RATES AND FX OUTLOOK

POLISH FINANCIAL MARKETS

April 2016

Bank Zachodni WBK

Grupa Santander

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Summary

- There have been no major changes to the economic growth scenario after the first quarter. Most of the data confirmed that first quarter GDP is likely to exceed 3% again, although we see a slight slowdown vs the very strong 4Q15 (c4%). We expect industrial output and retail sales to be strong again (our forecasts are above market consensus). The flash CPI for March surprised to the downside again (-0.9%), which confirms deflation is likely to continue until 4Q16.
- This no-inflation environment does not the change monetary policy outlook, as it seems the new Monetary Policy Council (MPC) accepts a deviation of CPI from the target until 2018. Thus, if the Council did not cut rates with the new, rather dovish, inflation projection available, we should not expect it to happen in the following months. The next projection will be available in July, when the new NBP Governor will have been appointed (most likely ex-MPC member, Adam Glapiński). However, we believe that the building up of hawkish rhetoric by the new Council (in the context of wide expectations for an overly dovish MPC to be named by the new administration) was an important argument behind leaving rates unchanged in March. The same may happen in July with the new Governor. Therefore, we think any change in rates could happen in autumn and only if there is an economic slowdown (driven by global factors) or a significant strengthening of the zloty.
- On the fiscal front, there are still a lot of uncertainties. Nevertheless, it seems that for investors political risks have recently receded into the background. After a controversial S&P downgrade, foreign investors extended duration in February and drove a rally at the long-end of the curve, which was also supported by global factors (dovish ECB and Fed driving Bund and US Treasury yields down). The short end of the curve is still supported by demand form local banks fuelled by the banking tax.
- The general government deficit for 2015 (2.5% of GDP) was a positive surprise and we expect the government to maintain the below-3% path in the new Convergence Programme. Still, the document is not going to be a game changer and the key when assessing the fiscal plan will be the 2017 budget. On page 6 we show an update on fiscal policy issues, as the Polish government recently signalled it may backtrack on some of its proposals (although not all of them).
- The CHF-denominated loans issue still seems to be still alive. After the central bank gave its estimate of the consequences of the president's proposal (cPLN40bn), the Polish Financial Supervision Authority (KNF) released a report with an even higher estimate of the cost (cPLN67bn). This might suggest that the higher the cost, the lower the chances of the proposal being implemented. This interpretation was likely one of the factors helping the zloty to strengthen last month (along with the global mood). However, in recent weeks the local media reported a number of comments from government officials (including PM Beata Szydło and the chief of her chancellery) questioning the quality of the KNF report and suggesting that the KNF will have to prepare another version. Also, the Financial Stability Committee is scheduled to meet on April 18 to discuss the issue. It seems, therefore, that work on the proposal (old or new one) will continue and it is hard to guess what will emerge or when. Our view is that uncertainty here has not yet entirely disappeared.

Short- and Medium-Term Strategy: Interest rate market

	Change (bp)		Current Level	Expected Trend	
	Last 3M	Last 1M	4 April 2016	1M	3M
Reference rate	0	0	**1.50**	→	→
3M WIBOR	-5	0	**1.67**	→	→
2Y bond yield	-13	-1	**1.43**	→	→
5Y bond yield	-8	-1	**2.19**	↘	↗
10Y bond yield	-12	-14	**2.84**	↘	↗
2/10Y curve slope	2	-13	**141**	↘	↗

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: We think that the MPC will continue its current monetary policy. In our view the Council would cut interest rates in response to much weaker GDP growth or strong zloty appreciation, but this is not our baseline scenario. We expect upcoming Polish macro data releases to confirm healthy economic growth. These factors could continue to generate upside pressure on FRAs. WIBOR rates are likely to range-trade in coming weeks/months, in our view.

Short end: We think the short end of the bond curve is well anchored near the current level and should remain well supported by the impact of the banking tax (which creates incentives for banks to move money from NBP bills to short-term Treasuries).

Long end: In our view, efforts by the ECB to prop up inflation and the dovish FOMC should be supportive for the belly and long end of the Polish yield curve. We still see some room for a gradual decline in yields/IRS rates in the short run as the 'hunt for yield' strategy supports domestic curves. As a consequence we expect the risk premium to tighten further. Still, we see higher yields later in the year.

Risks to our view: The room for further debt strengthening may be limited by risk of negative rating decisions. Moody’s has warned recently that a constitutional crisis could impair the investment climate and is credit negative. However, Moody’s is scheduled to review Poland’s rating in mid-May, still several weeks away.

Short- and Medium-Term Strategy: FX market

	Change (%)		Current Level	Expected Trend	
	Last 3M	Last 1M	4 April 2016	1M	3M
EUR/PLN	-1.4	-2.3	**4.24**	↗	↗
USD/PLN	-5.2	-5.8	**3.73**	↗	↗
CHF/PLN	-1.9	-2.6	**3.88**	↘	↘
GBP/PLN	-9.0	-5.4	**5.29**	↗	↗↗
EUR/USD	4.0	3.7	**1.14**	↘	→

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: We do not expect EUR/PLN to continue sliding down, but rather to hover in a horizontal trend in the coming weeks, despite generally supportive internal and external economic factors. The main reason for that is uncertainty about the final solution of the FX loans problem. It seems that work on the proposal will continue and it is hard to guess what will emerge or when.

USD: We retain a positive outlook for the EUR through to the end of 2016. However the recent rise in EUR/USD may have been overdone, implying downside risks may dominate over the coming months. Thus, in the nearest weeks USD/PLN may rebound from its six-month low.

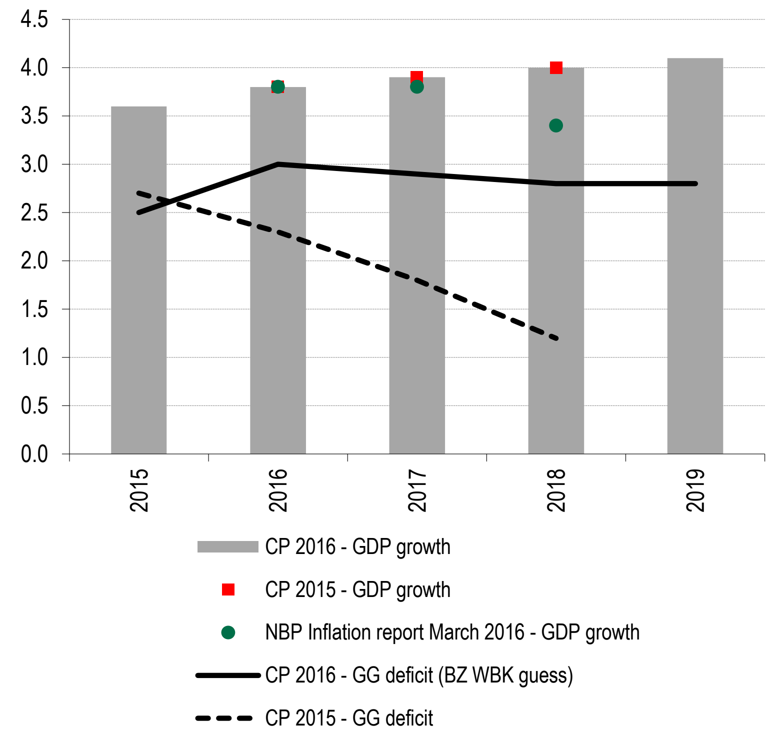
CHF: We still expect EUR/CHF to rise throughout 2016. The SNB views the CHF as overvalued and remains willing to intervene to weaken it (we think a cut the deposit rate further into negative territory and/or more FX interventions are possible) . We expect CHF/PLN to decline gradually, as a result.

Risks to our view: A sharp deterioration in global market sentiment and a return of 'risk-off' mood seems to be the main threat to the zloty. Further ahead, potential negative rating decisions may also undermine the currency, at least temporarily.

Fiscal Plans: To be revealed soon, at least partially

- In April, the government will approve the new version of the Convergence Programme (CP). The Polish Press Agency already reported the official GDP growth estimates (see chart). They are quite optimistic, although they do not differ much from the NBP inflation projection (2017) or the previous CP (2018). Faster economic growth, with higher revenues, should make it easier to assume that the fiscal deficit does not exceed 3% in the medium term.
- Still, for 2017 there is a gap to be covered: the need to finance full-year spending of the so-called 500+ programme (benefits for families with children, worth PLN23bn) without the one-off revenues of 2016 (LTE frequency auction and high NBP profit). We estimate that to maintain the deficit at c3% of GDP an additional fiscal adjustment of PLN12bn would be needed. We believe the Ministry of Finance will try to cover this in the new CP with an assumption of higher effective tax collection (the required amount is one-third of the estimated VAT revenue gap).
- As regards a promise of higher tax-free income, PM Szydło clearly suggested that this would be introduced only gradually (perhaps in five years) and concentrated on low-income families. Lowering the retirement age is a more risky idea (the bill is currently with the parliamentary commission) and it has to be closely watched in the coming months to see what final form it takes (whether an additional condition of minimum years worked or extra contributions is introduced, which would water down the negative impact).
- Overall, we do not believe the new Convergence Programme will be a game changer and the 2017 budget should be key to address investor concerns regarding medium-term fiscal policy.

