



RATES AND FX OUTLOOK

POLISH FINANCIAL MARKETS

February 2016



Bank Zachodni WBK

 Grupa Santander

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Summary

- ▶ **GDP growth in Poland reached 3.6% in 2015, which implies that it accelerated to 3.8% YoY or more in the fourth quarter.** We predict that in 2016E growth should stabilise near 3.5%, supported by strong private consumption, solid investment and accelerating exports. At the same time, inflation keeps surprising on the downside and it seems that deflation in Poland may last until as late as 3Q16E, depressed by low prices for food, fuel, and energy.
- ▶ The first comments from new MPC members were surprisingly hawkish, and the recent zloty depreciation has lowered the odds in favour of rate cuts further. However, **we think that it is too early to say further monetary easing is off the agenda.** If the zloty trims most of its recent losses, if the chances of further ECB policy easing increase, and if Polish inflation keeps surprising on the downside, the new MPC may change its bias towards more dovish, in our view. The last communique from the outgoing MPC in January already sounded more dovish. Note also that the MPC's March meeting has been changed to 10-11 March, i.e. after the ECB meeting. Further policy easing in the euro zone may affect the Polish central bank's decision, we think.
- ▶ Poland's assets suffered significantly in early 2016 in response to the unexpected S&P decision to downgrade Poland's rating. As a consequence, the EURPLN increased to nearly 4.50, while the yield of the 10Y benchmark increased temporarily, to 3.26%. However, the sell-off was short-lived and the dovish rhetoric of the ECB (Draghi left the window wide open for further easing in March) helped both interest rate and FX markets to rebound, trimming some of the earlier losses.
- ▶ Given a low inflation environment and likely additional monetary policy easing, **we remain mildly bullish on the front end of the curve.** In our view, the downward trend in short dated instruments should be supported by expectations that commercial banks will switch their liquidity from NBP bills to T-bills, short-term fixed-rate T-bonds and/or floaters, which will not be taxed.
- ▶ The belly and long end of the curve should remain more vulnerable to global factors. Investors are likely to keep a close eye on China and global central banks (ECB, Fed). A possible further policy easing by the ECB and a shift towards a less hawkish stance by the Fed may support the long end of the curve, in our view. However, we think sentiment is still fragile and the scope for strengthening is rather limited, with 3% as a strong support level for the 10Y benchmark yield.
- ▶ The beginning of 2016 showed that internal issues may be important for the zloty. S&P's decision to downgrade Poland's rating and warnings from other rating agencies may attract market attention and make foreign investors follow the situation in Poland even more carefully, focusing on the budget performance (amid ambitious spending plans by the new government). In our view, **uncertainty related to the final shape of the FX loans bill and higher fiscal risk could weigh on the zloty and limit its appreciation potential when global market sentiment improves.**

Short- and Medium-Term Strategy: Interest Rate Market

	Change (bp)		Current Level	Expected Trend	
	Last 3M	Last 1M	1 February 2016	1M	3M
Reference rate	0	0	1.50	→	↘↘
3M WIBOR	-3	-3	1.70	→	↘↘
2Y bond yield	-17	-17	1.51	↘	↘
5Y bond yield	17	17	2.36	↘	↘
10Y bond yield	51	51	3.17	↘	→
2/10Y curve slope	69	69	166	→	↗

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

PLN Rates: Our view and risk factors

Money market: FRA rates are still well below WIBOR for most tenors, pricing in an almost 25bp rate cut on a 6-month horizon. Some see this as strange given that the first comments by new MPC members were surprisingly hawkish, and the recent zloty depreciation has lowered the odds in favour of rate cuts. However, we think that it is too early to say that further monetary easing is off the agenda. If the zloty trims most of its recent losses, if the chances for further ECB policy easing increase, and Polish inflation keeps surprising on the downside, the new MPC may change its bias towards a more dovish stance, in our view.

Short end: Given a low inflation environment and possible additional monetary policy easing, we remain mildly bullish on the front end of the curve. In our view, the downward trend in short dated instruments should also be supported by expectations that commercial banks will switch their excess liquidity from NBP bills to treasury securities (T-bills, short-term fixed-rate T-bonds and/or floaters), which will not be taxed.

Long end: The belly and long end of the curve should remain more vulnerable to global factors. Investors are likely to keep a close eye on China and global central banks (ECB, Fed). A possible further policy easing by the ECB and a shift towards a less hawkish stance by the Fed may support the long end of the curve, in our view. However, we think sentiment is still fragile and the scope for strengthening is rather limited, with 3% as a strong support level for the 10Y benchmark yield.

Risks to our view: We think that the main risks for the interest rate market are external and are asymmetric to the upside – there is greater scope for a yield/rate increase if the next data from major economies appear to be better than forecast, than room for further strengthening if data prove disappointing.

Short- and Medium-Term Strategy: FX Market

	Change (%)		Current Level	Expected Trend	
	Last 3M	Last 1M	1 February 2016	1M	3M
EUR/PLN	3.8	3.5	4.41	→	↘
USD/PLN	5.3	4.2	4.06	→	↘
CHF/PLN	1.7	0.9	3.97	↘	↘
GBP/PLN	-3.1	0.0	5.79	↘	↘
EUR/USD	-1.4	-0.6	1.09	→	→

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

PLN FX Market: Our view and risk factors

EUR: A shift towards more accommodative monetary policies by the main central banks helped the zloty to trim some of the losses suffered after the rating downgrade. We do not expect EUR/PLN to rise in the short term, but room for the zloty to gain in the months to come looks limited. In our view, uncertainty related to the final shape of the FX loans bill and higher fiscal and political risk could weigh on the zloty and limit its appreciation potential even when global market sentiment improves.

USD: The US dollar has remained firm at the start of 2016. However, the decreasing possibility of quick rate hikes due to the less hawkish than expected Fed tone after January's meeting led us to revise our Fed outlook. Now we expect only two hikes in 2H16E. Consequently, we think that EUR/USD will move sideways in the short to medium term. Given this, we still expect USD/PLN to decrease gradually in upcoming weeks/months.

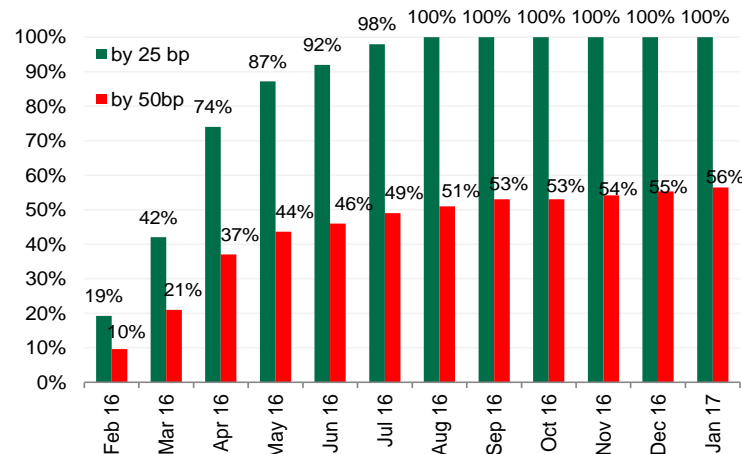
CHF: The fairly strong increase in EUR/CHF at the end of January (there was speculation this could be due to the SNB's interventions) helped the zloty to trim some of its losses against the CHF, with CHF/PLN declining to below 4.00 for the first time since the start of 2016. We stick to our view that EUR/CHF will continue its gradual upward move, which should support the zloty's strengthening in the medium term.

Risks to our view: Global sentiment remains important for the zloty, but domestic risk factors have gained in significance after the rating downgrade. Any suggestion that the FX loans bill could be approved in a form close to the president's proposal (very costly for banks) would trigger PLN depreciation, in our view.

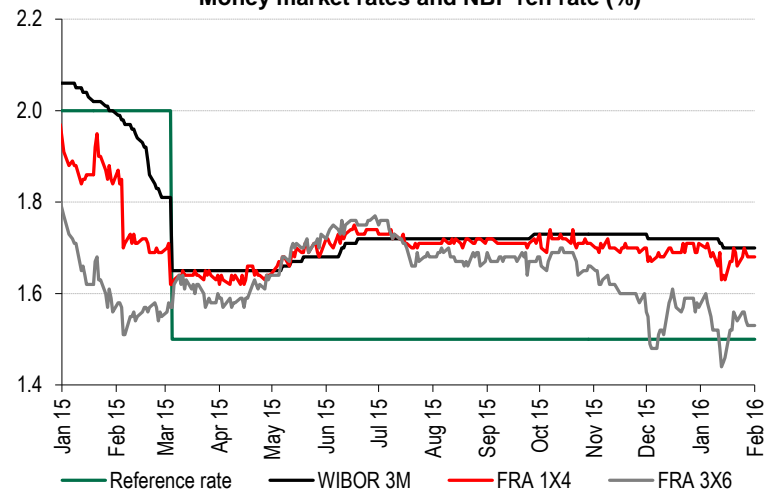
Domestic Money Market: No significant changes in WIBORs

- In January, WIBORs dropped by 2-5bp across the curve, with the biggest decline being seen in the 1M rate. As a consequence, the spread to the NBP reference rate narrowed gradually and reached 11bp for the 1M rate, the lowest level since February 2015. FRAs, as in previous months, have remained more vulnerable. The lower than expected flash CPI for December pushed the FRA curve downwards, with FRA3x6 and FRA6x9 reaching new historical lows in mid-January. But the trend reversed quickly and FRAs increased visibly after S&P's decision to downgrade Poland's rating and cautious comments by MPC members and candidates for this authority. All in all, at the end of January, FRAs were 2-16bp lower as compared to the end of 2015.
- Currently, the market is pricing in a 25bp rate cut on a six-month horizon and is no longer expecting a 50bp rate cut.
- We maintain our baseline scenario, which assumes that the new MPC is likely to ease monetary conditions in 1Q16E. Despite the quite hawkish rhetoric of the new MPC members, we still expect a 25bp rate cut in March, especially as the new NBP forecasts are likely to confirm deflation for much longer than previously expected, and other central banks are changing their policies towards more accommodative ones. However, in our view, the WIBOR rate is not likely to decline much in the coming weeks and we expect a more significant fall closer to the Council's March meeting.

