RATES AND FX OUTLOOK

POLISH FINANCIAL MARKET

November 2014

Bank Zachodni WBK

Grupa Santander

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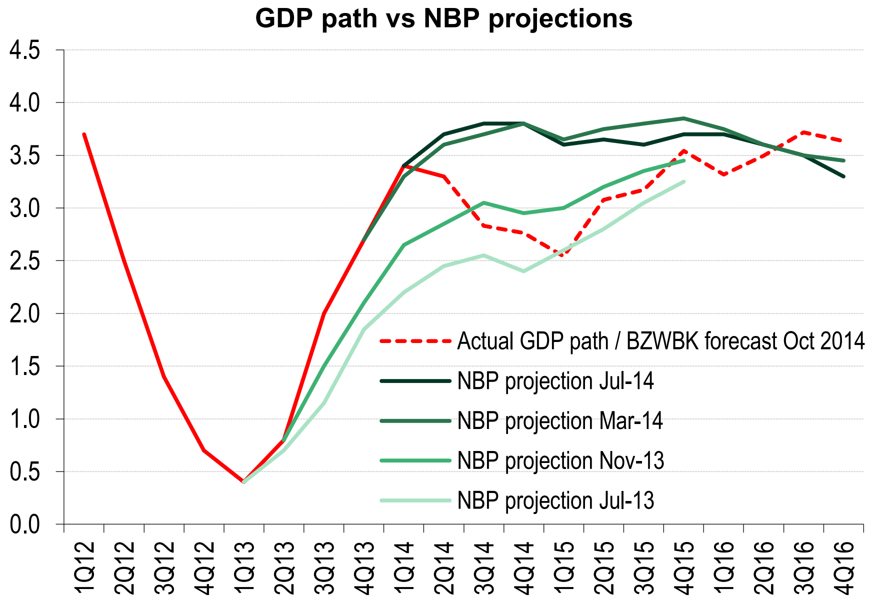
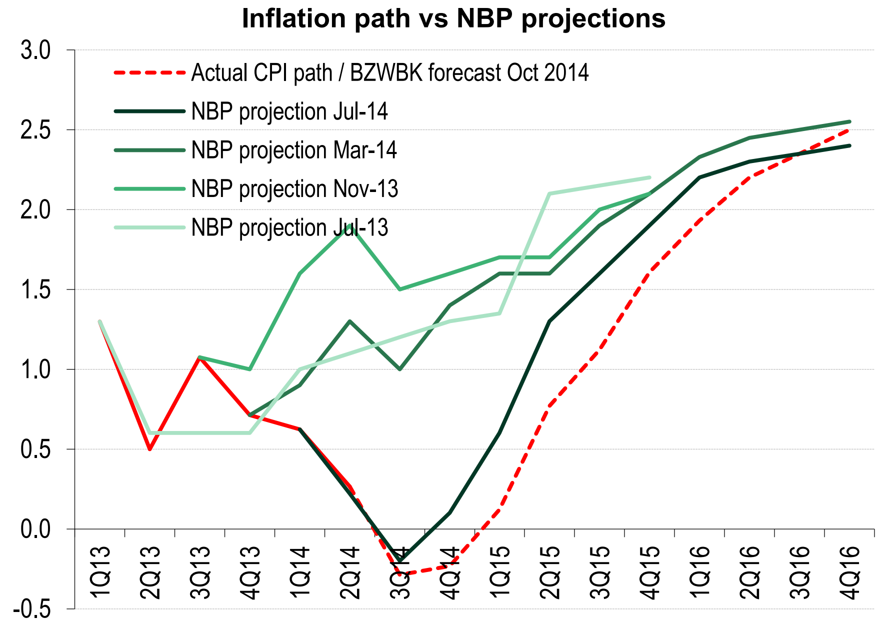
Summary

- **Recent economic data from Poland were not as bad as the previous month, but they still pointed to a deceleration of GDP growth in 3Q, probably to slightly below 3% YoY** (flash 3Q data is due in mid November). The worsening international economic climate, especially in the Euro zone, is the main trigger of a slowdown. Meanwhile, domestic demand is still showing signs of relative strength. The continuing improvement in the labour market supports the growth of households' income and consumption and, in our view, reflects the underlying upward trend in investments. This is confirmed by continuing growth in loans for consumption and for investment, among other things. The latest PMI index for the Polish manufacturing sector also showed a clear rebound in October, mainly on the back of improving domestic orders, suggesting that domestic demand is buoying the economy. Inflation remains below zero and may drop even further before starting a gradual rise at the beginning of next year.
- The Monetary Policy Council (MPC) took the market by surprise, cutting interest rates more than expected in October. The reference rate was trimmed by 50bp, the lombard rate by 100bp and the deposit rate was unchanged. We think that the decision to cut more deeply was better than the alternative of a gradual cycle of 25bp reductions, which we had expected the council to deliver. In our opinion, the decision in October was a very close call and the casting vote of the NBP governor may well have determined the cut. Thus, building a majority for further monetary easing may be difficult. However, **we think that the new NBP projection (which the MPC will have available at its next meeting) will show considerably lower GDP and inflation forecasts, giving the Council arguments to cut interest rates again in November, this time by 25bp**. The statement will probably leave the door open for further easing if the economy deteriorates.
- The market is currently pricing-in a 25bp rate cut at the next MPC meeting and slightly more than a 50bp reduction in total over the next three months. So, **the scope for further gains in the fixed income market seems limited, although some move is still possible, given our low CPI forecast** (-0.5%YoY in October). If the MPC opts for another 50bp rate cut in November with a statement signalling that the cycle of easing is over, the trend in the fixed interest market may reverse.
- We see two opposite forces at work on the EUR/PLN rate. On one hand, there is an inflow of foreign capital to the Polish bond market, amid expectations of an ECB liquidity injection and further rate cuts in Poland. On the other hand, the Russia-Ukraine crisis continues and media reports of intensified Russian army activity makes the CEE region less attractive. **We expect a gradual appreciation of the zloty in the coming quarters as the slowdown in the Polish economy proves only temporary and the MPC concludes a short rate-cut cycle.** Geopolitics is the main risk. Fed policy and USD strength also generate a short-term risk, but this should be offset by increased liquidity in the Euro zone monetary system.

MPC Preview: Significant change in GDP and CPI forecasts

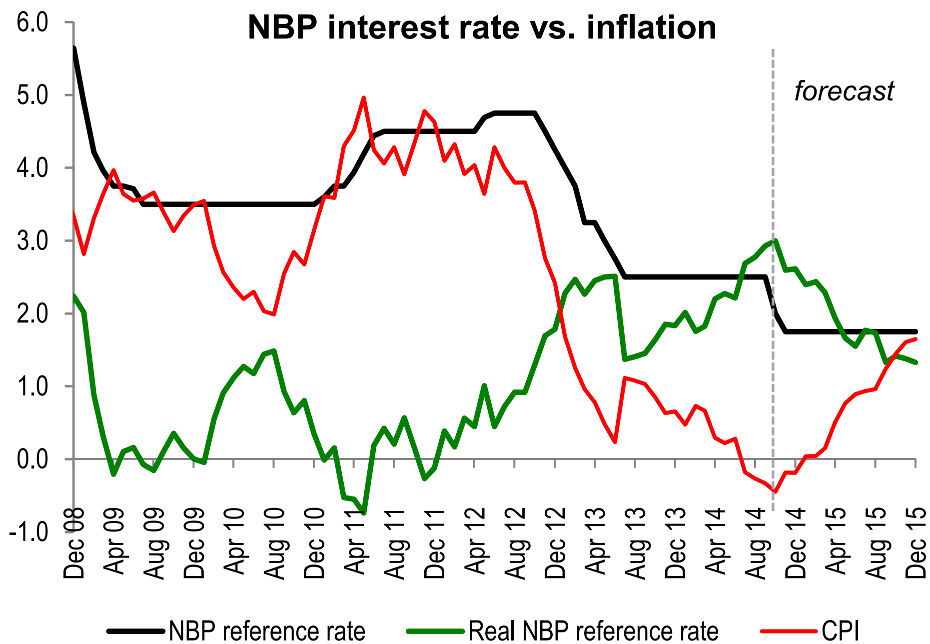




- We are expecting the NBP's new projection (due in November) to point to considerably lower GDP growth for the coming quarters (possibly 1pp lower in 1Q15).
- Slower economic growth means it will take longer for the negative output gap to close, so we see no substantial rise in inflationary pressure in the near term. Additionally, the oversupply of food on the Polish and European markets is likely to persist in the coming months, dragging prices lower, due to the Russian ban on food imports from the EU. This means inflation may be notably lower than earlier assumed, with the CPI staying below zero until the end of 2014E and rising gradually toward 1.5% by the end of 2015E. We think it will not reach the central bank's 2.5% target until the end of 2016E.
- We now face: (1) sub-zero inflation, i.e., way below target; (2) lack of demand-side pressure; (3) lack of cost pressure; and (4) very low inflationary expectations among households and companies.

Source: GUS, NBP, BZ WBK

MPC Preview: The MPC has already acted



- Negative inflation and the change in the inflation outlook for the coming quarters led to an increase in real interest rates (in an environment of lower rates in the Euro zone and the ECB's asset purchases).
- The new environment prompted the Monetary Policy Council (MPC) to cut rates by 50bp in October. At the time it emphasised that the larger-than-expected cut was driven by a desire to concentrate monetary easing in a short period of time.