GDP growth and GG deficit in Convergence Programmes

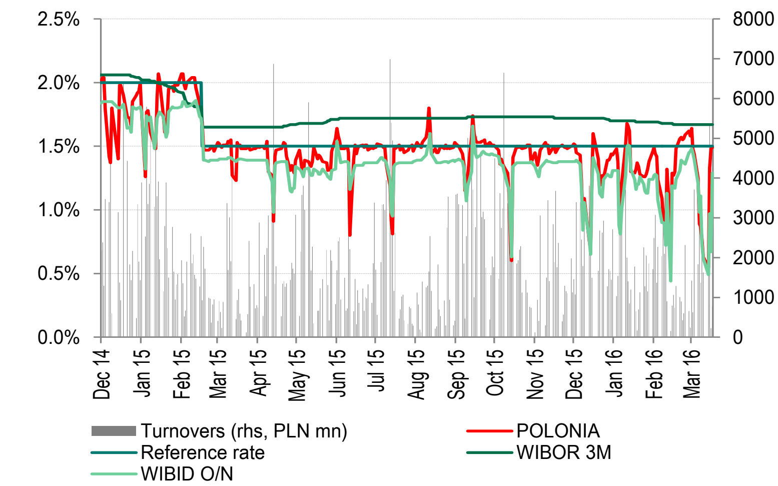


Source: PAP, NBP, MF BZ WBK

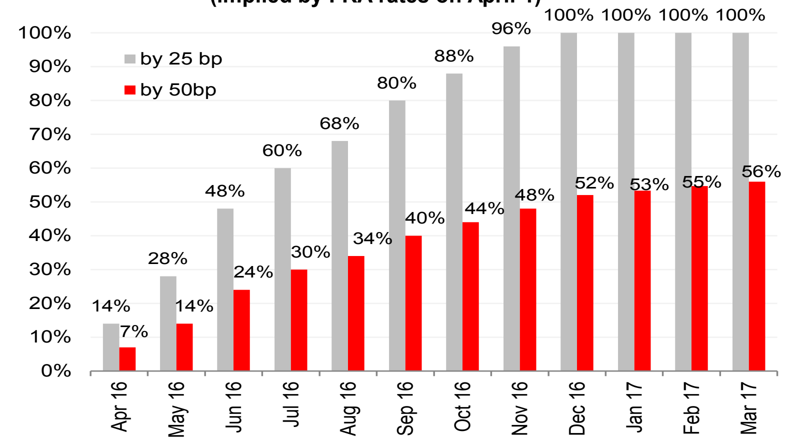
Domestic Money Market: Rate cuts still priced in despite hawkish MPC rhetoric

- In March investors continued to pull back on their expectations for further monetary easing in the next few months, as the MPC's rhetoric and the new Council members' comments sounded hawkish. As a result, FRAs increased by 3-11bp across the curve over the month. Meanwhile, WIBORs were roughly unchanged (on monthly basis only the 3M rate increased, by 1bp). However, the end of March brought significant changes in the POLONIA rate. Similarly to the end of February, the rate fell well below the reference rate (to 0.55%) due to the banking tax.
- Currently, the FRA market is pricing in a rate cut of 25bp on a 9M horizon. We think the new MPC will continue its current monetary policy with its cautious approach to further monetary easing. In our view, the Council would cut rates due to weaker GDP growth or a strong zloty appreciation but this is not our baseline scenario. We expect upcoming Polish data releases to confirm healthy economic growth (our forecasts for industrial output and retail sales are above market expectations). Therefore, these factors could continue to generate upside pressure on FRAs.
- After the March MPC meeting we have adjusted our baseline scenario for rates. Now we expect WIBORs to be fairly stable in the coming months. However, there could be a gradual increase in WIBOR in the last quarter of the year, in particular if deflation is over and 4Q16 economic growth is solid.

POLONIA vs NBP's reference rate and money market rates



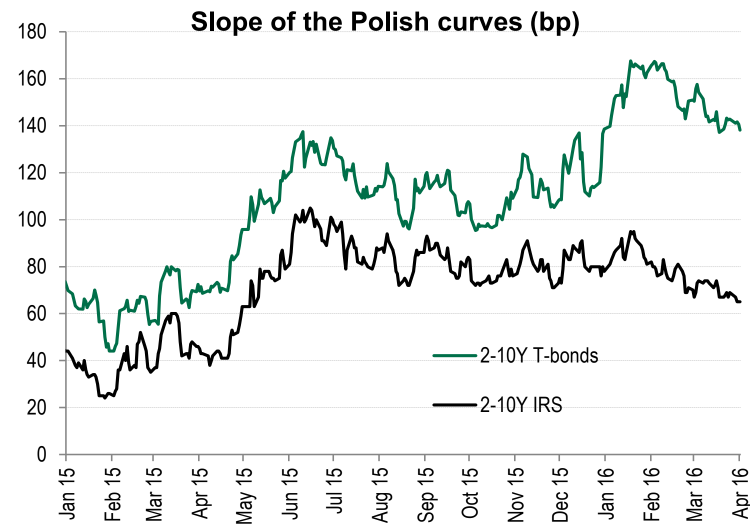
Probability of rate cuts
(implied by FRA rates on April 1)

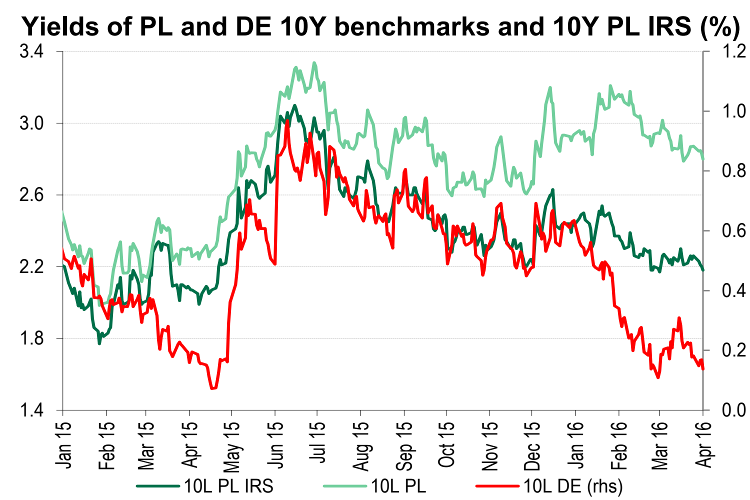


Source: Reuters, BZ WBK

Domestic IRS and the T-Bond Market: Hunt for yield supports domestic curves

- Polish bond and IRS benefited from the improved global mood after the ECB delivered more substantial monetary easing and the Fed surprisingly scaled back its forecast to only two rate hikes this year. Tracking trends on core markets, the 10Y benchmark yield fell temporarily below 2.80% at the beginning of April. Bonds performed better than IRS, which caused the asset swap spreads for the 10Y sector to tighten markedly. What is more, the yield curve flattened visibly, thanks to the belly and long end outperforming the short end. The risk premium on domestic bonds also fell, as reflected in the tightening spread over the Bunds for the 10Y sector (to c265bp at the end of March, down from c280bp at the end of the previous month).
- We think that the short end of the bond curve is well anchored near the current level and should remain well supported by the impact of the banking tax (creating incentive for banks to move money from NBP bills to short-term Treasuries).
- The belly and the long end remain under the influence of global factors, in particular major central banks' rhetoric. In our view, efforts by the ECB to prop up inflation and the dovish FOMC should support debt markets in the coming weeks. It seems that foreign investors' perception of Polish bonds has improved recently as non-residents used the opportunity to extend the duration of their portfolios in February and probably in March, according to officials from the Finance Ministry. Therefore, we still see some scope for a gradual decline in yields/IRS rates in the short run as the strategy of hunting for yield supports domestic curves. Therefore, we expect the risk premium to tighten further in April.



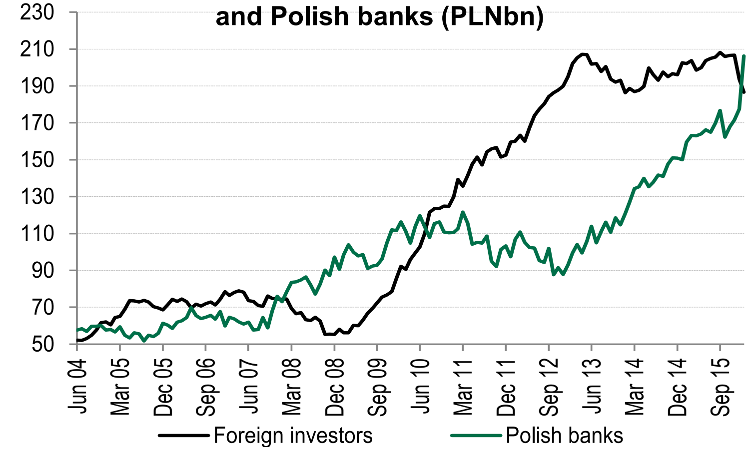


Source: Reuters, BZ WBK.

