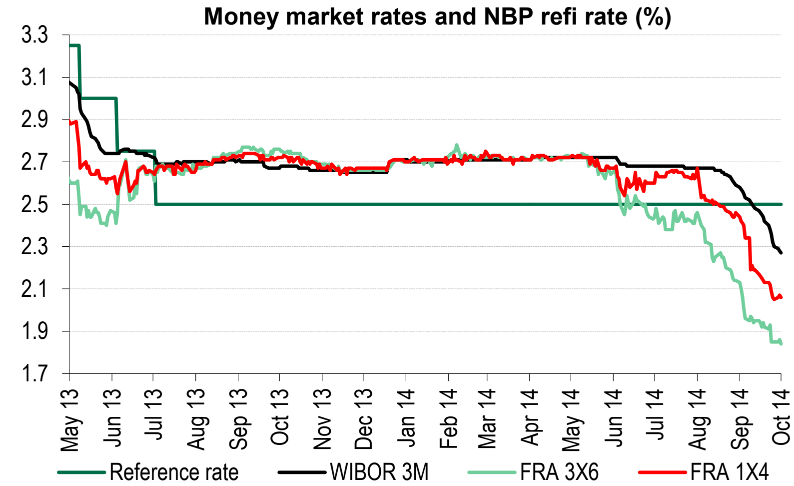
Risks to our view: The biggest risk for the FX market is likely to be the monetary policy outlook in the US. Worries about faster Fed interest rate hikes may trigger further dollar strengthening and a zloty sell-off, as they did in mid-2013. Another risk is the situation in Ukraine, where growing evidence of ceasefire violations could trigger a re-escalation of the military conflict.

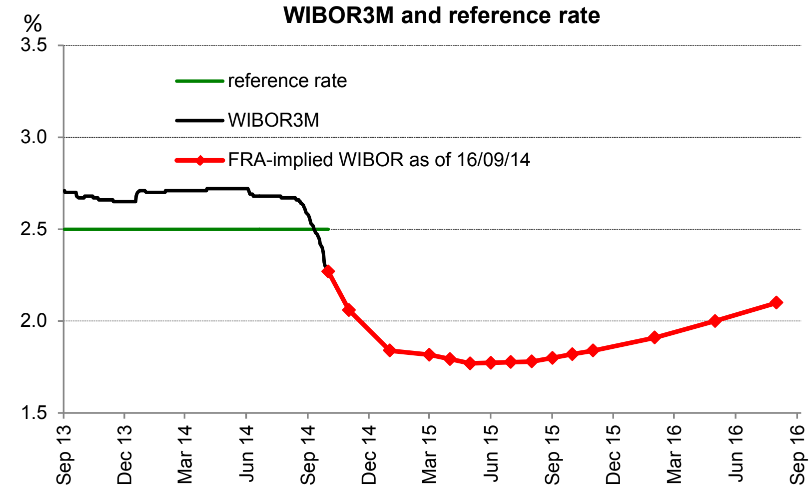
Domestic Money Market: The market expects aggressive monetary easing

- Money market rates fell significantly in September as rate cut expectations strengthened after dovish comments from MPC members, suggesting deeper cuts in official rates than the market expected. In monthly terms, WIBORs fell by 19-39bp across the board, with the 12M rate dropping most.

- Three to 12M WIBOR rates have fallen by 40-51bp since the July MPC meeting, when the Council dropped its forward guidance, indicating rates would be stable until the end of 3Q. The FRA market is currently pricing-in a further 50bp decline in the 3M WIBOR over the next six months. This means that the market is anticipating interest rate cuts of almost 100bp by the end of 1Q 2015, with high odds of a 50bp cut in October. Our baseline scenario assumes that the total adjustment will reach 75bp, with the central bank more likely to deliver cuts in small steps: 25bp in each of the next three months. We, therefore, see the risk of a correction (at least a short-term one) if the MPC decides to cut by only 25bp at its next meeting.

- In the medium term (between now and year end) we expect WIBOR rates to continue their gradual decline, with the 3M rate falling towards 1.90%, supported by gradual monetary easing, weak macro data and a prolonged period of below-zero inflation. As we do not expect any further changes in the NBP policy rate throughout 2015, we expect stable short-term money market rates next year, with WIBOR 3M averaging close to 2%.





Source: Reuters, BZ WBK

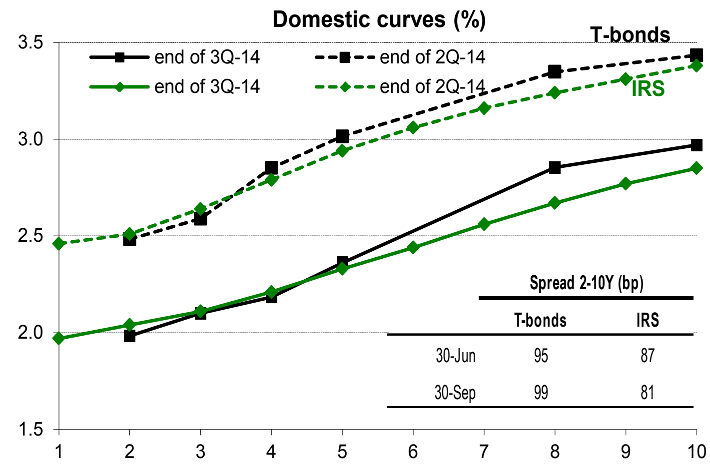
Domestic IRS and the T-Bond Market: Domestic assets mirror Bunds

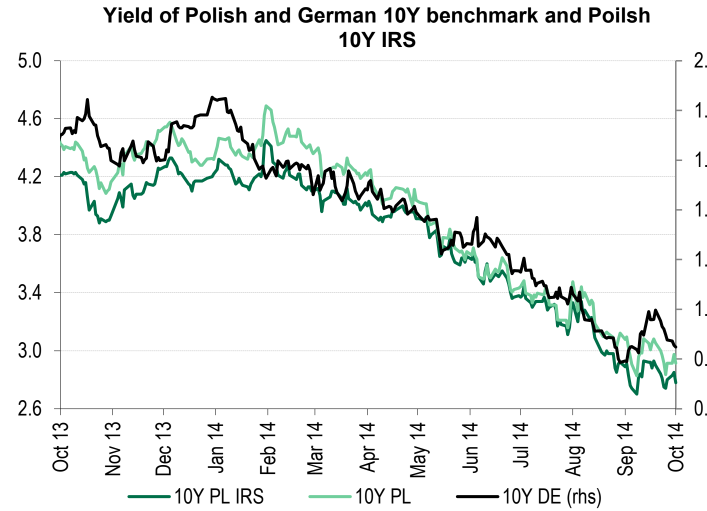
- Poland's T-bonds and IRS gained considerably in the past month. Yields and IRS rates shifted down in September (by 14-25bp and 7-24bp, respectively), in line with the ECB's action, which pushed Euro zone core and semi-core yields down, and due to dovish comments from Polish MPC members, which boosted speculation about deeper rate cuts than were already priced-in. September's FOMC meeting, which slightly raised worries about earlier monetary tightening in the US, brought only a short-lived correction at the long end of curves. Overall, yields and IRS rates reached fresh all time-lows in September.

- The spread over Bunds continued to narrow, dropping briefly below 190bp (the lowest level since May 2013). Domestic curves steepened slightly, in line with the global trend, with the 2-10Y spread increasing to nearly 100bp for T-bonds (from c90bp at the end of August) and to c80bp for IRS (from c70bp).

- We think that a rate cut of 25bp at the next MPC meeting may bring another correction, but, in our opinion, it will be only short-lived. We think there is still room for a further decline in yields/IRS rates in the coming weeks. This should be supported by accommodative ECB policy, as the search for yield will continue to help shrink risk premiums, and by still-uninspiring economic data.

- Polish assets should continue to be attractive to foreign investors as the looming abundance of cheap liquidity in the Euro zone favours yield hunting. Domestic bonds look attractive when compared with Italian or Spanish debt. The risks for this scenario, apart from geopolitical risks, are signals from the US that rate hikes may happen earlier than expected.