Probability of rate cuts
(implied by FRA rates on February 1)



Money market rates and NBP refi rate (%)



Source: Reuters, BZ WBK

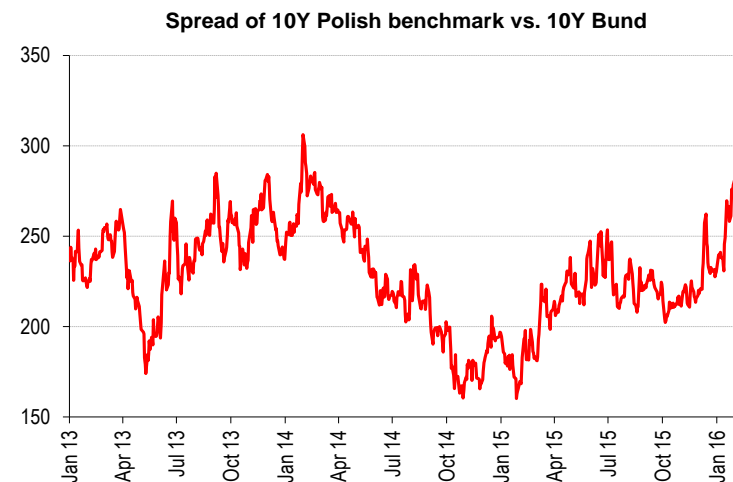
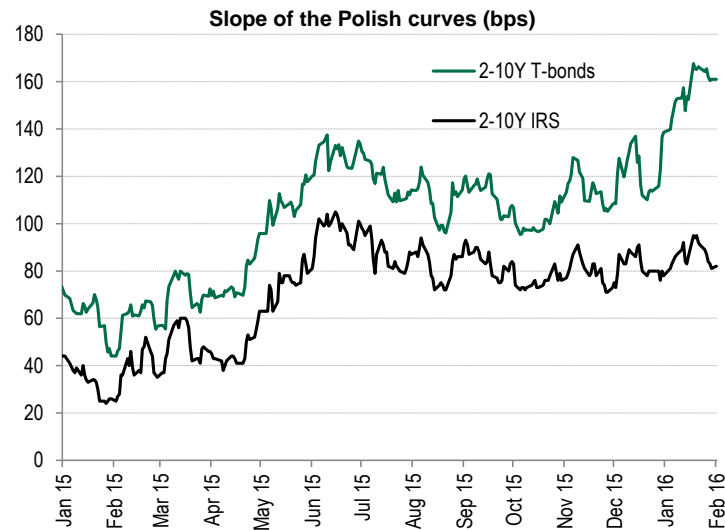
Domestic IRS and the T-Bond Market: Steeper curves, larger risk premium

January was a turbulent and highly volatile month on the interest rate market. Yields and IRS rates increased noticeably in response to the rating downgrade by S&P after a reasonably favourable start to 2016. However, the dovish rhetoric of the ECB (Draghi left the window wide open for further easing in March) and Fed, but also the introduction of negative rate by the Bank of Japan helped the market to rebound. As a result, Poland's bonds and IRS trimmed most of their earlier losses.

Given a low inflation outlook and likely additional monetary policy easing, we remain mildly bullish on the front end of the curve. The downward trend in short dated instruments should also be supported by expectations that commercial banks will switch their liquidity from NBP bills to T-bills, short-term fixed-rate T-bonds and/or floaters, which will not be taxed.

The belly and long end of the curve should remain more vulnerable to global factors. An improvement in the global mood might bring some revival in 5Y and 10Y benchmark yields. However, we think sentiment is still fragile and, therefore, the potential for strengthening is rather limited, with 3% as a strong support level for the 10Y benchmark yield.

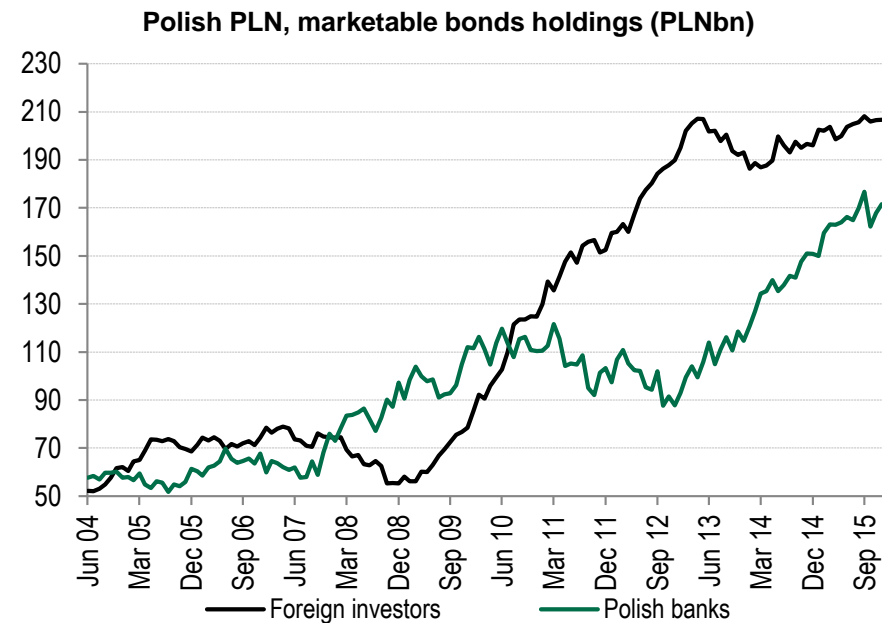
The Polish yield and IRS curves steepened in early 2016 as the economy continued to expand at a solid pace, and fiscal expansion plans and the risk of a revenue shortfall in 2016 led to heightened uncertainty over medium-term fiscal prospects and the direction of policy, adding to the Polish risk premium. The spread to 10Y Bunds soared above 270bp, to its highest since March 2014. Steep curves and a higher risk premium are still a valid scenario for upcoming weeks/months. We continue to see sustained pressure on medium- and longer-dated instruments due to policy uncertainty, and the risk of further downgrades by other agencies.



Source: Reuters, Bloomberg, NBP, MoF, BZ WBK.

Demand Corner: No big changes in non-residents' portfolio

- In December, the nominal value of Poland's marketable PLN bonds held by non-residents did not change much (+PLN200mn). As regards particular groups, commercial and central banks raised their holdings by cPLN1bn while mutual funds disposed of PLN4.1bn. Given the geographical criteria, institutions from the euro zone sold PLN1.7bn of Polish bonds in nominal terms, while U.S. investors reduced their portfolio by PLN1bn. At the same time, Asia was on the bid side with a nearly PLN2.0 rise.
- As regards Polish investors, domestic bank holdings rose for the 2nd month in a row, by over PLN3.6bn to PLN171.5bn (the 2nd highest level ever after the PLN176.6bn seen in Sept-15). A substantial change, but on the negative side, was recorded by Polish mutual funds (-PLN3bn).
- The biggest activity among Polish banks was recorded by OK0717 (+PLN1.0bn) and PS0421 (+PLN1.4bn), while non-residents particularly traded PS0421 (+PLN1.2bn) and PS0420 (-PLN1.2bn).
- As regards quarterly statistics, 4Q15 saw a PLN5bn cut in Polish banks' holdings (the first since 4Q13 and the biggest since -PLN14bn in 4Q12). Domestic mutual funds sold bonds for a nominal value of PLN2.5bn (the biggest quarterly cut since the -PLN4bn seen in 3Q08). Non-residents cut holdings in 4Q15 by PLN1.4bn. On an annual basis, in 2015 Polish banks bought bonds for a PLN20.7bn nominal value and foreign investors for PLN10.7bn (vs. +PLN2.8bn in 2014 and +PLN3.3bn in 2013).

