

MACROscope

Economic equinox

■ We know we have said it a million times already – the economic acceleration has reached the top and now we should switch to expansion phase, with some gradual slowdown. And yet, the 2Q GDP was no different from most of the readings from 2017/2018 in getting above market expectations. What is more, the 2Q growth breakdown showed that investments are still lagging behind the business cycle which means (to optimists) that when they finally do shoot higher the growth plateau of 5% y/y will be maintained for several more quarters. But there is an alternative way to read the surprisingly low investment path. Even the explanations from the Stats Office that military expenditures got reclassified, and there is nothing more to it, will not entirely remove our doubts that there is a split in the situation of enterprises that prevents a full-blown rebound of investments. Large enterprises have high profits, liquidity and are willing and able to invest (investment growth of 13% y/y reported for 2Q). But when it comes to SMEs, the labour cost pressure is denting margins, there are liquidity issues, payment delays and bankruptcies and this is not an environment that would encourage expansion plans through excessive investments. Meantime, in the public sector the local governments ahead of autumn elections are in investment boom phase.

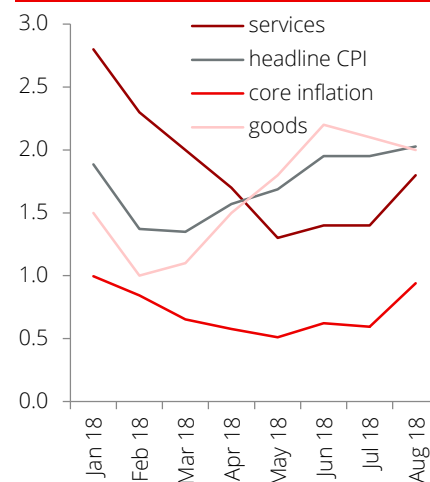
■ We do not think economic growth could push higher from where it stood in 2Q, and July/August declines in business sentiment indicators are not going to be corrected. It is a broader phenomenon, affecting the euro zone too, and it requires an increasing amount of optimism to still see Germany's deterioration in industry as something transitory, especially with the way trade wars are expanding.

■ Another area where we are at a point of a change of direction is the Polish inflation. August saw the first significant rebound of core CPI in this cycle, a long overdue rebound, given all the labour costs pressure coming from the tight labour market. Services prices have also just started to grow at a higher pace. It was easy for the Monetary Policy Council (MPC) to tolerate GDP growth rate above potential and the closed output gap, as long as core inflation remained very low and idle. Still, we are expecting the underlying inflation to climb in the months to come. The NBP projections have already shown that core inflation could be heading above 1% this year, to 2.5% (the target for headline CPI) by the end of 2019 and beyond in 2020, but if this projection materialised it would be more difficult for monetary policy makers to just ignore the process. Note however the headline CPI is unlikely to push higher in 2H18, due to base effects in food and fuel.

■ All the turmoil on emerging market currencies plus the protectionist rhetoric and actions across the globe do not feel like the environment that could strengthen the zloty. The positive side to this is that all this should already be priced-in and markets got fed up with Trump tariff announcements and trade negotiations. The zloty was also quite resilient to the TRY, BRL and ARS meltdown as well as to the sharp reaction of US Treasuries after the strong August NFP report. It might not be doomed after all.

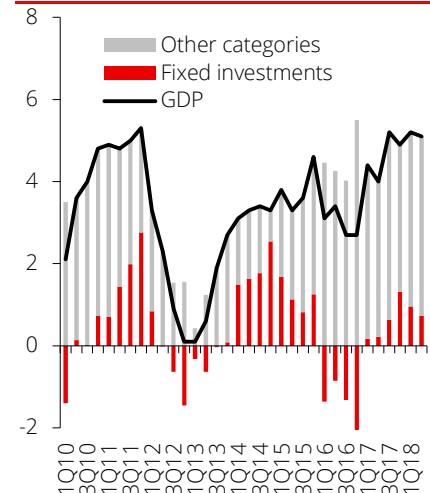
■ As regards Polish bonds, we think that upward pressure on yields may persist in the coming weeks. It would be caused by global factors (higher bond supply in core markets, negative EM sentiment) and domestic situation (higher expected issuances of POLGBs in next months and in 2019, plus bonds sell-off by some local asset management firms due to large redemptions). Still, we think that in the medium horizon the Polish market should remain relatively well protected from the EM turmoil due to solid economic fundamentals and lack of important vulnerabilities of the economy.

