RATES AND FX OUTLOOK

POLISH FINANCIAL MARKETS

July-August 2016

Bank Zachodni WBK

Grupa Santander

Table of Contents

Summary	3
Short- and Medium-Term Strategy	4
Domestic Money Market	6
Domestic IRS and T-Bond Market	7
Demand Corner	8
Supply Corner	9
International Interest Rate Market	10
Foreign Exchange Market	11
FX Technical Analysis Corner	12
Economic and Market Forecasts	14
Economic Calendar and Events	16
Appendix	17

Summary

- The post-Brexit market turbulence did not last long. Growing hopes for more monetary stimulus by the main central banks triggered a rally in the bond markets with Polish bond yields falling to April lows and the spread vs the 10Y Bunds returning below 300bp. EM currencies also rebounded, although the zloty and the CEE region's currencies gained less than, for example, their Latam counterparts. They were probably held back by worries about the looming economic slowdown in Europe as well as some country-specific risk factors (see below).
- In our view, the risk for Poland's growth outlook is indeed rising – GDP growth in 2017E-18E may be closer to 3% than to the government-envisaged 4%. 2016E may also be weaker, as recent data disappointed (1Q only at 3%) and high-frequency figures for 2Q have signalled that the 2nd quarter may not be much better. Additionally, Brexit poses a risk for the Polish economy due to a direct impact through the trade channel amid high exposure to the British market in foreign trade (c7% of the total exports and high trade surplus) and an indirect impact of a risk of the euro zone's slowdown. Overall, we have revised our GDP forecast for Poland by 0.3-0.4pp in 2016-17E.
- The Monetary Policy Council kept rates on hold in July. More interestingly, the new NBP projection assumes that inflation will rise gradually with the mid-point of the projection for 12M CPI in 2018 at a mere 1.5%. This means the central bank expects inflation to be below the 2.5% target for more than two years going forward. Also, the GDP growth forecast was lowered by 0.6pp for 2016 and by 0.2pp for 2017. It seems MPC members have a more optimistic view of the GDP outlook than suggested by the NBP model. In our opinion, if the next economic data confirm that a significant acceleration of growth is not very likely, market expectations for rate cuts will grow, being positive for the front end of the curve. The FRA market has already started to price in a rising chance of rate cuts. The next MPC meeting in September will take place after the 2Q GDP data release but we do not think a change in interest rates is possible just after the summer break. In November, however, the new projection for the NBP will be available and if it confirms a weaker growth scenario (in line with our forecast), the MPC might consider an easing then, given the no-inflation environment. Historically, the Polish central bank has not been forward-looking in the decision-making process, but we believe a 50bp cut might be delivered at the turn of 2016/17.
- The MPC's decisions will be complicated further by the zloty's depreciation and the possibility of CHF-loans conversion. The latter issue is still alive and even if the head of PM Chancellery said recently that any project will require consultation with the KNF (limiting the risk of big losses for the sector), this would probably still prevent the zloty from strengthening in the following months. Also, lower economic growth and some fiscal risks (though higher tax-free income will not be increased starting 2017) are arguments in favour of a higher EURPLN path as compared to our previous forecasts.
- The government presented the plan for another overhaul of the pension system in Poland (see page 6). This caused some short-term negative market impact (zloty, equity), but it is certainly less harmful than expected by some market participants (risk of "nationalisation"). We believe it should be neutral for bonds and the zloty in the short term.

Short- and Medium-Term Strategy: Interest rate market

	Change (bp)		Current Level	Expected Trend	
	Last 3M	Last 1M	5 July 2016	1M	3M
Reference rate	0	0	**1.50**	→	→
3M WIBOR	4	3	**1.71**	→	→
2Y bond yield	23	6	**1.66**	↘	→
5Y bond yield	0	-19	**2.15**	→	↗
10Y bond yield	2	-30	**2.84**	→	↗
2/10Y curve slope	-21	-36	**118**	↗	↗

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: WIBORs inched gradually upwards due to hawkish comments from MPC members plus a 'wait-and-see' stance by the Council. However, FRA rates declined significantly as investors have started pricing in monetary easing by the MPC later this year (a 60% chance rates will be cut by 25bp before year-end). In our view, WIBORs should move sideways in the coming months. We see some room for a further decline in FRA rates, as the market should price in more easing.

Short end: The belly of the curves outperformed the front end as global markets started anticipating a growing probability of more accommodative monetary policies around the world (delayed interest rate hikes by Fed, more stimulus from ECB, BoE and others). In our view, there may be bull steepening of the curve if expectations for NBP interest rate cuts continue to build, given the story of lower GDP growth.

Long end: The uncertainty introduced by the UK's 'leave' vote and the repricing of monetary policy expectations should delay the bearish trend in yields in upcoming months. However, the scope of further significant decline in yields of Poland's longer term assets is rather limited after the sharp rally. Still, the most important risk factor is the uncertainty about the final shape of the FX-loan conversion proposal. This might limit gains at the long end of the yield curve, keeping the spread to the Bund (and EURPLN) quite elevated.

Risks to our view: a **f**aster and sharper downturn in the global economy may shift expectations towards further monetary easing not only by the ECB and BoE, but also by the Fed. As a consequence we can see a more significant decline in yields on core markets, which should result in a more visible drop in domestic yields/rates as compared to our expectations.

Short- and Medium-Term Strategy: FX market

	Change (%)		Current Level	Expected Trend	
	Last 3M	Last 1M	5 July 2016	1M	3M
EUR/PLN	5.0	1.4	**4.45**	→	→
USD/PLN	7.4	1.6	**4.00**	→	→
CHF/PLN	6.3	3.8	**4.12**	↘	↘
GBP/PLN	-1.5	-7.8	**5.25**	↗	→
EUR/USD	-2.3	-0.2	**1.11**	→	↘

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: the Brexit vote triggered only a temporary zloty weakening but we see limited room for the PLN to gain due to higher risk for the global (and Polish) economic growth. However, hopes (and possibly delivery) of more monetary policy easing worldwide should keep the exchange range near the current spot level.

USD: We have revised our EUR/USD forecasts down after the outcome of the UK referendum but still expect the euro to gain vs the dollar as the FOMC is only likely to deliver one more rate hike this year (probably in December). At the same time, euro zone economic growth has improved in 1Q and PMIs in 2Q do not show any deceleration.

CHF: As for EUR/USD, our EUR/CHF path runs lower than a month ago due to the strong demand for CHF after the UK referendum. The SNB still views the CHF as “heavily overvalued” and may continue to intervene in the market to push CHF towards weaker levels.

Risks to our view: Data showing significant deterioration in global economic growth and delayed action by central banks to stabilize the situation. Significant rate cuts in Poland by the MPC amid slower GDP growth.

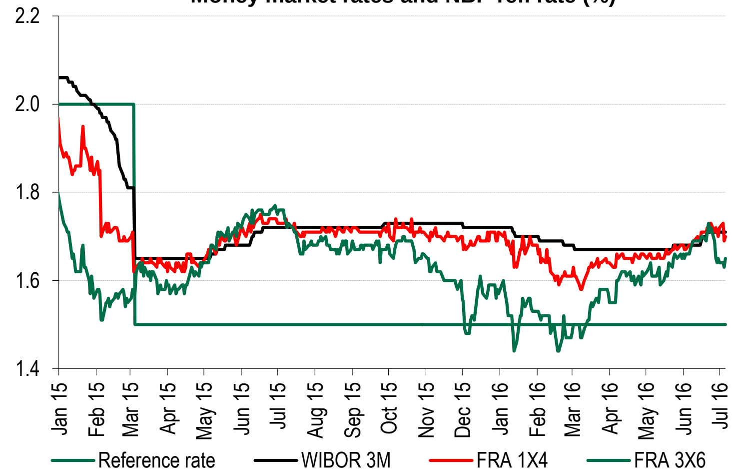
Another OFE overhaul, extension of 3rd pillar