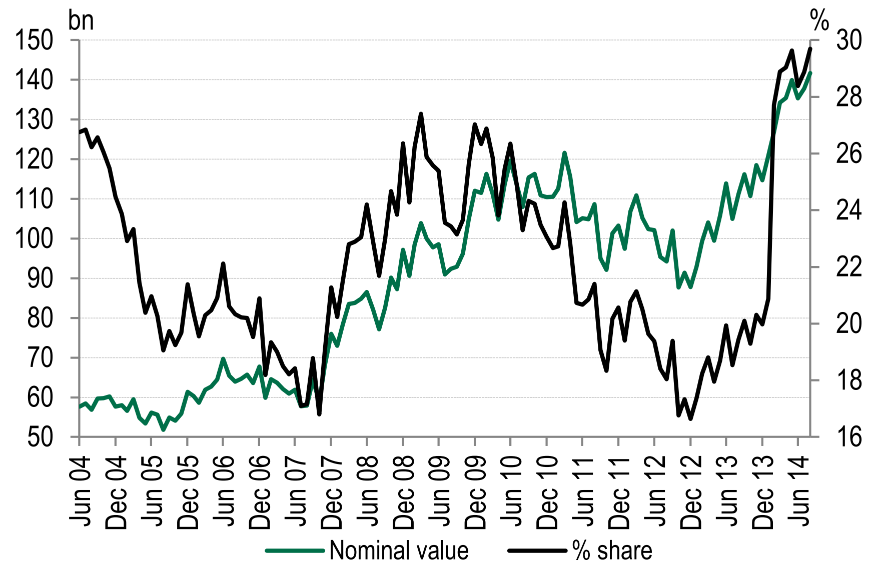


Source: Reuters, BZ WBK.

Demand Corner: Polish banks' holdings at record highs

- Non-residents reduced their nominal holdings of Polish, PLN-denominated marketable debt in August by cPLN3bn. However, the Director of the Public Debt Department, Piotr Marczak, said that in September foreigners' portfolios increased, so some rebound from the current foreign holdings of PLN193.1bn may take place this month (probably due to the decision of the ECB to launch its ABS programme).
- Foreigners sold bonds along the curve in August with the biggest outflow at the long end (PLN1.7bn of sales, including nearly PLN1.1bn in the case of the WS0922 alone).
- Domestic investors increased their portfolios by cPLN3bn in nominal terms, with commercial banks' contributing PLN3.9bn. These entities focused mainly on medium-term bonds. The share of bonds held by banks in the total PLN, marketable debt rose above its peak in May to reach a fresh record high in August (29.7%). In nominal terms, the banks' portfolio value was highest in history (more than PLN140bn).

Share and nominal value of Polish banks portfolio in total, PLN, marketable bonds



Source: Ministry of Finance, BZ WBK.

Supply Corner: Limited T-bond supply in 4Q14

- As expected, Polish T-bond supply will be limited in 4Q14 as the Ministry of Finance had already fully covered this year's gross borrowing requirements at the end of July. The ministry plans only two regular auctions (October and November), worth PLN8-12bn in total (versus sales of PLN12bn in 3Q14).

- The ministry plans three switch auctions in the last quarter (one each month) at which it is offering to repurchase bonds maturing between January and July 2015.

- As regards foreign financing, the ministry expects to receive loans from international financial institutions of €0.6-0.9bn. Bond issuance on the international markets is a possibility if market conditions are favourable. This would justify increasing the level of pre-financing of next year's borrowing requirements during the current year.

- In summary, T-bonds sales in 4Q14 (on both domestic and foreign markets) will be done to pre-finance the 2015 borrowing needs. There is still a favourable environment for T-bonds and we do not foresee any major problems with the debt sales, despite record low yields. Investors' liquidity situation, in particular in October (with inflows of PLN7.9bn from interest payments), will also support auction results.

Issuance plan for 4Q2014

T-bond auction

Auction date	Settlement date	T-bonds	Expected supply
23 Oct 2014	27 Oct 2014	Choice depends on market conditions, with no bond offered at the switching auction	PLN2.0-6.0bn
6 Nov 2014	10 Nov 2014	Choice depends on market conditions, with no bond offered at the switching auction	Up to PLN6.0bn

T-bond switching auction

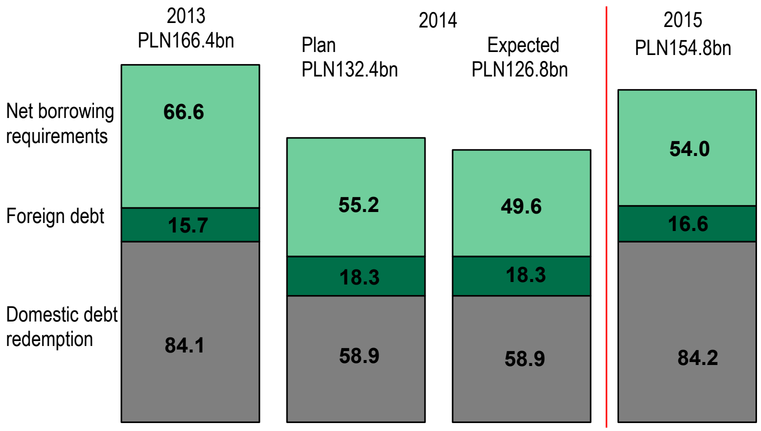
Auction / Settlement date	T-bonds to be offered	Source T-bonds	Outstanding (PLN m)
2 Oct 2014 / 6 Oct 2014	WZ0124/DS0725/WS0428	WZ0115	13,705
		PS0415	25,190
20 Nov 2014 / 24 Nov 2014	The choice depends on market conditions	T-bonds maturing in the period January-July 2015	
4 Dec 2014 / 8 Dec 2014	The choice depends on market conditions	T-bonds maturing in the period January-July 2015	

Source: Ministry of Finance, BZ WBK.

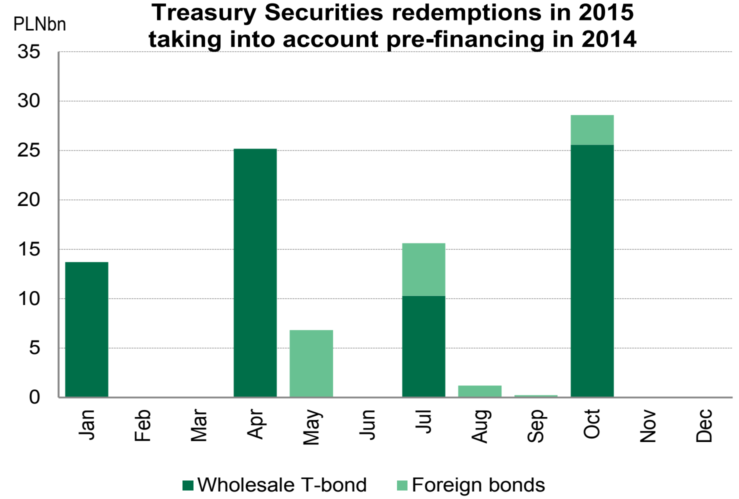
Supply Corner: Higher (net) borrowing needs in 2015

- The budget draft for 2015 assumes a deficit of PLN46.1bn, net borrowing needs of PLN53.98bn and gross borrowing needs of PLN154.8bn. The increase in the borrowing requirement compared with 2014 is mainly due to the larger budget deficit and a sharp increase in redemptions of domestic debt (see chart).
- It is possible, in our view, that the next year's budgeted spending will be at least PLN5bn less than planned. In 2009-13 actual expenditure was lower than planned by cPLN7bn on average. On the other hand, there is a risk of lower budget revenues, as both GDP growth and inflation next year may fall short of the Finance Ministry's assumptions. On balance, it is hard to argue, at this point, that the budget deficit – and the net borrowing needs – will be significantly lower than projected in 2015.
- However, the total supply of debt next year may be lower than suggested by the budget's gross borrowing requirements (possibly by as much as PLN30bn), as the latter do not take into account the pre-financing that has already started this year. We think it very likely that the ministry will pre-fund at least 20% of the 2015 borrowing requirements by year-end 2014, taking advantage of favourable market conditions and strong demand for Polish bonds from foreign investors. If this is the case, gross borrowing needs next year should be no higher than in 2014.

Gross borrowing requirements



Treasury Securities redemptions in 2015 taking into account pre-financing in 2014



Source: Ministry of Finance, BZ WBK.

Supply Corner: More flexible foreign financing

- PLN-denominated securities (mainly fixed-rate T-bonds) will still play the main role in funding the country's net borrowing needs (nearly 80%). The Ministry of Finance plans to keep foreign currency bond issues and net foreign loans at similar levels to this year (respectively, nearly PLN4bn and PLN5bn). However, the importance of foreign funding will be substantially higher than this year, as the Ministry also plans to use liquid money accumulated in the FX account (PLN9.4bn).

- This implies greater flexibility in foreign financing. The ministry will not be under any time pressure to place debt on the international markets as it will be able to use money from the FX account to repay foreign debt or pay interest.

- Overall 2015 gross FX issuance is projected at PLN18.3bn. We think euro-denominated issues will account for the majority of this. The rest is likely to be US dollar debt.