Inflation measures, % y/y



Source: GUS, Santander Bank Polska

Contribution of investment to GDP, % y/y



Source: GUS, Santander Bank Polska

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This report is based on information available until 14.09.2018.

Economic Update

Top performance in 1Q18, but slowdown ahead

GDP growth in 2Q18 amounted to 5.1% y/y in line with flash estimate and versus 5.2% y/y in 1Q18. Seasonally adjusted q/q growth reached 1%. Performance of the Polish economy remained impressive in 1H18, but we expect it to slow down in 2H18, given weaker economic data from Europe and geopolitical tensions, weighing on business sentiments. In our view, in 2018 the GDP will expand by 4.7%.

Puzzling investment

The structure of economic growth in 2Q was surprising, given that investment rose by a mere 4.5% y/y versus 8.1% y/y in 1Q18. Earlier information pointed to significant rebound of investments in big companies and in local governments in 2Q, which suggested that this category could come stronger, not weaker than expected.

Our estimate shows that local government secured virtually all of the investment growth in 2Q18, which means that the private sector, especially SMEs, may have still be witnessing stagnation or even declining investment. We can suspect some link to the difficult situation on the labour market and rising cost pressure. It is likely that bigger companies are dealing with these challenges more effectively. The data showing quickly growing number of firms' restructuring (mainly smaller companies) seem to support this hypothesis.

A milder interpretation could be offered, when taking into account the comment of Stats Office Director Maria Jeznach, that investment weakness was caused partly by accounting changes when it comes to military orders, while an improvement was seen after exclusion of that sector. However, detailed breakdown of investment reveals no major changes in "other machinery and equipment and weapons systems", with non-dwelling construction remaining the main driver of investment.

In our view, local governments will remain the main investing entity in 2H18, at least until the elections scheduled for October 21, 2018. In July, construction and assembly output rose by 18.7% y/y versus 24.7% y/y in June and 23.5% y/y on average in 1H18. As we have stated earlier, we are expecting construction to remain under pressure due to high capacity utilization. Thus, revival in private investment in machinery is essential to see a more pronounced rebound in total outlays.

Consumption running strong

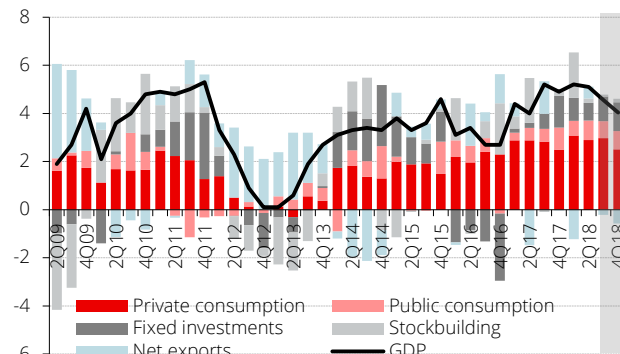
The private consumption did not surprise, rising 4.9% y/y, in line with our estimates, and stayed the main engine of economic growth. In the next quarters we do not expect a change of its trend. We believe that the household income will continue to grow fast, thanks to rapid wage growth. It should help maintain elevated pace of consumer spending.

Retail sales, our main proxy of consumer consumption, rose by 7.1% y/y in July, slightly below expectations. The monthly change in July retail sales (0.2% m/m in constant prices) clearly departs negatively from the seasonal pattern, but the fact is that the two previous months were unusually strong, so we would not draw strong conclusions from this slight disappointment. It is possible that consumer behaviour is still in a process of adjustment to Sunday retail trade ban, introduced earlier this year.