- The Development Ministry presented its plan for the pension system overhaul and actions aiming at promoting long-term savings. The Ministry plans to transfer savings from OFE (open pension funds) to Individual Pension Accounts (IKE, 75%, i.e. Polish stocks) and to the Demographic Reserve Fund (FRD, 25% - foreign stocks, bonds and cash). The value of the latter is to be recorded in individual sub-accounts in ZUS (Social Security Authority). All new obligatory contributions will be transferred to ZUS going forward, but the pension funds will not transfer contributions of people who are 10 years or less from retirement to ZUS (as is currently the case).
- According to the Ministry, these changes will allow public debt to be cut by 2% of GDP. However, in ESA terms the public debt will decrease only marginally (by the amount of Treasury bonds transferred to FRD). The change will be neutral for the fiscal deficit. The changes are planned to be introduced in 2018.
- The introduction of such a plan should not be negative for the Warsaw stock market. The feared “nationalisation” of assets is off the cards: Polish equity will be moved to individual IKE pension accounts (not be managed centrally, but by private investment funds), while the value of other assets will be added to sub-accounts in ZUS. A possible negative impact on the stock market may stem from the adjustment between asset classes within IKE accounts (if savers’ preference shifts towards instruments other than stocks). However, an additional inflow to IKE (if tax incentives are strong enough) might neutralize this effect.
- The transfer of 25% of funds to FRD (PLN35bn or 2% of GDP) would lower liquidity needs of the government, which might be positive for bonds (lower borrowing needs). This would not affect public sector revenues, so there will be no additional room for higher spending. In the longer run, theoretically, money from FRD might be transferred directly to the Social Security Authority (ZUS) in order to finance pension payments. This has happened before (previous government) and was aimed at limiting current pressure on the budget.
- As regards the currency, we will probably see a sell-off of OFE’s foreign stocks (once planned changes are implemented in 2018), which could be positive for PLN. However, in the short run the changes should be neutral for bonds and zloty.
- Another (and actually, more important) part of the plan is to create an additional system, which would promote long-term savings of Polish households: Employees Capital Plans (Pracownicze Plany Kapitałowe, PPK) with tax incentives for both employees and employers (contribution of 2-4% paid by employee, 1.5-2.5% paid by employer, and 0.5% paid by the government). The Ministry also plans to introduce new investment instruments and to cut capital gains tax to 10% for investments with over 12M maturity. In our view, additional incentives for long-term saving should be regarded as positive.

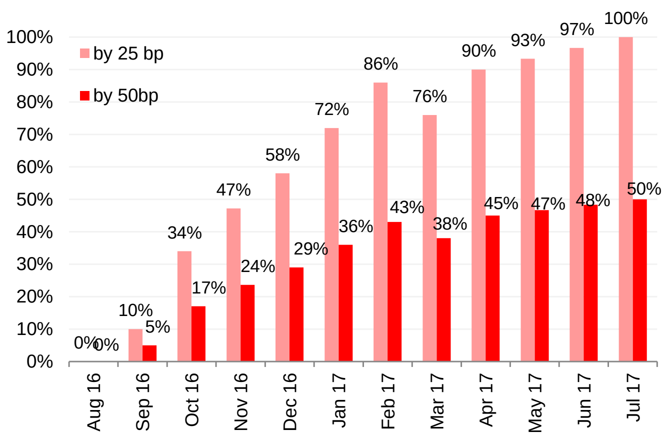
Domestic Money Market: Rate cut expectations return

- In June the money market situation was mixed. WIBORs started a gradual rise amid a still rather hawkish rhetoric of the Monetary Policy Council and comments by its members suggesting there is no need to cut rates. As a result, WIBORs increased by 3-6bp across the board. FRAs declined significantly in the last week of June and early July, trimming all earlier losses and reaching their lowest levels since mid-May. Consequently, on a monthly basis, the FRA curve moved down by 5-15bp, with the biggest decline in rates for longer tenors. This stemmed from IRS market strengthening as the unexpected outcome of the UK referendum regarding its membership of the EU renewed expectations for monetary easing later this year. Currently, the FRA market sees a 60% chance rates will be cut by 25bp in the next six months.
- The July Monetary Policy Council meeting was the last before the holiday period (the next meeting will take place on 6-7 September). As expected, the Council left interest rates unchanged and kept a "wait-and-see" bias despite the new GDP projection showing a lower path compared with March's prediction. This, in our view, supports a horizontal trend in WIBOR rates in coming months.
- In our view, FRA rates will be more vulnerable to macro data releases. We forecast GDP growth in 2Q16 to be only marginally above 1Q16's, as recently released monthly data were quite disappointing. If this scenario is confirmed, we see some room for a further decline in FRA rates, in particular as the market may overreact if the main central banks announce further adjustments in their monetary policy due to Brexit. We expect the market to price in at least a 50bp cut in Poland within the next few months.

Money market rates and NBP refi rate (%)



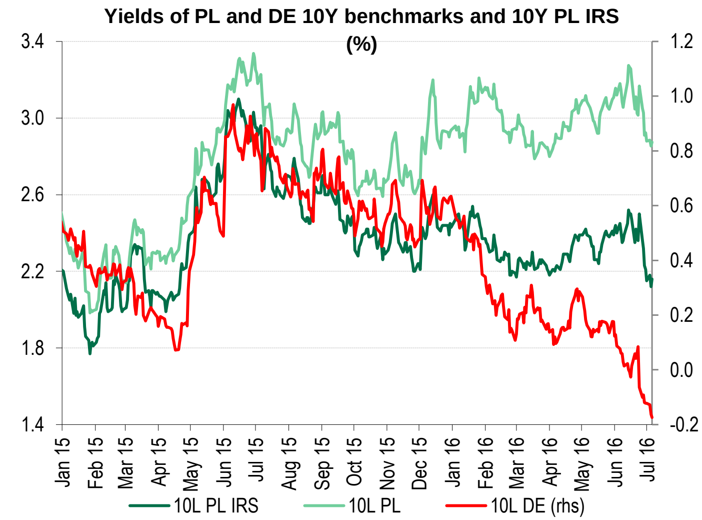
Probability of rate cuts
(implied by FRA rates on 6 July)

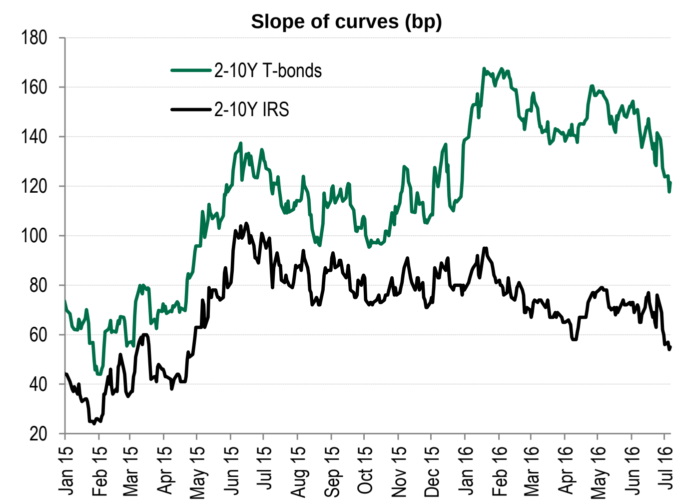


Source: Reuters, BZ WBK

Domestic IRS and the T-Bond Market: Bull steepening

- In June, two tendencies clashed on Poland's interest rate market. In the first half of the month, domestic bonds and IRS lost ground due to uncertainty about the UK referendum result. The post-Brexit yields surge on the Polish bond market was only temporary. Gains on the cores and peripheries, fuelled by speculation that more monetary easing could be needed to minimise the negative effects of Brexit on the global economy, pushed Poland's IRS and yields down, towards April's levels.
- Both yield and IRS curves have flattened markedly over the past month. The 2-10Y spread narrowed significantly to 125bp for T-bonds (down from 152bp at the end of May) and to 60bp for IRS (down from 72bp). At the same time, the spread to the Bund for the 10Y sector has remained relatively wide, close to 300bp.
- Global trends are still key for Polish rates in the months to come with a focus on the growing probability of more accommodative monetary policies around the world (delayed interest rate hikes by Fed, more stimulus from ECB, BoE and others). In this new environment, yields in core euro zone markets should stay lower for longer. Thus, we see limited scope for an increase in Polish yields over the coming months. Moreover, there may be a bull steepening of the curve if expectations for NBP interest rate cuts start building, given the lower GDP growth Story.
- Domestic factors should remain in the background for long-term bonds. Still, the most important risk factor is uncertainty about the final shape of the FX-loan conversion proposal. This might limit gains at the long end of the yield curve, keeping the spread to the Bund (and EURPLN) quite elevated.