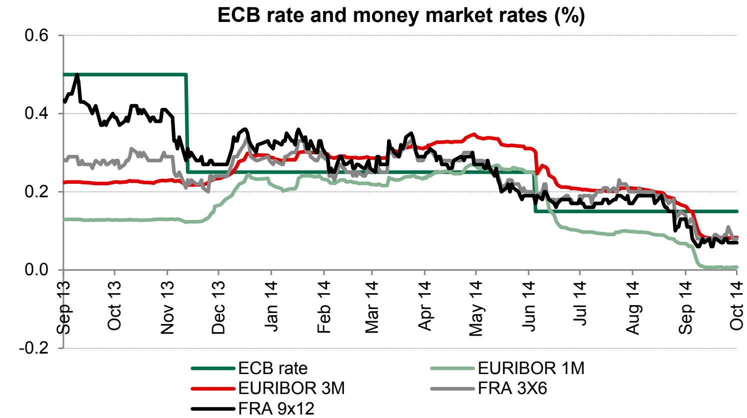
Funding net borrowing requirements in 2015 (PLN mn)

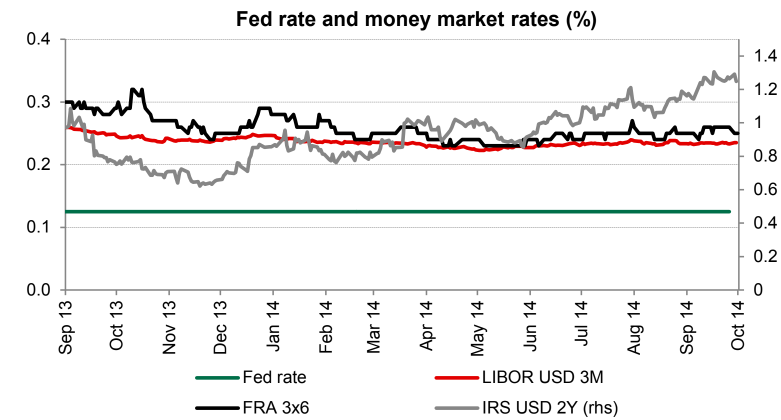
	2014 expected realisation	2015E
Net borrowing needs	**47,377.9**	**53,977.4**
Domestic financing	***51,458.1***	***42,517.2***
1. Issuance on the domestic market	47,184.5	42,517.2
2. Funds on the budget accounts	4,273.6	0.0
Foreign financing	***-4,080.2***	***11,460.2***
1. Issuance on foreign market	3,808.5	3,933.8
2. Loans	4,946.0	5,170.0
3. Management of EU funds	-6,987.5	-7,088.6
4. Flows on FX account	-5,847.3	9,444.2

Source: Ministry of Finance, BZ WBK.

International Money Market and IRS: Central banks set market direction

- The unexpected ECB decision to cut official rates by 10bp at its September meeting changed the market environment considerably. EURIBOR rates fell by 5-7bp in the month (4-5bp of that after the decision). This, together with disappointing Euro zone macro data, caused a decline in IRS rates up to 5Y, while long-term instruments were little changed from the end of August.
- At the same time the US money market rates have remained relatively stable as the FOMC continues its accommodative monetary policy. However, the statement signalled a slight shift towards a more restrictive stance within the committee. The number of dissenting votes increased, compared with July's meeting, and the average interest rate expectations of committee members rose from 1.125% in June to 1.375% in September. USD IRS rates increased by 2-16bp in the month.
- Central bank meetings are set to dominate markets both in the Euro zone and the US. The information presented by the ECB after its October meeting about its asset purchase programmes was less detailed than expected, which disappointed investors. As regards October's FOMC meeting, we think the Fed will end its QE tapering in line with expectations and will adjust its forward guidance. Stronger US economic data could strengthen expectations of an earlier interest rate hike than is currently priced in by the market.





Source: Reuters, ECB, Fed, BZ WBK.

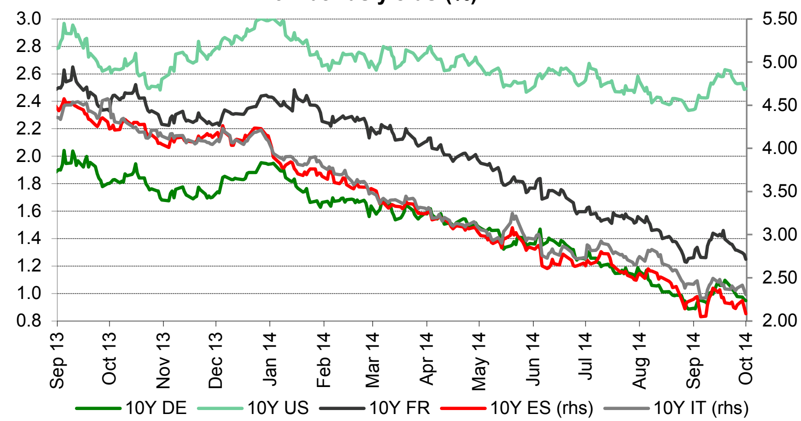
International Bond Market: The front end of curve is supported by central banks

- Contrary to our expectations, September brought another rally on both core and peripheral markets on the back of the unexpected ECB decision to ease monetary conditions further by cutting rates, launching a new long-term liquidity facility (TLTRO) and starting an asset purchase programme for ABS and covered bonds. Consequently, Bund and peripheral debt yields dropped to fresh historical lows. Moreover, spreads over Bunds narrowed noticeably over the month, approaching 100bp for Spain.

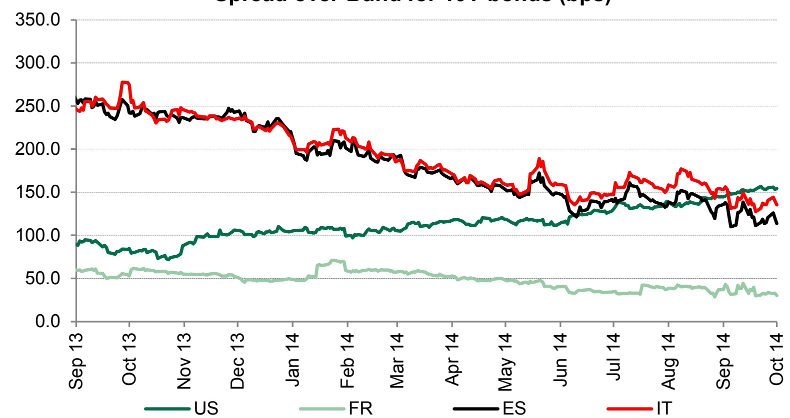
- US Treasuries (UST) yields increased by 5-15bps in September vs August as better macroeconomic data fuelled expectations of early rate hikes. The scale of the upward move in yields increased (the 10Y UST temporarily climbed above 2.60%) as the FOMC revised upward its interest rate forecasts.

- UST yields should remain relatively stable in the short term, but, in the medium to long term, we still expect them to rise, as the improving outlook for the US economy should heighten expectations of earlier hikes by the Fed. However, we think that the increase in long-term yields may be limited due to high global liquidity (in Japan and the Euro zone). On the other hand, we see limited upside risks to EUR rates in the coming weeks. Spanish bonds could rebound slightly as the Catalan president suspended the formal referendum campaign on independence from Spain after a preliminary ruling by the Constitutional Court. Brighter prospects for the Euro zone economy could result in a gradual increase in yields in the medium to long term.

10Y bonds yields (%)



Spread over Bund for 10Y bonds (bps)

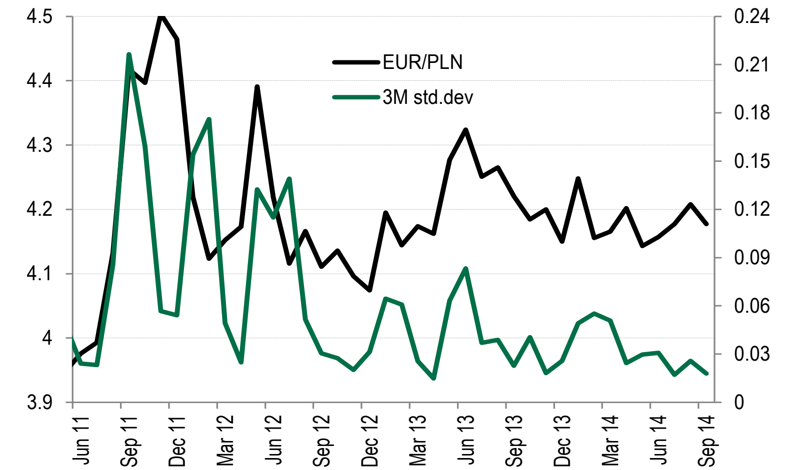


Source: Reuters, BZ WBK.