Source: GUS, NBP, BZ WBK

MPC Preview: The decision was a very close call

- In our opinion, the MPC decision in October was a very close call and the casting vote of the NBP governor may well have determined the cut.
- This shows that building a majority for further monetary easing may be difficult.

<u>MPC minutes from October meeting:</u>
While discussing NBP interest rates level, the majority of Council members believed that due to the sluggish economic activity, the risk of further weakening of economic growth, the deepening of the negative output gap and, consequently, higher risk of inflation remaining below target in the medium term, it was justified to cut interest rates significantly. (...) These members also believed that due to lags in the transmission mechanism of monetary policy, the adjustment of NBP interest rates should be rather quick and significant. **In this context, a few Council members assessed that a significant interest rates cut would be justified if it was accompanied with the statement, that this decision denoted the one-off adjustment in the interest rates to the current economic forecasts.**

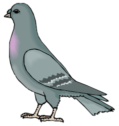
-50bp in October (our guess)

-25bp in September (officially published result)

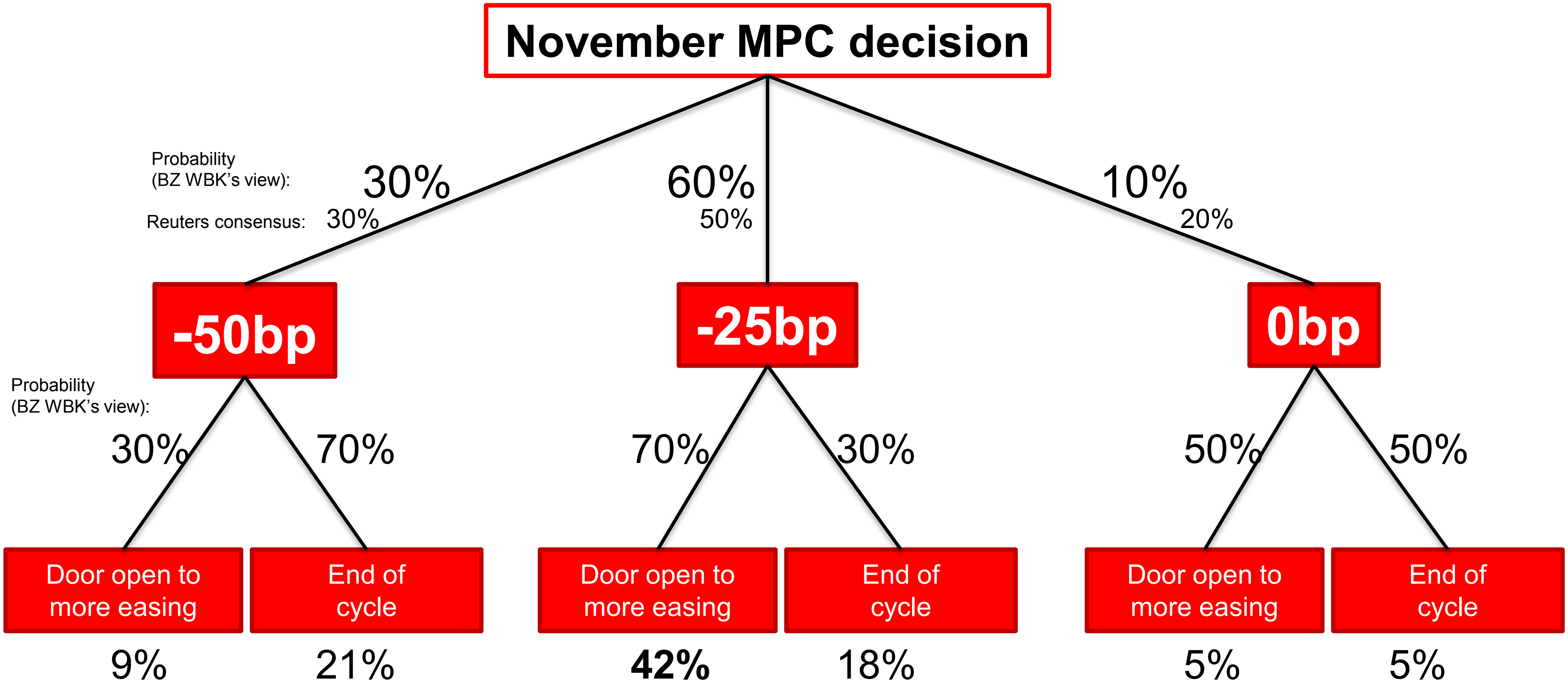
-50bp in September (officially published result)

MPC Preview: Who is ready to support the next move(s)?

Rzońca	(29.10, Gazeta Wyborcza) I do not understand why we should cut rates further.
Winiecki	(27.10, Polsat) We are very close to entering unconventional but ineffective action. (10.10, Bloomberg) Rate cuts are a wasted effort, irrelevant to Polish growth.
Kaźmierczak	(21.10, PAP) Of course, if deflation is prolonged, we will not rule out further action, but we should not be impulsive. (17.10, PAP) I think we should not hurry with next interest rate cut. (...) To make it clear, for sure I am not in favour of an interest rate cut in November.
Glapiński	(13.10, PAP) Poland has no more room for further rate cuts.
Hausner	(24.10, Bloomberg) When asked if rates should be cut further, I reply: no. But I don't rule it out if current forecasts become subject to significant changes. (...) The probability of maintaining interest rates at current levels is greater than that of reducing them.
Belka	(22.10, Financial Times) We want to concentrate our moves in a very short time. No promises, but **we might have another move or moves in the rest of the year**. (10.10, Bloomberg) Don't expect us to postpone any possible future steps until the first or second quarter of 2015, at least the way things look now.
Bratkowski	(13.10, Bloomberg) **The MPC may cut rates by 75bp**, if GDP growth was to slow down below 3% in 2015. (...) No more big moves, but as long as we don't have the data showing that worsening tendencies in the economy have been halted, **we should get on with more cuts**.
Zielińska-Głębocka	(15.10, Reuters) **If we want to cut rates, we should do it in November** and then also keep the door open to further changes down the road.
Chojna-Duch	(27.10, PAP) **There is room for interest rate cuts in November**, but it is significantly narrower after the significant reduction of the main interest rate in October. In my opinion, options are still open here, there is nothing determined yet.
Osiatyński	(13.10, Bloomberg) **There is room to cut rates by 75bp**.



MPC Preview: What next in terms of cuts and messages?



- In our view, if the MPC cuts interest rates again by 50bp, it is very likely it would accompany the decision with a statement signalling the end of the short easing cycle.
- Meanwhile, in the case of cautious 25bp move, the door for further policy adjustment will probably remain open to allow further reaction if subsequent economic data prove disappointing.

Source: Reuters, BZ WBK

Short- and Medium-term Strategy: Interest rate market

	Change (bp)		Level	Expected trend	
	Last 3M	Last 1M	end-October	1M	3M
Reference rate	-50	-50	**2.00**	↘↘	↘↘
3M WIBOR	-71	-32	**1.96**	↘↘	↘
2Y bond yield	-78	-29	**1.69**	↘	→
5Y bond yield	-93	-37	**2.00**	↘	→
10Y bond yield	-98	-54	**2.43**	→	↗
2/10Y curve slope	-20	-25	**74**	↗	↗↗

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: WIBOR rates still have some room to decline in the coming weeks, in reaction to a likely MPC decision in November and in anticipation of possible further moves. This trend should be supported by upcoming data, which we expect to show still-subdued economic activity and sub-zero inflation (we forecast the CPI fell 0.5%YoY in October).

Short end: With further monetary easing already reflected in market prices, the scope for further gains in the fixed income market seems limited, although some move is still possible, especially at the short end of the curve, given our low CPI forecast.

Long end: The long end of the curve should stabilise after its recent rally, especially as further monetary policy easing in Poland after a cut in November should not be a one-way bet. When investors become convinced that the rate-cut cycle is over, there could be a gradual, bearish steepening of the curve.

Risks to our view: If the MPC opts for another 50bp rate cut in November with a statement signalling that easing cycle is over, the trend in the fixed income market may reverse. A significant change in market expectations of the pace of interest rate hikes in the US would also be a significant risk factor for Polish bonds.

Short- and Medium-term Strategy: FX market

	Change (%)		Level	Expected Trend	
	Last 3M	Last 1M	end-October	1M	3M
EURPLN	1.0	0.7	**4.20**	→	→
USDPLN	7.6	1.5	**3.35**	→	↘
CHFPLN	2.1	0.5	**3.49**	→	↘
GBPPLN	2.8	0.7	**5.39**	→	→
EURUSD	-6.2	-0.8	**1.26**	→	↗

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: After a period of extremely low volatility, the EURPLN rate rose in October and we expect it to remain around the current level in the near term in a context of subdued economic growth, lower interest rates and geopolitical tension in the region. We still expect a gradual appreciation of the zloty in the medium term as the slowdown in the Polish economy proves only temporary and the MPC concludes a short rate-cut cycle.

USD: The zloty continued to weaken against the dollar last month. We think the rate may stabilise in the nearest month but that the trend should then reverse and the zloty should strengthen again.