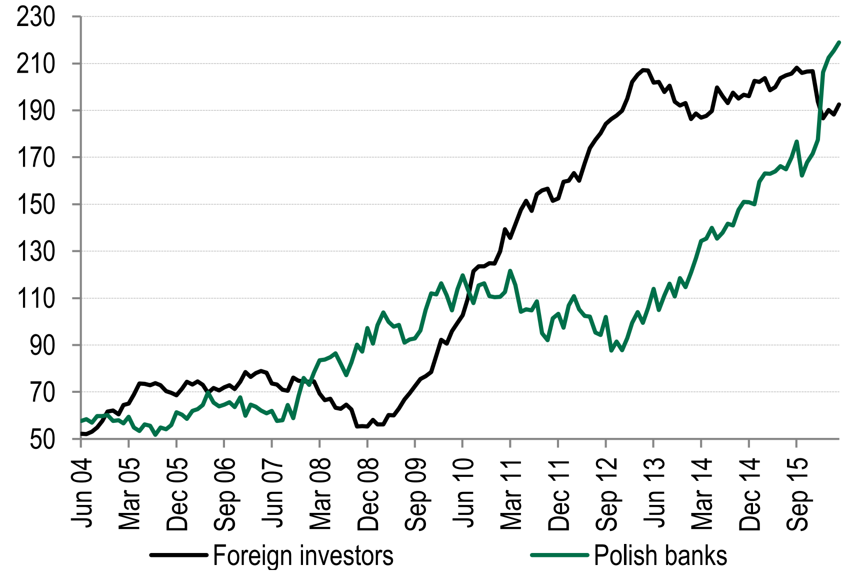


Source: Reuters, BZ WBK.

Demand Corner: Foreigners buy Polish banks' holdings at a new record rate

- In May, foreign investors bought Polish, marketable, PLN-denominated bonds for almost PLN4.3bn in nominal terms, the biggest monthly increase since January 2015. As a result, the total value of bonds held by non-residents is near the level of January (PLN192.5bn vs PLN193.7bn). In May, the biggest buyers within this group were investment funds (PLN1.6bn – the biggest monthly increase since January 2015) and central banks (cPLN1.2bn – mostly Asia, excluding the Middle East).
- From a geographical point of view, investors from Asia (excluding the Middle East) purchased bonds for PLN2.7bn, and those from North America for PLN1.8bn while EU countries outside the euro zone were net sellers (-PLN1.2bn).
- Banks were the most active among domestic players (PLN 3.6bn), as their bond holdings rose to a record level of cPLN219bn. May was the seventh month in a row of bond purchases.
- Polish banks bought PLN2.2bn and mutual funds PLN1.2bn of PS0721 and the share of domestic investors in this bond outstanding rose to 62% from 49%. The biggest increase in nonresidents' holdings was recorded for DS0726 (+PLN2.3bn) and at the end of May foreign investors held 60% of this issue outstanding.

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



Source: Finance Ministry. BZ WBK.

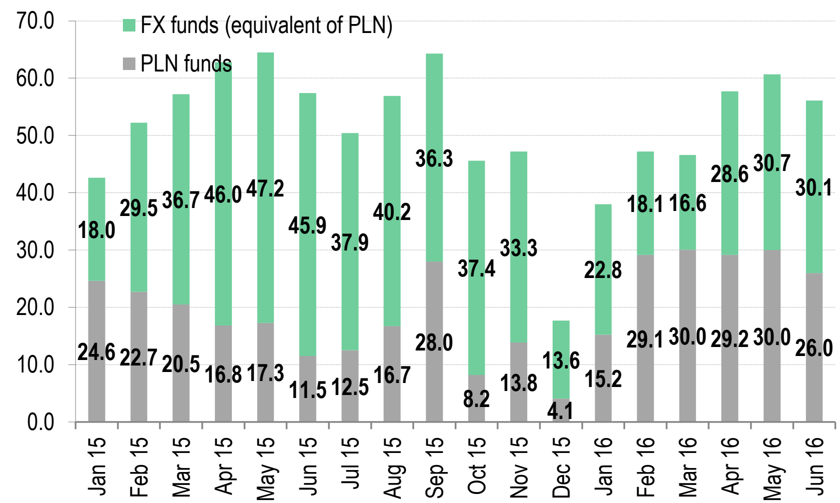
Supply Corner: Limited offer of T-bonds in 3Q16

- In June, Poland's Ministry of Finance offered T-bonds only at one regular auction, selling short and long-term bonds (2Y and 10Y benchmarks) worth PLN4.3bn. What is more, the Ministry decided to cancel June's switch auction as market volatility increased significantly due to the result of the UK referendum. All in all, 2Q16 was favorable for launching T-bonds on the primary market as the Ministry tapped securities worth PLN28.7bn (not far from the initially planned maximum level of PLN30bn for April-June). Poland has financed over 70% of this year's gross borrowing needs and held a PLN56bn liquidity cushion at the end of June.

- The high level of this year's borrowing needs financing allows the Ministry to limit T-bond supply in 3Q16 to PLN15-25bn at four auctions. In July, two regular tenders are set worth PLN7-15bn in total. At the first, the Ministry will offer 2Y benchmark OK1810, 10Y benchmark DS0726 and floaters WZ0428 worth PLN3-6bn in total, while at the second one total supply is planned at PLN4-9bn with the offer to be announced later this month. The switch tender is planned for September.

- We see no problem with launching debt on the primary market in coming months given the liquidity situation. In July-September, flows from both redemptions (OK0716, IZ0816) and interest payments (WZ, PS, DS. and WS series) will amount to PLN19.4bn in total, of which PLN14.4bn in July alone.

Funds on budgetary accounts at the end of month
(funds financing the borrowing needs, PLN bn)



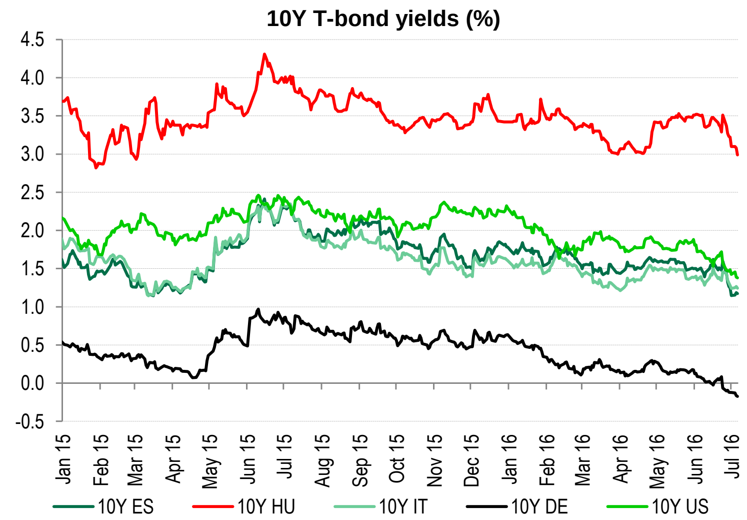
Auction plan for July 2016

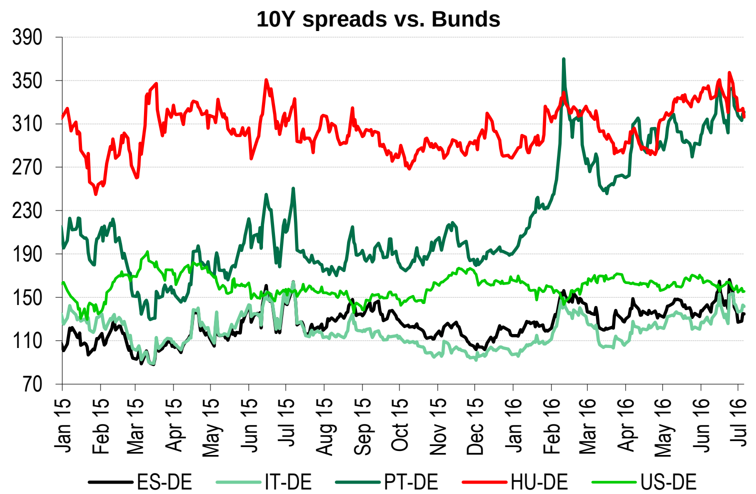
Auction Date	Settlement Date	T-bonds to Be Offered	Offer (PLN m)	Sale (PLN m)
7 July 2016	11 July 2016	OK1018/DS0726/WS0428	3,000-6,000	4,434.9
28 July 2016	1 August 2016	To be announced, choice will depend on the market conditions, excluding bonds offered at the first auction	4,000-9,000	

Source: Finance Ministry, BZ WBK.