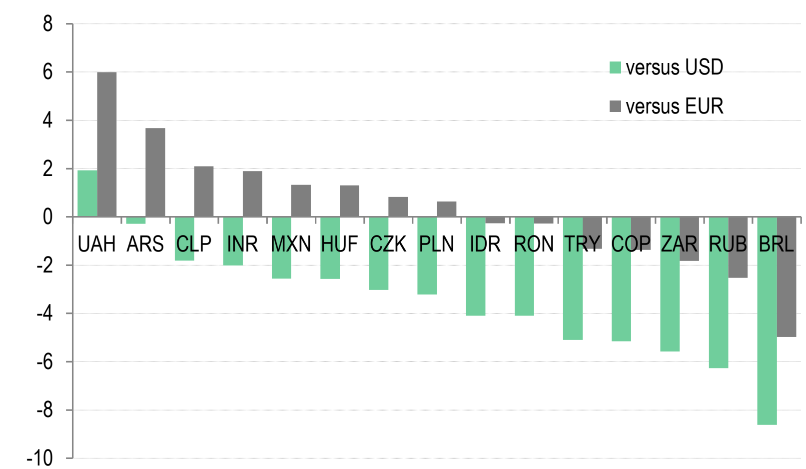
Foreign Exchange Market: Zloty surprisingly stable vs euro

- The zloty has proved surprisingly stable vs. the euro in the last couple of weeks. Its September trading range was the narrowest monthly one since April 1998. Both implied volatilities and monthly standard deviations are clearly moving lower. Three-month EUR/PLN implied volatility is at its lowest since late July and the levels seen in the last few months are even below those of just before the 2007-08 financial crisis. The three-month standard deviation for monthly data is at its lowest since April and only marginally above the levels observed in late 2007.
- At the same time, the zloty lost significant ground vs the dollar. The USD/PLN surged c3% in September to a one-year high.
- Monetary policy in the Euro zone and US should be the key factor affecting Polish FX market in the coming months. Hopes for more accommodative ECB policy should support the zloty, while concern about looming interest rate cuts in the US may work in the opposite direction. We think the two forces will cancel each other out, assuming there are no significant upside surprises from US data and no major disappointments in Europe. As a result, the EUR/PLN should stay in a horizontal trend in the nearest month.
- We still expect a gradual appreciation of the zloty in the coming quarters, as the Polish economy should outperform its peers in the medium term and real interest rates will remain among the highest in the region. The biggest threats to this forecast include a hawkish surprise from the FOMC, disappointing Polish data and a re-escalation of the military conflict in Ukraine.

EUR/PLN and 3-month standard deviation calculated on monthly data



Change of EM currencies versus EUR and USD in September (%)



Source: Bloomberg, BZ WBK

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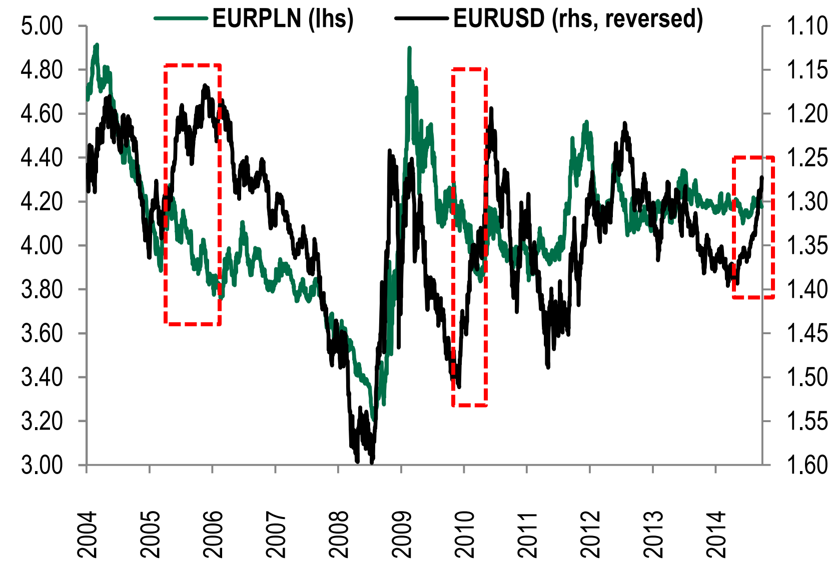
Foreign Exchange Market: Will the strong dollar hit the zloty?

- The EUR/PLN tends to be negatively correlated with EUR/USD, however in recent weeks it remained surprisingly stable, despite a sharp dollar appreciation versus the euro. In the past ten years we found only three periods of clear divergence between the two rates, including the current episode. What those past periods had in common was that the Polish economy was in the middle of a vigorous recovery after a major slowdown and the zloty was climbing steadily following significant losses incurred during the economic downturn. This is not exactly the case this time, as the pace of (modest) economic recovery has just started abating, and the zloty has been moving horizontally for quite some time.
- It seems that the factor preventing the EUR/PLN from a deeper correction this time was the inflow of foreign money to the debt market. We note that the sudden EUR/USD drop has recently put a pressure on EM currencies: those markets that were hit the most, also saw their bonds fall, while the Polish debt gained noticeably amid expectations of interest rate cuts and an inflow of foreign capital.
- The question is whether this trend will continue. We still see some room for the debt market to strengthen and the process of yield hunting in Europe may support Polish assets. However, the yield spread between Poland and other markets is decreasing. Moreover, the country's economic performance is very likely to be less impressive in the next few quarters. This creates a risk that, if the dollar surge continues, it may have more of a negative effect on the zloty.



Source: Bloomberg, BZ WBK

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FX Technical Analysis Corner: EUR/PLN close to strong support

- The upward Shark-32 we presented last month failed to bring an increase in the EUR/PLN. Instead, the exchange rate continued to hover within the 4.17-4.23 range.
- The EUR/PLN is close to strong support at 4.17, consisting of two quite tight SMAs. ADX is on the decline but close to levels that, in the past, have heralded the start of a directional move.
- Breaking 4.163 would be a strong sell signal.

Source: Reuters, BZ WBK

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FX Technical Analysis Corner: EUR/USD keeps falling

- The downtrend in the EUR/USD has accelerated over the last month.
- The exchange rate broke through support points at 1.275 and 1.266, opening the door to a decline towards 1.245.

Source: Reuters, BZ WBK.

Macroeconomic Forecasts

Poland		2012	2013	2014E	2015E	1Q14	2Q14	3Q14E	4Q14E	1Q15E	2Q15E	3Q15E	4Q15E
GDP	PLNbn	1,596.4	1,635.7	1,696.6	1,761.7	397.4	413.46	418.4	467.3	404.6	427.2	437.2	492.7
GDP	%YoY	2.0	1.6	3.1	3.1	3.4	3.30	2.8	2.8	2.5	3.1	3.2	3.5
Domestic demand	%YoY	-0.1	0.0	3.9	4.0	3.0	5.10	3.9	3.6	3.5	3.9	4.2	4.3
Private consumption	%YoY	1.3	0.8	2.8	2.8	2.6	2.80	2.9	2.9	2.8	2.7	2.8	2.9
Fixed investment	%YoY	-1.6	-0.2	7.5	5.4	10.7	8.40	7.0	6.0	5.0	5.0	5.0	6.0
Unemployment rate [a]	%	13.4	13.4	12.1	11.7	13.5	12.00	11.6	12.1	12.4	11.1	11.0	11.7
Current account balance	EURmn	-13,697	-5,245	-6,379	-10,519	-1,403	-553.00	-1,573	-2,850	-2,924	-1,552	-2,568	-3,475
Current account balance	% GDP	-3.6	-1.3	-1.6	-2.4	-1.2	-1.20	-1.2	-1.6	-1.9	-2.1	-2.3	-2.4
General government balance	% GDP	-3.9	-4.3	5.7	-2.9	-	-	-	-	-	-	-	-
CPI	%YoY	3.7	0.9	0.1	0.9	0.6	0.26	-0.3	-0.2	0.1	0.8	1.1	1.6
CPI [a]	%YoY	2.4	0.7	-0.1	1.7	0.7	0.28	-0.4	-0.1	0.2	0.9	1.4	1.7
CPI excluding food and energy prices	%YoY	2.2	1.2	0.8	1.4	0.8	0.84	0.6	0.8	1.2	1.3	1.4	1.5

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

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Interest Rate and FX Forecasts