Export

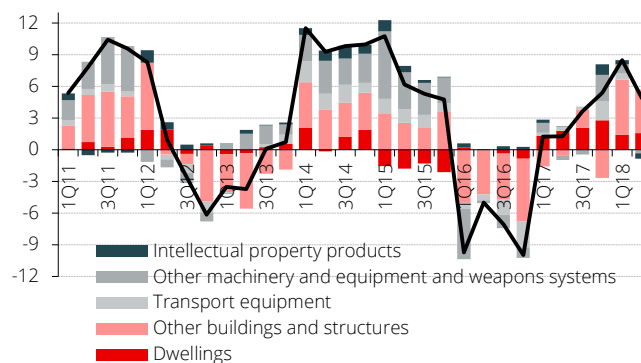
Net export added to the 2Q18 GDP growth 0.5pp, which was a big improvement compared to the negative impact of this category in 1Q18 (-1.2pp). In our opinion, in the next quarters the influence of this category on GDP growth will return to the negative territory, due to the fact that export growth will continue to be outpaced.

Contribution of demand components to GDP growth, % y/y



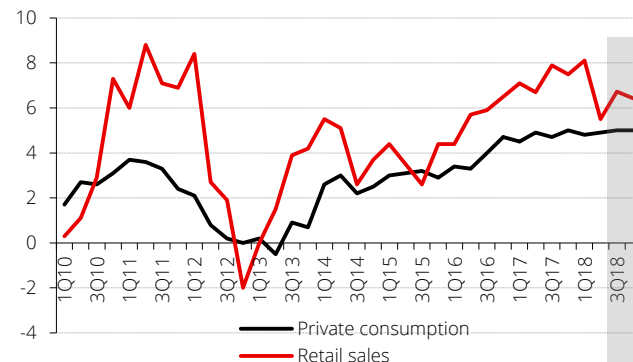
Source: GUS, Santander Bank Polska

Fixed investment growth - breakdown by assets, % y/y



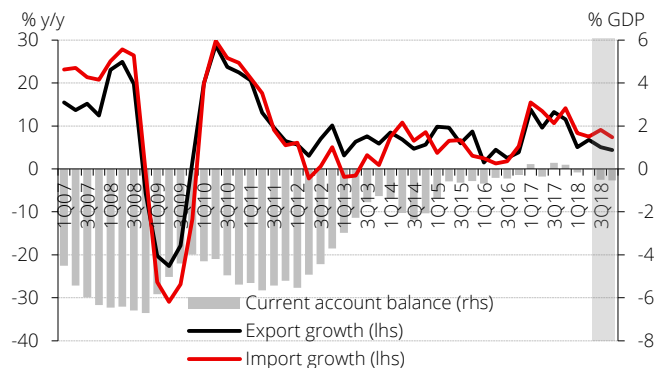
Source: Eurostat, Santander Bank Polska

Retail sales vs private consumption, % y/y



Source: GUS, Santander Bank Polska

Balance of payments data



Source: NBP, Santander Bank Polska

Economic Update

A new chapter for Polish inflation

Inflation was at 2% y/y in August, unchanged vs June and July. However, its breakdown changed markedly. Services prices rebounded from 1.4% to 1.8% y/y after their 1H18 descent from 2.8%. The earlier deceleration in services inflation occurred mostly due to a heavy drop in insurance prices, and this is now being reversed, with a 5.2% m/m rebound in August. Transport services also recorded a similar jump (5% m/m), with package holidays and telecommunications also getting more expensive (0.7% m/m and 0.4% m/m, respectively). On the other hand, financial services prices fell by 4.1% m/m, which was probably triggered by the obligation on banks to introduce a free-of-charge account into their offer.

Monthly change of fruit prices was in line with the seasonal pattern, despite downward pressure on the wholesale market due to high crops. On the other hand, vegetable prices fell less significantly than usually, by 4.6% m/m as compared to -10% m/m on average in 2010-2017. In our view, this is the effect of [the drought](#) and it should hold in the months to come, mitigating the negative effect of base effect in non-core categories on headline CPI.

In August, footwear and clothing prices were decreasing at a slower pace than we had assumed. It was a sign of a strong demand and a solid financial situation of households, which received the new government school kit benefit in August.