International Interest Rate Market: The downward pressure on global yields remains

- In June, safe-haven flows dominated global trading, with the Bund the biggest gainer. The 10Y Bund yield reached nearly -0.20% for a while. Czech government bonds also followed core euro area bonds and the 10Y benchmark yield fell gradually, reaffirming their CEE safe haven status. The outcome of the UK referendum proved disappointing. During the first market reaction, yields of euro zone peripheries and CEE debt increased significantly, but market expectations that central banks might announce more monetary easing helped the global debt market to revive at the end of June-July.
- The downward pressure on global rates and yields should continue in the coming months. Despite the healthy US economy, the Fed may decide to delay the next hike as a consequence of uncertainty about the global economy and financial markets following Brexit. This should keep US yields on a horizontal trend.
- As regards the euro zone debt market (both core and peripheral), we expect yields to stay low for an even longer period. We think that further ECB intervention is likely and its adjustments might be presented at the earliest at the July meeting. The ECB is likely to concentrate on longer maturities and that suggests curve flattening.
- Given the dovish ECB and Fed, we think the CEE debt market might also gradually strengthen in coming months. However, the scope of the decline in yields might be limited by some country-specific factors, for example a possible increase in debt supply by the Czech government later this year or the CHF-loans issue in Poland.

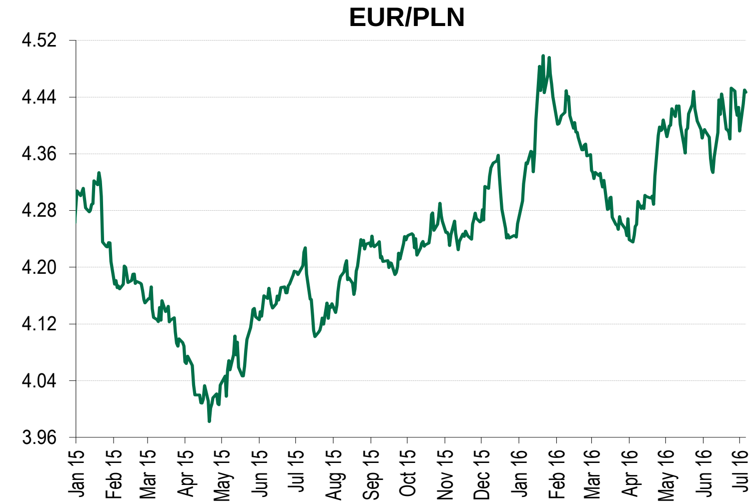


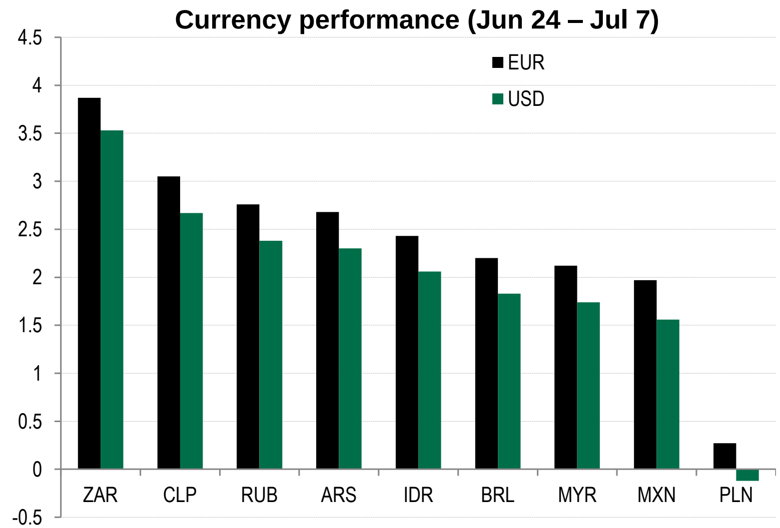


Source: Reuters, ECB, Fed, BZ WBK.

Foreign Exchange Market: Little room for the zloty to gain

- The Polish currency weakened sharply in response to the referendum result, with EUR/PLN rising to 4.55, but the rate quickly corrected. We see growing upside risk for the EUR/PLN as the zloty is more exposed to potential post-Brexit market turbulence than other CEE currencies. At the same time, we expect a weaker zloty vs the dollar and a stronger Swiss franc vs Sterling in the months to come.
- Since closing levels on the day of the UK referendum result's announcement, Latam and Asian currencies have outperformed their CEE peers suggesting that the zloty may gain less from further monetary policy easing in Europe and fewer hikes in the US.
- Brexit poses a risk for the Polish economy due to a direct impact through the trade channel amid high exposure to the British market in foreign trade (c7% of the total exports and high trade surplus) and an indirect impact of a risk of the euro zone's slowdown.
- Apart from potential Brexit costs, there are also other risk factors on the horizon that could weigh on the Polish currency in coming months: decisions on FX loan conversions or a reduction in the retirement age, and the pace of economic growth in coming quarters.
- Statistically the summer is not very positive for the zloty. In the last ten years the zloty has gained vs the euro in August only in 2009 and 2010 and given the abovementioned factors we think the summer holidays could be a rather negative period for the Polish currency again.





Source: Bloomberg, Reuters, BZ WBK

FX Technical Analysis Corner: No big changes for EUR/PLN

- EUR/PLN touched and then rebounded from the upper boundary of the 4.263-4.313 support area we mentioned last month.
- Post-Brexit volatility was pretty high but the exchange rate pulled back very fast.
- The situation has not changed much and the scenario of a horizontal trend with a slight upside tilt should persist in the coming weeks.

Source: Reuters, BZ WBK.

FX Technical Analysis Corner: Sharp moves in EUR/USD

- The market drew a big black candle after the UK referendum result was released and the exchange rate broke the bottom of the big white candle that last month we said would be the first important support to watch.
- Now, the peak of the big black candle is the first, pretty distant resistance for EUR/USD.

Source: Reuters, BZ WBK.

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Macroeconomic Forecasts

Poland		2013	2014	2015	2016E	1Q15	2Q15	3Q15	4Q15	1Q16	2Q16E	3Q16E	4Q16E
GDP	PLNbn	1,656.3	1,719.1	1,790.1	1,851.0	413.1	431.0	437.1	508.4	426.2	443.3	451.9	529.7
GDP	%YoY	1.3	3.3	3.6	3.1	3.6	3.1	3.4	4.3	3.0	3.1	3.1	3.2
Domestic demand	%YoY	-0.7	4.9	3.3	3.5	2.9	3.0	3.0	4.5	4.1	2.9	3.5	3.6
Private consumption	%YoY	0.2	2.6	3.1	4.0	3.1	3.1	3.1	3.0	3.2	3.5	4.6	4.8
Fixed investment	%YoY	-1.1	9.8	6.1	0.5	11.8	5.8	4.4	4.4	-1.8	-0.5	0.5	2.0
Unemployment rate [a]	%	13.4	11.4	9.8	8.6	11.5	10.2	9.7	9.8	10.0	8.8	8.4	8.6
Current account balance	EURmn	-5,031	-8,303	-1,059	-1,839	900	864	-2,348	-475	296	91	-2,243	17
Current account balance	% GDP	-1.3	-2.0	-0.2	-0.4	-1.3	-0.4	-0.4	-0.2	-0.4	-0.6	-0.6	-0.4
General government balance (ESA 2010)	% GDP	-4.0	-3.3	-2.6	-2.8	-	-	-	-	-	-	-	-
CPI	%YoY	0.9	0.0	-0.9	-0.6	-1.5	-0.9	-0.7	-0.6	-0.9	-0.9	-0.8	0.1
CPI [a]	%YoY	0.7	-1.0	-0.5	0.4	-1.5	-0.8	-0.8	-0.5	-1.1	-0.8	-0.5	0.4
CPI excluding food and energy prices	%YoY	1.2	0.6	0.3	-0.1	0.4	0.3	0.3	0.2	-0.1	-0.3	-0.2	0.2