Poland		2012	2013	2014E	2015E	1Q14	2Q14	3Q14E	4Q14E	1Q15E	2Q15E	3Q15E	4Q15E
Reference rate [a]	%	4.25	2.50	1.75	1.75	2.50	2.50	2.50	1.75	1.75	1.75	1.75	1.75
WIBOR 3M	%	4.91	3.02	2.50	1.96	2.71	2.71	2.59	2.00	1.93	1.95	1.97	1.99
Yield on 2-year T-bonds	%	4.30	2.98	2.48	2.13	3.01	2.76	2.26	1.90	1.97	2.07	2.17	2.33
Yield on 5-year T-bonds	%	4.53	3.46	3.01	2.55	3.71	3.35	2.67	2.28	2.37	2.47	2.60	2.78
Yield on 10-year T-bonds	%	5.02	4.04	3.57	3.01	4.38	3.82	3.18	2.90	2.90	2.90	3.03	3.20
2-year IRS	%	4.52	3.10	2.54	2.36	3.07	2.82	2.32	1.94	2.18	2.33	2.38	2.53
5-year IRS	%	4.47	3.51	2.97	2.40	3.70	3.31	2.63	2.25	2.28	2.33	2.42	2.58
10-year IRS	%	4.56	3.86	3.42	2.94	4.16	3.73	3.07	2.72	2.78	2.89	3.00	3.11
EUR/PLN	PLN	4.19	4.20	4.17	4.09	4.19	4.17	4.18	4.16	4.13	4.10	4.07	4.05
USD/PLN	PLN	3.26	3.16	3.13	3.21	3.06	3.04	3.15	3.29	3.20	3.22	3.23	3.17
CHF/PLN	PLN	3.47	3.41	3.43	3.27	3.42	3.42	3.45	3.43	3.36	3.31	3.26	3.16
GBP/PLN	PLN	5.16	4.94	5.23	5.60	5.06	5.11	5.26	5.48	5.58	5.62	5.62	5.58

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

Economic Calendar and Events

Date		Event:	Note:
8-Oct	**PL**	**MPC Meeting – interest rate decision**	**We expect the MPC to cut rates by 25bp**
14-Oct	EZ	Ecofin Meeting	–
15-Oct	**PL**	**CPI for September**	**Our forecast: -0.4%YoY, in line with the market consensus**
16-Oct	**PL**	**Core CPI excluding food and energy prices for September**	**Our forecast: 0.8%YoY, slightly above market consensus (0.7%)**
	PL	**Employment and wages for September**	**We expect employment to increase by 0.8%YoY and wages to grow 3.5% YoY, in line with market consensus**
17-Oct	**PL**	**Industrial output and PPI for September**	**Our forecast for industrial output is 4.7%YoY (vs market consensus of 2.8%YoY). We predict PPI at -1.6%YoY**
23-Oct	**PL**	**Minutes from September's MPC meeting**	–
	PL	**Regular auction**	**Offer: PLN2.0-6.0bn**
28-Oct	HU	NBH meeting - interest rate decision	–
29-Oct	US	FOMC Meeting – interest rate decision	Summary of Economic Projections and press conference by the Chair
TBA	**PL**	**Retail sales for September**	**Our forecast of 2.5% YoY is in line with market consensus**
3-Nov	**PL**	**PMI manufacturing for October**	–
	EZ	PMI manufacturing for October	–
5-Nov	**PL**	**MPC Meeting – interest rate decision**	**We expect a cut of 25bpi**
6-Nov	EZ	ECB Meeting – interest rate decision	–
	CZ	CNB Meeting – interest rate decision	–

Source: CB, Markit, CSO, Finance Ministry

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Annexe

1. Domestic Market Performance
2. Polish Bonds: Supply Recap
3. Polish Bonds: Demand Recap
4. Euro Zone Bonds: Supply Recap
5. Poland vs Other Countries
6. Central Bank Watch

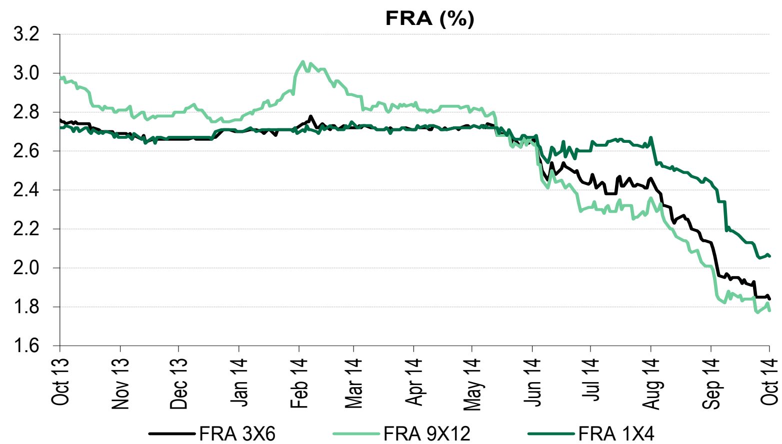
1. Domestic Market Performance

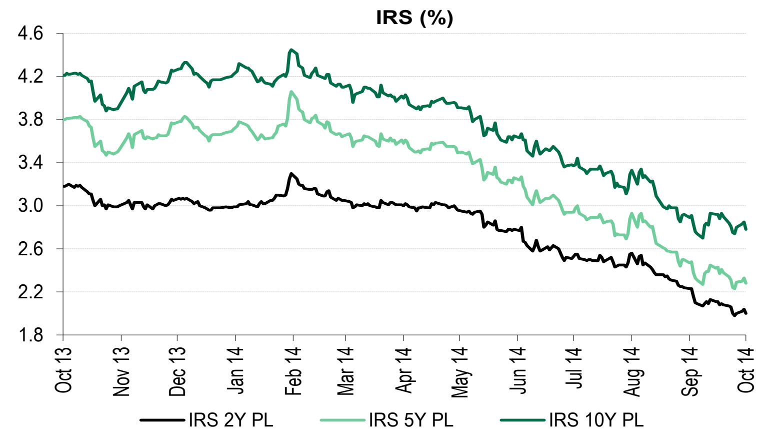
Money market rates (%)

	Reference rate (%)	Polonia (%)	WIBOR (%)				OIS (%)				FRA (%)			
			1M	3M	6M	12M	1M	3M	6M	12M	1x4	3x6	6x9	9x12
End of September	**2.50**	**2.51**	**2.40**	**2.28**	**2.25**	**2.23**	**2.11**	**1.83**	**1.75**	**1.71**	**2.07**	**1.86**	**1.80**	**1.82**
Last 1M change (bp)	0	-6	-19	-31	-35	-39	-30	-40	-29	-27	-39	-28	-21	-19
Last 3M change (bp)	0	-2	-21	-40	-44	-51	-30	-50	-48	-47	-53	-57	-51	-49
Last 1Y change (bp)	0	13	-19	-39	-46	-52	-25	-58	-67	-85	-65	-90	-105	-116

Bond and IRS market (%)

	BONDS			IRS			Spread BONDS / IRS (bp)		
	2Y	5Y	10Y	2Y	5Y	10Y	2Y	5Y	10Y
End of September	**1.98**	**2.36**	**2.97**	**2.04**	**2.33**	**2.85**	**-6**	**3**	**12**
Last 1M change (bp)	-20	-17	-14	-20	-17	-7	0	0	-7
Last 3M change (bp)	-50	-65	-46	-47	-61	-53	-3	-4	7
Last 1Y change (bp)	-104	-147	-150	-114	-148	-136	10	1	-14





Source: Reuters, BZ WBK

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2. Polish Bonds: Supply Recap

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

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
T-bonds auction	18,143	8,821	6,573	17,503	5,694	4,990	8,418		3,595	6,000	5,000		84,737
T-bills auction													0
Retail bonds	256	475	190	170	170	170	170	180	170	175	185	176	2,326
Foreign bonds/credits	16,724	1,150								3,753			21,627
Prefinancing and financial resources at the end of 2013	25,000												25,000
Total	**60,123**	**10,445**	**6,763**	**17,673**	**5,864**	**5,160**	**8,588**	**180**	**3,765**	**9,928**	**5,185**	**176**	**133,689**
Redemption	16,497	5,613	2,230	16,035	116	60	9,470	1,793	2,796	83	816	91	55,599
Net inflows	**43,626**	**4,832**	**4,533**	**1,638**	**5,749**	**5,100**	**-882**	**-1,613**	**969**	**9,845**	**4,369**	**85**	**78,089**
Rolling over T-bonds			4,807			6,117			3,508				**14,432**
Buy-back of T-bills/ FX-denominated bonds													**0**
Total	**43,626**	**4,832**	**9,340**	**1,638**	**5,749**	**11,216**	**-882**	**-1,613**	**4,477**	**9,845**	**4,369**	**85**	**92,521**
Coupon payments from domestic debt	1,546			5,596			2,775		*1,298*	*7,910*			*19,125*