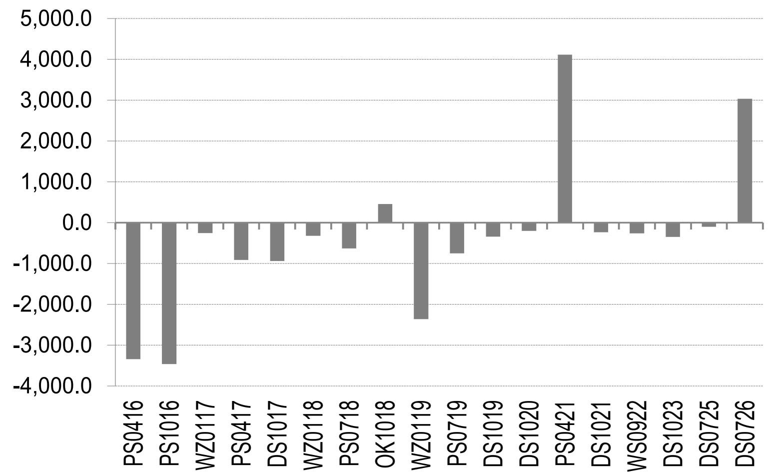
Demand Corner: Non-residents sell bonds but extend duration

- The Finance Ministry's data on holders of Polish, marketable PLN-denominated bonds again showed significant shifts in holdings.
- In February 2016, Polish banks bought bonds worth nearly PLN29bn, the biggest monthly purchase since data are available (June 2004) and the nominal value of their portfolio reached a fresh all-time high at PLN206bn. Polish banks focused on short-term bonds and it seems obvious to us that this was due to a switch from taxable central bank bills to tax-free Treasury bonds.
- Data showed that, after January's outflow of foreign investment, non-residents' nominal holdings of local bonds fell in February as well (by PLN7bn) to its lowest since January 2014 (PLN186.5bn). However, while they sold bonds maturing in 2016-17, foreign investors bought large amounts of the 5Y and 10Y benchmarks (+PLN4.1bn of PS0421 and +PLN3bn of DS0726) neutralising the sales of short-term debt or effectively even raising their risk exposure to the Polish yield curve.
- The biggest sellers among non-residents in nominal terms were the mutual funds, with the largest outflows recorded for investors from the Euro zone (-PLN5.2bn) and US (-PLN4.2bn). Asian holders sold for the second month in a row (-PLN1.1bn in February). Meanwhile, non-Euro zone EU investors bought Polish bonds in February.

Polish PLN, marketable bonds held by foreign investors and Polish banks (PLNbn)



Net changes in Polish bonds held by foreign investors (PLNbn)



Source: Finance Ministry. BZ WBK.

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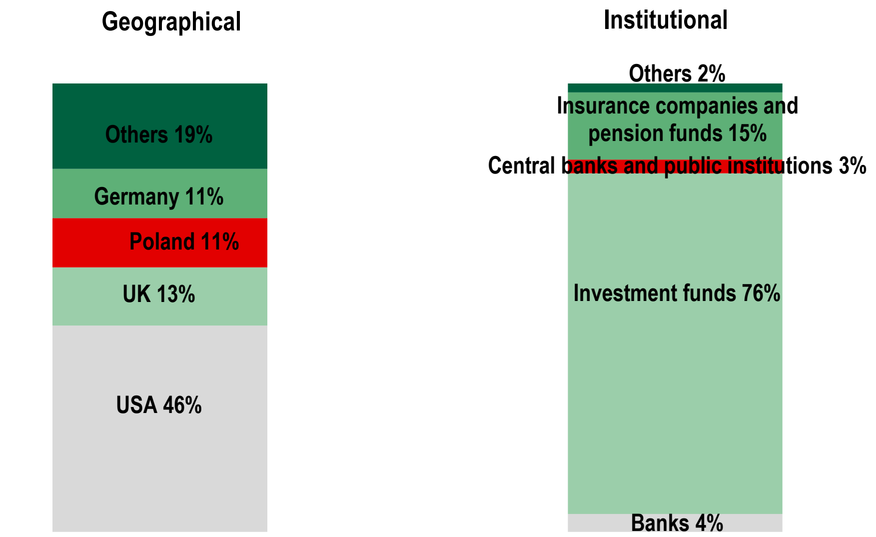
Supply Corner: Poland has covered over 50% of its 2016 target

- Year-to-date, Poland has covered c52% of its total gross borrowing needs for 2016 (PLN182.7bn). The progress in March was the result of a favourable auction result on both domestic and foreign markets. Poland tapped 2Y and 10Y bonds worth PLN8.4bn via a regular auction and 5Y and floaters worth PLN8.6bn at switching auctions. Moreover, at the end of March it also priced a 10-year USD denominated benchmark bond maturing on April 6, 2026. The nominal amount of the issue was USD1.75bn (vs recorded demand of USD3.6bn).
- Poland's issuance plan for 2Q16 is quite moderate. The ministry plans five or six regular auctions to raise PLN20-30bn in total. In April alone the T-bond offer will be PLN7-15bn. At the next auction on April 7 the ministry will offer OK1018 and DS0726 worth a total PLN3-6bn.
- We think the ministry is unlikely to have a problem selling the bonds. Current market conditions (expansionary ECB policy, dovish Fed) should be supportive. Market liquidity should also help, as flows to investors will reach cPLN16bn from the domestic T-bond PS0416 redemption and interest rate payments. Assuming that the ministry taps the market for the maximum value of the bonds on offer in 2Q16 (PLN30bn), we predict that this year's target will have been c70% covered at the end of the month.

Distribution of 10Y USD-denominated bond



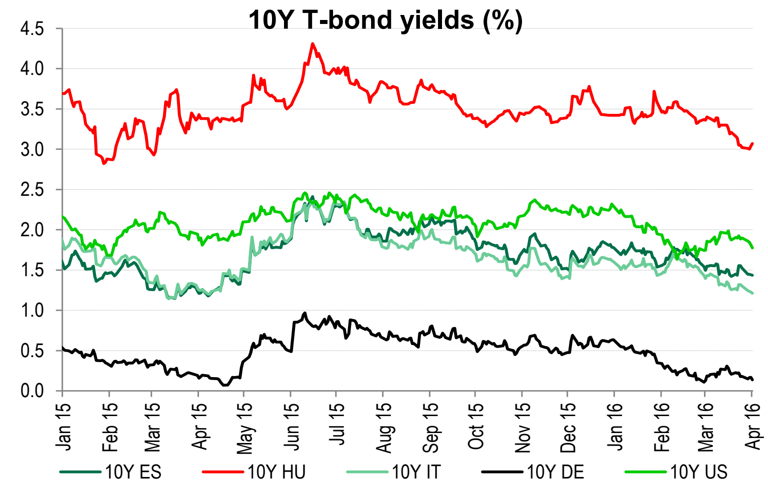
Auction plan for April 2016

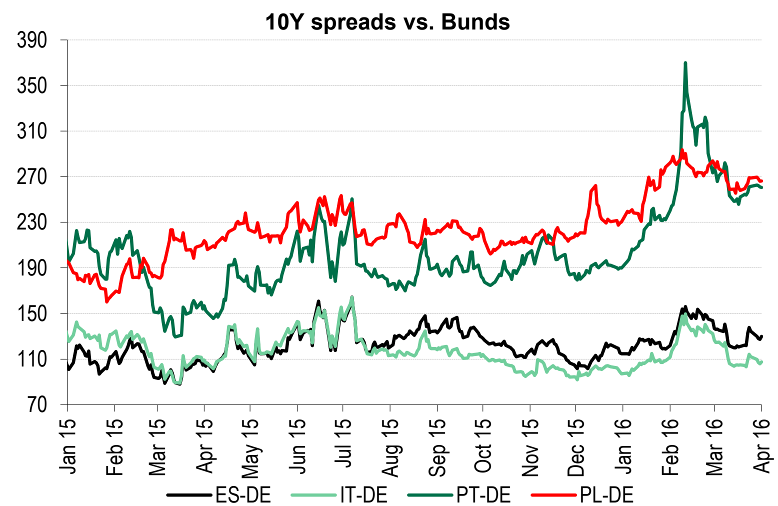
Auction Date	Settlement Date	T-bond/T-bills to Be Offered	Offer (PLN mn)
7 Apr 2016	11 Apr 2016	OK1018/DS0726	3,000-6,000
21 Apr 2016	25 Apr 2016	To be announced; choice will depend on the market conditions	4,000-9,000

Source: Finance Ministry, BZ WBK.

International Interest Rate Market: Central banks set direction

- Core and peripheral Euro zone debt markets rallied in March, benefiting from supportive central bank policy: the aggressive easing package announced by the ECB and the Fed's dovish stance. As a result, the 10Y Bund yield is closer and closer to zero (0.14% at the start of April), while the 10Y US Treasury yield has increased gradually (by 7bp over the past month). It was slightly below 2% (1.77%) at the start of April).
- In March, Hungarian bonds outperformed other CEE and peripheral peers as the central bank not only cut rates by 15bp (and introduced a negative deposit rate) but also announced it was re-opening the easing cycle. As a result, the yield of the 10Y Hungarian benchmark fell by c35bp on monthly basis to nearly 3%, its lowest level since February 2015. What is more, spread over Bunds in 10Y sector for both CEE and peripheral bonds tightened visibly in March.
- Central banks should continue to drive markets in the coming weeks/months. In our view, the comprehensive easing package has bought the ECB some time before additional action will be required. Therefore, we expect yields of German Bunds to stay low and relatively flat. In a low-yield environment, the peripheral market looks attractive, in particular given the improving macroeconomic data. This should support current peripheral spreads vs Bunds or even lead to tightening. Further monetary easing by the Hungarian central bank should a support downward move in yields there.
- In our view, Fed will keep rates on hold until September. However, a dovish message from the Fed, together with an easing bias by other major central banks (mainly ECB, BoJ), creates a very positive environment for global fixed income markets. Therefore we expect the 10Y UST yield to range trade.