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	1Q16	2Q16	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	1.70	1.87	1.67	1.72	1.73	1.69	1.68	1.71	1.74
Yield on 2-year T-bonds	%	2.98	2.46	1.70	1.59	1.61	1.75	1.80	1.65	1.45	1.57	1.67	1.65
Yield on 5-year T-bonds	%	3.46	2.96	2.21	2.23	1.90	2.35	2.43	2.19	2.23	2.29	2.18	2.23
Yield on 10-year T-bonds	%	4.04	3.49	2.69	3.02	2.24	2.79	2.93	2.77	2.98	3.04	2.99	3.07
2-year IRS	%	3.10	2.51	1.72	1.62	1.65	1.85	1.78	1.58	1.54	1.64	1.67	1.64
5-year IRS	%	3.51	2.92	2.02	1.87	1.80	2.23	2.17	1.89	1.85	1.92	1.82	1.92
10-year IRS	%	3.86	3.34	2.41	2.35	2.06	2.57	2.62	2.38	2.32	2.34	2.30	2.41
EUR/PLN	PLN	4.20	4.18	4.18	4.39	4.20	4.09	4.19	4.26	4.37	4.37	4.42	4.40
USD/PLN	PLN	3.16	3.15	3.77	3.97	3.72	3.70	3.77	3.90	3.96	3.87	4.01	4.02
CHF/PLN	PLN	3.41	3.45	3.92	4.00	3.93	3.93	3.90	3.93	3.98	3.99	4.04	4.00
GBP/PLN	PLN	4.94	5.19	5.77	5.40	5.64	5.67	5.84	5.91	5.67	5.55	5.25	5.12

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

Economic Calendar and Events

Date		Event:	Note:
11 July	**PL**	**CPI for June**	**We expect inflation at -0.8% y/y, in line with the flash estimate**
12 July	**PL**	**Core inflation for June**	**We predict gradual increase to -0.2% y/y**
14 July	**PL**	**Balance of payments for May**	**We expect a current account surplus of €338m, with subdued growth of export**
	PL	**Money supply for June**	**We expect solid 11.4% y/y growth**
18 July	**PL**	**Wages and employment for June**	**We expect wages growth of 4.8% y/y and employment growth of 2.9%**
19 July	**PL**	**Industrial production for June**	**We predict solid output growth of 6.7% y/y**
	PL	**Retail sales for June**	**We expect solid growth of 5.5% y/y in constant prices**
	PL	**PPI for June**	**We expect -1.1% y/y**
21 July	EU	ECB decision	Refi rate: unchanged
25 July	**PL**	**Registered unemployment rate**	**Our forecast is at 8.8%**
26 July	HU	Central bank decision	3M base rate: unchanged
27 July	US	FOMC decision	Fed rate: unchanged
28 July	**PL**	**T-bond auction**	**Offer: PLN4.0-9.0bn**
1 August	**PL**	**PMI for manufacturing**	
4 August	CZ	Central bank decision	Base rate: unchanged
12 August	**PL**	**Flash GDP for 2Q16**	**We predict GDP growth of 3.0% y/y**
	PL	**CPI for July**	**We expect inflation at -0.9% y/y**
	PL	**Balance of payments for June**	**We expect a current account deficit of €855m**
17 August	**PL**	**Wages and employment for July**	**We expect wages growth of 4.4% y/y and employment growth of 2.8%**
18 August	**PL**	**Industrial production for July**	**We predict output growth of 1.3% y/y**
	PL	**Retail sales for July**	**We expect solid growth of 4.4% y/y**
	PL	**PPI for July**	**We expect -0.7% y/y**
23 August	HU	Central bank decision	3M base rate: unchanged
25 August	**PL**	**Minutes of July MPC meeting**	
30 August	**PL**	**Detailed GDP for 2Q16**	**We predict GDP growth of 3.0% y/y with private consumption growth by 3.5% y/y and investment decline by -0.5% y/y**

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

Bank Zachodni WBK
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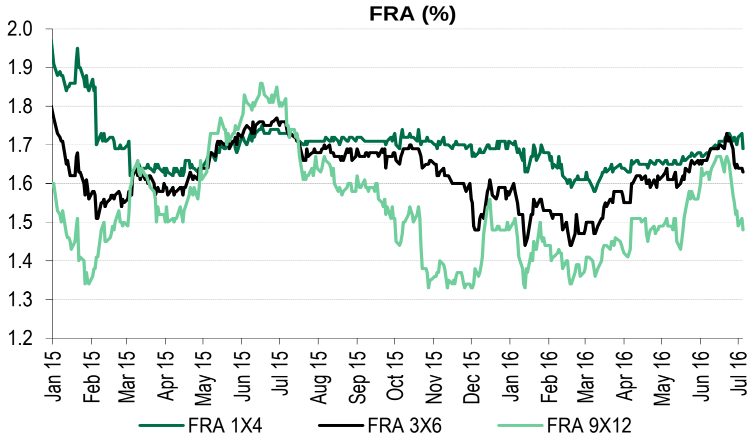
1. Domestic Market Performance

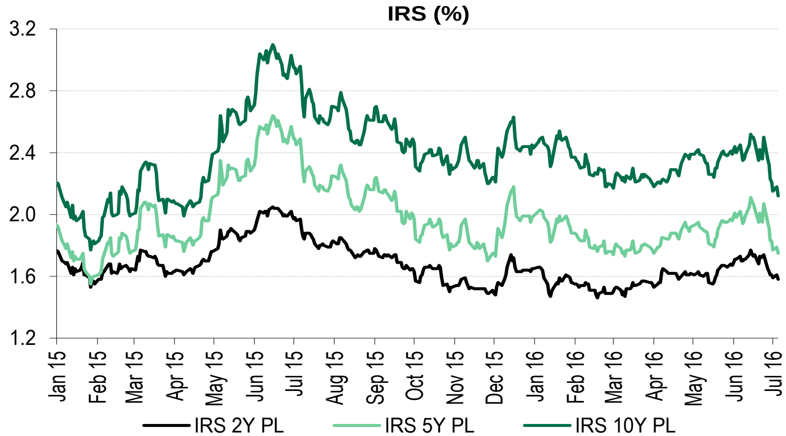
Money Market Rates (%)

	Reference	Poland	WIBOR (%)				OIS (%)				FRA (%)			
	rate (%)	(%)	1M	3M	6M	12M	1M	3M	6M	12M	1x4	3x6	6x9	9x12
End of June	**1.50**	**1.17**	**1.65**	**1.71**	**1.79**	**1.81**	**1.43**	**1.42**	**1.40**	**1.39**	**1.70**	**1.65**	**1.56**	**1.53**
Last 1M change (bp)	0	-44	6	3	5	5	-1	4	4	7	2	-1	-3	-3
Last 3M change (bp)	0	-16	9	4	5	5	19	14	18	20	6	7	7	9
Last 1Y change (bp)	0	-34	-1	-1	0	-1	-2	-5	-9	-13	-4	-11	-22	-29

Bond and IRS Market (%)

	BONDS			IRS			Spread BONDS / IRS (bp)		
	2Y	5Y	10Y	2Y	5Y	10Y	2Y	5Y	10Y
End of June	**1.66**	**2.21**	**2.91**	**1.61**	**1.83**	**2.21**	**5**	**38**	**70**
Last 1M change (bp)	9	-10	-18	-7	-14	-20	16	4	2
Last 3M change (bp)	23	3	6	5	5	0	18	-2	6
Last 1Y change (bp)	-32	-54	-40	-38	-70	-78	6	16	38





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	14,891	9,506	4,322	12,000	3,500	5,000	10,000	3,000		99,456
T-bill auctions	2,400	2,390	1,000										5,790
Retail bonds	200	600	175	167	160	192	200	200	200	250	1100	250	3,694
Foreign bonds/credits	7,700			9,883									17,583
Pre-financing and financial resources at the end of 2015	36,500												36,500
Total	**59,429**	**19,211**	**9,562**	**24,941**	**9,666**	**4,514**	**12,200**	**3,700**	**5,200**	**10,250**	**4,100**	**250**	**163,023**
Redemption	13,680	11,645	153	13,688	146	124	11,067	8,688	2,590	23,572	3,684	210	89,249
Net inflows	**45,749**	**7,566**	**9,409**	**11,253**	**9,519**	**4,389**	**1,133**	**-4,988**	**2,610**	**-13,322**	**416**	**40**	**73,774**
Rolled-over T-bonds			8,590										**8,590**
Buy-back of T-bills/ FX-denominated bonds													**0**
Total	**45,749**	**7,566**	**17,999**	**11,253**	**9,519**	**4,389**	**1,133**	**-4,988**	**2,610**	**-13,322**	**416**	**40**	**82,365**
Coupon payments from domestic debt	*1,084*			*3,767*			*4,461*		*1,295*	*6,244*			*16,852*

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	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	81,651		1,313	**82,964**	12,977	**95,941**
Total 2019	63,811		1,237	**65,048**	23,512	**88,559**
Total 2020	65,481		634	**66,115**	21,805	**87,920**
Total 2021+	232,751		1,749	**234,500**	134,266	**368,766**

Source: MF, BZ WBK.