Note: our forecasts = shaded area

Source: MF, BZ WBK

2. Polish Bonds: Supply Recap (cont.)

Schedule of Treasury security redemptions by instrument (in PLN mn)

	Bonds	Bills	Retail bonds	Total domestic redemption	Foreign Bonds/Credits	Total redemptions
January	13,660		155	**13,815**	2,681	**16,497**
February			171	**171**	5,442	**5,613**
March			117	**117**	2,113	**2,230**
April	15,968		66	**16,035**		**16,035**
May			116	**116**		**116**
June			60	**60**		**60**
July	8,145		89	**8,234**	1,236	**9,470**
August			198	**198**	1,594	**1,793**
September			359	**359**	2,438	**2,796**
October			83	**83**		**83**
November			171	**171**	645	**816**
December			91	**91**		**91**
Total 2014	37,773		1,677	**39,450**	16,149	**55,599**
Total 2015	74,561		1,710	**76,271**	14,789	**91,060**
Total 2016	84,347		1,273	**85,621**	17,262	**102,882**
Total 2017	79,417		917	**80,334**	12,566	**92,900**
Total 2018	66,317		911	**67,228**	14,396	**81,624**
Total 2019+	186,202		3,233	**189,435**	135,784	**325,220**

Source: MF, BZ WBK

2. Polish Bonds: Supply Recap (cont.)

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

	Foreign investors	Domestic banks	Insurance funds	Pension funds	Mutual Funds	Individuals	Non-financial sector	Other	Total
Q1 2014	0	0	0	0	0	0	0	0	0
Q2 2014	0	0	0	0	0	0	0	0	0
Q3 2014	0	0	0	0	0	0	0	0	0
Q4 2014	0	0	0	0	0	56	7	14	77
Total 2014	**0**	**0**	**0**	**0**	**0**	**56**	**7**	**14**	**77**
	0%	**0%**	**0%**	**0%**	**0%**	**73%**	**9%**	**19%**	**100%**
Total 2015	31,122	25,538	9,571	536	3,638	244	233	7,225	78,107
	40%	33%	12%	1%	5%	0%	0%	9%	100%
Total 2016	41,399	18,579	9,147	776	9,479	117	99	5,805	85,402
	48%	22%	11%	1%	11%	0%	0%	7%	100%
Total 2017	24,436	16,296	6,168	583	6,762	56	198	4,045	58,543
	42%	28%	11%	1%	12%	0%	0%	7%	100%
Total 2018	17,131	30,518	4,012	360	9,392	78	421	4,405	66,317
	26%	46%	6%	1%	14%	0%	1%	7%	100%
Total 2019+	79,024	50,807	24,705	1,169	15,016	218	359	8,228	179,526
	44%	28%	14%	1%	8%	0%	0%	5%	100%

Source: MF, BZ WBK

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3. Polish Bonds: Demand Recap

Holders of marketable PLN bonds

	Nominal value (PLN bn)			Nominal value (PLN bn)			% change in August			Share in TOTAL (%) in August
	End Aug'14	End Jul14	End Jun'14	End 1Q 2014	End 4Q 2013	End 3Q 2013	MoM	3-mth	YoY	
Domestic investors	284.2	281.2	277.2	277.9	381.2	377.3	1.04	1.12	-24.02	59.5 (0.6pp)
Commercial banks	141.7	137.8	135.4	134.3	114.7	116.2	2.84	1.31	27.56	29.7 (0.8pp)
Insurance companies	53.6	53.4	53.1	52.9	52.0	52.8	0.31	1.76	-1.40	11.2
Pension funds	3.4	3.5	3.3	3.5	125.8	122.7	-1.30	2.62	-97.17	0.7
Mutual funds	44.3	45.1	44.8	45.8	46.7	46.1	-1.79	-4.21	-9.51	9.3 (-0.2pp)
Others	41.1	41.4	40.6	41.4	42.0	39.5	-0.7	2.2	6.3	8.6 (-0.1pp)
Foreign investors*	193.1	196.1	199.8	186.9	193.2	200.6	-1.52	1.83	-2.40	40.5 (-0.6pp)
Banks	10.0	10.8	12.6	n.a.	n.a.	n.a.	-8.0	-4.7	n.a.	2.1 (-0.2pp)
Central banks	18.4	18.1	18.0	n.a.	n.a.	n.a.	1.4	6.3	n.a.	3.9 (0.1pp)
Public institutions	0.7	0.7	0.7	n.a.	n.a.	n.a.	-0.3	3.5	n.a.	0.2
Insurance companies	10.7	9.8	9.5	n.a.	n.a.	n.a.	8.9	14.0	n.a.	2.2 (0.2pp)
Pension funds	12.2	12.3	12.3	n.a.	n.a.	n.a.	-0.9	0.5	n.a.	2.6
Mutual funds	80.0	79.6	83.4	n.a.	n.a.	n.a.	0.5	-0.3	n.a.	16.8 (0.1pp)
Hedge funds	0.1	0.1	0.1	n.a.	n.a.	n.a.	-8.8	-7.1	n.a.	0
Non-financial sector	12.3	11.9	14.2	n.a.	n.a.	n.a.	3.3	-2.0	n.a.	2.6 (0.1pp)
Others	18.6	19.6	16.5	4.5	4.7	5.2	-5.0	17.1	n.a.	3.9 (-0.2pp)
TOTAL	477.3	477.3	477.0	464.8	574.3	577.9	0.0	0.6	-16.5	100

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

Source: MF, BZ WBK

4. Euro Zone Bonds: Supply Recap

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

	Total redemptions	Deficit	Borrowing needs	Expected bond supply	% of completion (YtD*)
Austria	23.4	4.3	27.7	24.7	62.8
Belgium	21.8	9.8	31.6	30.0	91.1
Finland	6.9	4.8	11.7	11.7	106.5
France	105.0	70.2	175.2	174.0	93.9
Germany	144.0	-	144	144.0	75.8
Greece	16.8	5.6	-	-	-
Ireland	6.9	7.7	14.6	14.6	70.0
Italy	187.8	27.6	235.4	235.4	89.1
Netherlands	32.0	15.9	47.9	45.9	89.4
Portugal	11.4	7.4	18.8	7.2	123.2
Spain	68.2	36.7	141.3	141.3	84.4
Total	**624.2**	**189.9**	848.2	**828.8**	**86.6**

Source: Eurostat, BZ WBK.

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

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5. Poland vs. Other Countries

Main macroeconomic indicators (European Commission forecasts)

	GDP (%)		Inflation (HICP, %)		C/A balance (% of GDP)		Fiscal balance (% of GDP)		Public debt (% of GDP)	
	2013	2014	2013	2014	2013	2014	2013	2014	2013	2014
Poland	**1.6**	**3.2**	**0.8**	**1.1**	**-1.6**	**-1.7**	**-4.3**	**5.7**	**57.0**	**49.2**
Czech Republic	-0.9	2.0	1.4	0.8	-1.2	-0.4	-1.5	-1.9	46.0	44.4
Hungary	1.1	2.3	1.7	1.0	3.1	3.0	-2.2	-2.9	79.2	80.3
EU	0.1	1.6	1.5	1.0	1.6	1.8	-3.0	-2.5	88.9	89.5
Euro area	-0.4	1.2	1.3	0.8	2.6	2.9	-3.3	-2.6	95.0	96.0
Germany	0.4	1.8	1.6	1.1	7.4	7.3	0.0	0.0	78.4	76.0

Main market indicators (%)

	Reference rate (%)		3M market rate (%)		10Y yields (%)		10Y Spread vs Bund (bp)		CDS 5Y	
	2013	end of September	2013	end of September	2013	end of September	2013	end of September	2013	end of September
Poland	**2.50**	**2.50**	**2.71**	**2.28**	**4.32**	**2.98**	**238**	**203**	**79**	**69**
Czech Republic	0.05	0.05	0.05	0.04	2.53	1.19	58	24	60	47
Hungary	3.00	2.10	2.99	2.09	5.71	4.73	377	378	256	167
Euro area	0.25	0.05	0.29	0.08						
Germany					1.94	0.95			26	18

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

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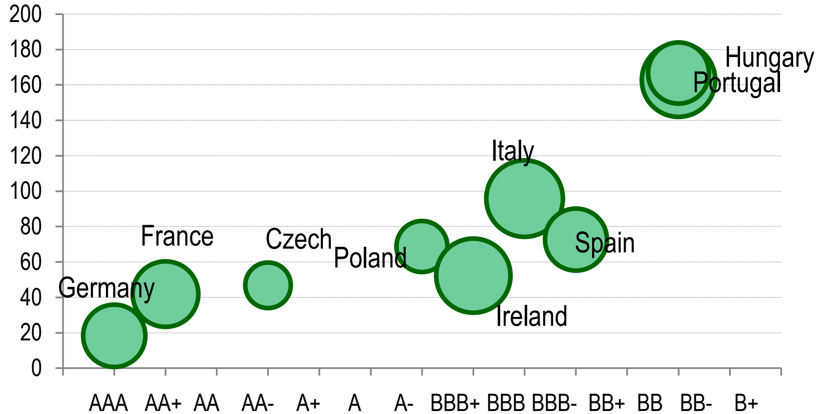
5. Poland vs Other Countries (cont.)