Background for core inflation

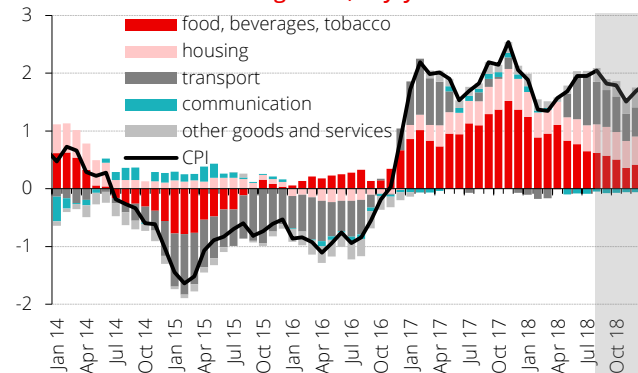
Core CPI accelerated to 0.9% y/y in August from 0.6% y/y. This is its first significant jump this year and the highest monthly acceleration of y/y growth in 4.5 years. In our view, this is the beginning of the upward trend that will take core inflation to 1.3% y/y at the end of 2018 and around 2.5% at the end of 2019. The labour shortages are one source of the pressure on CPI, via rising labour costs. Energy prices are another, as they may rise by c25% in one year and 70% in two years given rising prices of energy commodities and CO2 permissions (consumers may be shielded by the energy regulator so these factors will enter CPI indirectly). We also wonder if an increased rate of bankruptcies and firms' consolidation is not going to reduce the competition on some markets, also leading to a bit more inflationary environment. We also point out that the external environment is now becoming less disinflationary: the US core inflation (CPI Urban Consumers, NSA) rebounded to the highest level since 2008 while the September ECB projection assumes a rise of core inflation from 1.1% this year to 1.5% in 2019 and 1.8% in 2020.

Despite the expected upward trend in core inflation, Polish headline CPI might ease somewhat, to 1.7% y/y in December due to the base effect in food and fuel prices. We assume 2019 will see an upward push of both CPI and core inflation to 2.5% y/y, or even slightly above.

Labour demand and vacancies in 2Q

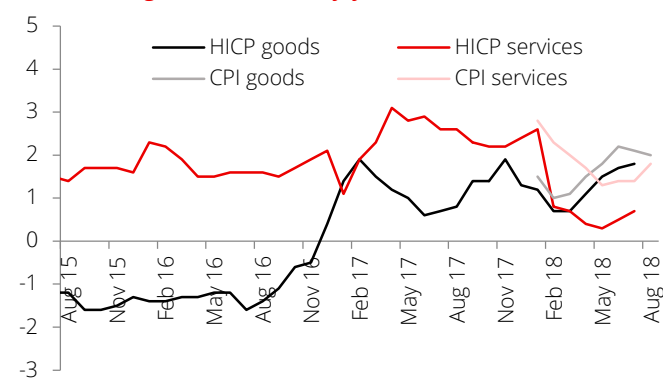
Labour demand in 2Q stabilised in y/y terms. Number of newly created jobs rose by only 1.7% y/y vs 14.4% in 1Q18 and 19.5% in 4Q17. Net job creation (number of newly created jobs less number of jobs liquidated) rose 4.8% y/y, while since mid-2016 the measure was growing by 15-42% (with an average of 28% y/y). At the same time, vacancy statistics show that the labour shortage is intensifying. In 2Q, as much as 25.3% out of all new jobs remained vacant. This is a sizeable increase vs 1Q (14.4%) and last three years (8-17%). This trend should support further acceleration of wages in the economy, albeit the August deterioration of business sentiment, if it were to last, may decrease labour demand with time.