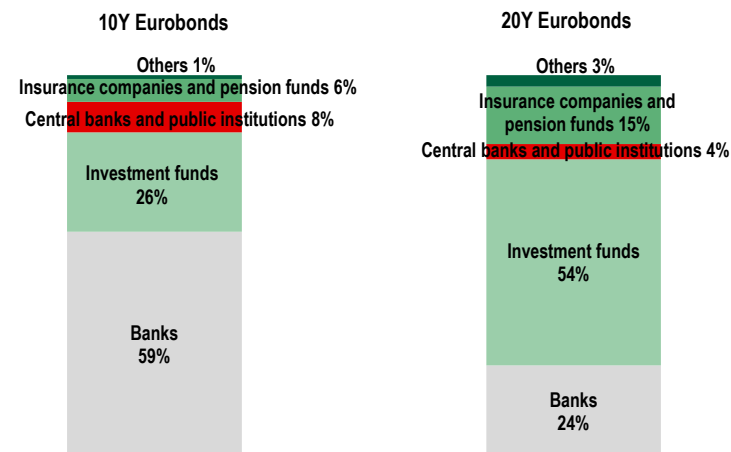


Source: Finance Ministry. BZ WBK.

Supply Corner: Busy start to 2016

- ▶ The start of 2016 was busy for Poland's Finance Ministry. In January it tapped both the domestic and foreign primary debt markets. On the domestic market it sold 2Y (OK1018) and 5Y (PS0421) benchmarks and floaters (WZ0120, WZ0126) worth PLN12.63bn in total. Two regular auctions attracted solid demand from both domestic and foreign investors, with a bid to cover ratio at 1.53 on average.
- ▶ Poland also launched long-term (10Y and 20Y) eurobonds worth €1.75bn in total in January. It placed the 10Y bonds at 65bp above mid-swaps (with an average yield at 1.542%) and 20Y at 100bp above mid-swaps at an average 2.471%. The structure of buyers was well diversified. The bonds were placed mainly among asset managers and commercial banks.
- ▶ Summing up, at the end of January gross borrowing requirements had covered c30% of the 2016 target.
- ▶ The issuance plan for February assumes two regular T-bond auctions worth PLN6-14bn in total. At the first auction (4 February), the ministry will offer 2Y and 10Y benchmarks (OK1018 and DS0726) worth PLN4-8bn. In February the ministry will also offer 32-week T-bills (worth PLN1-2bn).

The structure of Eurobonds buyers by type of investor



Auction plan for February 2016

Auction Date	Settlement Date	T-bond/T-bills to Be Offered	Offer (PLN m)
4 Feb 2016	8 Feb 2016	OK1018/DS0726	4,000-8,000
15 Feb 2016	17 Feb 2016	32-week T-bills	1,000 – 2,000
18 Feb 2016	22 Feb 2016	choice will depend on the market conditions	2,000 – 6,000

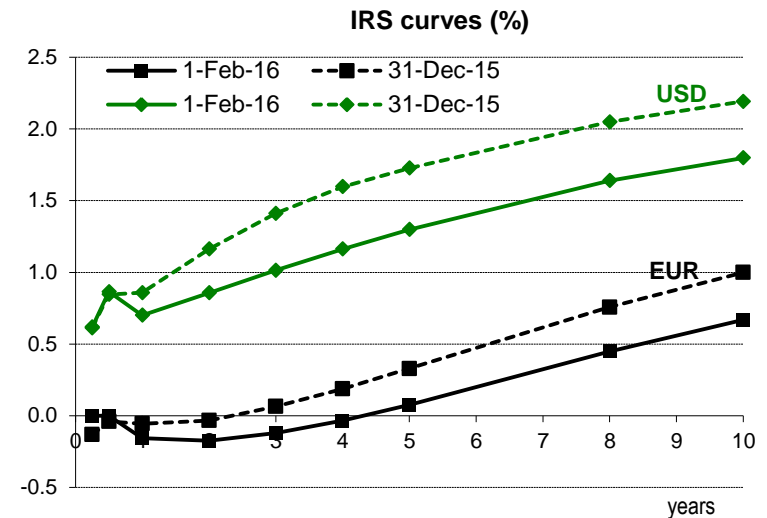
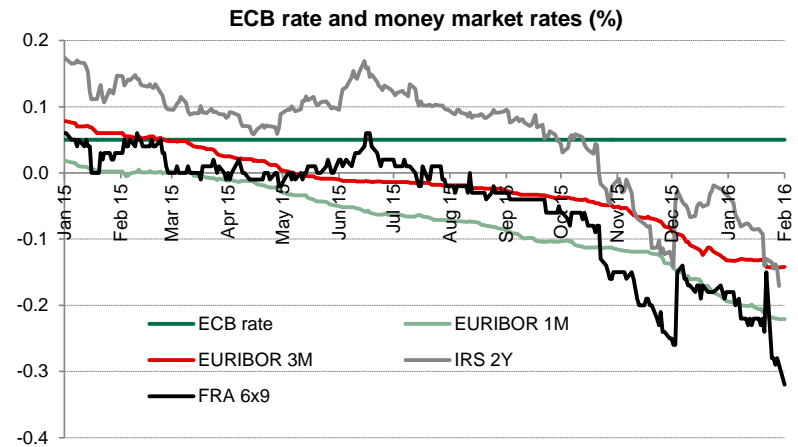
Source: Finance Ministry, BZ WBK.

International Money Market and IRS: Market believe that central banks will keep rates ultra-low

Central banks' monetary policy has remained the main driver of both money and IRS markets in Europe. Unexpectedly, at its January meeting the ECB left the door wide open to further stimulus in March and in response to this declaration EURIBORs and IRS fell markedly in early 2016. The EUR IRS curve shifted downwards by 10-30bp on a monthly basis, while EURIBOR rates fell by 2-5bp across the board. On the other hand, USD and GBP LIBOR rates have continued their upward move, but the trend slowed visibly after the dovish rhetoric by both the Fed and BoE. At the same time, USD IRS rates fell gradually as US macro data deteriorated in 4Q15.

Global factors (including China, falling oil prices) have biased central banks back to the dovish side. We expect the ECB to further ease its monetary conditions (including a 10bp deposit rate cut), while the Fed is in no hurry to hike rates in the near term. Given our ECB scenario we expect the EUR money market rate to continue to fall, reaching new historical lows. What is more, as the ECB prepares to ease again and euro area growth prospects are clouded by global financial worries, we expect EUR IRS rates to continue to fall, testing lows reached in 2H15.

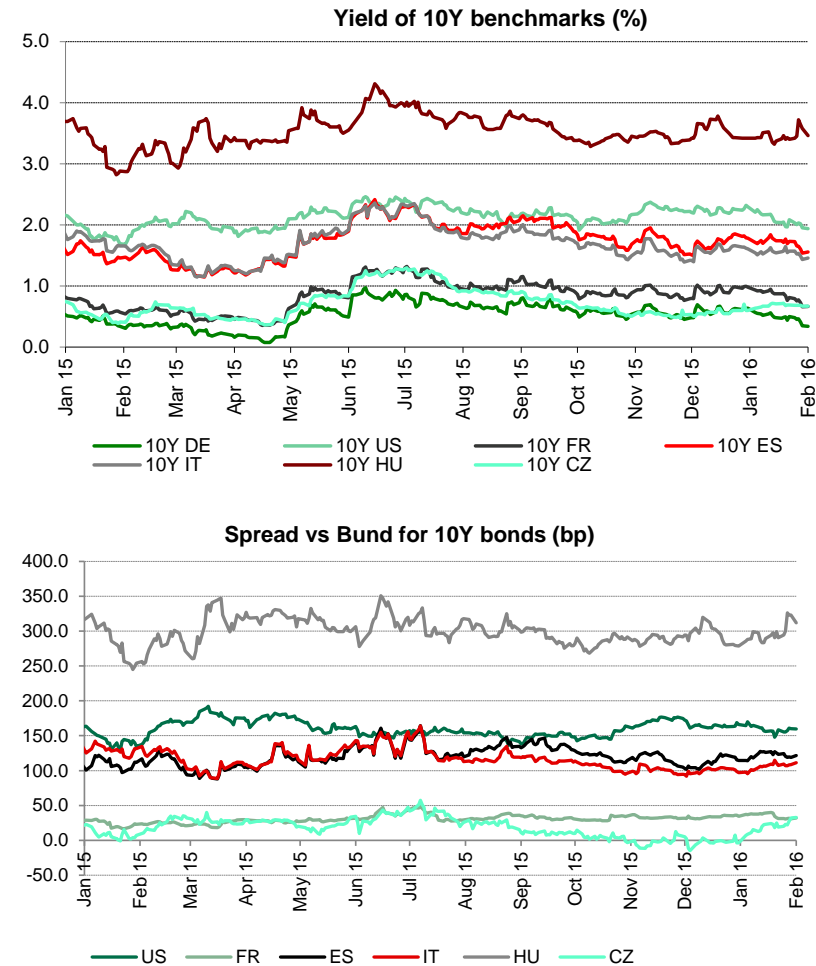
The recent turmoil in China and concerns about global growth will likely make the Fed maintain its neutral monetary policy stance, with the Fed fund rate stable for longer than previously expected. Therefore we think that USD LIBOR should be more or less stable in upcoming months. On the other hand, weaker US growth at the start of the year and external developments that ensure inflation pressure in the US will likely remain subdued might support a downward trend in USD IRS rates in upcoming weeks/months.