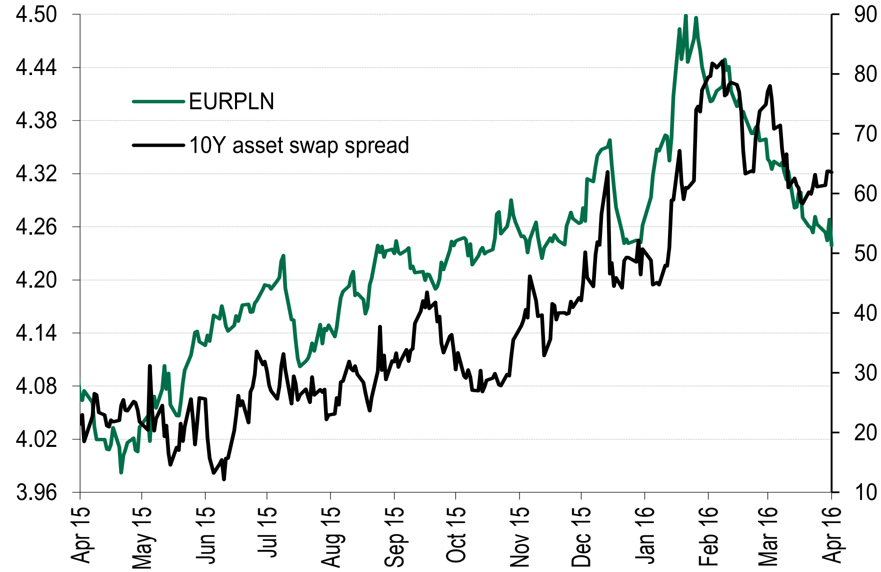


Source: Reuters, ECB, Fed, BZ WBK.

Foreign Exchange Market: Time to take profits?

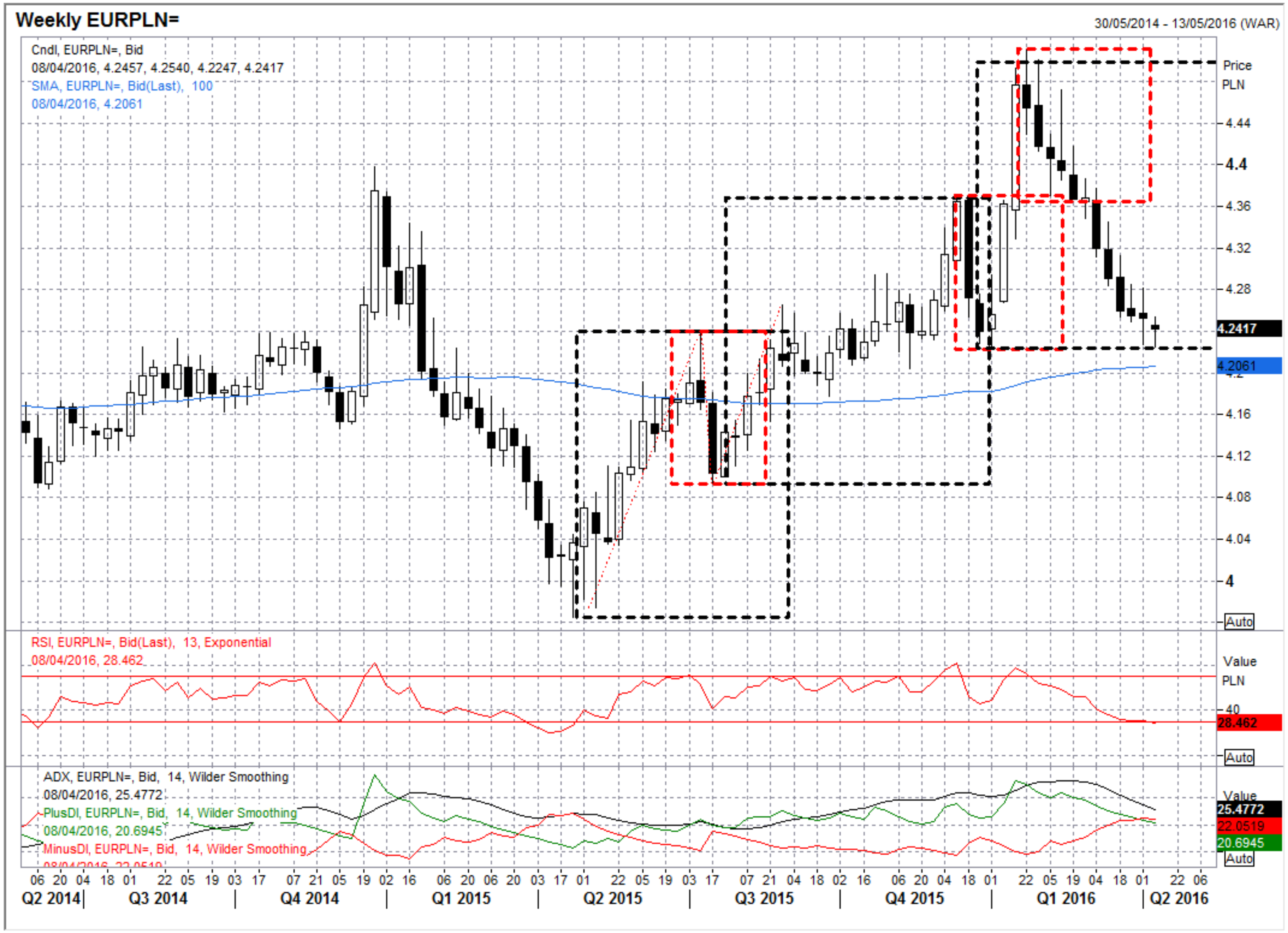
- In March EUR/PLN fell by 2.25% and USD/PLN by 6.6%, the biggest monthly drops since January 2015 and July 2010, respectively. The zloty gained as positive market sentiment persisted, mainly thanks to dovish signals from the Fed. As a result, the Polish currency reached a fresh 2016 peak vs the euro at just below 4.23.
- In addition to the supportive global environment, we think the zloty was supported by internal issues – the neutral MPC rhetoric and some re-pricing of country-specific political risk (the CHF-denominated loans issue and/or the government's fiscal plans).
- The Financial Supervision Authority's (KNF) estimate of the losses that Polish banks would incur if President Andrzej Duda's proposal on FX loans is introduced is higher than the central bank's estimates (PLN67bn vs PLN40bn). This might have created an impression that there is less chance of this proposal being implemented and, therefore, the issue may have lost some of the market's interest. However, it seems that work on the proposal will continue and it is hard to guess when and in what form it will emerge. The uncertainty regarding this issue has not yet entirely disappeared.
- Overall, although both internal and external economic factors look fairly supportive for the zloty, we do not expect EUR/PLN to continue its downtrend.

EUR/PLN vs asset swap spread (bp)



Source: Reuters, BZ WBK

FX Technical Analysis Corner: Waiting for an RSI buy signal



- In February we wrote that extending the down wave makes a more sustainable zloty recovery more likely but the scale of the subsequent decline was larger than we expected.
- The exchange rate is close to the 4.23 support and ADX does not show that the strength of the downward trend is becoming excessive. However, the Relative Strength Index (RSI) fell below 30pts, so a buy signal could emerge in the coming weeks. Past experience shows that the RSI is very reliable in signaling a significant jump in EUR/PLN.

Source: Reuters, BZ WBK.

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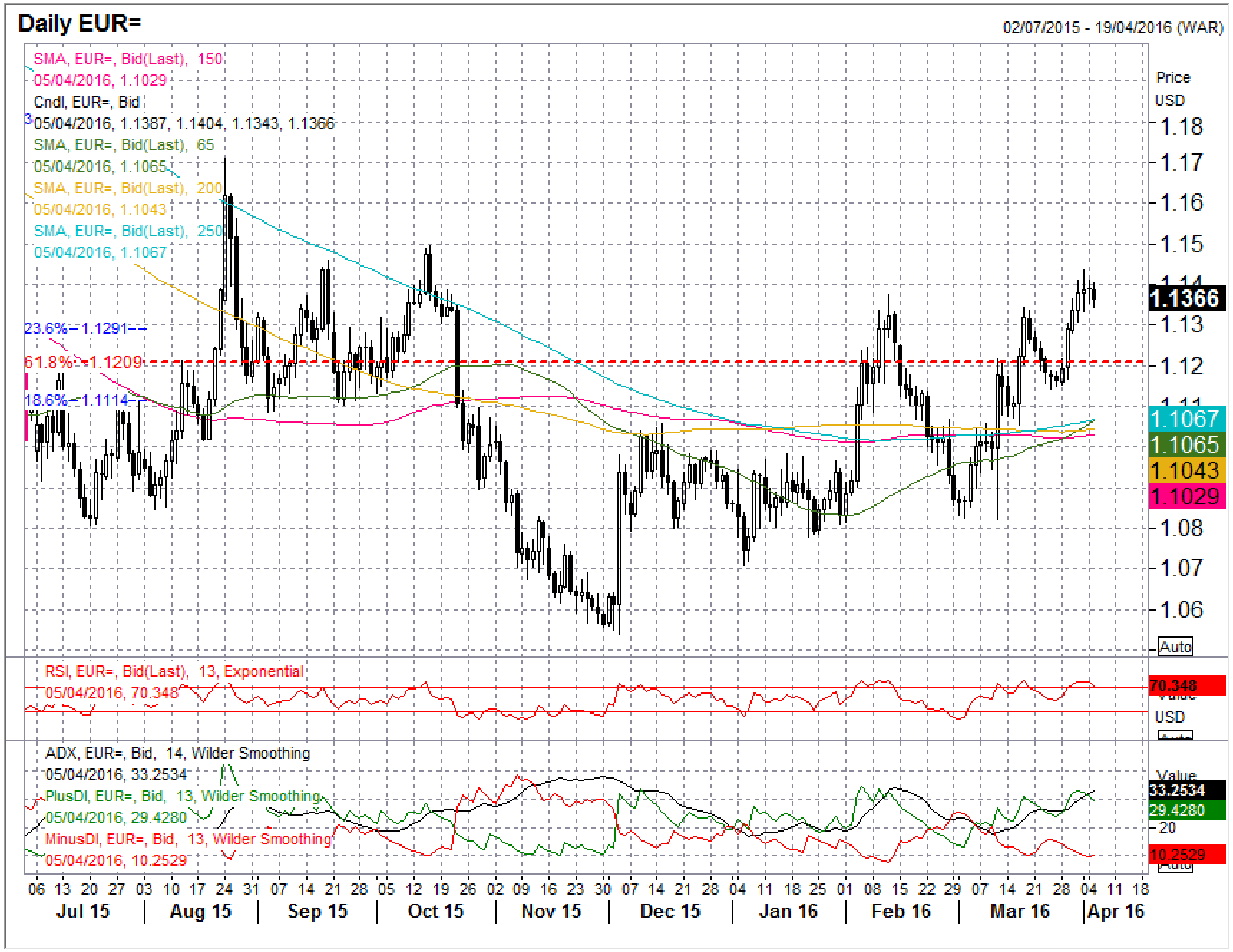
FX Technical Analysis Corner: EUR/USD nearing resistance area