Sovereign ratings

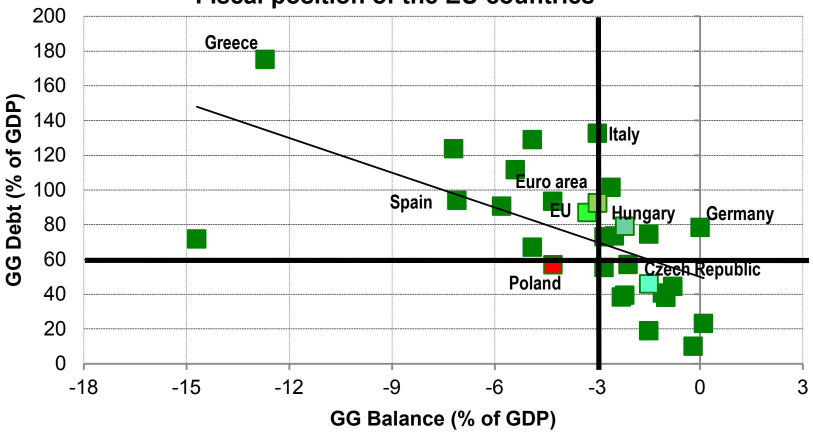
	S&P		Moody's		Fitch	
	rating	outlook	rating	outlook	rating	outlook
Poland	A-	stable	A2	stable	A-	stable
Czech	AA-	stable	A1	stable	A+	stable
Hungary	BB	stable	Ba1	negative	BB+	stable
Germany	AAA	stable	Aaa	negative	AAA	stable
France	AA	stable	Aa1	negative	AA+	negative
UK	AAA	negative	Aa1	negative	AA+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

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

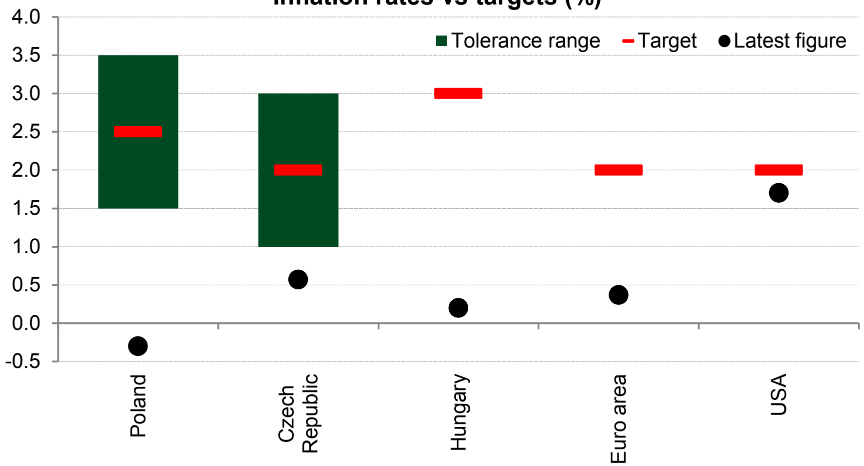


Note: Size of bubbles reflects the debt/GDP ratio

Fiscal position of the EU countries



Inflation rates vs targets (%)



Source: rating agencies, Reuters, EC, BZ WBK

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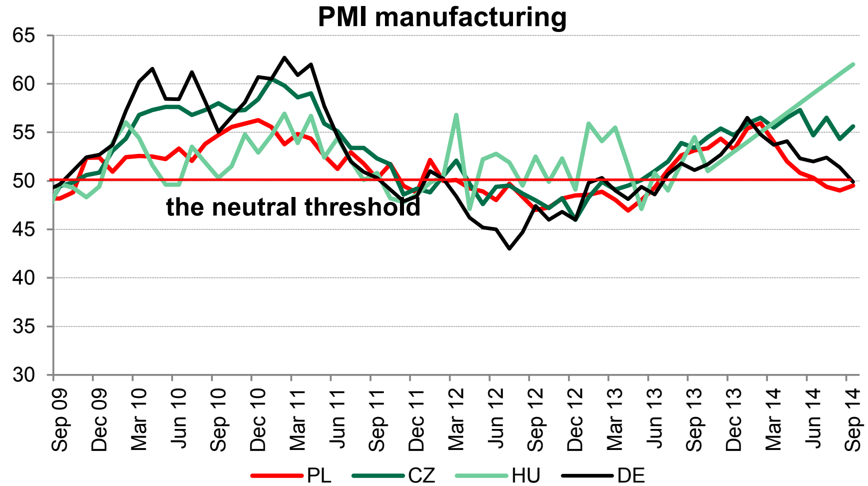
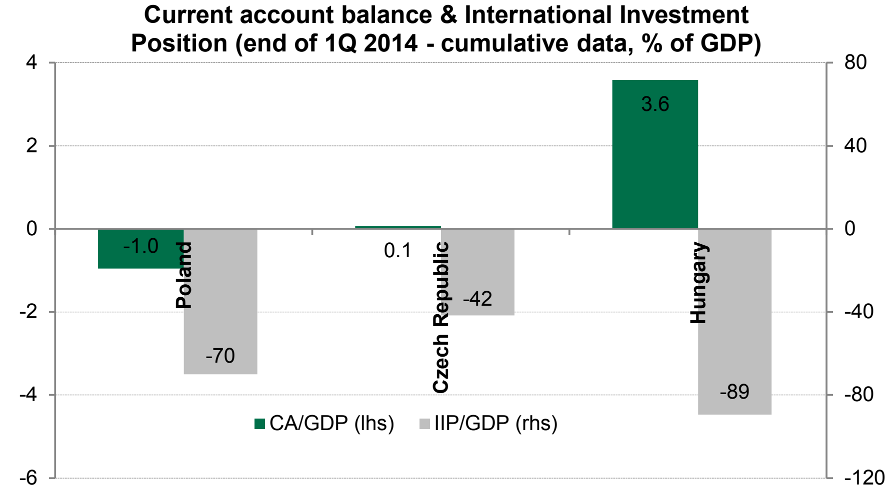
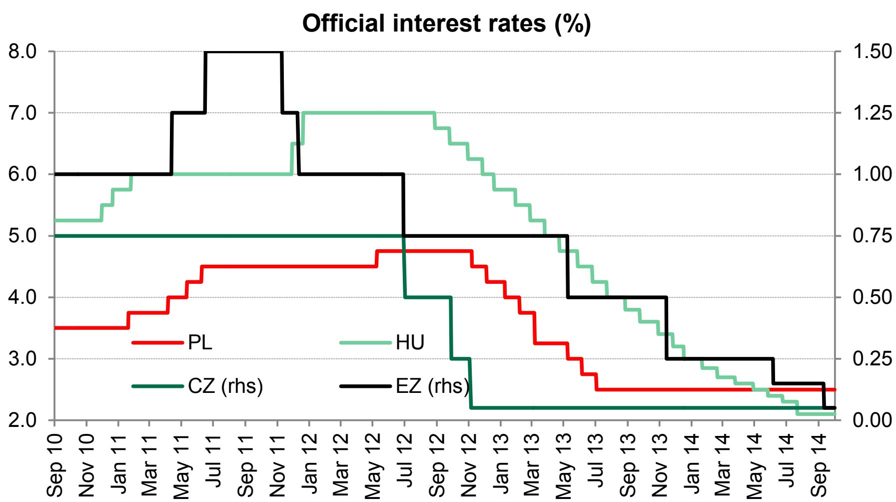
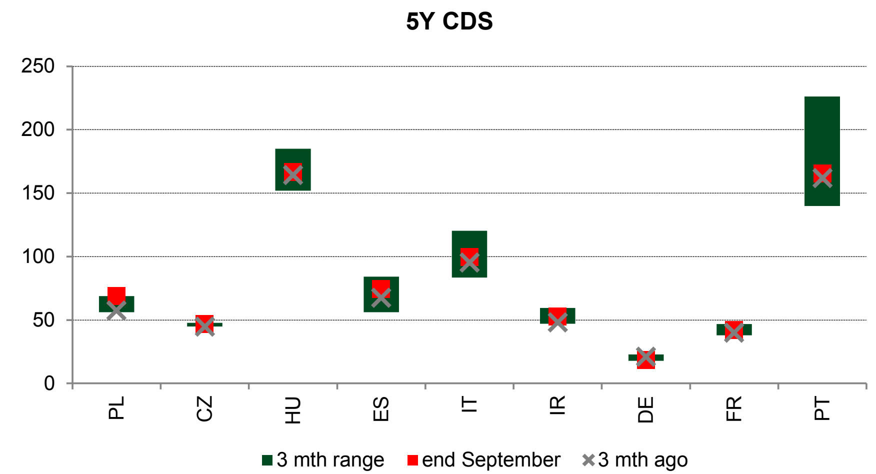
5. Poland vs Other Countries (cont.)