Source: Reuters, ECB, Fed, BZ WBK.

International Bond Market: More dovish tone supports some flattening in the short term

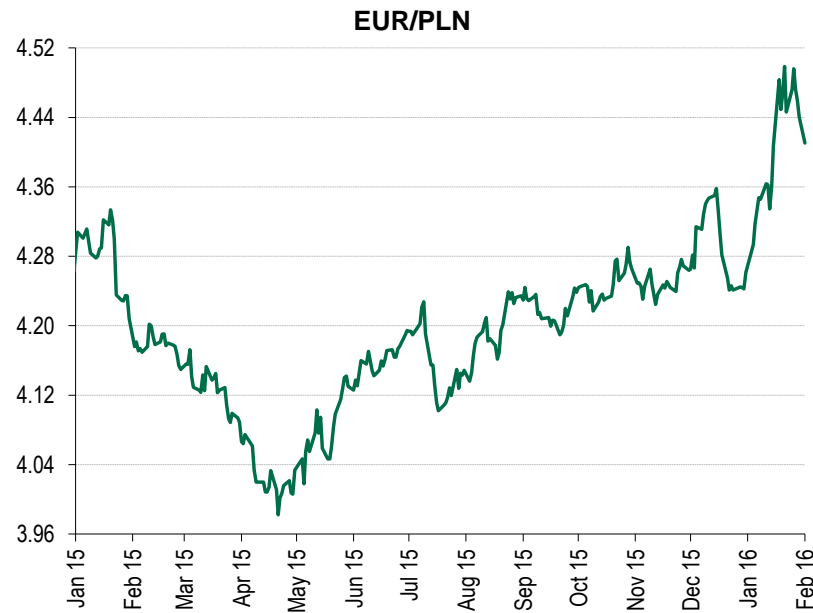
- In January, global deflation fears and expectations for further easing or less tightening of monetary policy by global central banks boosted demand for core debt. As a result, the 10Y Bund yield fell to nearly 0.30%, while the 10Y UST yield dropped below 2%. The improved global mood helped also peripheral debt to rebound, which resulted in spread tightening vs Bunds. CEE bonds were more volatile, with a moderate increase in yields on a monthly basis.
- Even with an improving euro zone outlook, the ECB's dovish tone in January suggesting further monetary easing in March should keep yields on core debt market close to their local lows. While the front end of the German curve is well anchored by expected ECB action, the long end of the curve should remain more vulnerable to global mood changes. In our view, the German yield curve might slightly flatten as there has been some excess steepening in recent weeks. However, in the medium to long term, we still expect a rise in the 10Y Bund yield driven by the spill-over from US yields.
- In our view, macro data and the ECB background remain supportive for peripheral debt. As a consequence, we expect more tightening of the spread to the Bund.
- The uncertain global outlook and a further decline in commodity prices (in particular oil) will probably force the Fed to adjust its monetary policy at a slower pace. We expect two more hikes in 2H16E (25bp each) and so we foresee some flattening of the curve. We think that risk aversion (mainly due to China) and macro weakening could favour the belly and the long end of the curve.



Source: Reuters, BZ WBK.

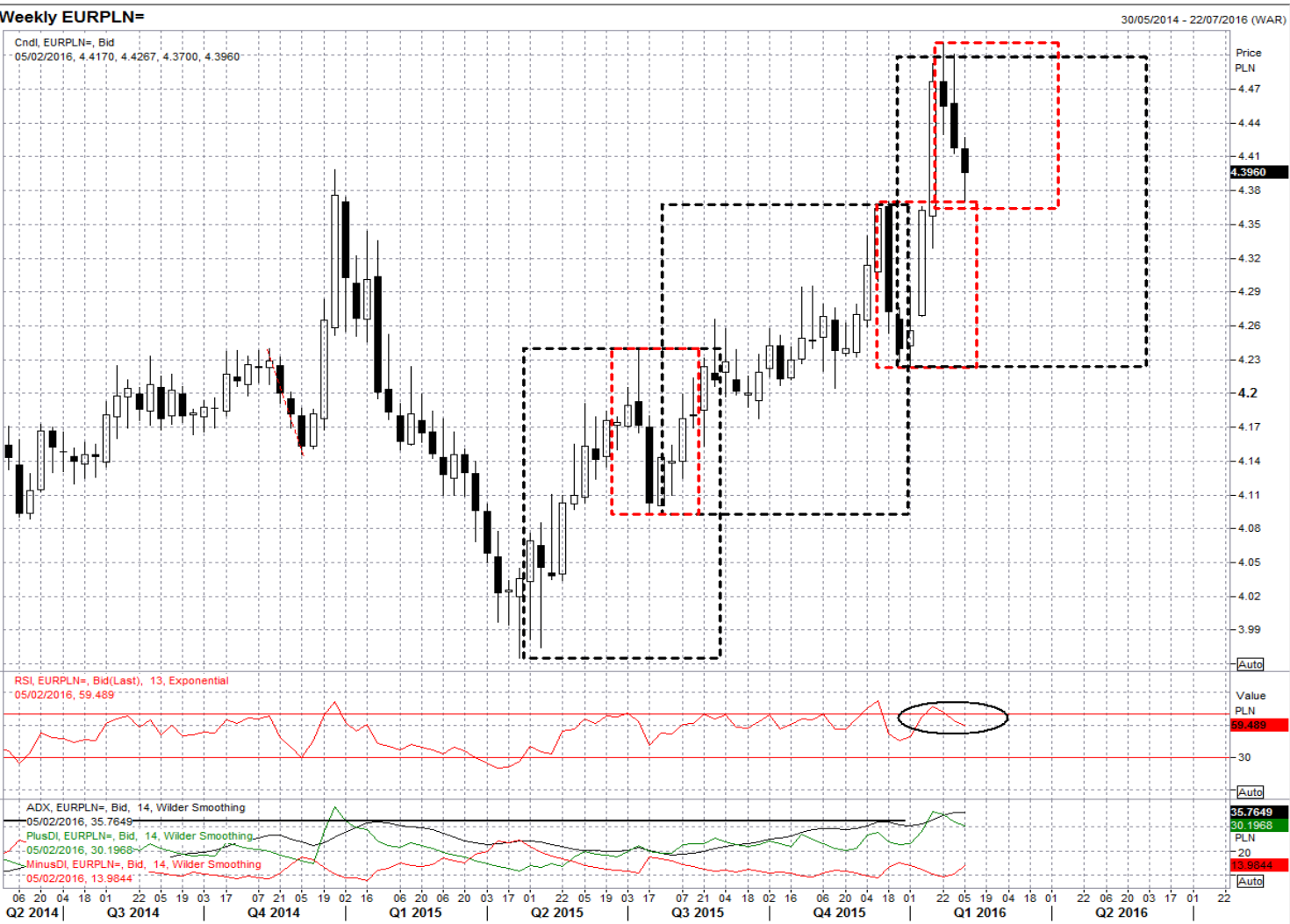
Foreign Exchange Market: Outlook less optimistic

- EUR/PLN jumped in mid-January to 4.50 on S&P's decision to downgrade Poland's sovereign rating, although even before the decision the zloty was negatively affected by global risk aversion, worries about China, and concerns about the Polish banking sector.
- After the zloty's sharp fall, we have raised our EUR/PLN forecast. We do not expect the exchange rate to rise in the short term, but the room for the zloty to gain in the months to come looks limited. In our base scenario, global market sentiment would be positive enough to allow the Fed to continue with its rate hikes, but the zloty may not advance much after reaching 4.30, due to perceived risks related to Poland's internal situation.
- The beginning of 2016 has shown that internal issues may be an important factor for the zloty. We think the S&P decision was exaggerated, but it may attract market attention and make foreign investors follow the situation in Poland even more carefully, focusing on the budget performance (due to ambitious spending plans by the new government).
- The president's office has made a proposal on how to deal with the FX loans and a draft will now be passed to the Financial Supervisory Authority and a discussion will follow. This could take several months and, in our view, uncertainty related to the final shape of the bill could weigh on the zloty and limit its appreciation potential when global market sentiment improves.
- Another risk for the Polish currency could be more dovish rhetoric from the new MPC if the deflation outlook worsens. However, the first comments from the new central bankers suggest they may not be in a hurry to ease monetary policy further.



Source: Reuters, BZ WBK

FX Technical Analysis Corner: Room for a slight drop in EUR/PLN



- EUR/PLN continued to rise and draw the third upside wave that was similar in size (although slightly longer) to the previous two. Should the exchange rate follow the same pattern as in the last few months, we can expect EUR/PLN to reach c4.36 in the near future.
- RSI gave another sell signal but given past experience we should not pay too much attention to this. However, ADX is at its highest since 2012 giving hope of a somewhat more sustainable correction.

Source: Reuters, BZ WBK.