Breakdown of annual CPI growth, % y/y



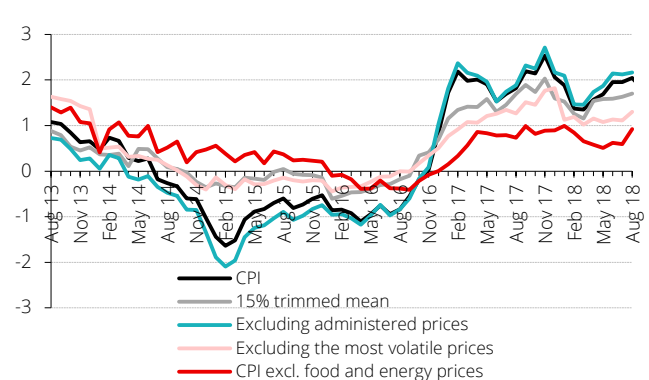
Source: GUS, Santander Bank Polska

Services and goods inflation, % y/y



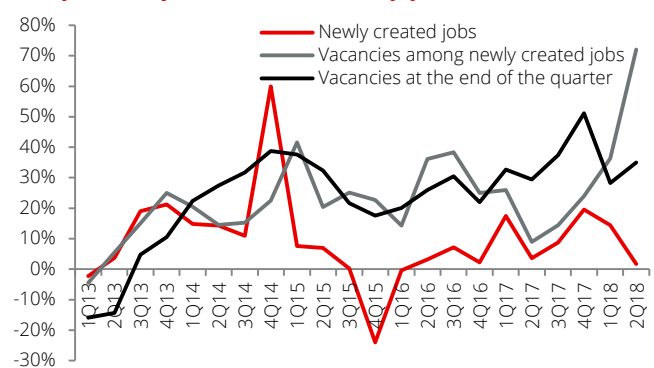
Source: Eurostat, GUS, Santander Bank Polska

Core inflation measures, % y/y



Source: GUS, NBP, Santander Bank Polska

Newly created jobs and vacancies, % y/y



Source: GUS, Santander Bank Polska

Special topic – Will Turkish crisis affect Poland?

Depreciation of the Turkish lira was the main topic for financial markets over the last few weeks. Negative development of Turkish assets was due to the rising risk of economic overheating, worries about the central bank independence as well as diplomatic conflict with the USA. Slowdown of the Turkish economy, which is currently widely expected on the financial market (Bloomberg consensus is expecting the Turkish economy to grow by 2.0% in 2019 versus 7.4% in 2017) as well as the probable sudden stop of foreign financing likely to affect other countries, which have economic ties with Turkey.

Trade links are not significant...

Polish-Turkish trade links have developed strongly over the last few years. In 1990s, these were almost non-existent. In 2017, Poland exported goods worth €2.9bn to Turkey and imported €2.1bn. Average growth rates of exports in 1999-2017 amounted to 21.1% y/y, while imports to 14.4% y/y. Polish exports were rising in every single year of that period but for 2013, when ban on ritual slaughter evaporated the Polish meat exports to Muslim countries.

Still, Turkey is not a top-echelon Polish trade partner with mere 1.4% share in exports and 1.0% share in imports. This trade exposure is similar to that of other EU countries and way lower than to Bulgaria and Greece, which are the most exposed countries as regards the trade link. It is worth noting that Poland's big trade partners like Germany, UK, Italy or France also do not record high exposure to Turkey, so our indirect links are also not so strong. The economic meltdown as well as depreciation of the Turkish lira are likely to undermine Polish exports to Turkey and may boost Polish imports from Turkey. In our view, however, this will not be a major drag for the Polish economy.

... but for a few sectors

Even though Poland's exposure is not high, there are a few sectors that could be affected, mostly those producing capital goods. Turkey is receiving as much as 6% of Polish exports in passenger cars (€410mn in 2017), 5.7% of power-generating machinery (€458mn) and 6.1% of telecommunications equipment (€212mn). Note that these three categories make up almost 40% of Polish exports to Turkey. Especially carmakers can be under pressure, given the risk of introduction of trade tariffs by the USA.

Polish imports from Turkey are concentrated on durable consumer goods, with a 6.3% share in household equipment (washing machines, dishwashers, refrigerators etc.) worth €123mn. Turkish products show a high presence on Polish market also in textiles (6.5%, €258mn) and fruit/vegetables (3.3%, €52.4mn), especially raisins, figs, grapefruits and nuts.