CHF: At the end of November Swiss citizens will vote on an initiative to force the central bank to hold at least 20% of its assets in gold. While some Polish media have speculated that the CHFPLN rate could surge towards 4.0 if the referendum is successful, we think this is quite unlikely as the Swiss National Bank will probably not abandon its goal of preventing the franc from strengthening and will defend a 1.2 floor vs the euro.

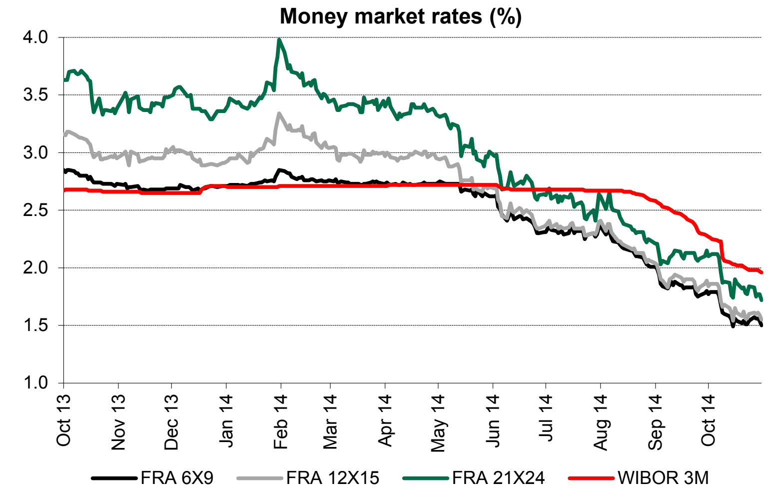
Risks to our view: Geopolitics is the main risk for the zloty. Fed policy and US dollar strength also generate a short-term risk, but this should be offset by increased liquidity in the Euro zone monetary system.

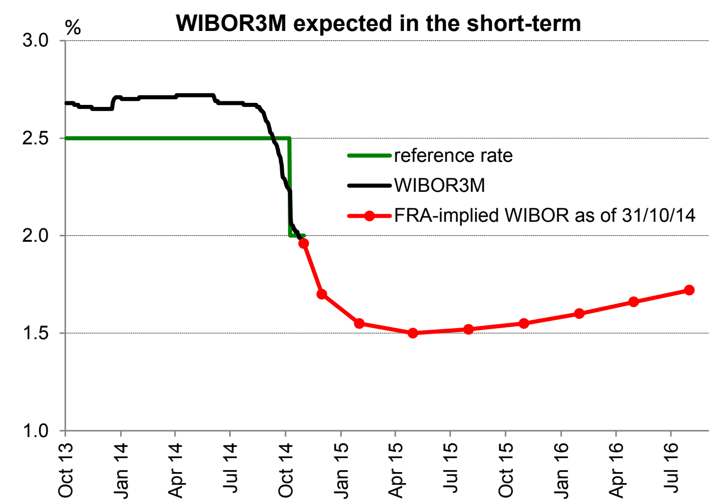
Domestic Money Market: WIBOR may drop further

- October was the fifth month in a row in which money market rates declined. WIBORs fell significantly after the unexpected MPC decision to cut the reference rate by 50bp in October, shedding 29-40bp in the month (with the 1M rate retreating the most). The downward trend in FRA rates was halted by hawkish comments from some of the MPC members.

- The FRA market is currently pricing-in a rate cut of 25bp in November. This is in line with our view and we think market expectations of at least 50bp of rate cuts over the next three months are exaggerated. Our baseline scenario still assumes that the NBP reference rate will stabilise at 1.75% before the year-end.

- That said, we think that WIBOR rates still have some room for decline in the coming weeks, in reaction to a likely MPC decision in November and in anticipation of possible further moves. This should be supported by the next data releases, which are likely to show subdued economic activity and sub-zero inflation (we expect the CPI to drop 0.5%YoY in October).

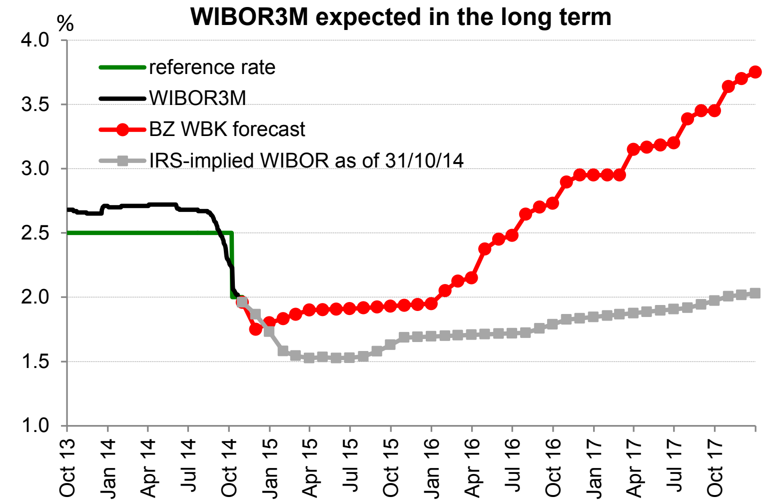




Source: Reuters, BZ WBK

Domestic IRS and the T-Bond Market: The likely scale of MPC easing looks priced-in

- Domestic T-bond and IRS markets have continued their strong rally with both yields and IRS rates reaching new record lows. Sentiment in global markets was also supportive for domestic fixed income as the 10Y Bund yield hit a new record low (0.75%). Upward corrections (mainly due to higher risk aversion or more hawkish rhetoric from some MPC members) were only short-lived. A bullish flattener developed in both markets, tracking the global trend. The spread over Bunds has continued to narrow for all sectors and temporarily dropped to 160bp for 10Y debt, the lowest level ever recorded.
- The key event this month will be the MPC meeting. With additional monetary easing already reflected in market prices, the scope for further gains in the fixed income market seems limited. In fact, a smaller rate cut (-25bp), which left the door open to possible further moves, would probably be a more positive scenario for the fixed income market than a second 50bp rate cut, accompanied by a strong signal about the end of the easing cycle. The latter could, in our view, reverse the current bullish trend in the fixed income market.
- Polish bond yields (in particular 10Y rates – see chart) seem to have been highly correlated with investors' expectations about Federal Reserve monetary policy in recent quarters. Any swing in market expectations towards faster rate hikes in the US is a risk factor for Polish bonds (at least until the ECB starts expanding its balance sheet).



Source: Reuters, Bloomberg, BZ WBK.

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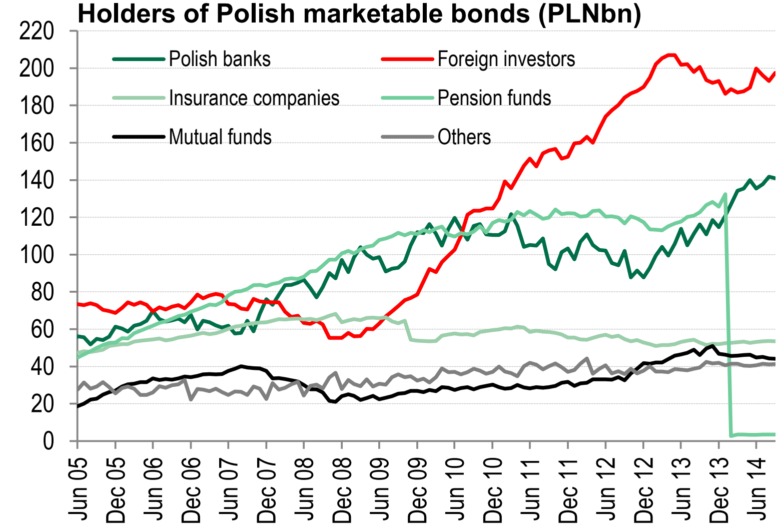
Demand Corner: Foreigners accumulated 5Y and 10Y benchmarks in September

- Non-residents increased their portfolios of Polish PLN-denominated bonds in September by cPLN4.4bn to PLN197.5bn. However, 3Q ended with a PLN2.3bn outflow of foreign capital. Polish banks reduced their holdings by nearly PLN1bn in September, but were net buyers in 3Q as a whole (+PLN5.5bn). This was the third consecutive quarter in which banks increased their bond holdings.
- Foreign investors bought PS0719 bonds worth nearly PLN3.2bn and PLN3.3bn of the new 10Y benchmark DS0725 bond in September. As a result, their share of the total outstanding amounts surged to 49% and 70%, respectively, (from 26% and 41% at the end of August). In the case of 10Y bond, this accumulation might have been mainly due to the switch to the new benchmark from the old one, as non-residents sold PLN2.5bn of DS1023. Foreigners were net sellers of the DS bonds (PLN1.7bn).
- Meanwhile, Polish banks were net sellers of the PS bonds (-PLN4.9bn in total). In particular, they sold PLN2bn of PS0719.
- Piotr Marczak, director of the Debt Department at the Finance Ministry, said that non-residents were selling Polish debt in October.

Share of PS0719 outstanding held by the non-residents

Holders of Polish marketable bonds (PLNbn)



Source: Finance Ministry, BZ WBK.