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



- ▶ Last month we pointed out that EUR/USD had broken the lower boundary of the 1.08-1.106 range, but ADX is still in the low 20s, indicating that the move is not too strong so far and that the big white candle from early December may slow the decline.
- ▶ The exchange returned to the horizontal range and is still waiting for an impulse that could trigger a directional move.
- ▶ Three SMAs are running tight just above 1.10 and this looks to be a first important resistance.

Source: Reuters, BZ WBK.

Macroeconomic Forecasts

Poland		2013	2014	2015E	2016E	1Q15	2Q15	3Q15E	4Q15E	1Q16E	2Q16E	3Q16E	4Q16E
GDP	PLNbn	1,656.3	1,719.1	1,788.6	1,842.1	414.6	432.2	438.6	503.2	424.8	444.2	450.9	522.2
GDP	%YoY	1.3	3.3	3.6	3.5	3.7	3.3	3.5	3.8	3.2	3.4	3.6	3.7
Domestic demand	%YoY	-0.7	4.9	3.4	3.9	2.9	3.1	3.2	4.2	4.6	3.7	3.6	3.7
Private consumption	%YoY	0.2	2.6	3.1	3.2	3.1	3.1	3.1	3.1	3.1	3.2	3.4	3.3
Fixed investment	%YoY	-1.1	9.8	6.1	5.7	11.5	6.1	4.6	5.0	4.0	6.0	6.0	6.0
Unemployment rate ^a	%	13.4	11.4	9.8	9.0	11.5	10.2	9.7	9.8	10.1	9.1	8.8	9.0
Current account balance	EURmn	-5,031	-8,303	-848	-2,639	900	864	-2,527	-85	-407	362	-2,565	-30
Current account balance	% GDP	-1.3	-2.0	-0.2	-0.6	-1.3	-0.4	-0.5	-0.2	-0.5	-0.6	-0.6	-0.6
General government balance (ESA 2010)	% GDP	-4.0	-3.2	-3.1	-3.3	-	-	-	-	-	-	-	-
CPI	%YoY	0.9	0.0	-0.9	-0.1	-1.5	-0.9	-0.7	-0.6	-0.5	-0.3	-0.3	0.6
CPI ^a	%YoY	0.7	-1.0	-0.5	1.0	-1.5	-0.8	-0.8	-0.5	-0.5	-0.2	0.1	1.0
CPI excluding food and energy prices	%YoY	1.2	0.6	0.3	0.6	0.4	0.3	0.3	0.2	0.4	0.5	0.5	0.9

Source: CSO, NBP, Finance Ministry, BZ WBK estimates.

^a at the end of the period

Interest Rate and FX Forecasts

Poland		2013	2014	2015	2016E	1Q15	2Q15	3Q15E	4Q15	1Q16E	2Q16E	3Q16E	4Q16E
Reference rate ^a	%	2.50	2.00	1.50	1.25	1.50	1.50	1.50	1.50	1.25	1.25	1.25	1.25
WIBOR 3M	%	3.02	2.52	1.75	1.50	1.87	1.67	1.72	1.73	1.62	1.45	1.45	1.46
Yield on 2-year T-bonds	%	2.98	2.46	1.70	1.47	1.61	1.75	1.80	1.65	1.44	1.43	1.45	1.55
Yield on 5-year T-bonds	%	3.46	2.96	2.21	2.45	1.90	2.35	2.43	2.19	2.24	2.35	2.53	2.67
Yield on 10-year T-bonds	%	4.04	3.49	2.69	3.25	2.24	2.79	2.93	2.77	3.08	3.17	3.30	3.45
2-year IRS	%	3.10	2.51	1.72	1.48	1.65	1.85	1.78	1.58	1.52	1.46	1.43	1.50
5-year IRS	%	3.51	2.92	2.02	2.19	1.80	2.23	2.17	1.89	1.97	2.10	2.28	2.42
10-year IRS	%	3.86	3.34	2.41	2.91	2.06	2.57	2.62	2.38	2.61	2.87	3.00	3.15
EUR/PLN	PLN	4.20	4.18	4.18	4.34	4.20	4.09	4.19	4.26	4.39	4.31	4.36	4.32
USD/PLN	PLN	3.16	3.15	3.77	3.88	3.72	3.70	3.77	3.90	4.02	3.88	3.86	3.76
CHF/PLN	PLN	3.41	3.45	3.92	3.78	3.93	3.93	3.90	3.93	3.98	3.80	3.73	3.62
GBP/PLN	PLN	4.94	5.19	5.77	5.76	5.64	5.67	5.84	5.91	5.77	5.63	5.78	5.88

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

Economic Calendar and Events

Date		Event:	Note:
3-Feb	PL	MPC meeting – interest rate decision	No change in monetary policy conditions expected
4-Feb	PL	T-bond auction: OK1018, DS0726	Offer: PLN4.0-8.0bn
	CZ	CNB meeting – interest rate decision	We expect rates to remain unchanged
12-Feb	PL	Flash GDP for 4Q15	We think 4Q15E GDP growth accelerated to 3.8% YoY (in line with market forecasts)
	PL	C/A balance for December 2015	We expect a current account gap of €0.54bn, slightly above market consensus (-€0.30bn)
	PL	CPI for January	Our and market expectations are -0.5%YoY
15-Feb	PL	32-weeks T-bill auction	Offer: PLN1.0-2.0bn
16-Feb	PL	Wages and employment for January	We expect employment growth of 1.6%YoY and an increase in wages of 3.9%YoY, slightly above market consensus
17-Feb	PL	Industrial output for January	We expect an increase of 1.7%YoY, below market expectations (3.3%)
	PL	Construction output for January	In our view, construction output will decrease by 5.4%YoY vs the median forecast of -3.9%YoY
	PL	Retail sales for January	We estimate retail sales growth (in constant prices) of 6.9%YoY, above market forecasts at 5.0%YoY
18-Feb	PL	T-bond auction	Offer: PLN2.0-6.0bn
	PL	Minutes from November MPC meeting	-
23-Feb	HU	HNB meeting – interest rate decision	We expect rates to remain unchanged
TBA	PL	Unemployment rate for January	We expect an increase in the registered unemployment rate to 10.3%, due to the seasonal pattern. Our forecast is in line with market consensus
29-Feb	PL	Detailed GDP data for 4Q15	We expect GDP growth at 3.8%YoY, with private consumption at 3.1%YoY and investment at 5%YoY
10-Mar	EZ	ECB meeting – interest rate decision	We expect the deposit rate to be cut by 10bp and a further extension of the QE programme
11-Mar	PL	MPC meeting – interest rate decision	The new MPC is likely to cut rates by 25 bp

Source: CB, Markit, CSO, Finance Ministry

Annex

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

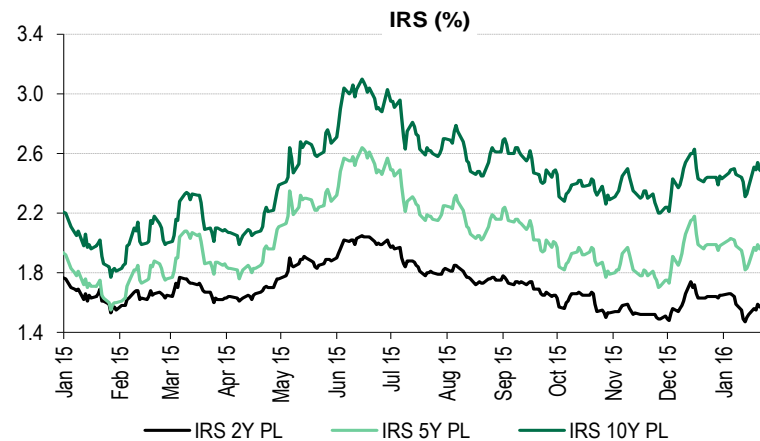
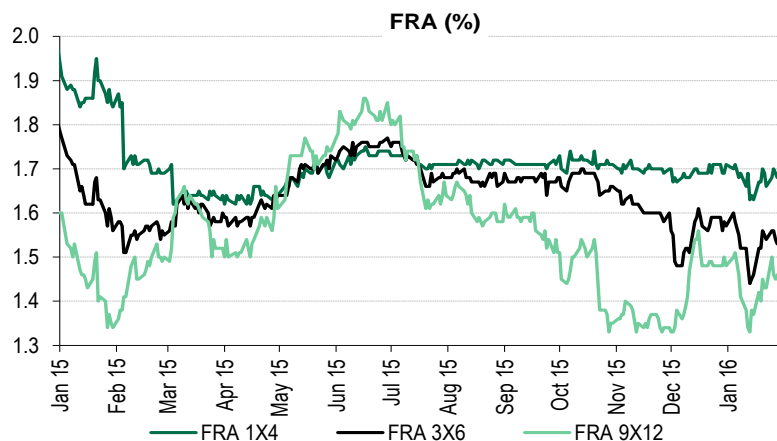
1. Domestic Market Performance

Money market rates (%)