- EUR/USD neared the 1.15-1.17 resistance area.
- However, there are some circumstances suggesting it could be difficult for it to break this level, at least at the first attempt.
- ADX on the daily chart is close to levels that in the recent past have signaled a trend reversal.
- RSI on the daily chart rose above 70pts, meaning a sell signal could emerge in the coming weeks.

Source: Reuters, BZ WBK.

Macroeconomic Forecasts

Poland		2013	2014	2015	2016E	1Q15	2Q15	3Q15	4Q15	1Q16E	2Q16E	3Q16E	4Q16E
GDP	PLNbn	1,656.3	1,719.1	1,790.1	1,850.0	414.6	432.2	438.6	504.8	425.1	443.9	451.6	529.4
GDP	%YoY	1.3	3.3	3.6	3.5	3.7	3.3	3.5	3.9	3.4	3.3	3.6	3.6
Domestic demand	%YoY	-0.7	4.9	3.3	4.0	2.9	3.1	3.2	4.0	4.7	3.8	4.0	3.6
Private consumption	%YoY	0.2	2.6	3.1	4.1	3.1	3.1	3.1	3.1	3.1	3.8	4.6	4.8
Fixed investment	%YoY	-1.1	9.8	6.1	3.5	11.5	6.1	4.6	4.9	4.5	4.0	3.0	3.0
Unemployment rate [a]	%	13.4	11.4	9.8	9.0	11.5	10.2	9.7	9.8	10.0	9.1	8.8	9.0
Current account balance	EURmn	-5,031	-8,303	-1,011	4,259	900	864	-2,348	-427	2,350	2,452	-1,365	821
Current account balance	% GDP	-1.3	-2.0	-0.2	1.0	-1.3	-0.4	-0.4	-0.2	0.1	0.5	0.7	1.0
General government balance (ESA 2010)	% GDP	-4.0	-3.3	-2.5	-3.0	-	-	-	-	-	-	-	-
CPI	%YoY	0.9	0.0	-0.9	-0.5	-1.5	-0.9	-0.7	-0.6	-0.9	-0.8	-0.7	0.1
CPI [a]	%YoY	0.7	-1.0	-0.5	0.5	-1.5	-0.8	-0.8	-0.5	-0.9	-0.7	-0.4	0.5
CPI excluding food and energy prices	%YoY	1.2	0.6	0.3	0.1	0.4	0.3	0.3	0.2	0.0	0.0	0.0	0.4

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

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Interest Rate and FX Forecasts

Poland		2013	2014	2015	2016E	1Q15	2Q15	3Q15	4Q15	1Q16E	2Q16E	3Q16E	4Q16E
Reference rate [a]	%	2.50	2.00	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
WIBOR 3M	%	3.02	2.52	1.75	1.68	1.87	1.67	1.72	1.73	1.69	1.67	1.67	1.69
Yield on 2-year T-bonds	%	2.98	2.46	1.70	1.47	1.61	1.75	1.80	1.65	1.45	1.45	1.45	1.52
Yield on 5-year T-bonds	%	3.46	2.96	2.21	2.24	1.90	2.35	2.43	2.19	2.23	2.16	2.22	2.35
Yield on 10-year T-bonds	%	4.04	3.49	2.69	3.03	2.24	2.79	2.93	2.77	2.98	2.79	3.00	3.33
2-year IRS	%	3.10	2.51	1.72	1.51	1.65	1.85	1.78	1.58	1.54	1.51	1.47	1.51
5-year IRS	%	3.51	2.92	2.02	1.88	1.80	2.23	2.17	1.89	1.85	1.77	1.86	2.03
10-year IRS	%	3.86	3.34	2.41	2.40	2.06	2.57	2.62	2.38	2.32	2.14	2.38	2.73
EUR/PLN	PLN	4.20	4.18	4.18	4.34	4.20	4.09	4.19	4.26	4.37	4.30	4.36	4.32
USD/PLN	PLN	3.16	3.15	3.77	3.85	3.72	3.70	3.77	3.90	3.96	3.83	3.86	3.76
CHF/PLN	PLN	3.41	3.45	3.92	3.79	3.93	3.93	3.90	3.93	3.98	3.82	3.73	3.62
GBP/PLN	PLN	4.94	5.19	5.77	5.73	5.64	5.67	5.84	5.91	5.67	5.52	5.85	5.88

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

Economic Calendar and Events

Date		Event:	Note:
6-Apr	**PL**	**MPC meeting – interest rate decision**	**We expect the MPC to keep NBP rates on hold**
7-Apr	**PL**	**T-bond auction: OK1018, DS0726**	**Offer: PLN3-6bn**
11-Apr	**PL**	**CPI for March**	**We expect the final CPI reading to be unchanged from the flash number of -0.9%y/y**
12-Apr	**PL**	**Core CPI for March**	**Our forecast is 0% y/y, but the risk is skewed to the downside after deflation proved deeper than we predicted in March.**
13-Apr	**PL**	**C/A Balance of payments for February**	**We expect a surplus of €442mn, slightly above the consensus (€418mn)**
14-Apr	**PL**	**M3 money supply for March**	**We expect 9.8%YoY, in line with consensus**
15-Apr	**PL**	**Final data of the GG deficit and debt for 2015**	**We expect the flash numbers to be confirmed: the GG deficit at 2.5% of GDP and GG debt at 51.5% of GDP**
18-Apr	**PL**	**Wages and employment for March**	**We expect employment growth of 2.6% y/y and wage growth of 3.7% y/y, slightly above consensus**
19-Apr	**PL**	**Industrial output for March**	**We expect 4.4% y/y, above the consensus (3.7% y/y)**
	PL	**Construction output for March**	**We expect -12.8% y/y, below the consensus (-8.8% y/y)**
	PL	**Real retail sales for March**	**We expect 4.5% y/y, above the consensus (3.5% y/y)**
	PL	**PPI inflation for March**	**We expect -1.3%YoY, close to consensus (-1.4%YoY)**
21-Apr	**PL**	**Minutes from April MPC meeting**	
	EZ	ECB meeting – interest rate decision	We expect the ECB to keep rates unchanged
26-Apr	HU	MNB meeting – interest rate decision	Further monetary easing is likely
27-Apr	US	Fed meeting – interest rate decision	
28-Apr	**PL**	**T-bond auction**	**Offer: PLN4-9bn**
TBA	**PL**	**Registered unemployment rate for March**	**We expect 10.0%, in line with consensus**

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

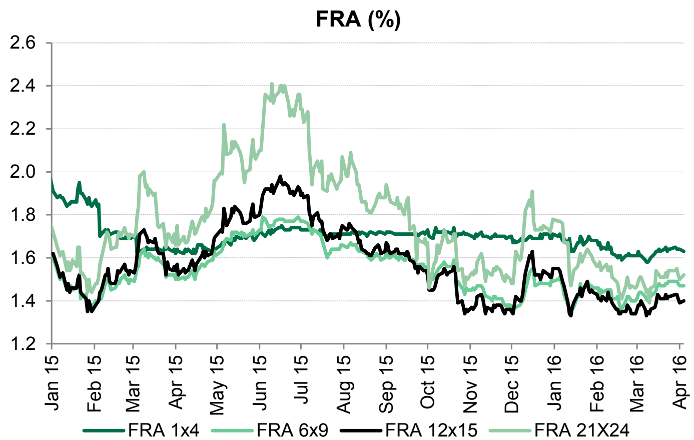
1. Domestic Market Performance

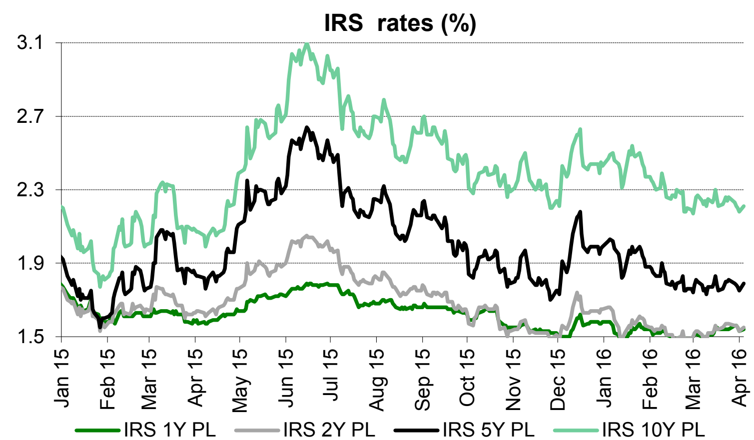
Money market rates (%)