Supply Corner: Relatively low supply in November should attract healthy demand

- In October the Finance Ministry sold cPLN6.1bn of T-bonds (OK0716 and PS0719) at a standard auction, slightly more than planned and with slightly higher yields than on the secondary market. Strong demand (cPLN9.6bn) was supported by weaker macro data and the interest payments due. The ministry had already tapped the market that month, selling PLN3.7bn of T-bonds at a switch tender.

- In line with its 4Q issuance plan, in November the Ministry of Finance has scheduled a regular auction (Nov 6) for PLN2-4bn and a switch tender (Nov 20). Given the favourable market conditions, the Ministry decided to offer long-term T-bonds (fixed rate DS0725 and WS0428 and floating rate WZ0124) worth PLN2-4bn at the first auction this month. In our view the relatively low offer should attract healthy demand and allow the ministry to sell T-bonds at close to their peak levels.

- We should bear in mind that these funds will pre-finance 2015 gross borrowing needs. We estimate that, at the end of October, the Ministry had already pre-financed nearly 13% of the 2015 funding target (which would be PLN154.8bn, assuming that next year's budget deficit is cPLN10bn lower than planned).

Auction plan for November 2014

Auction date	Settlement date	T-bonds	Expected supply
6 Nov 2014	10 Nov 2014	WZ0124, DS0725, WS0428	PLN2.0-4.0bn

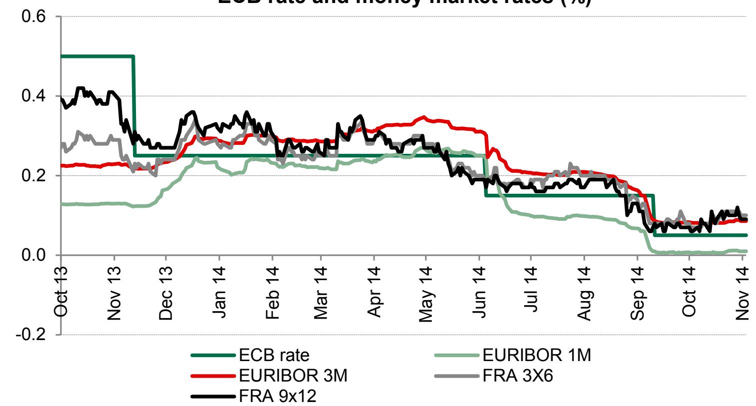
Auction / Settlement date	T-bonds to be offered	Source T-bonds	Outstanding (PLN m)
20 Nov 2014 / 24 Nov 2014	The choice depends on market conditions	WZ0115	12,347
		PS0415	22,905
		OK0715	10,297

Source: Finance Ministry, BZ WBK.

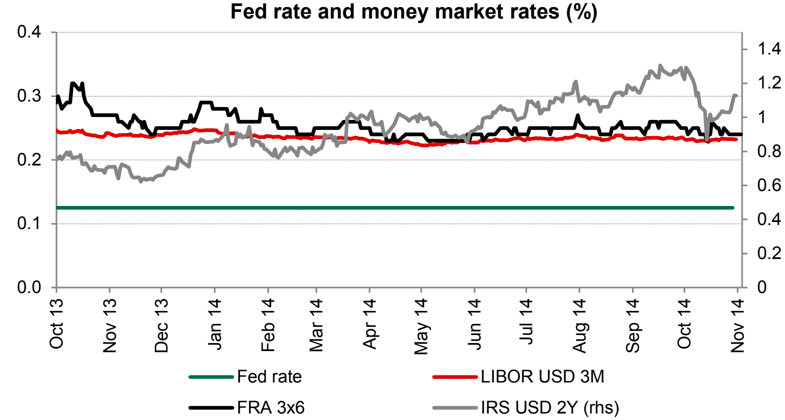
International Money Market and IRS: Weak macro data should anchor EUR rates

- EUR money market rates edged gradually higher in October (+3-6bp in monthly terms) despite the more expansive monetary policy implemented by the ECB. Slightly higher money market rates caused a gradual increase in EUR IRS up to 5Y tenors. Longer IRS rates continued to shift down (by 1-7bp) due to the weak macro data and continuing concern about the inflation outlook (in particular taking into account the recent decline in the oil prices).
- Meanwhile, USD money market rates were unchanged and IRS returned to their downward trend, due to the uncertain macro outlook (macro data releases were mixed in October). However, the slightly more hawkish tone of the Fed's October statement pushed IRS rates up at the end of the month (by 2-8bp), but they are still well below the levels seen at the end of September.
- The ECB meeting and macro data releases will be the main drivers for the market this month. In our view, the ECB will maintain its soft tone while it waits to see the results of the measures it has already deployed and the second TLTRO in mid-December. We think both EUR and USD money market rates should remain centred around their current levels in the coming months.
- The IRS market could be more vulnerable to upcoming macro data. In our view, the still weak global macro outlook, combined with falling commodity prices (and consequently lower headline CPI), largely removes any significant upside risks to EUR and USD interest rates for the time being.

ECB rate and money market rates (%)



Fed rate and money market rates (%)



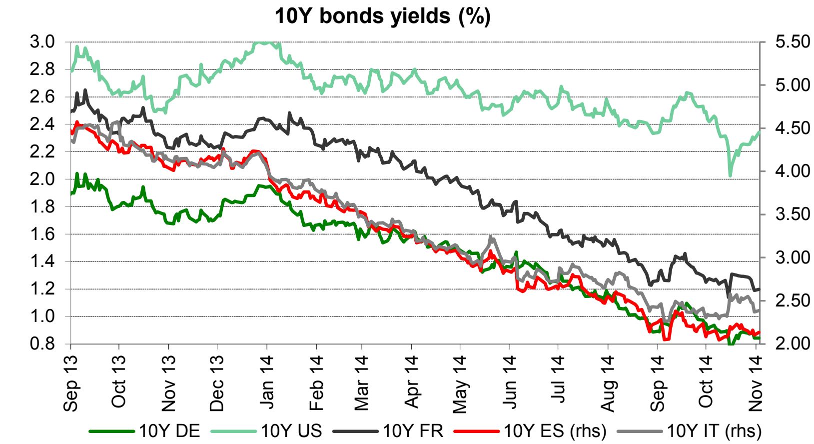
Source: Reuters, ECB, Fed, BZ WBK.

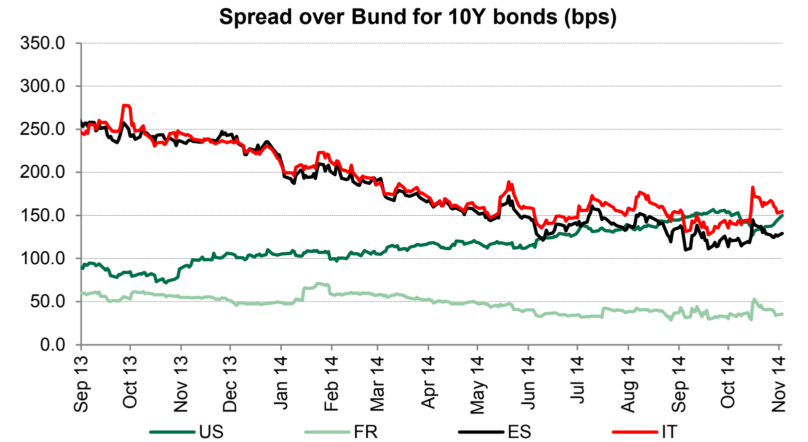
International Bond Market: Still on the strong side

- While the front end of the curves (in core and peripheral markets) remained well anchored by central bank decisions, long- term instruments have continued their strong rally, due to the weak global outlook. 10Y Bund yields hit a new record low of 0.75%, while 10Y US Treasuries fell temporarily towards 2%. Consequently, both the EUR and the USD curves have flattened from the long end over the past month. However, the more hawkish tone of October's FOMC pushed US T-bond yields higher, with the 10Y benchmark slightly above 2.30%.

- Peripheral debt benefited from the strengthening on core markets. 10Y Spanish and Italian benchmark yields fell again to record low levels last seen in September, of 2.05% and 2.26%, respectively. Meanwhile, the spread over Bunds widened slightly on a monthly basis (with the highest increase in Greece) as investors focused more sharply on the fundamentals of the individual countries.

- In the short to medium term, investors are likely to keep a close eye on central bank meetings and macro data. In our opinion, the combination of weak data and low inflation will keep QE speculation alive in the Euro zone, leaving room for a further decline in yields. However, if there is no ECB decision until year-end, we may see a gradual increase in yields, leading to a steepening of the yield curve in the coming months. In the US, the ongoing economic upswing and rising interest rate expectations lead us to expect higher yields in the medium term.