	Reference	Poland	WIBOR (%)				OIS (%)				FRA (%)			
	rate (%)	(%)	1M	3M	6M	12M	1M	3M	6M	12M	1x4	3x6	6x9	9x12
End of January	1.50	1.53	1.60	1.70	1.75	1.77	1.39	1.33	1.21	1.15	1.68	1.53	1.46	1.44
Last 1M change (bp)	0	14	-5	-2	-2	-2	-4	-8	-10	-10	-3	-4	-3	-4
Last 3M change (bp)	0	3	-7	-3	-6	-6	-7	-13	-17	-14	-3	-13	0	9
Last 1Y change (bp)	-50	-10	-41	-30	-24	-21	-34	-24	-24	-25	-17	-6	8	9

Bond and IRS market (%)

	BONDS			IRS			Spread BONDS / IRS (bp)		
	2Y	5Y	10Y	2Y	5Y	10Y	2Y	5Y	10Y
End of January	1.52	2.37	3.14	1.56	1.88	2.37	-4	49	77
Last 1M change (bp)	-3	16	21	-9	-11	-6	6	27	27
Last 3M change (bp)	-4	27	47	3	7	5	-7	20	42
Last 1Y change (bp)	0	68	115	-1	28	54	1	40	61



Source: Reuters, BZ WBK

2. Polish Bonds: Supply Recap

Total issuance in 2016 by instrument (in PLN mn, nominal terms)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
T-bond auctions	12,629	13,000	10,000	9,500	7,000	8,500	7,500	3,600	4,000	10,000	3,000		88,729
T-bill auctions	2,400	2,000	1,000	1,000	1,000	700	500		700				9,300
Retail bonds	200	600	175	167	160	192	200	215	200	250	1100	250	3,709
Foreign bonds/credits	7,700		7,525		5,238		4,360			2,006	4,900		31,728
Pre-financing and financial resources at the end of 2015	36,500												36,500
Total	59,429	15,600	18,700	10,667	13,398	9,392	12,560	3,815	4,900	12,256	9,000	250	169,966
Redemption	13,680	11,645	153	18,494	146	124	8,795	8,688	2,200	23,573	6,884	910	95,293
Net inflows	45,749	3,955	18,547	-7,827	13,252	9,268	3,765	-4,873	2,700	-11,318	2,116	-660	74,674
Rolled-over T-bonds													0
Buy-back of T-bills/ FX-denominated bonds													0
Total	45,749	3,955	18,547	-7,827	13,252	9,268	3,765	-4,873	2,700	-11,318	2,116	-660	74,674
Coupon payments from domestic debt	1,084			3,767			3,306		1,295	5,487			14,940

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	13,451		229	13,680	0	13,680
February			647	647	10,999	11,645
March			153	153	0	153
April	17,443		136	17,579	915	18,494
May			146	146	0	146
June			124	124	0	124
July	7,658		226	7,884	911	8,795
August	3,689	2,400	199	6,288	0	6,288
September			200	200	0	200
October	22,420		242	22,662	911	23,573
November			1,056	1,056	1,628	2,684
December			210	210	0	210
Total 2016	64,662	2,400	3,567	70,629	15,364	85,993
Total 2017	72,603		2,485	75,087	11,728	86,815
Total 2018	69,670		1,313	70,983	12,977	83,959
Total 2019	63,811		1,237	65,048	23,512	88,559
Total 2020	59,340		634	59,974	21,805	81,779
Total 2021+	188,956		1,749	190,705	116,866	307,571

Source: MF, BZ WBK.

2. Polish Bonds: Supply Recap (cont.)

Scheduled wholesale bond redemptions by holders (data at the end of December 2015, in PLN mn)

	Foreign investors	Domestic banks	Insurance funds	Pension funds	Mutual funds	Individuals	Non-financial sector	Other	Total
Q1 2016	8,007	2,151	2,027	54	579	26	42	459	13,346
Q2 2016	9,706	3,305	1,650	187	493	16	54	2,033	17,443
Q3 2016	5,564	5,518	1,551	104	2,407	38	531	695	16,408
Q4 2016	11,585	7,269	2,282	128	895	25	43	1,759	23,985
Total 2016	34,862	18,242	7,511	474	4,373	104	670	4,946	71,182
	49%	26%	11%	1%	6%	0%	1%	7%	100%
Total 2017	26,246	25,959	7,644	607	5,775	106	162	5,837	72,338
	36%	36%	11%	1%	8%	0%	0%	8%	100%
Total 2018	19,626	28,415	4,542	397	6,943	86	195	6,205	66,409
	30%	43%	7%	1%	10%	0%	0%	9%	100%
Total 2019	21,018	26,474	5,511	426	5,925	82	168	4,220	63,825
	33%	41%	9%	1%	9%	0%	0%	7%	100%
Total 2020	24,227	17,198	4,048	187	7,191	49	68	3,527	56,494
	43%	30%	7%	0%	13%	0%	0%	6%	100%
Total 2021+	80,765	55,211	22,877	416	16,869	251	269	6,479	183,137
	44%	30%	12%	0%	9%	0%	0%	4%	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 December			Share of total in December (%)
	End Dec'15	End Nov'15	End Oct'15	End 1Q 2015	End 2014	End 2013	MoM	3-mth	YoY	
Domestic investors	316.9	316.9	308.4	309.1	295.9	381.2	2.8	0.0	7.6	60.5
Commercial banks	171.5	167.8	162.2	163.1	150.8	114.7	3.5	-1.3	11.2	32.7 (0.7pp)
Insurance companies	52.1	51.6	50.3	52.4	52.8	52.0	2.5	-1.8	-1.2	10.0 (0.1pp)
Pension funds	2.5	2.8	2.9	3.1	3.3	125.8	-1.9	-5.0	-18.3	0.5 (-0.1pp)
Mutual funds	47.1	50.2	50.9	48.5	46.9	46.7	-1.3	2.4	8.1	9.0 (-0.6pp)
Others	43.7	44.5	42.1	42.0	42.0	42.0	5.7	2.6	7.2	8.3 (-0.1pp)
Foreign investors*	206.8	206.6	206.0	203.8	196.0	193.2	0.3	0.5	5.1	39.5
Banks	12.7	11.5	15.6	9.9	9.9	n.a.	-25.8	-28.1	16.7	2.4 (0.2pp)
Central banks	30.1	29.1	28.6	20.3	16.4	n.a.	1.8	38.1	87.0	5.8 (0.2pp)
Public institutions	9.4	10.0	9.7	8.8	8.1	n.a.	3.6	5.1	13.7	1.8 (-0.1pp)
Insurance companies	12.4	11.6	10.9	11.0	10.7	n.a.	6.5	0.7	10.6	2.4 (0.2pp)
Pension funds	14.1	13.6	13.0	13.2	13.0	n.a.	4.8	4.0	6.7	2.7 (0.1pp)
Mutual funds	54.9	59.1	58.6	80.2	78.1	n.a.	0.9	-14.7	-25.0	10.5 (-0.8pp)
Hedge funds	0.04	0.04	0.04	0.1	1.1	n.a.	-4.1	-5.3	-93.6	0.0
Non-financial sector	9.1	9.3	9.3	12.6	8.2	n.a.	-0.1	16.4	-23.2	1.7
Others	19.0	19.1	18.0	17.0	14.3	n.a.	6.0	1.7	28.6	3.6
TOTAL	523.7	523.5	514.3	512.9	491.8	574.3	1.8	-0.3	6.6	100

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

Source: MF, BZ WBK.

4. Euro Zone Bonds: Supply Recap

Euro zone: 2016 net and gross supply by country vs 2015 (€ bn)

	2016 gross issuance	% change (vs 2015)	2016 net issuance	% change (vs 2015)
Austria	19.4	14	5.6	50
Belgium	33.6	3	8.0	84
Finland	15.8	58	5.9	169
France	187.0	0	60.5	-14
Germany	168.6	16	0.0	-100
Greece	-	-	-	-
Ireland	10.8	-20	2.7	-76
Italy	221.9	-10	38.6	-9
Netherlands	36.8	-23	8.5	5
Portugal	11.9	-34	5.1	-55
Spain	138.8	0	45.5	6
Total	844.5	-1	180.3	-1

* YTD is supply since January 1, 2015

Source: European Commission, Euro zone countries' debt agencies, BZ WBK.