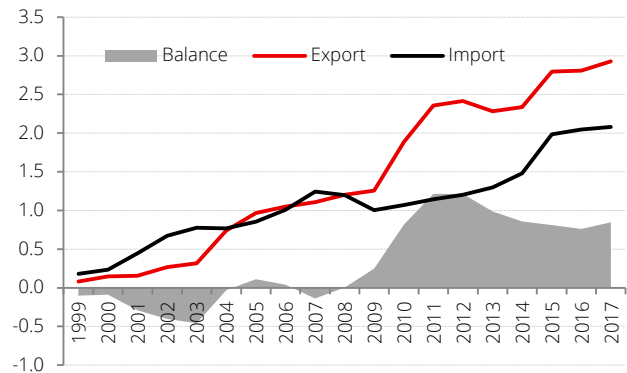
Not much connection between financial markets

Polish FDIs in Turkey amount to €271mn and Turkish in Poland to €77mn and both of those numbers are totally insignificant (<0.1% of totals, data for 2016). Polish investment funds held about PLN2.4bn in Turkish assets at the end of 2017, which makes up about 0.9% of total Polish investment fund assets. Exposure of Polish banking system to Turkish assets is negligible.

Poland much more immune to turmoil than other EMs

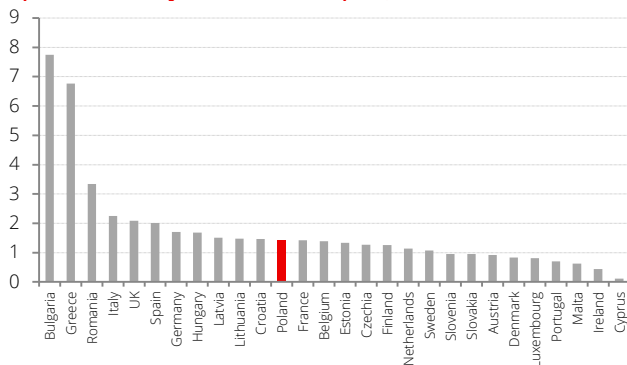
To sum up, neither the Polish economy nor its financial market are significantly exposed to Turkey. We also find reasons to believe that Poland is quite well protected against the sell-off affecting emerging markets recently. The current account deficit is very low and more than fully funded by the inflow of EU structural funds, which means that Poland is relatively resistant to a sudden stop in global money flows. The share of USD dominated debt is not high, so the country is not vulnerable to dollar appreciation and higher US rates. The banking sector is strong and well capitalized. This explains why the Polish market reaction to EM sell-off has been limited to date.

Poland-Turkey foreign trade, €bn



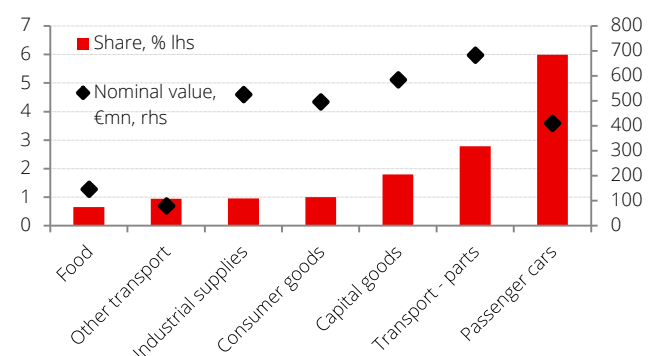
Source: Eurostat, Santander Bank Polska

Exports to Turkey as % of total export, 2017



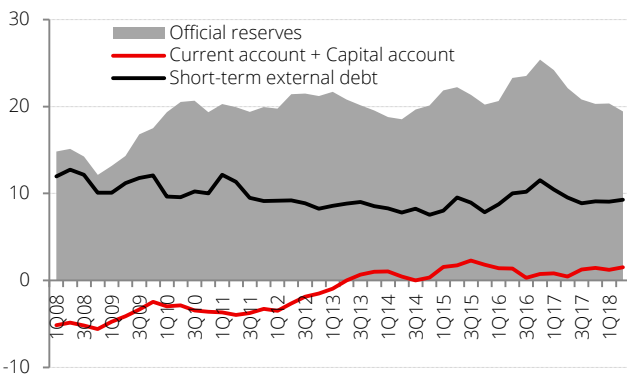
Source: Eurostat, Santander Bank Polska

Export to Turkey, main sectors



Source: Eurostat, Santander Bank Polska

External vulnerability of Polish economy, % GDP



Source: NBP, GUS, Santander Bank Polska

Monetary Policy Watch

Stable rates as the response high GDP-low CPI mix

The Monetary Policy Council (MPC) kept interest rates unchanged in September (main rate at 1.50%), as expected. Summer holiday break did not bring a revision of the Council's views. The statement was almost the same as in July, stressing that a continued positive economic situation in Poland and abroad still has no impact on the inflation. The concluding remarks in the statement still point to the Council's conviction that inflation will remain close to the target for long. The MPC sees economic outlook as positive despite some slowdown expected in the coming years. Thus the Council still thinks keeping rates stable is the optimal solution.