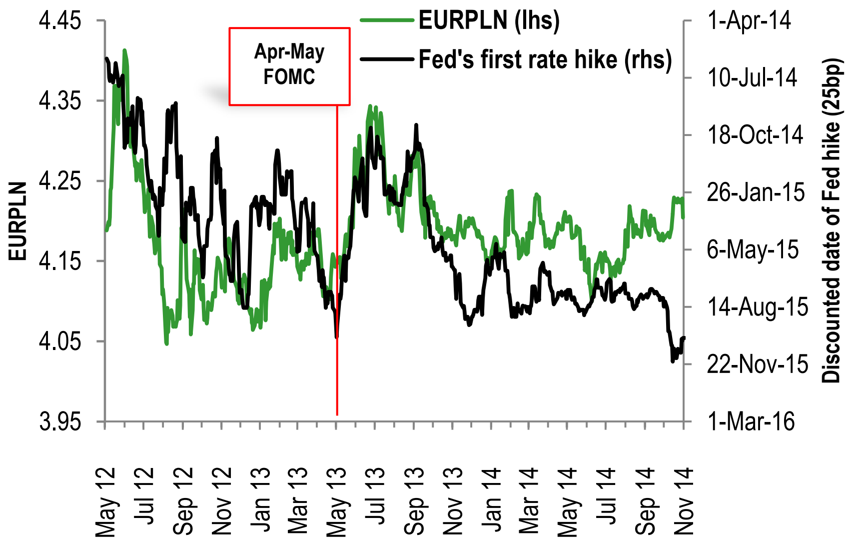




Source: Reuters, BZ WBK.

Foreign Exchange Market: Only a temporary depreciation?

- Last month, we pointed to the zloty's surprisingly low volatility vs. the euro. The situation changed somewhat in mid-October, when the exchange rate surged from 4.17 to nearly 4.24 on the back of global risk aversion due to worries about world economic growth, which led to a significant weakening of EM currencies and debt markets.
- Market expectations about the first interest rate hike in the US have ceased to be a major factor driving EM currencies, including the zloty. The Fed's tapering and talk of a US rate hike weighed on the zloty (although to a lesser extent than other EMs). However, when the market recently pushed back its pricing in of the first Fed rate hike, the zloty did not benefit.
- We see two opposite forces at work in the EUR/PLN market. On one hand, there is an inflow of foreign capital to the Polish bond market, amid expectations of an ECB liquidity injection and further rate cuts in Poland. On the other hand, the Russia-Ukraine crisis continues and media reports of intensified Russian army activity makes the CEE region less attractive.
- We expect a gradual appreciation of the zloty in the coming quarters as the slowdown in the Polish economy proves only temporary and the MPC concludes a short cycle of rate cuts. Geopolitics is the main risk. Fed policy and USD strength also generate a short-term risk, but this should be offset by the increased liquidity in the Euro zone monetary system.



Source: Bloomberg, BZ WBK

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FX Technical Analysis Corner: Room for EUR/PLN to fall

- The EUR/PLN rate failed to break strong support consisting of tight 100-day and 150-day SMAs.
- The ADX oscillator reached levels that in the past months would herald a pause in the trend. This suggests some room for the zloty to recover, but the potential for appreciation is limited by the two tight moving averages.
- The expanding triangle on the daily chart (higher peaks and lower bottoms) suggests that some more noticeable move may take place soon.

Source: Reuters, BZ WBK.

FX Technical Analysis Corner: EUR/USD still in a downtrend

- The EUR/USD rate continued its move down and reached the support level mentioned last month (1.245).
- The ADX eased somewhat from its extremely high level, opening up potential for it to gain strength again.
- If 1.245 is broken, the exchange rate may continue falling to 1.226.

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	1,697.4	1,762.2	397.4	413.5	419.3	467.2	404.5	427.1	438.0	492.5
GDP	%YoY	2.0	1.6	3.1	3.1	3.4	3.3	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	5.1	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	2.8	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	8.4	7.0	6.0	5.0	5.0	5.0	6.0
Unemployment rate [a]	%	13.4	13.4	11.8	11.5	13.5	12.0	11.5	11.8	12.1	10.9	10.8	11.5
Current account balance	EURmn	-13,697	-5,245	-6,466	-11,062	-1,403	-553.0	-1,639	-2,871	-2,957	-1,587	-3,032	-3,487
Current account balance	% GDP	-3.6	-1.3	-1.6	-2.6	-1.2	-1.2	-1.2	-1.6	-2.0	-2.2	-2.5	-2.6
General government balance	% GDP	-3.9	-4.3	5.7	-2.9	-	-	-	-	-	-	-	-
CPI	%YoY	3.7	0.9	0.1	0.8	0.6	0.3	-0.3	-0.3	0.0	0.7	1.0	1.5
CPI [a]	%YoY	2.4	0.7	-0.2	1.6	0.7	0.3	-0.3	-0.2	0.1	0.8	1.2	1.6
CPI excluding food and energy prices	%YoY	2.2	1.2	0.7	1.1	0.8	0.8	0.5	0.6	0.9	1.0	1.1	1.4

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

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	2.47	1.91	2.71	2.71	2.59	1.87	1.87	1.91	1.92	1.94
Yield on 2-year T-bonds	%	4.30	2.98	2.43	1.74	3.01	2.76	2.26	1.69	1.65	1.68	1.77	1.87
Yield on 5-year T-bonds	%	4.53	3.46	2.95	2.11	3.71	3.35	2.67	2.04	2.03	2.08	2.13	2.18
Yield on 10-year T-bonds	%	5.02	4.04	3.48	2.75	4.38	3.82	3.18	2.53	2.60	2.68	2.77	2.93
2-year IRS	%	4.52	3.10	2.48	1.80	3.07	2.82	2.32	1.73	1.70	1.73	1.82	1.95
5-year IRS	%	4.47	3.51	2.93	2.11	3.70	3.31	2.63	2.06	2.03	2.08	2.13	2.18
10-year IRS	%	4.56	3.86	3.33	2.63	4.16	3.73	3.07	2.36	2.40	2.55	2.70	2.85
EUR/PLN	PLN	4.19	4.20	4.18	4.13	4.19	4.17	4.18	4.20	4.18	4.15	4.11	4.06
USD/PLN	PLN	3.26	3.16	3.14	3.24	3.06	3.04	3.15	3.31	3.24	3.26	3.26	3.19
CHF/PLN	PLN	3.47	3.41	3.44	3.30	3.42	3.42	3.45	3.46	3.40	3.35	3.29	3.17
GBP/PLN	PLN	5.16	4.94	5.20	5.44	5.06	5.11	5.26	5.38	5.43	5.50	5.44	5.38

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

Economic Calendar and Events

Date		Event:	Note:
5-Nov	**PL**	**MPC Meeting – interest rate decision**	**We expect a cut of 25bp**
6-Nov	EZ	ECB Meeting – interest rate decision	–
	CZ	CNB Meeting – interest rate decision	–
	PL	**Auction of: WZ0124, DS0725 and WS0428**	**Offer: PLN2-4bn**
13-Nov	**PL**	**CPI for October**	**Our forecast: -0.5% YoY vs market consensus of -0.4% YoY**
14-Nov	**PL**	**Core CPI excluding food and energy prices for October**	**Our forecast: 0.3% YoY vs market consensus of 0.5%**
19-Nov	**PL**	**Employment and wages for October**	**We expect employment to increase by 0.7% YoY and wages to grow 3.3% YoY, close to market consensus**
	US	Minutes from October's FOMC meeting	
20-Nov	**PL**	**Industrial output and PPI for October**	**Our forecast for industrial output is 2.1% YoY (vs market consensus of 1.7% YoY). We predict PPI at -1.1% YoY**
	PL	**Switch tender**	
	PL	**Minutes from November's MPC meeting**	–
25-Nov	HU	NBH meeting - interest rate decision	–
TBA	**PL**	**Retail sales for October**	**We forecast 2.6% YoY, vs market consensus of 2.2% YoY**
1-Dec	**PL**	**PMI manufacturing for November**	–
	EZ	PMI manufacturing for November	–
3-Dec	**PL**	**MPC Meeting – interest rate decision**	**-**
4-Dec	EZ	ECB Meeting – interest rate decision	–

Source: CB, Markit, CSO, Finance Ministry

Annexe

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

Bank Zachodni WBK
Grupa Santander

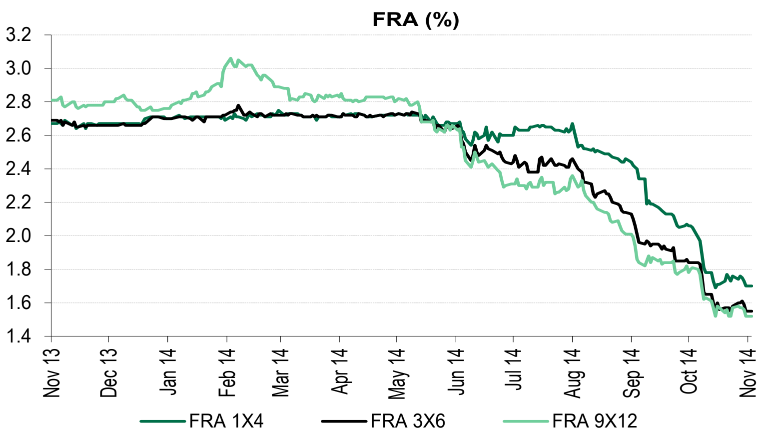
1. Domestic Market Performance

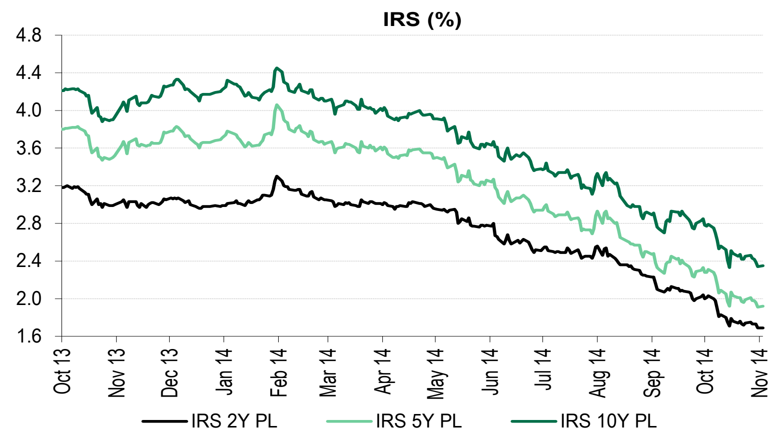
Money market rates (%)