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)	
	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016
Poland	3.5	3.5	-0.6	1.4	-0.5	-0.9	-2.8	-2.8	51.4	52.4
Czech Republic	4.3	2.2	0.4	1.0	-2.5	-2.4	-1.9	-1.3	41.0	41.0
Hungary	2.9	2.2	0.1	1.9	4.3	5.5	-2.3	-2.1	75.8	74.5
EU	1.9	2.0	0.0	1.1	2.2	2.2	-2.5	-2.0	87.8	87.1
Euro zone	1.6	1.8	0.1	1.0	3.7	3.6	-2.0	-1.8	94.0	92.9
Germany	1.7	1.9	0.2	1.0	8.7	8.6	0.9	0.5	71.4	68.5

Main market indicators (% , end of period)

	Reference rate (%)		3M market rate (%)		10Y yields (%)		10Y spread vs Bund (bp)		CDS 5Y	
	2015	End-Jan 2016	2015	End-Jan 2016	2015	End-Jan 2016	2015	End-Jan 2016	2015	End-Jan 2016
Poland	1.50	1.50	1.72	1.70	2.94	3.14	230	278	75	87
Czech Republic	0.05	0.05	0.29	0.29	0.60	0.67	-4	32	50	46
Hungary	1.35	1.35	1.35	1.35	3.42	3.58	279	323	164	159
Euro zone	0.05	0.05	-0.13	-0.16						
Germany					0.63	0.35			12	13

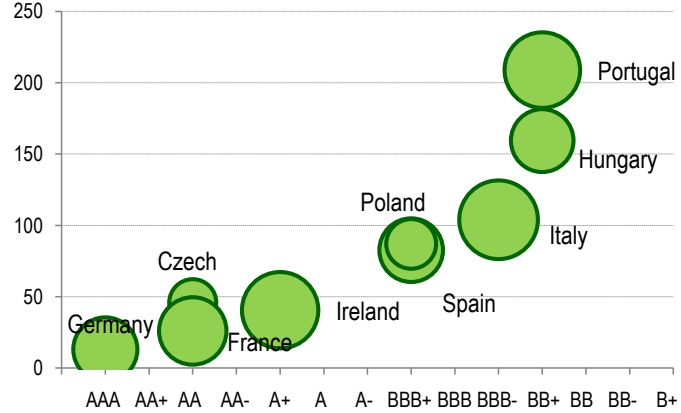
Source: EC – Autumn 2015, statistics offices, central banks, Reuters, BZ WBK.

5. Poland vs. Other Countries (cont.)

Sovereign ratings

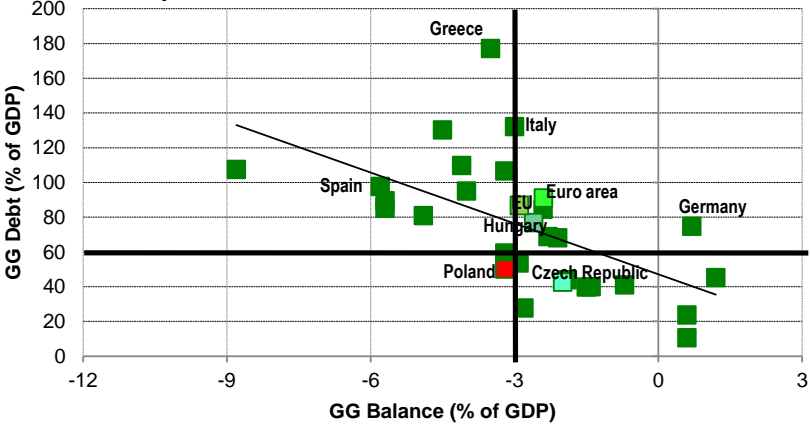
	S&P		Moody's		Fitch	
	rating	outlook	rating	outlook	rating	outlook
Poland	BBB+	negative	A2	stable	A-	stable
Czech	AA-	stable	A1	stable	A+	stable
Hungary	BB+	stable	Ba1	positive	BB+	positive
Germany	AAA	stable	Aaa	stable	AAA	stable
France	AA	negative	Aa2	stable	AA	stable
UK	AAA	negative	Aa1	stable	AA+	stable
Greece	B-	stable	Caa3	stable	CCC	stable
Ireland	A+	stable	Baa1	positive	A-	positive
Italy	BBB-	stable	Baa2	stable	BBB+	stable
Portugal	BB+	stable	Ba1	stable	BB+	positive
Spain	BBB+	stable	Baa2	positive	BBB+	stable

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



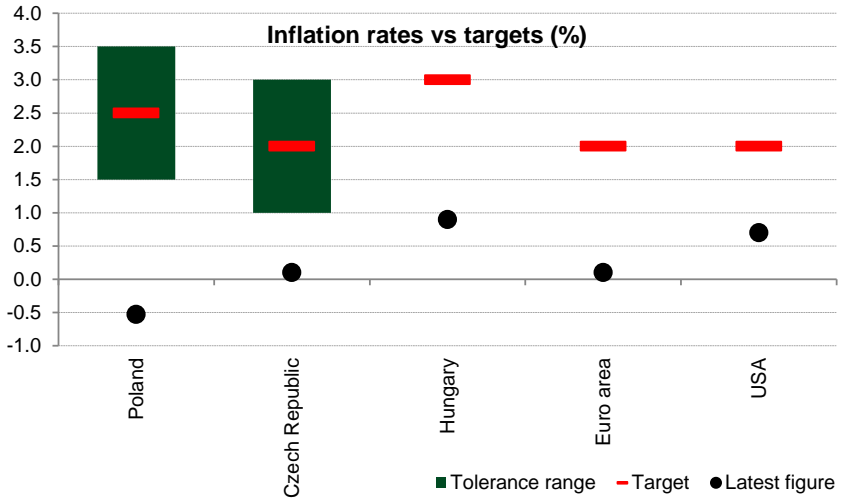
Note: Size of bubbles reflects the debt/GDP ratio

Fiscal position of the EU countries at the end of 2014

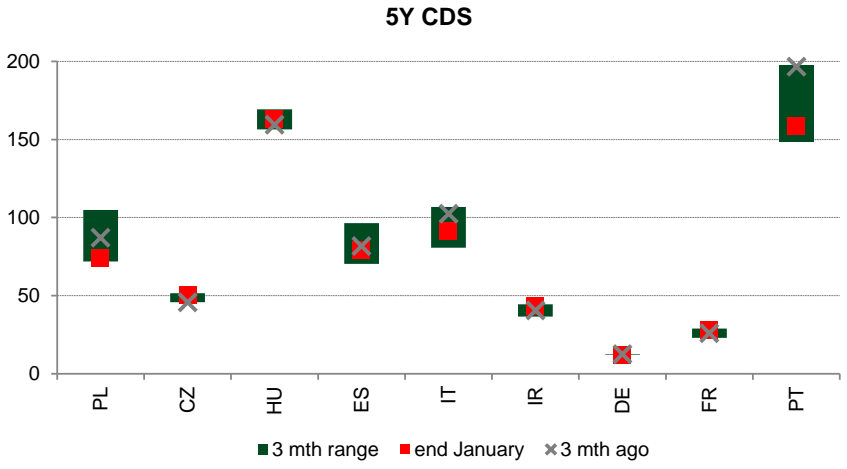
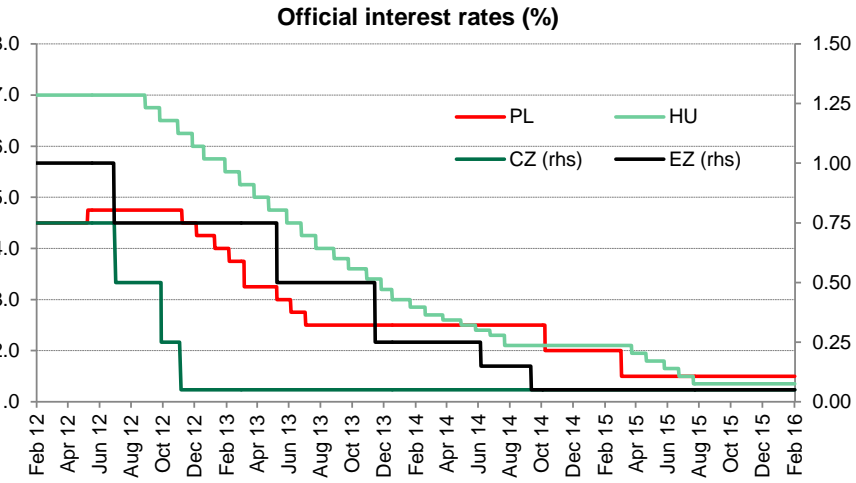
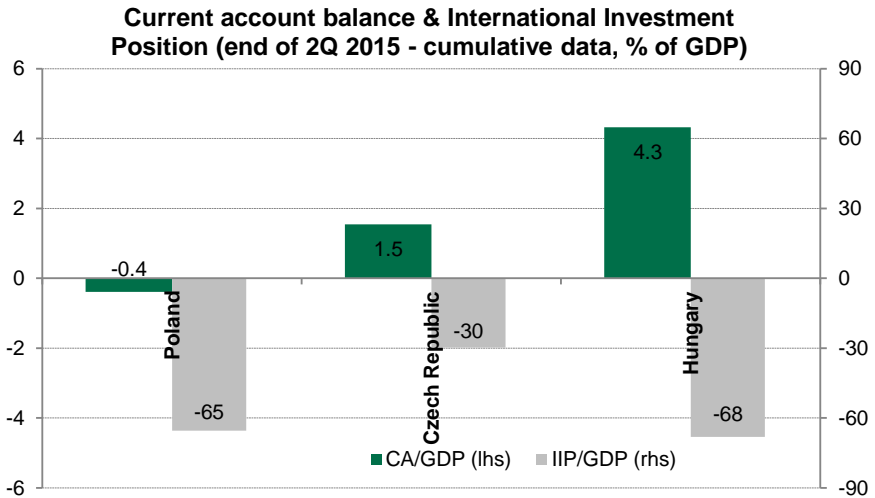
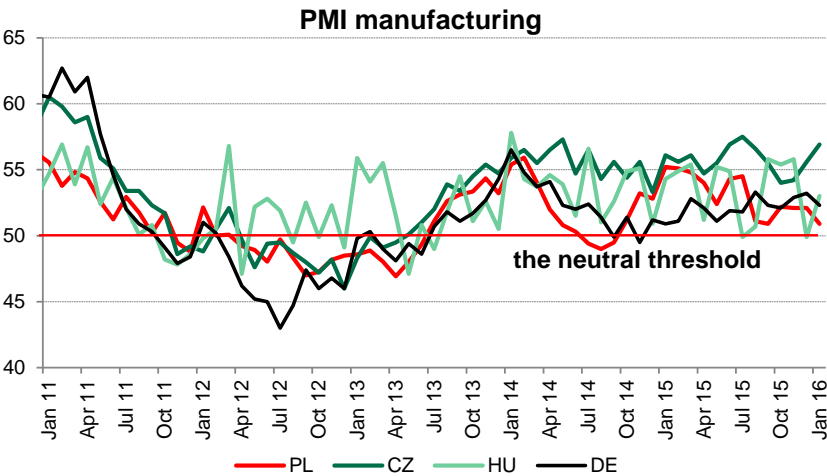


Source: Rating agencies, Reuters, EC, BZ WBK.