	Reference	Poland	WIBOR (%)				OIS (%)				FRA (%)			
	rate (%)	(%)	1M	3M	6M	12M	1M	3M	6M	12M	1x4	3x6	6x9	9x12
End of March	**1.50**	**1.53**	**1.56**	**1.67**	**1.74**	**1.76**	**1.41**	**1.36**	**1.23**	**1.17**	**1.64**	**1.57**	**1.48**	**1.43**
Last 1M change (bp)	0	23	0	-1	0	0	17	12	2	2	3	10	8	6
Last 3M change (bp)	0	14	-9	-5	-3	-3	-2	-5	-8	-8	-7	0	-1	-5
Last 1Y change (bp)	0	4	-8	2	8	8	-4	-6	-19	-25	0	-3	-4	-9

Bond and IRS market (%)

	BONDS			IRS			Spread BONDS / IRS (bp)		
	2Y	5Y	10Y	2Y	5Y	10Y	2Y	5Y	10Y
End of March	**1.43**	**2.19**	**2.84**	**1.55**	**1.77**	**2.20**	**-12**	**42**	**64**
Last 1M change (bp)	0	-2	-10	6	1	1	-6	-3	-11
Last 3M change (bp)	-12	-3	-10	-10	-22	-23	-2	19	13
Last 1Y change (bp)	-15	25	53	-8	-9	11	-7	34	42





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	16,221	8,387	13,000	7,000	8,500	7,500	3,600	4,000	10,000			90,838
T-bill auctions	2,400	2,390	1,000	1,000	1,000	700	500		700				9,690
Retail bonds	200	600	175	167	160	192	200	215	200	250	1100	250	3,709
Foreign bonds/credits	7,700			7,438	5,238					3,106	4,900		28,381
Pre-financing and financial resources at the end of 2015	36,500												36,500
Total	**59,429**	**19,211**	**9,562**	**21,605**	**13,398**	**9,392**	**8,200**	**3,815**	**4,900**	**13,356**	**6,000**	**250**	**169,118**
Redemption	13,680	11,645	153	18,494	146	124	8,795	8,688	2,590	23,573	6,884	910	95,683
Net inflows	**45,749**	**7,566**	**9,409**	**3,110**	**13,252**	**9,268**	**-595**	**-4,873**	**2,310**	**-10,218**	**-884**	**-660**	**73,435**
Rolled-over T-bonds			8,590										**8,590**
Buy-back of T-bills/ FX-denominated bonds													**0**
Total	**45,749**	**7,566**	**17,999**	**3,110**	**13,252**	**9,268**	**-595**	**-4,873**	**2,310**	**-10,218**	**-884**	**-660**	**82,025**
Coupon payments from domestic debt	*1,084*			*3,276*			*3,306*		*1,295*	*5,487*			*14,449*

Note: Our forecasts = shaded area

Source: MF, BZ WBK

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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	0		647	**647**	10,999	**11,645**
March	0		153	**153**	0	**153**
April	12,637		136	**12,773**	915	**13,688**
May	0		146	**146**	0	**146**
June	0		124	**124**	0	**124**
July	9,931		226	**10,156**	911	**11,067**
August	3,689	2,400	199	**6,288**	0	**6,288**
September	0	2,390	200	**2,590**	0	**2,590**
October	22,420		242	**22,661**	911	**23,572**
November	0		1,056	**1,056**	1,628	**2,684**
December	0		210	**210**	0	**210**
Total 2016	62,127	4,790	3,567	**70,485**	15,364	**85,848**
Total 2017	72,603		2,485	**75,087**	11,728	**86,815**
Total 2018	77,116		1,313	**78,429**	12,977	**91,406**
Total 2019	63,811		1,237	**65,048**	23,512	**88,559**
Total 2020	63,794		634	**64,428**	21,805	**86,233**
Total 2021+	210,254		1,749	**212,003**	124,303	**336,306**

Source: MF, BZ WBK.

2. Polish Bonds: Supply Recap (cont.)

Scheduled wholesale bond redemptions by holders (data at the end of February 2016, 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	5,215	7,806	1,728	197	547	15	49	1,743	17,300
Q3 2016	4,851	5,968	2,255	75	2,365	27	8	846	16,394
Q4 2016	6,104	13,320	1,741	69	881	7	42	1,821	23,985
Total 2016	**24,177**	**29,246**	**7,750**	**395**	**4,372**	**74**	**141**	**4,869**	**71,024**
	34%	**41%**	**11%**	**1%**	**6%**	**0%**	**0%**	**7%**	**100%**
Total 2017	24,043	29,008	7,648	567	5,844	108	141	5,176	72,534
	33%	40%	11%	1%	8%	0%	0%	7%	100%
Total 2018	17,689	36,828	4,656	447	7,721	80	182	6,712	74,315
	24%	50%	6%	1%	10%	0%	0%	9%	100%
Total 2019	18,561	30,038	5,225	175	4,970	81	188	4,608	63,846
	29%	47%	8%	0%	8%	0%	0%	7%	100%
Total 2020	24,131	22,662	4,672	180	5,728	67	69	3,919	61,428
	39%	37%	8%	0%	9%	0%	0%	6%	100%
Total 2021+	85,939	60,612	24,058	227	20,495	343	311	7,012	198,997
	43%	30%	12%	0%	10%	0%	0%	4%	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 February			Share of total in February (%)
	End Feb'16	End Jan'16	End Dec'15	End 3Q 2015	End 2014	End 2013	MoM	3-mth	YoY	
Domestic investors	352.6	321.2	316.9	325.5	295.9	381.2	9.8	3.0	15.3	65.4 (3.0)
Commercial banks	206.2	177.4	171.5	176.7	150.8	114.7	16.2	22.9	29.3	38.3 (3.8pp)
Insurance companies	52.0	51.6	52.1	52.5	52.8	52.0	0.7	0.8	-0.2	9.6 (-0.4pp)
Pension funds	1.9	2.0	2.5	3.0	3.3	125.8	-3.7	-30.8	-39.2	0.4
Mutual funds	48.6	46.6	47.1	49.7	46.9	46.7	4.3	-3.3	-2.8	9.0
Others	43.9	43.6	43.7	43.7	42.0	42.0	0.8	0.8	7.0	8.1 (-0.3pp)
Foreign investors*	186.5	193.7	206.8	208.2	196.0	193.2	-10.6	28.0	32.7	34.6 (-3.0pp)
Banks	14.8	16.5	12.7	13.5	9.9	n.a.	-0.3	0.2	57.5	2.7 (-0.5pp)
Central banks	29.2	29.3	30.1	28.3	16.4	n.a.	0.0	-5.6	10.7	5.4 (-0.3pp)
Public institutions	9.4	9.4	9.4	9.7	8.1	n.a.	-6.9	-2.0	12.2	1.8 (-0.1pp)
Insurance companies	11.4	12.2	12.4	11.6	10.7	n.a.	1.6	-1.6	0.6	2.1 (-0.3pp)
Pension funds	13.4	13.2	14.1	13.0	13.0	n.a.	-13.4	-30.4	-49.6	2.5 (-0.1pp)
Mutual funds	41.1	47.4	54.9	64.7	78.1	n.a.	0.0	6.0	-96.4	7.6 (-1.6pp)
Hedge funds	0.04	0.04	0.04	0.1	1.1	n.a.	2.3	-29.0	-18.6	0.0
Non-financial sector	6.6	6.4	9.1	12.2	8.2	n.a.	-0.1	-7.0	2.3	1.2
Others	17.7	17.8	19.0	19.5	14.3	n.a.	4.7	11.3	6.1	3.3 (-0.2)
TOTAL	539.2	514.9	523,7	533.7	491.8	574.3	-10,6	28,0	32,7	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.