	Reference	Polonia	WIBOR (%)				OIS (%)				FRA (%)			
	rate (%)	(%)	1M	3M	6M	12M	1M	3M	6M	12M	1x4	3x6	6x9	9x12
End of October	**2.00**	**1.80**	**2.00**	**1.96**	**1.95**	**1.94**	**1.69**	**1.61**	**1.56**	**1.54**	**1.70**	**1.55**	**1.50**	**1.52**
Last 1M change (bp)	-50	-71	-40	-32	-30	-29	-42	-22	-19	-17	-37	-31	-30	-30
Last 3M change (bp)	-50	-71	-60	-71	-74	-79	-78	-77	-74	-69	-93	-90	-85	-82
Last 1Y change (bp)	-50	-86	-60	-70	-75	-81	-72	-78	-85	-96	-97	-114	-123	-129

Bond and IRS market (%)

	BONDS			IRS			Spread BONDS / IRS (bp)		
	2Y	5Y	10Y	2Y	5Y	10Y	2Y	5Y	10Y
End of October	**1.69**	**2.00**	**2.53**	**1.69**	**1.91**	**2.34**	**0**	**9**	**19**
Last 1M change (bp)	-30	-36	-44	-35	-42	-51	5	6	7
Last 3M change (bp)	-78	-86	-88	-86	-97	-95	8	11	7
Last 1Y change (bp)	-114	-150	-163	-131	-161	-159	17	11	-4





Source: Reuters, BZ WBK

2. Polish Bonds: Supply Recap

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

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
T-bonds auction	18,143	8,821	6,573	17,503	5,694	4,990	8,418		3,595	6,062	4,000		83,799
T-bills auction													0
Retail bonds	256	475	151	121	155	116	169	176	168	170	170	170	2,297
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**	**6,724**	**17,624**	**5,849**	**5,106**	**8,587**	**176**	**3,763**	**9,985**	**4,170**	**170**	**132,723**
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**	**4,495**	**1,589**	**5,733**	**5,046**	**-883**	**-1,617**	**967**	**9,902**	**3,354**	**79**	**77,123**
Rolling over T-bonds			4,807			6,117			3,508	3,743			**18,174**
Buy-back of T-bills/ FX-denominated bonds										1,170			**1,170**
Total	**43,626**	**4,832**	**9,302**	**1,589**	**5,733**	**11,163**	**-883**	**-1,617**	**4,475**	**14,814**	**3,354**	**79**	**96,467**
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

Bank Zachodni WBK
Grupa Santander

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	70,918		1,710	**72,628**	14,789	**87,417**
Total 2016	86,607		1,273	**87,881**	17,262	**105,142**
Total 2017	58,543		917	**59,460**	12,566	**72,026**
Total 2018	66,317		911	**67,228**	14,396	**81,624**
Total 2019+	193,747		3,233	**196,980**	135,784	**332,765**

Source: MF, BZ WBK.

2. Polish Bonds: Supply Recap (cont.)

Scheduled wholesale bond redemptions by holders (data at the end of September 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%**	**8%**	**19%**	**100%**
Total 2015	29,771	24,375	9,156	617	3,949	232	230	6,301	74,632
	40%	33%	12%	1%	5%	0%	0%	8%	100%
Total 2016	42,094	19,129	8,709	788	9,060	112	135	5,259	85,286
	49%	22%	10%	1%	11%	0%	0%	6%	100%
Total 2017	23,185	16,148	6,649	557	6,821	59	181	4,677	58,277
	40%	28%	11%	1%	12%	0%	0%	8%	100%
Total 2018	19,229	29,046	3,350	370	9,270	81	407	4,563	66,317
	29%	44%	5%	1%	14%	0%	1%	7%	100%
Total 2019+	83,219	52,206	25,569	1,189	14,999	230	399	9,151	186,962
	45%	28%	14%	1%	8%	0%	0%	5%	100%

Source: MF, BZ WBK.

3. Polish Bonds: Demand Recap

Holders of marketable PLN bonds

	Nominal value (PLN bn)			Nominal value (PLN bn)			% change in September			Share of TOTAL (%) in September
	End Sep'14	End Aug'14	End Jun'14	End 1Q 2014	End 4Q 2013	End 3Q 2013	MoM	3-mth	YoY	
Domestic investors	283.2	284.2	277.2	277.9	381.2	377.3	-0.36	0.77	-24.95	58.9 (-0.6pp)
Commercial banks	140.9	141.7	135.4	134.3	114.7	116.2	-0.59	4.08	21.29	29.3 (-0.4pp)
Insurance companies	53.4	53.6	53.1	52.9	52.0	52.8	-0.31	0.55	1.17	11.1 (-0.1pp)
Pension funds	3.5	3.4	3.3	3.5	125.8	122.7	2.84	7.45	-97.13	0.7
Mutual funds	44.1	44.3	44.8	45.8	46.7	46.1	-0.42	-1.48	-4.42	9.2 (-0.1pp)
Others	41.2	41.1	40.6	41.4	42.0	39.5	0.2	1.4	4.4	8.6
Foreign investors*	197.5	193.1	199.8	186.9	193.2	200.6	2.27	-1.15	-1.52	41.1 (0.6pp)
Banks	12.1	10.0	12.6	n.a.	n.a.	n.a.	21.0	-4.4	n.a.	2.5 (0.4pp)
Central banks	19.3	18.4	18.0	n.a.	n.a.	n.a.	5.0	7.0	n.a.	4.0 (0.2pp)
Public institutions	0.5	0.7	0.7	n.a.	n.a.	n.a.	-23.4	-23.7	n.a.	0.1
Insurance companies	10.9	10.7	9.5	n.a.	n.a.	n.a.	2.4	14.8	n.a.	2.3
Pension funds	12.7	12.2	12.3	n.a.	n.a.	n.a.	4.0	3.4	n.a.	2.6 (0.1pp)
Mutual funds	80.8	80.0	83.4	n.a.	n.a.	n.a.	1.0	-3.1	n.a.	16.8
Hedge funds	0.1	0.1	0.1	n.a.	n.a.	n.a.	-1.7	-9.2	n.a.	0
Non-financial sector	12.2	12.3	14.2	n.a.	n.a.	n.a.	-0.6	-13.9	n.a.	2.5
Others	17.7	18.6	16.5	4.5	4.7	5.2	-5.1	6.9	n.a.	3.7 (-0.2pp)
TOTAL	480.7	477.3	477.0	464.8	574.3	577.9	0.7	2.2	-16,8	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	83.4
Belgium	21.8	9.8	31.6	30.0	100.2
Finland	6.9	4.8	11.7	11.7	116.5
France	105.0	70.2	175.2	174.0	103.6
Germany	144.0	-	144	144.0	87.6
Greece	16.8	5.6	-	-	-
Ireland	6.9	7.7	14.6	14.6	80.0
Italy	187.8	27.6	235.4	235.4	105.4
Netherlands	32.0	15.9	47.9	45.9	94.6
Portugal	11.4	7.4	18.8	7.2	94.5
Spain	68.2	36.7	141.3	141.3	94.1
Total	**624.2**	**189.9**	848.2	**828.8**	**98.0**

Source: Eurostat, BZ WBK..

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

5. Poland vs. Other Countries

Main macroeconomic indicators (European Commission forecasts)

	GDP (%)		Inflation (HICP, %)		C/A balance (% of GDP)		Fiscal balance (% of GDP)		Public debt (% of GDP)	
	2013	2014	2013	2014	2013	2014	2013	2014	2013	2014
Poland	**1.7**	**3.0**	**0.8**	**0.2**	**-1.6**	**-2.0**	**-4.0**	**-3.4**	**55.7**	**49.1**
Czech Republic	-0.7	2.5	1.4	0.5	-1.2	-1.3	-1.3	-1.4	45.7	44.4
Hungary	1.5	3.2	1.7	0.1	3.1	4.3	-2.4	-2.9	77.3	76.9
EU	0.0	1.3	1.5	0.6	1.6	1.4	-3.2	-3.0	87.1	88.1
Euro area	-0.5	0.8	1.3	0.5	2.6	2.5	-2.9	-2.6	93.1	94.5
Germany	0.1	1.3	1.6	0.9	7.4	7.1	0.1	0.2	76.9	74.5

Main market indicators (%)

	Reference rate (%)		3M market rate (%)		10Y yields (%)		10Y Spread vs Bund (bp)		CDS 5Y	
	2013	end of October	2013	end of October	2013	end of October	2013	end of October	2013	end of October
Poland	**2.50**	**2.00**	**2.71**	**1.96**	**4.32**	**2.53**	**238**	**169**	**79**	**67**
Czech Republic	0.05	0.05	0.05	0.04	2.53	0.94	58	10	60	47
Hungary	3.00	2.10	2.99	2.10	5.71	4.00	377	316	256	177
Euro area	0.25	0.05	0.29	0.09						
Germany					1.94	0.84			26	18