Inflation rates vs targets (%)

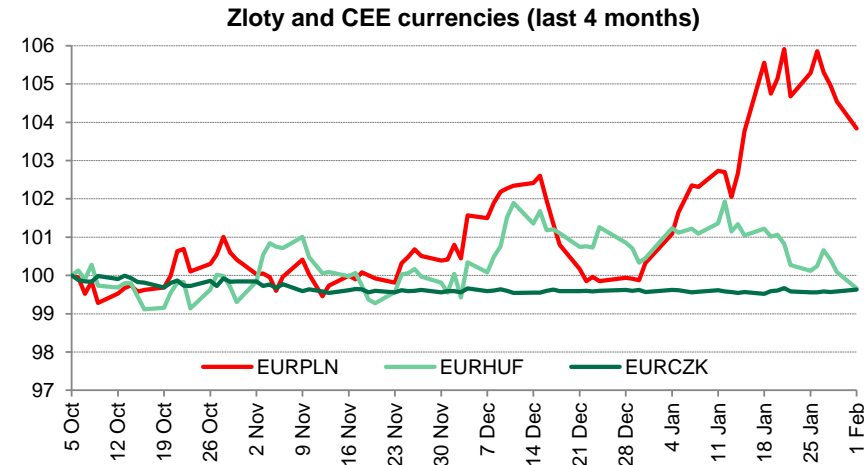
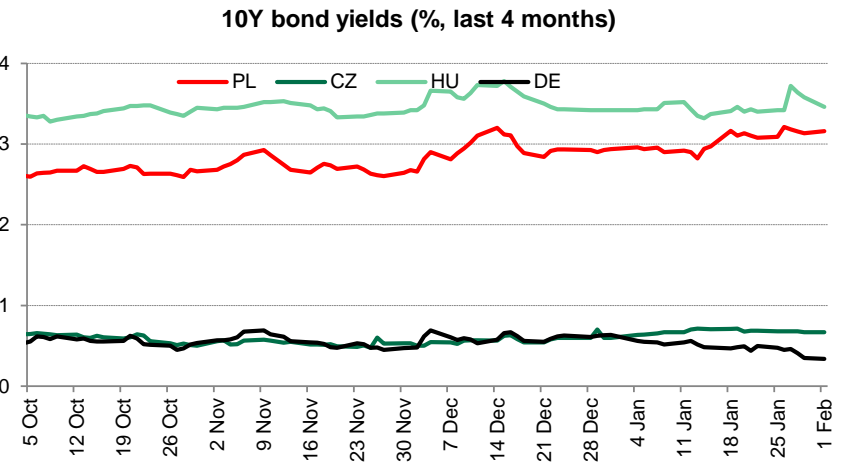
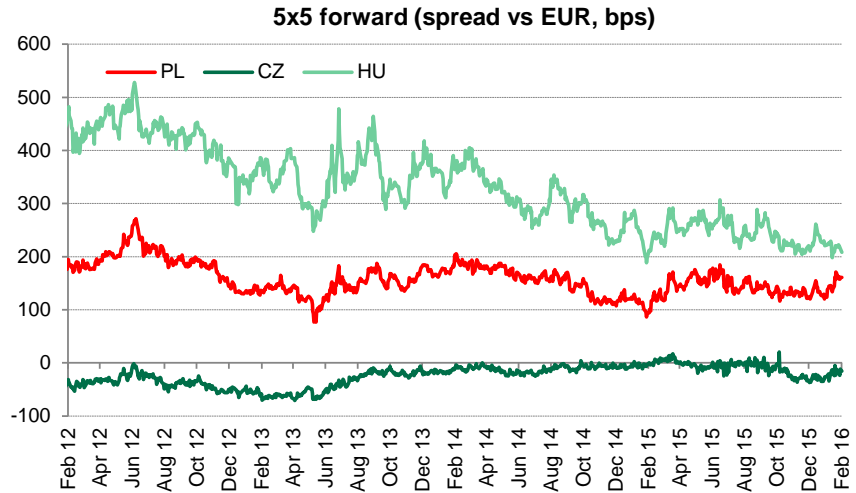
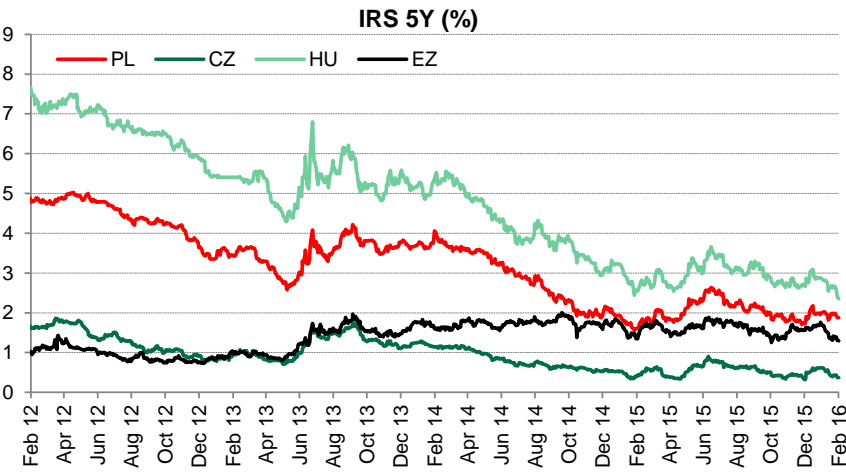


5. Poland vs. Other Countries (cont.)



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

5. Poland vs. Other Countries (cont.)



Source: Reuters, BZ WBK.

6. Central Bank Watch

		Last	2015	2016	Expected changes (bp)			Comments
					1M	3M	6M	
Euro zone	Forecast	0.05	0.05	0.05				As expected, the ECB kept key interest rates unchanged in January, but stated that, due to weaker euro area inflation dynamics, it will be necessary to review and possibly reconsider <i>its monetary policy stance</i> at the next meeting in early March. Draghi reiterated that the ECB has the power and willingness to act and he prepared the markets for the next steps they will take.
	Market implied »				-8	-14	-18	
UK	Forecast	0.50	0.50	0.75				In our view, the BoE will <i>cut its inflation forecasts</i> in its February Inflation Report. Given the inflation outlook and modest economic growth <i>it has decided to postpone</i> the start of monetary tightening, with the first hike expected in November.
	Market implied »				0	-1	-1	
US	Forecast	0.25-0.50	0.25-0.50	1.00				As expected, the Fed funds target rate was unchanged at 0.25%-0.50% in January. The Fed reiterated that it is monitoring global economic and financial developments and their implications for the US economic outlook and the <i>balance of risks for this</i> . Taking into account the recent market environment, we change our Fed call, postponing the next hike from March to September.
	Market implied »				43	62	87	
Poland	Forecast	1.50	1.50	1.25				The Monetary Policy Council kept the main interest rates on hold in January, its last meeting before the change of line-up. The tone of the press conference seemed quite dovish, however, as the Council acknowledged that inflation in the coming quarters may be lower than previously expected due to the renewed decline in commodity prices. We expect the MPC to keep rates unchanged in February, but we stick to our scenario that the reference rate might be reduced in March as the predicted CPI trend will be lowered.
	Market implied »				-2	-17	-24	
Czech Republic	Forecast	0.05	0.05	0.05				As expected, the CNB decided unanimously to keep interest rates unchanged and to use the exchange rate as an additional instrument to ease monetary conditions. In our view, any exit from the exchange rate commitment before the end of QE in the Euro zone could be very complicated. Therefore, we expect the CNB to keep monetary conditions unchanged in upcoming months.
	Market implied »				-1	-5	-12	
Hungary	Forecast	1.35	1.35	1.35				The NBH kept the base interest rate unchanged at 1.35% in January, in line with expectations. In our view, the central bank is in no hurry to change the key rate – in either direction. However, the NBH may use its unconventional measures if needed.
	Market implied »				-2	-12	-16	

This analysis is based on information available through February 1, 2016 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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