2. Polish Bonds: Supply Recap (cont.)

Scheduled Wholesale Bond Redemptions by Holders (data at the end of May 2016, in PLN mn)

	Foreign Investors	Domestic Banks	Insurance Funds	Pension Funds	Mutual Funds	Individuals	Non-financial Dector	Other	Total
Q1 2016	8,007	2,151	2,027	54	579	26	42	459	13,346
Q2 2016	4,631	4,876	1,710	180	361	15	45	820	12,637
Q3 2016	3,874	6,415	2,059	65	1,534	24	32	547	14,550
Q4 2016	5,543	12,042	2,007	40	778	5	30	1,957	22,400
Total 2016	**9,417**	**18,456**	**4,067**	**105**	**2,312**	**29**	**62**	**2,504**	**36,951**
	25%	**50%**	**11%**	**0%**	**6%**	**0%**	**0%**	**7%**	**100%**
Total 2017	21,759	32,538	7,145	453	5,031	101	93	5,483	72,603
	30%	45%	10%	1%	7%	0%	0%	8%	100%
Total 2018	18,390	41,528	4,347	575	7,871	72	148	7,614	80,544
	23%	52%	5%	1%	10%	0%	0%	9%	100%
Total 2019	16,425	31,382	5,445	176	5,355	81	145	4,802	63,811
	26%	49%	9%	0%	8%	0%	0%	8%	100%
Total 2020	25,137	24,831	4,140	166	6,920	71	71	4,161	65,498
	38%	38%	6%	0%	11%	0%	0%	6%	100%
Total 2021+	101,394	70,250	25,229	323	24,125	421	345	7,980	230,067
	44%	31%	11%	0%	10%	0%	0%	3%	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 May			Share of Total in May (%)
	End May'16	End Apr'16	End Mar'16	End 3Q 2015	End 2014	End 2013	MoM	3-mth	YoY	
Domestic investors	367.8	362.3	358.0	325.5	295.9	381.2	1.5	3.9	17.2	65.6 (-0.2)
Commercial banks	219.0	215.3	212.5	176.7	150.8	114.7	1.7	6.2	33.5	39.1
Insurance companies	50.4	50.6	51.1	52.5	52.8	52.0	-0.5	-3.1	-6.3	9.0 (-0.2pp)
Pension funds	1.8	1.8	1.9	3.0	3.3	125.8	0.5	-7.2	-36.2	0.3
Mutual funds	51.6	50.6	48.7	49.7	46.9	46.7	2.0	6.3	2.1	9.2
Others	45.0	43.9	43.8	43.7	42.0	42.0	2.5	2.6	5.7	8.0 (0.1pp)
Foreign investors*	192.5	188.3	190.2	208.2	196.0	193.2	2.3	3.2	-3.7	34.4 (0.2pp)
Banks	11.6	12.4	19.3	13.5	9.9	n.a.	-6.5	-21.8	-8.9	2.1 (-0.2pp)
Central banks	29.5	28.2	27.7	28.3	16.4	n.a.	4.4	1.0	27.8	5.3 (0.1pp)
Public institutions	8.9	8.9	9.5	9.7	8.1	n.a.	0.5	-5.7	-4.7	1.6
Insurance companies	11.3	10.8	11.9	11.6	10.7	n.a.	4.6	-0.9	6.6	2.0
Pension funds	14.4	13.7	13.8	13.0	13.0	n.a.	5.2	7.9	17.9	2.6 (0.1pp)
Mutual funds	42.3	40.7	41.7	64.7	78.1	n.a.	4.0	3.0	-40.2	7.6 (0.2pp)
Hedge funds	0.08	0.06	0.04	0.1	1.1	n.a.	21.0	90.9	-86.8	0.0
Non-financial sector	6.5	6.2	6.7	12.2	8.2	n.a.	4.5	-1.1	-23.7	1.2
Others	18.1	16.9	17.2	19.5	14.3	n.a.	6.9	2.0	9.7	3.2 (0.2)
TOTAL	560.3	550.6	548.1	533.7	491.8	574.3	1.8	4.3	9.1	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 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)	YTD Bond Issuance Completion
Austria	19.4	14	5.6	50	68%
Belgium	33.6	3	8.0	84	72%
Finland	15.8	58	5.9	169	66%
France	187.0	0	60.5	-14	66%
Germany	168.6	16	0.0	-100	53%
Greece	-	-	-	-	-
Ireland	10.8	-20	2.7	-76	71%
Italy	221.9	-10	38.6	-9	61%
Netherlands	36.8	-23	8.5	5	57%
Portugal	11.9	-34	5.1	-55	64%
Spain	138.8	0	45.5	6	56%
Total	**844.5**	**-1**	**180.3**	**-1**	**60%**

** 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)	
	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017
Poland	**3.7**	**3.6**	**0.0**	**1.6**	**-0.3**	**-0.9**	**-2.6**	**-3.1**	**52.0**	**52.7**
Czech Republic	2.1	2.6	0.5	1.4	-1.5	-1.3	-0.7	-0.6	41.3	40.9
Hungary	2.5	2.8	0.4	2.3	5.0	4.5	-2.0	-2.0	74.3	73.0
EU	1.8	1.9	0.3	1.5	2.2	2.1	-2.1	-1.8	86.4	85.5
Euro zone	1.6	1.8	0.2	1.4	3.7	3.6	-1.9	-1.6	92.2	91.1
Germany	1.6	1.6	0.3	1.5	8.5	8.3	0.2	0.1	68.6	66.3

Main Market Indicators (%, end of period)

	Reference Rate (%)		3M Market Rate (%)		10Y Yields (%)		10Y Sspread vs Bund (bp)		CDS 5Y	
	2015	End-Jun 2016	2015	End-Jun 2016	2015	End-Jun 2016	2015	End-Jun 2016	2015	End-Jun 2016
Poland	**1.50**	**1.50**	**1.72**	**1.71**	**2.94**	**2.91**	**230**	**305**	**75**	**99**
Czech Republic	0.05	0.05	0.29	0.29	0.60	0.47	-4	59	50	41
Hungary	1.35	0.90	1.35	1.01	3.42	3.22	279	334	164	161
Euro zone	0.05	0.00	-0.13	-0.286						
Germany					0.63	-0.12			12	19

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

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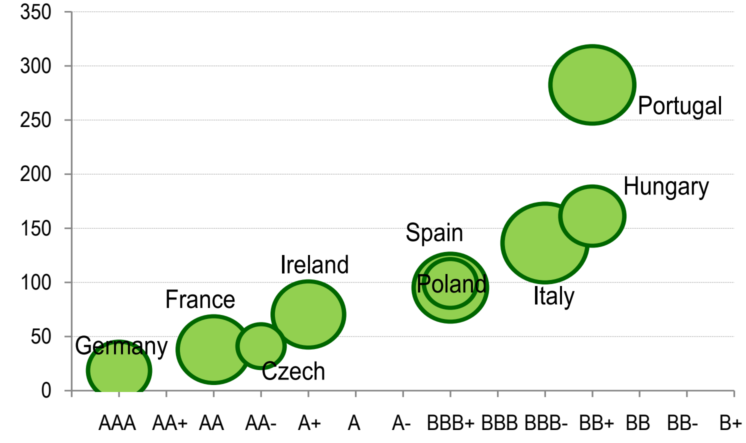
5. Poland vs Other Countries (cont.)