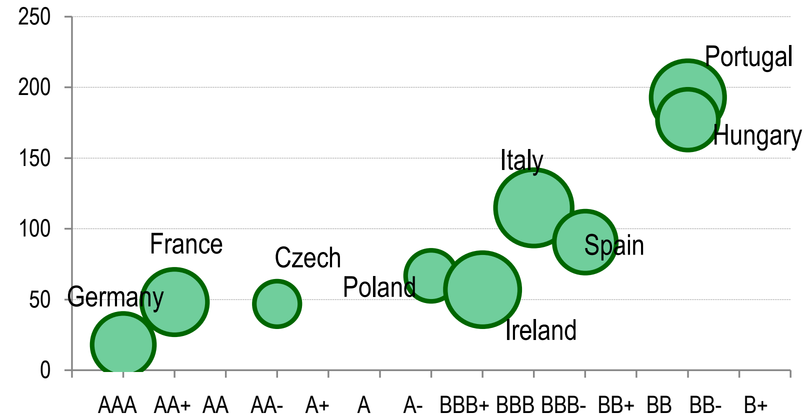
Source: EC – Autumn 2014, stat offices, central banks, Reuters, BZ WBK.

5. Poland vs Other Countries (cont.)

Sovereign ratings

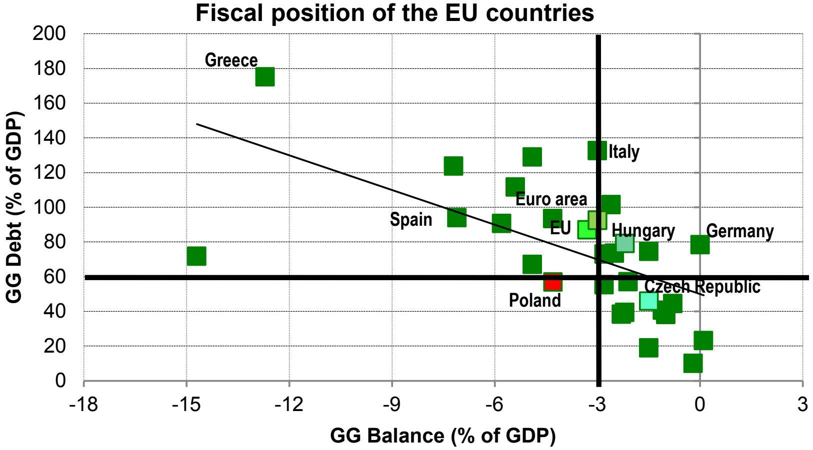
	S&P		Moody's		Fitch	
	rating	outlook	rating	outlook	rating	outlook
Poland	A-	stable	A2	stable	A-	stable
Czech	AA-	stable	A1	stable	A+	stable
Hungary	BB	stable	Ba1	negative	BB+	stable
Germany	AAA	stable	Aaa	negative	AAA	stable
France	AA	stable	Aa1	negative	AA+	negative
UK	AAA	negative	Aa1	negative	AA+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

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

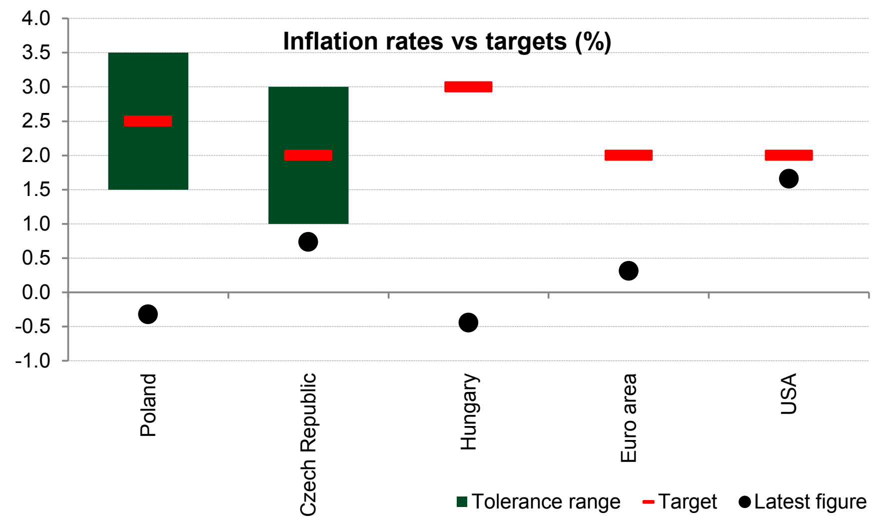


Note: Size of bubbles reflects the debt/GDP ratio

Fiscal position of the EU countries

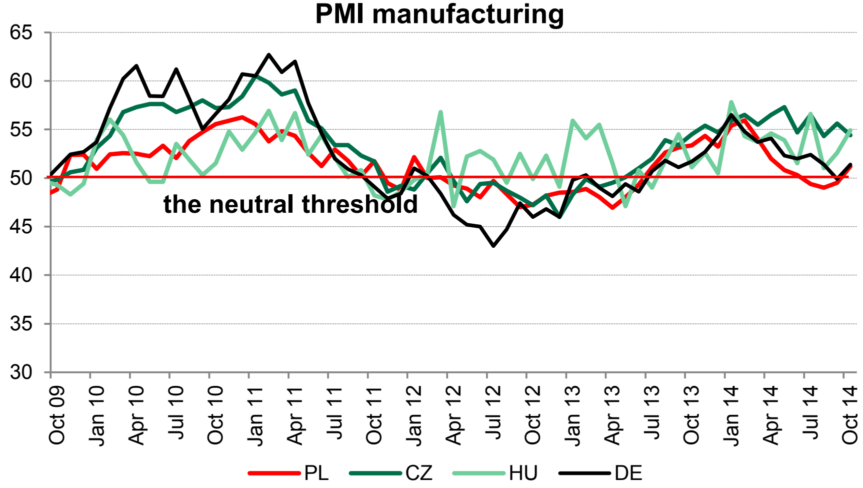


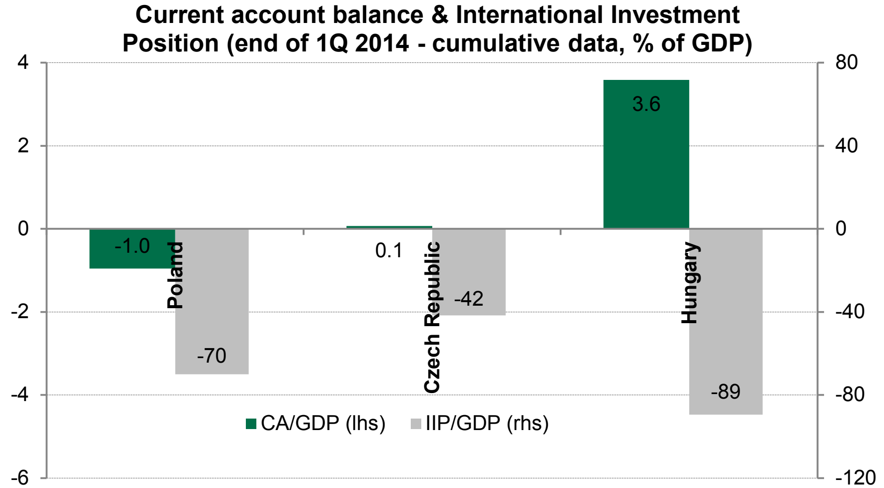
Inflation rates vs targets (%)

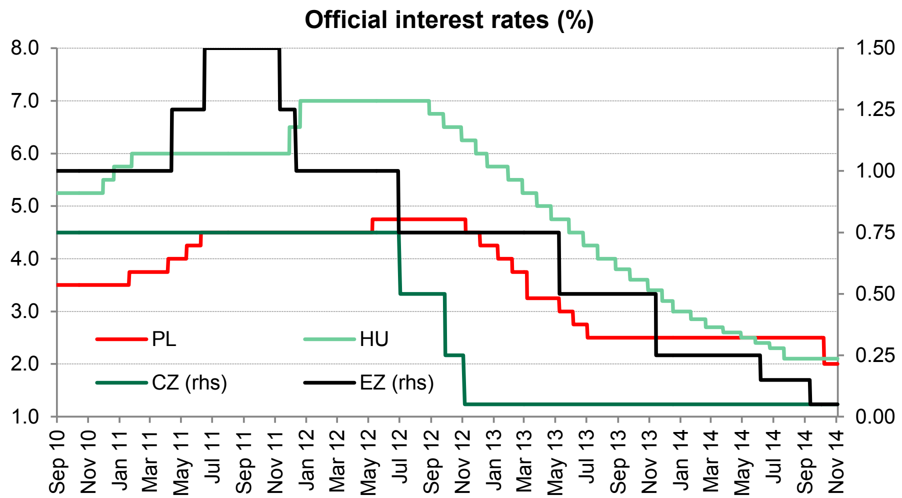


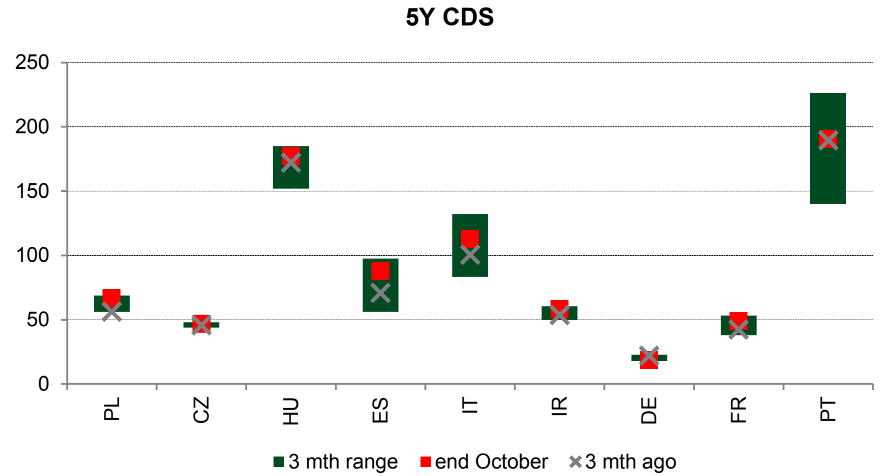
Source: rating agencies, Reuters, EC, BZ WBK.