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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)	YTD bond issuance completion
Austria	19.4	14	5.6	50	48%
Belgium	33.6	3	8.0	84	33%
Finland	15.8	58	5.9	169	43%
France	187.0	0	60.5	-14	33%
Germany	168.6	16	0.0	-100	29%
Greece	-	-	-	-	-
Ireland	10.8	-20	2.7	-76	50%
Italy	221.9	-10	38.6	-9	30%
Netherlands	36.8	-23	8.5	5	26%
Portugal	11.9	-34	5.1	-55	34%
Spain	138.8	0	45.5	6	32%
Total	**844.5**	**-1**	**180.3**	**-1**	**20%**

** YTD is supply since January 1, 2016*

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

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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)	
	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016
Poland	**3.5**	**3.5**	**-0.7**	**0.6**	**-0.2**	**-0.7**	**-3.0**	**-2.8**	**51.4**	**52.5**
Czech Republic	4.5	2.3	0.3	0.4	-2.4	-2.0	-1.6	-1.1	40.9	40.7
Hungary	2.7	2.1	0.1	1.7	5.0	5.6	-2.1	-2.0	75.8	74.3
EU	1.9	1.9	0.0	0.5	2.1	2.1	-2.5	-2.2	87.2	86.9
Euro zone	1.6	1.7	0.0	0.5	3.7	3.6	-2.2	-1.9	93.5	92.7
Germany	1.7	1.8	0.1	0.5	8.8	8.6	0.5	0.1	71.6	69.2

Main market indicators (%, end of period)

	Reference rate (%)		3M market rate (%)		10Y yields (%)		10Y spread vs Bund (bp)		CDS 5Y	
	2015	End-Mar 2016	2015	End-Mar 2016	2015	End-Mar 2016	2015	End-Mar 2016	2015	End-Mar 2016
Poland	**1.50**	**1.50**	**1.72**	**1.67**	**2.94**	**2.83**	**230**	**266**	**75**	**88**
Czech Republic	0.05	0.05	0.29	0.29	0.60	0.44	-4	28	50	43
Hungary	1.35	1.20	1.35	1.20	3.42	3.04	279	287	164	150
Euro zone	0.05	0.05	-0.13	-0.244						
Germany					0.63	0.17			12	18

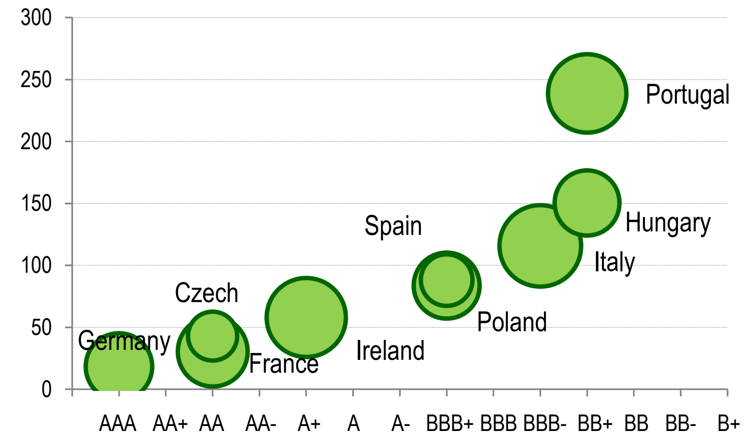
Source: EC – Winter 2016, statistics offices, central banks, Reuters, BZ WBK.

5. Poland vs. Other Countries (cont.)

Sovereign ratings

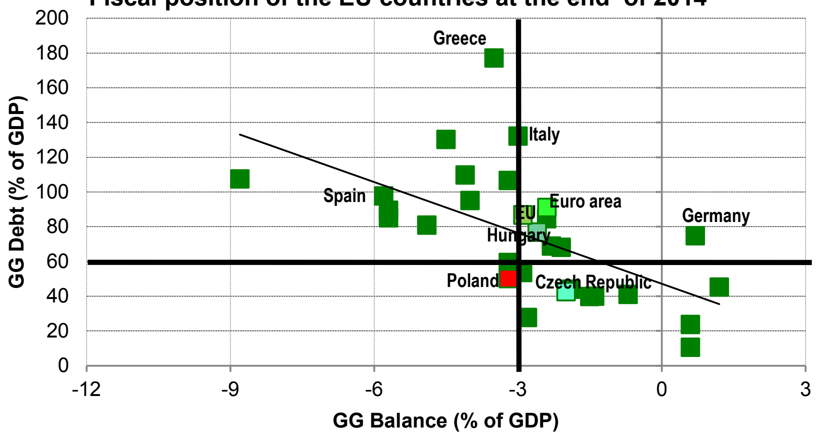
	S&P		Moody's		Fitch	
	rating	outlook	rating	outlook	rating	outlook
Poland	BBB+	negative	A2	stable	A-	stable
Czech	AA-	stable	A1	stable	A+	stable
Hungary	BB+	stable	Ba1	positive	BB+	positive
Germany	AAA	stable	Aaa	stable	AAA	stable
France	AA	negative	Aa2	stable	AA	stable
UK	AAA	negative	Aa1	stable	AA+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

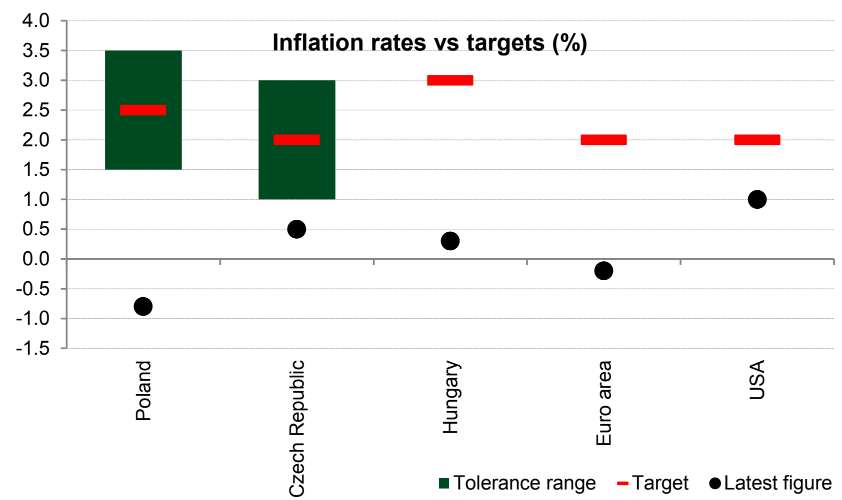


Note: Size of bubbles reflects the debt/GDP ratio

Fiscal position of the EU countries at the end of 2014

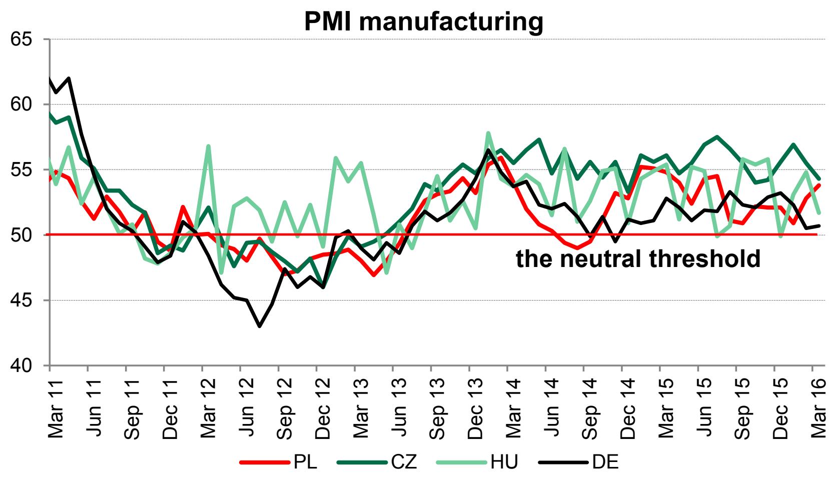


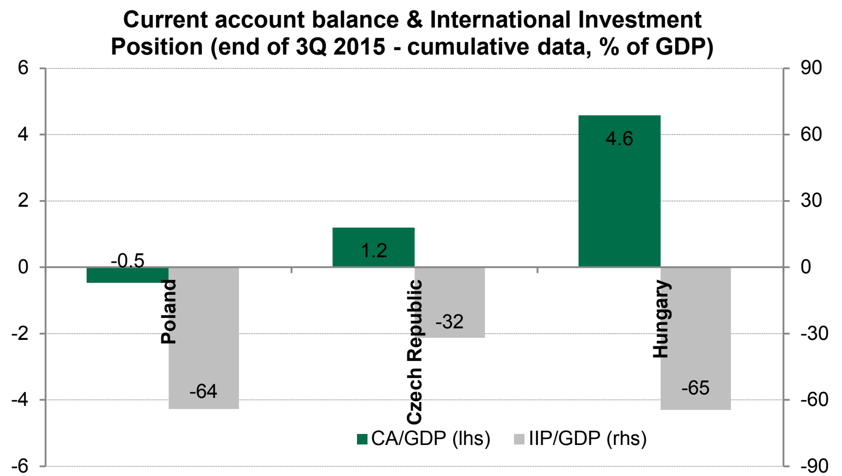
Inflation rates vs targets (%)

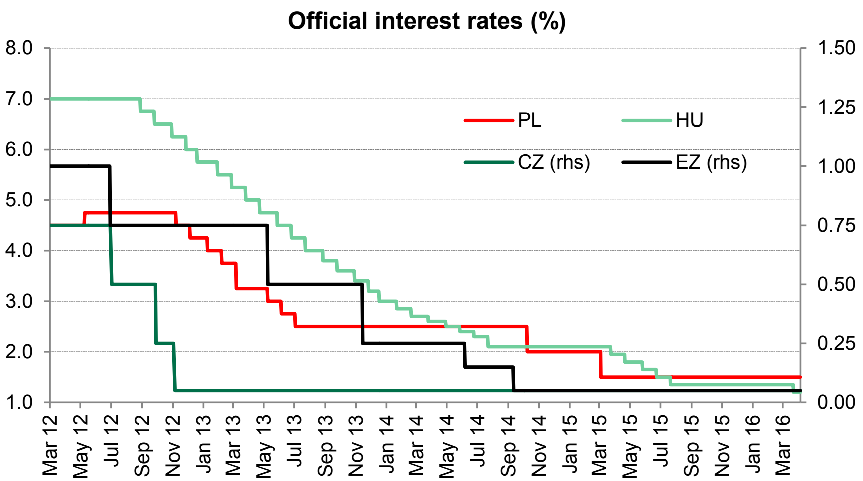


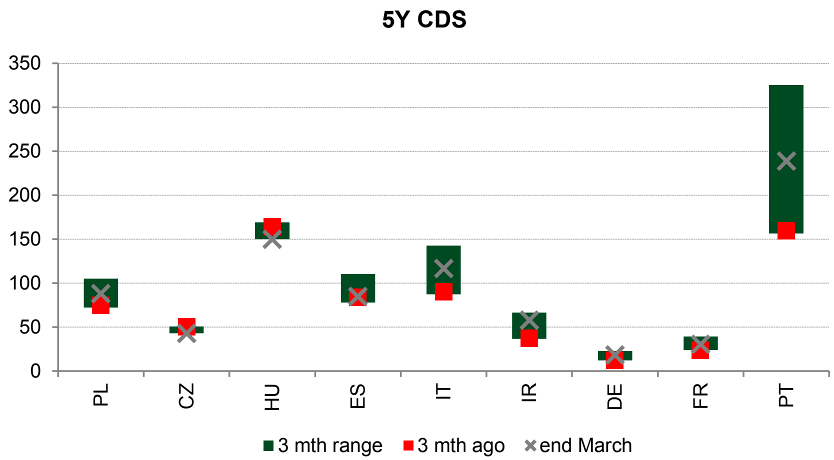
Source: Rating agencies, Reuters, EC, BZ WBK.