Sovereign ratings

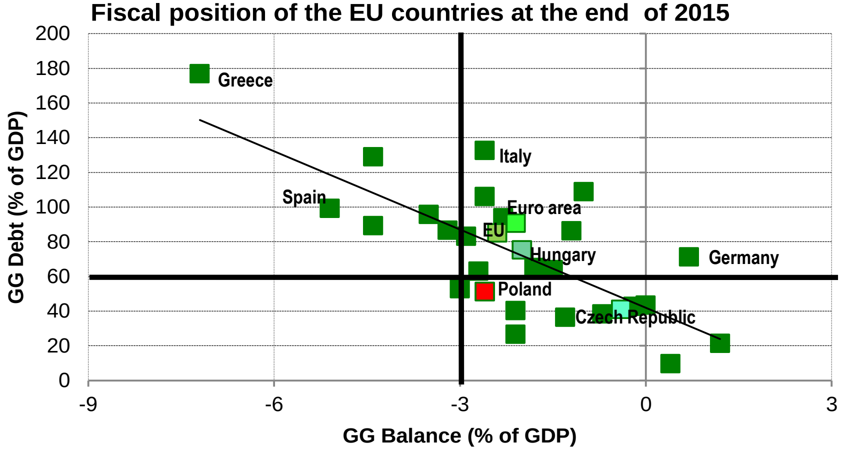
	S&P		Moody's		Fitch	
	rating	outlook	rating	outlook	rating	outlook
Poland	BBB+	negative	A2	negative	A-	stable
Czech	AA-	stable	A1	stable	A+	stable
Hungary	BB+	stable	Ba1	positive	BBB-	stable
Germany	AAA	stable	Aaa	stable	AAA	stable
France	AA	negative	Aa2	stable	AA	stable
UK	AA	negative	Aa1	negative	AA	negative
Greece	B-	stable	Caa3	stable	CCC	stable
Ireland	A+	stable	A3	positive	A	stable
Italy	BBB-	stable	Baa2	stable	BBB+	stable
Portugal	BB+	stable	Ba1	stable	BB+	stable
Spain	BBB+	stable	Baa2	stable	BBB+	stable

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

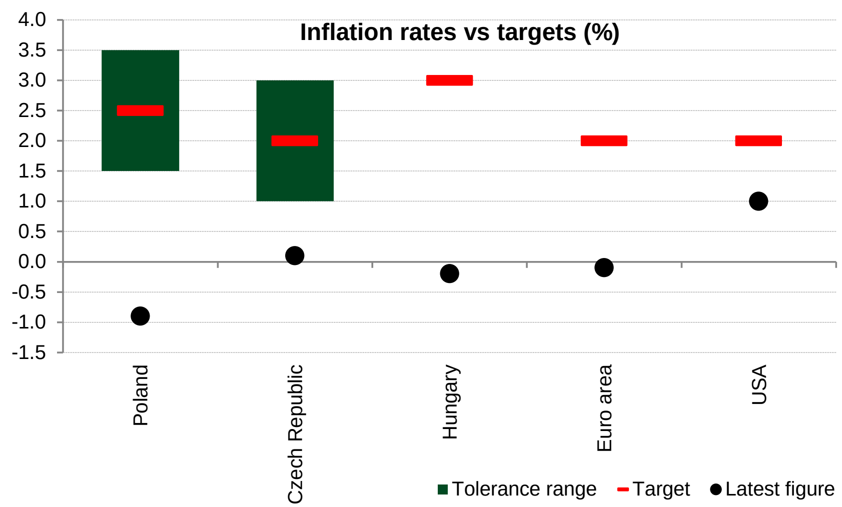


Note: Size of bubbles reflects the debt/GDP ratio

Fiscal position of the EU countries at the end of 2015

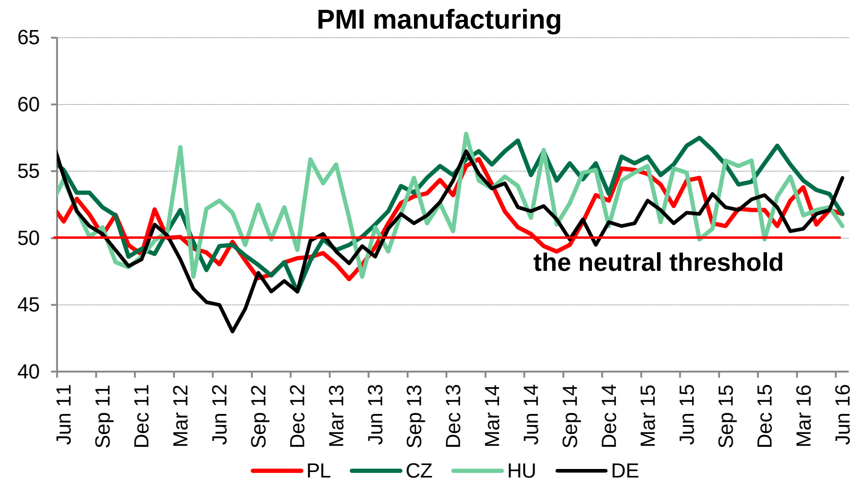


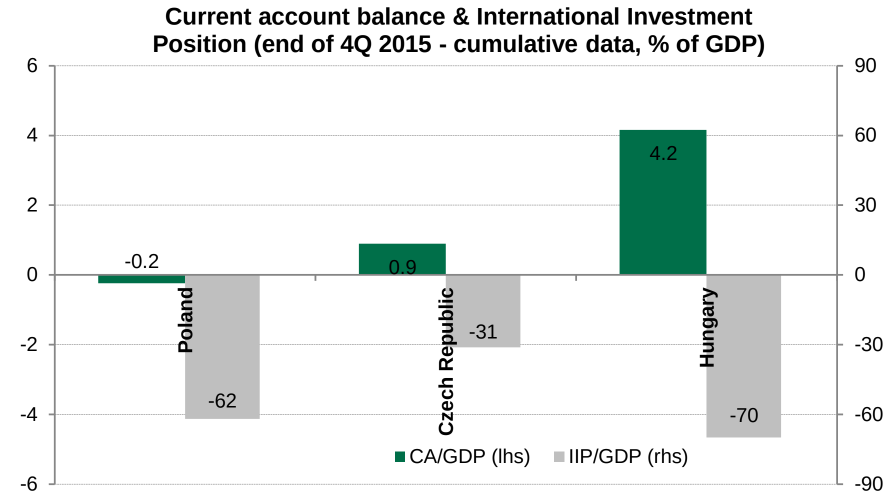
Inflation rates vs targets (%)

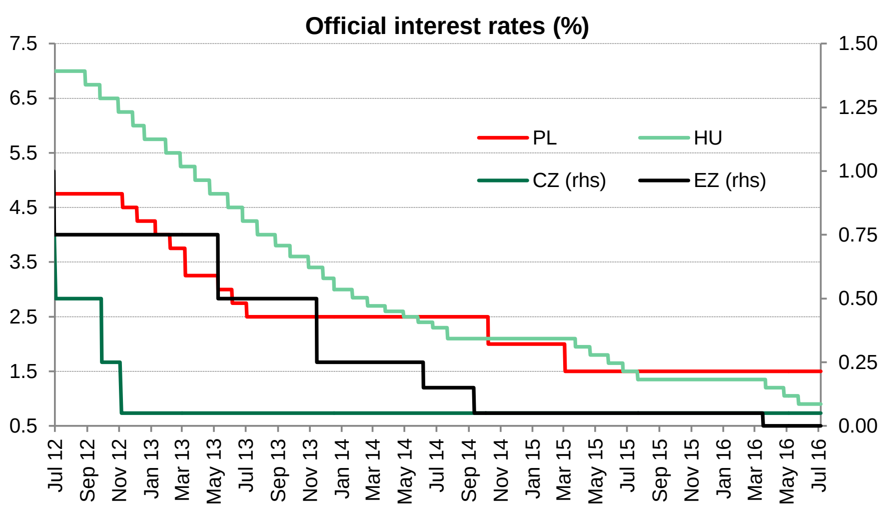


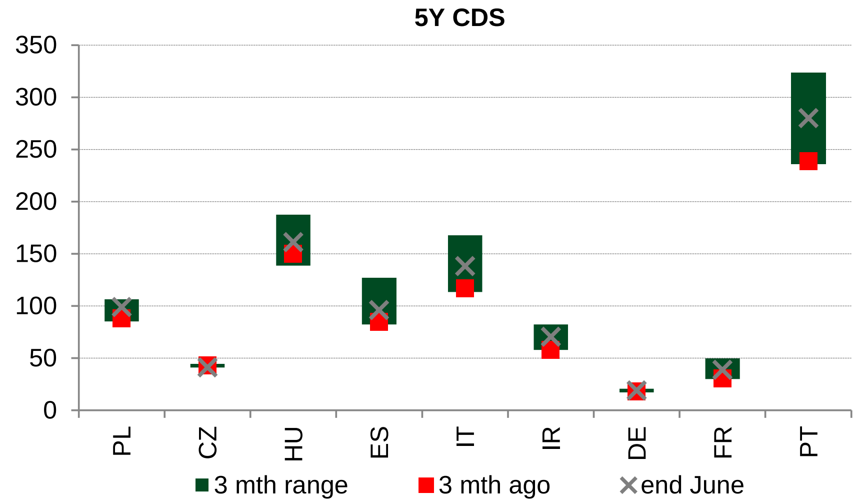
Source: Rating agencies, Reuters, EC, BZ WBK.