5. Poland vs Other Countries (cont.)



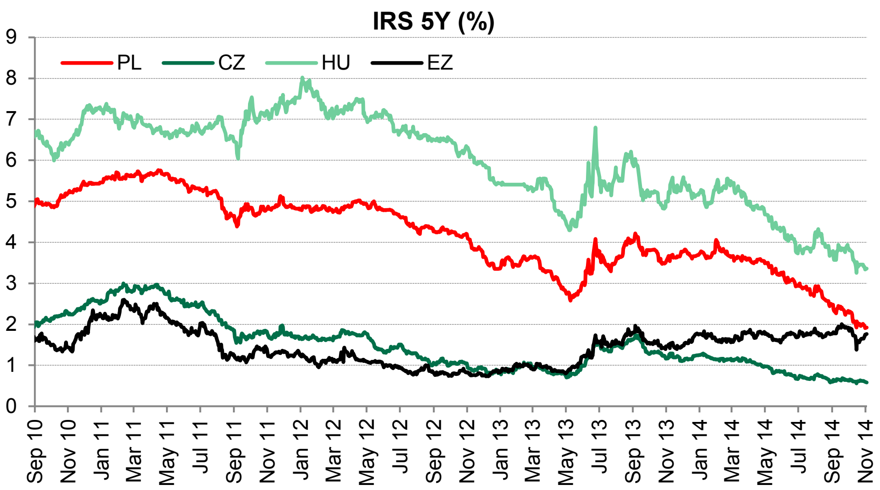


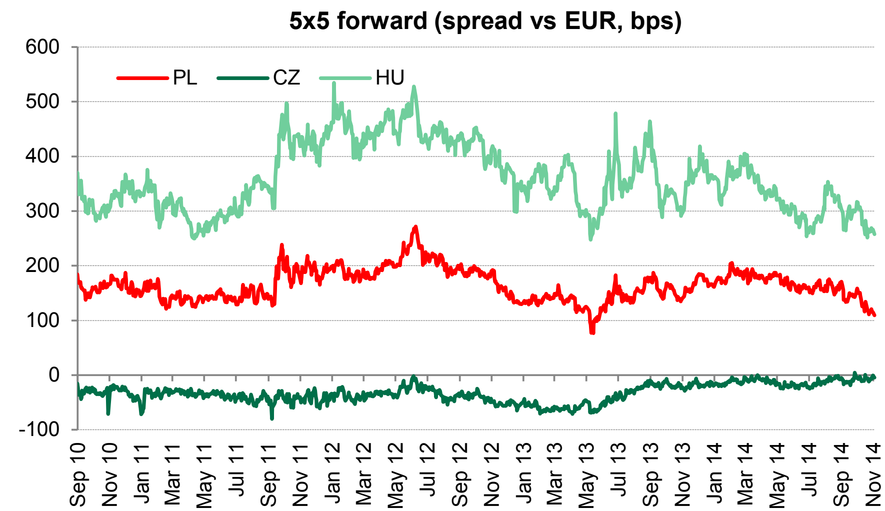


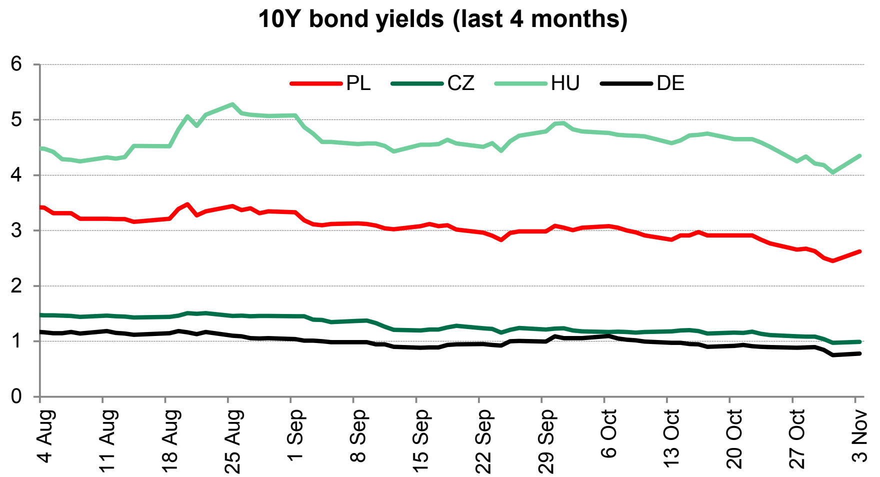


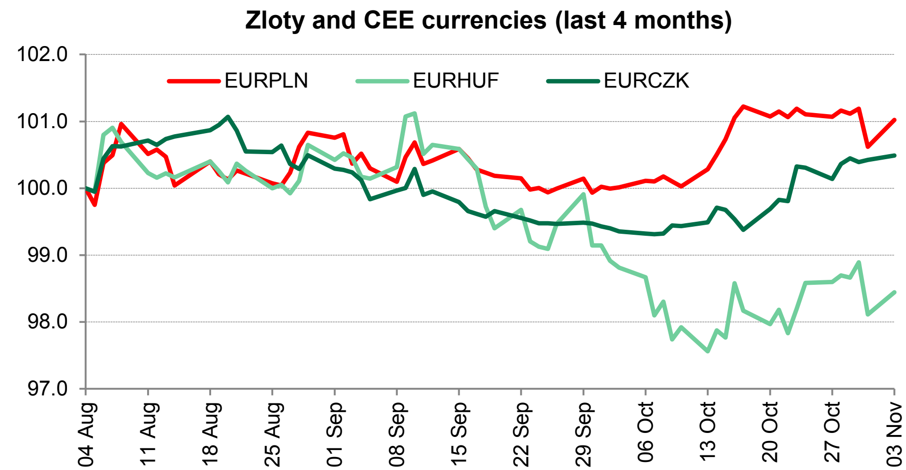
Source: Markit, Eurostat, central banks, Reuters, BZ WBK, EC.

5. Poland vs Other Countries (cont.)









Source: Reuters, BZ WBK.

6. Central Bank Watch

					Expected changes (bp)			Comments
		Last	2013	2014	1M	3M	6M	
Euro zone	Forecast	0.05	0.25	0.05				We think that November's ECB meeting will be rather uneventful . We expect the ECB to keep interest rates unchanged and to reaffirm its dovish rhetoric. Mr Draghi will probably emphasise the possibility of further action again, including a potential large-scale asset purchase programme.
	Market implied »				8	9	9	
UK	Forecast	0.50	0.50	0.50				In our opinion, the BoE will keep official rates unchanged and maintain the stock of asset purchases this month, which is consistent with current market expectations . The latest inflation report should be the main event in terms of monetary policy outlook.
	Market implied »				2	8	21	
US	Forecast	0-0.25	0-0.25	0-0.25				The Fed announced the end of its asset purchase programme and made no changes in official rates at its October meeting. The assessment on the macro situation was a bit more bullish on employment, but remained cautious on inflation. We expect the FOMC to gradually turn more hawkish and to deliver the first rate hike sooner than the market is pricing in.
	Market implied »				16	23	33	
Poland	Forecast	2.50	2.50	1.75				We think the Council will cut rates by 25bp in November, a scenario already priced-in by the market. We expect the new NBP projection to show a considerably lower GDP path for the upcoming quarters and lower inflation, which will provide arguments for further monetary easing.
	Market implied »				-25	-40	-45	
Czech Republic	Forecast	0.05	0.05	0.05				We do not expect any changes in monetary policy. In our opinion the CNB will keep its key policy rate close to zero (0.05%) and the Czech koruna cap 'near' 27/EUR.
	Market implied »				29	26	26	
Hungary	Forecast	2.10	3.00	2.10				The Monetary Council left the base rate at 2.1%, as expected. It pointed out that economic output is below its potential level, while inflationary pressure may remain low for an extended period of time. Therefore we expect official rates to remain stable in the coming months.
	Market implied »				-1	-2	-1	

Source: Reuters, BZ WBK.

This analysis is based on information available through November 3, 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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