5. Poland vs. Other Countries (cont.)



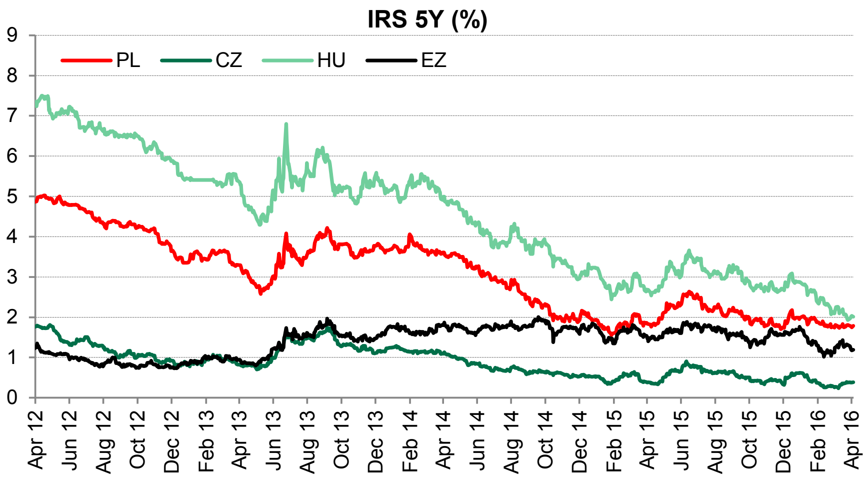


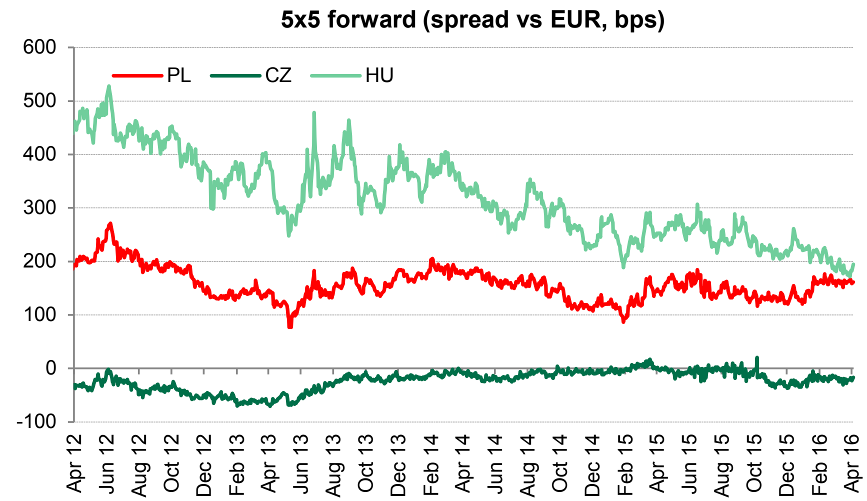


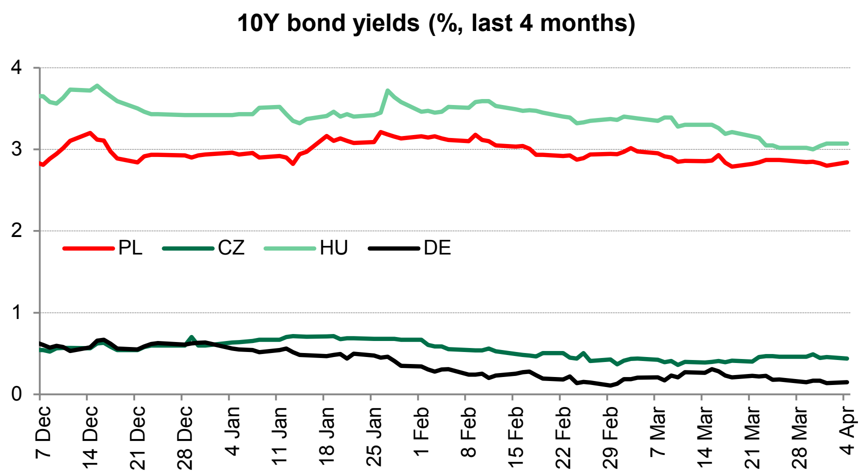


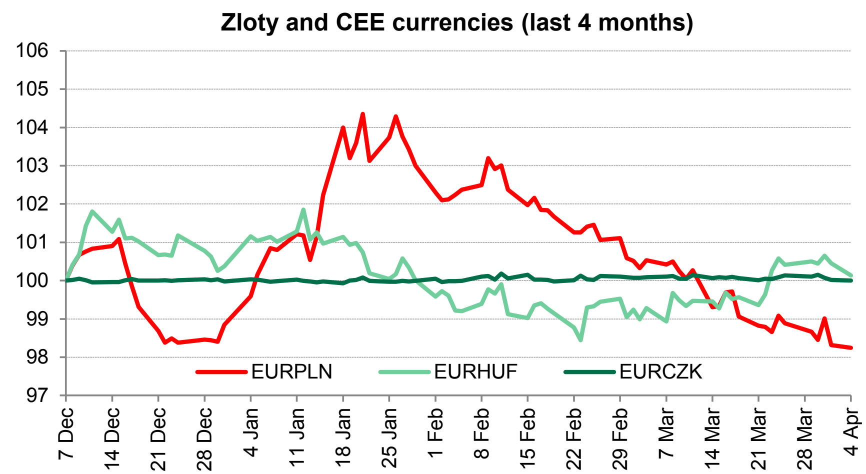
Source: Markit, Eurostat, central banks, Reuters, BZ WBK, EC.

5. Poland vs. Other Countries (cont.)









Source: Reuters, BZ WBK.

6. Central Bank Watch

					Expected changes (bp)			Comments
		Last	2015	2016E	1M	3M	6M	
Euro zone	Forecast	0.05	0.05	0.05				In March he ECB delivered a credible package of further easing measures, exceeding high expectations. Draghi played down the chances of further rate cuts, saying that, with the current outlook, the ECB expects rates to remain at current levels. Therefore we expect the ECB to remain on hold, keeping its rhetoric unchanged at the April meeting.
	Market implied »				-2	-3	-4	
UK	Forecast	0.50	0.50	0.75				We expect the Bank of England (BoE) to leave monetary conditions unchanged. The market has pulled back on pricing for cuts, however expectations are still relatively high. We still expect the BoE to hike rates later this year.
	Market implied »				0	0	4	
US	Forecast	0.25-0.50	0.25-0.50	1.00				The FOMC left its monetary conditions unchanged at the March meeting. Surprisingly, the Fed sent a very dovish message to the markets, stating that it wants to avoid tightening monetary policy too much and too quickly. In the updated projections, the 'dot' path for this year was lowered to two hikes (down from four predicted earlier). Our view has not changed as we expect very gradual rate hikes in 2H16E.
	Market implied »				44	63	90	
Poland	Forecast	1.50	1.50	1.25				Poland's Monetary Policy Council kept NBP rates unchanged in March despite a rather dovish inflation projection. The new MPC is now complete after the latest member, Mr Żyżyński, was approved by parliament. Mr Żyżyński has expressed more dovish views than the other new members, however this does not bring us closer to a rate cut. In our view rates should remain stable in the coming months.
	Market implied »				-4	-12	-20	
Czech Republic	Forecast	0.05	0.05	0.05				As expected, the Czech National Bank (CNB) left its rates on hold (with the 2W repo rate at 0.05%) and confirmed that there w ill be no exit from its FX commitment before 2017. According to the statement , the CNB discussed negative rates at its March meeting, but did not vote on this. Our view has not changed – we still expect the CNB to continue current monetary policy.
	Market implied »				-2	-7	-13	
Hungary	Forecast	1.20	1.35	1.00				Unexpectedly, the Hungarian central bank (MNB) cut rates by 15bp, trimming the main rate to 1.20%. Furthermore, it narrowed the interest rate corridor asymmetrically, introducing a negative O/N deposit rate (-0.05%). The statement gave some forward guidance, saying that interest rate cuts will continue. Therefore we revised our view of the interest rate path and now expect the main rate to be cut to 1.00% in the coming months.
	Market implied »				-14	-31	-38	

Source: Reuters, BZ WBK.

This analysis is based on information available through April 4, 2016 and has been prepared by:
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ANALYST CERTIFICATION:

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

EXPLANATION OF THE RECOMMENDATION SYSTEM

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

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