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

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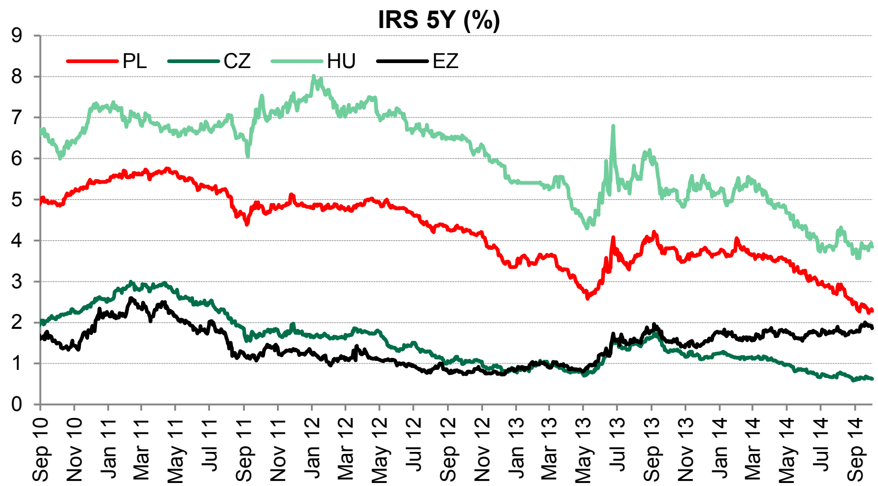
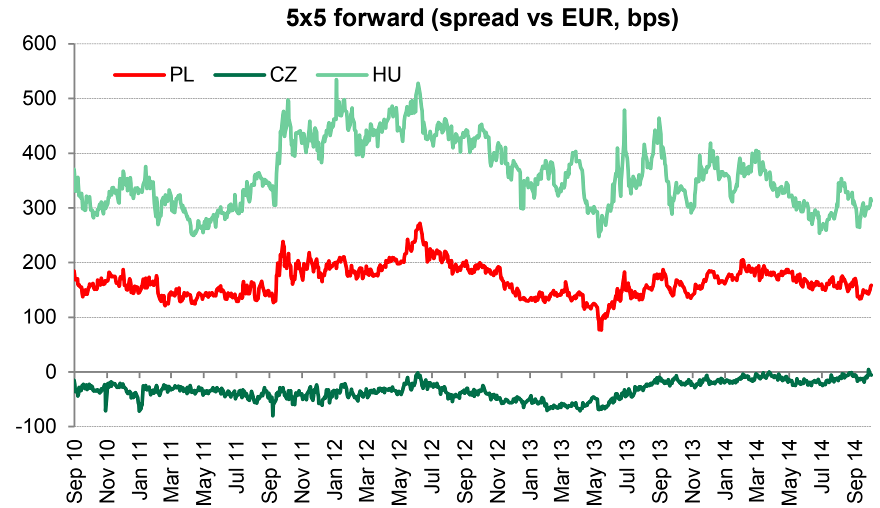
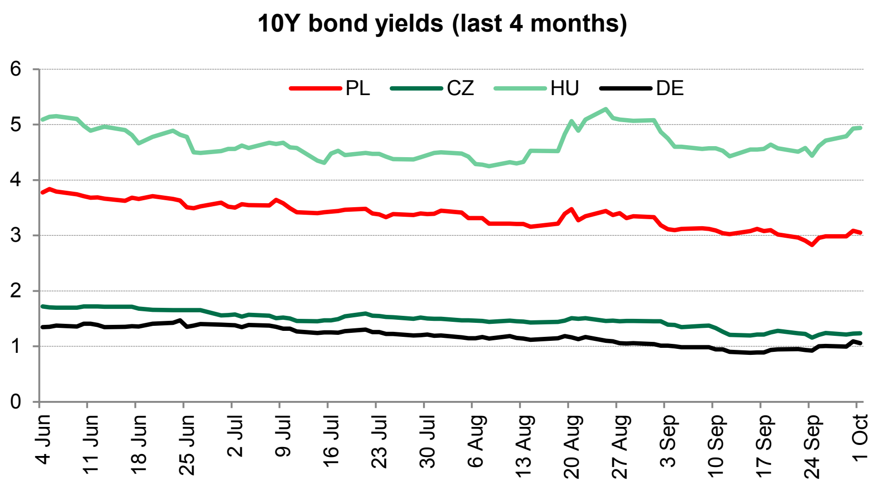
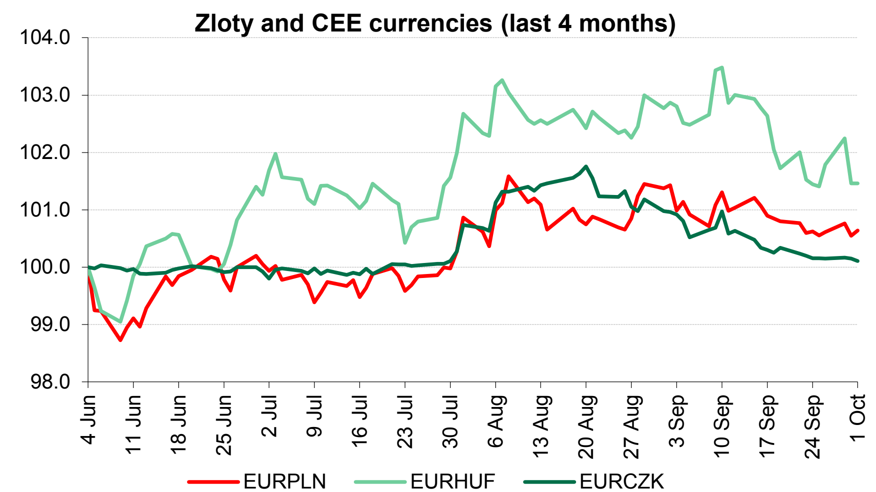
5. Poland vs Other Countries (cont.)









Source: Reuters, BZ WBK

6. Central Bank Watch

		Last	2013	2014	Expected changes (bp) 1M	3M	6M	Comments
Euro zone	Forecast	0.05	0.25	0.05				The market is pricing in an asset purchase programme after the ECB signalled its readiness to carry out QE if needed.
	Market implied »				8	7	6	
UK	Forecast	0.50	0.50	0.75				We expect the MPC to leave policy on hold . Both domestic and external developments have been broadly neutral for policy outlook. The BoE remains in wait-and-see mode until the next quarterly forecasts are published in November.
	Market implied »				4	12	29	
US	Forecast	0-0.25	0-0.25	0-0.25				At the October meeting the Fed tapered for the last time and asset purchases come to an end. In our opinion, FOMC's guidance still implies that policy will be dependent on data.
	Market implied »				16	24	33	
Poland	Forecast	2.50	2.50	1.75				Recent macro data clearly suggest that the Monetary Policy Council will re-open its monetary easing cycle. We stick to our scenario of a total 75bp rate cut in 4Q, based on 25bp each month with a risk of a 50bp cut in October.
	Market implied »				-21	-43	-50	
Czech Republic	Forecast	0.05	0.05	0.05				The central bank decided to leave monetary conditions unchanged. The key two-week repo rate is 0.05% and the EURCZK is above the 27 threshold. The CNB also reaffirmed its intention to continue using the exchange rate as a monetary policy instrument at least until 2016.
	Market implied »				30	28	28	
Hungary	Forecast	2.10	3.00	2.10				The Council decided to keep the base rate unchanged at 2.1%, as expected. The central bank published its September inflation report and revised its GDP growth forecasts (from 2.9% to 3.3% in 2014 and from 2.5% to 2.4% in 2015). Its inflation expectations have not changed much (0.1% in 2014, 2.5% in 2015).
	Market implied »				2	5	11	

Source: Reuters, BZ WBK

This analysis is based on information available through October 1, 2014 and has been prepared by:
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EXPLANATION OF THE RECOMMENDATION SYSTEM

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

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

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

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

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