5. Poland vs Other Countries (cont.)





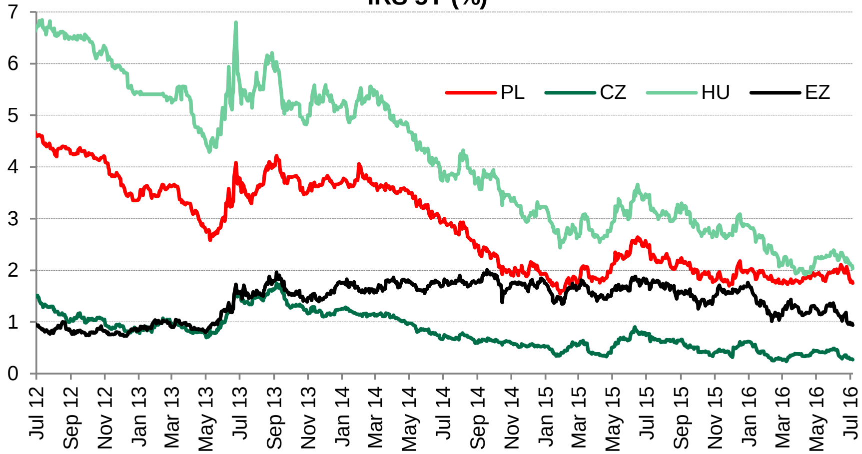




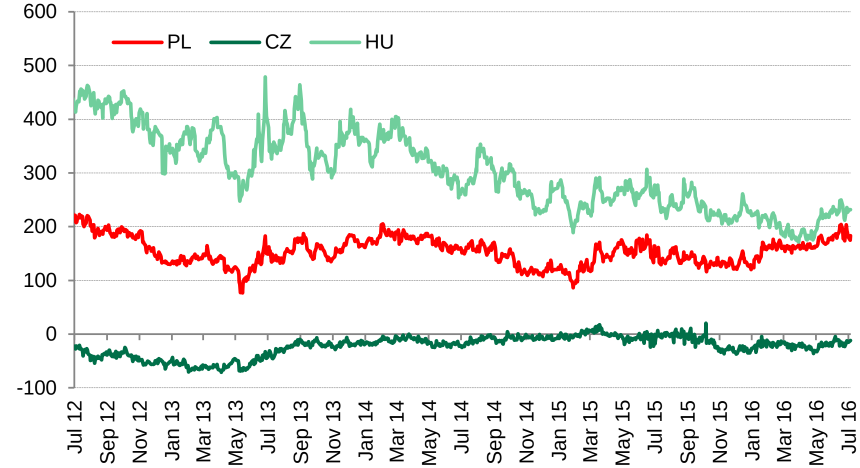
Source: Markit, Eurostat, central banks, Reuters, BZ WBK, EC.

5. Poland vs Other Countries (cont.)

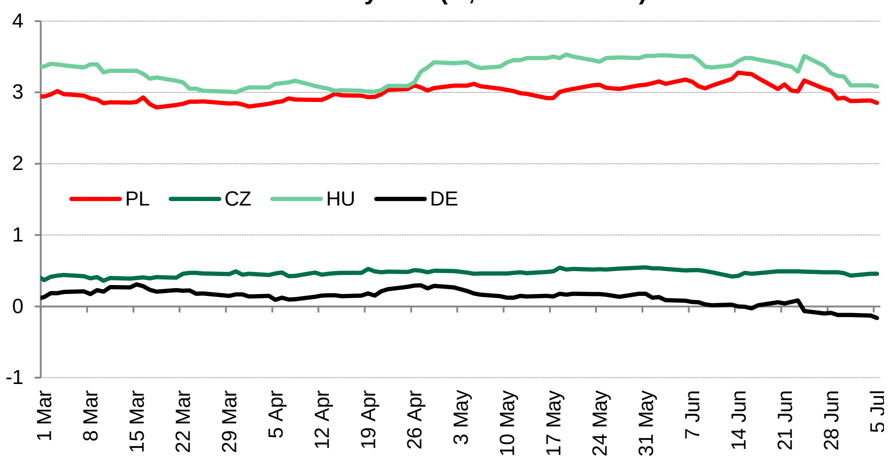
IRS 5Y (%)



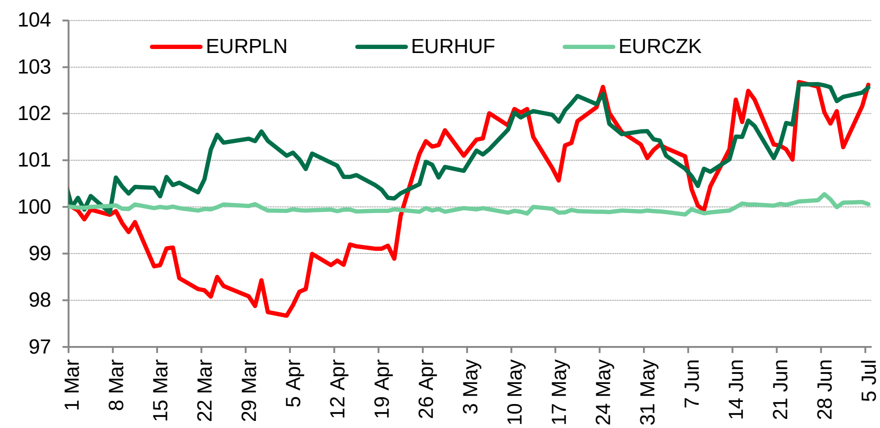
5x5 forward (spread vs EUR, bps)



10Y bond yields (%, last 4 months)



Zloty and CEE currencies (last 4 months)



Source: Reuters, BZ WBK.

6. Central Bank Watch

		Last	2015	2016E	Expected changes (bp) 1M	3M	6M	Comments
Euro zone	Forecast	0.00	0.05	0.00				The uncertainty introduced by the UK's voting to leave the EU reinforces that the ECB may take additional steps to support economic growth and to push inflation rate higher. Further ECB intervention is likely to concentrate on longer –term assets. The July ECB meeting might bring more light about how Brexit influences economic activity in Europe, in particular the euro zone countries and monetary policy guidance.
	Market implied »				-4	-7	-10	
UK	Forecast	0.50	0.50	0.25				Political development have dominated following Brexit vote. The UK GDP growth now seen falling in both 2016-2017. Mr. Carney, the BoE governor, signals easing of monetary policy. Therefore, we changed our monetary policy outlook for 2016 and now we expect a 25bp cut as soon as August. We also do not exclude some changes in QE programme prepared by BoE.
	Market implied »				-13	-20	-22	
US	Forecast	0.25-0.50	0.25-0.50	0.75				The dovish tone in the latest FOMC together with the uncertainty in the global economy and financial markets following the UK's vote will make Fed very cautious about removing its monetary policy accommodation, despite the healthy US economy. Therefore we think that FOMC will probably delay the next hike at least until December 2016.
	Market implied »				47	66	92	
Poland	Forecast	1.50	1.50	1.50				The Polish MPC kept interest rates on hold in July and maintained a 'wait and see' approach. The Council expects GDP growth to accelerate in coming quarters and if this assumption fails to materialise (as we expect), the chances for interest rate cuts will grow, in our view.
	Market implied »				-1	-6	-15	
Czech Republic	Forecast	0.05	0.05	0.05				As expected, the Czech National Bank (CNB) left its rates on hold (2W repo rate at 0.05%) and confirmed the exchange rate commitment. The CNB still expects the timing of the exit to be close to the halfway point of 2017. In our view, the CNB will wait for economic data to warrant such a move. The bank did not discuss the possibility of negative rates.
	Market implied »				-2	-6	-13	
Hungary	Forecast	0.90	1.35	0.90				The Monetary Policy Council (MPC) kept the 3M policy rate flat at 0.9% in June. The decision came as no surprise, as the MPC had indicated in May that the rate reduction cycle had ended and that the base interest rate should be sustained for a prolonged period. What is more, the tone of the statement remained rather cautious and refrained from revealing any explicit dovish bias.
	Market implied »				-4	-13	-21	

Source: Reuters, BZ WBK.

This analysis is based on information available through July 6, 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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