MPC puzzled with low investment

Interestingly, the MPC mentioned growing investment outlays in the public sector and in big companies and underlined these numbers contradict the data on total investment in 2Q18. According to the NBP president, he is planning to formally ask the stats office about the methodology of investment measurement.

Same good old dovish arguments

At the September MPC press conference, NBP Governor Adam Glapiński reiterated that Poland is an "oasis of stability". According to Glapiński, with no external shocks, rates could stay on hold until the end of 2019 or even in the first quarters of 2020. He also wondered if at that stage the ECB could resort to QE again to stimulate the economy - which would further delay interest rate hikes in Poland. On top of that, he said, the economic overheating or inflation overshooting the targets did not seem to be the major concern of those attending the BIS central bankers' meetings. What they worry about is the potential economic slowdown and the recurring risk of deflation. This was all the same dovish rhetoric the Governor made us used to.

There are two dissenters in the Council

The NBP Governor hinted that currently there are only two dissenters among MPC members, questioning the internal consensus, but that they are located at the opposite ends of the spectrum (that would be the hawkish Kamil Zubelewicz and the dovish Eryk Łon, in our view). Zubelewicz assumes, however, that with the current attitude inside the Council, the possibility of rate hikes will open up only once inflation is confirmed rising above the target, but he also suggested that motions to tighten the policy may appear sooner - when the risk of CPI overshoot in 1.5-2 years grows significantly).

To sum up, the September MPC statement and press conference did not change our understanding of the Council's attitude and plans. We still assume that rates will stay unchanged at least until November 2019. In our view, decision to hike rates will require solid macro conditions and economic outlook as well as ECB making the move first.

Policy guidelines unchanged

NBP released a draft of its monetary policy guidelines for 2019. The document does not include any meaningful changes compared to the previous years; the inflation target is to stay at 2.5% y/y. Dovish MPC member Eryk Łon postulated recently to input a passage allowing use of unconventional measures - which could be read as preparations for further easing - but apparently he did not build a majority around this idea.

Excerpts from the MPC's official statement after its September meeting

Global economic conditions remain favourable. In the euro area, economic situation continues to be favourable, despite slightly slower GDP growth than in 2017. In the United States, economic growth is higher than in the previous year, which confirms that economic conditions in this country are strong. In China, economic activity growth has continued at a stable pace for the past few quarters.

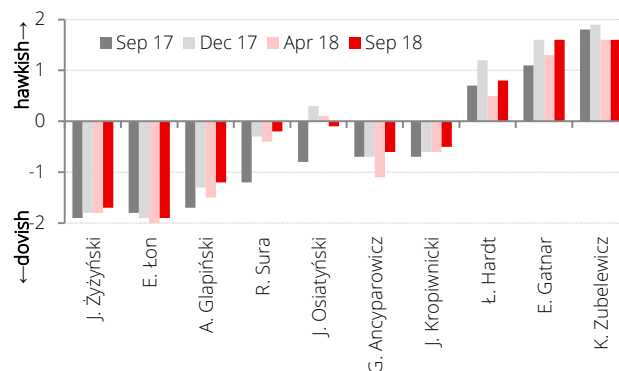
Despite favourable global economic conditions, inflation abroad remains moderate. At the same time, an increase in oil prices in the recent months has driven up inflation indices in many countries.

In Poland, the 2018 Q2 GDP data point to high economic growth. It is driven by rising consumption, fuelled by increasing employment and wages, disbursement of benefits and very strong consumer sentiment. This is accompanied by a rise in investment, both in the public sector and among big enterprises. In 2018 Q2, exports picked up markedly, leading to a positive contribution of net exports to GDP growth.

Notwithstanding high economic growth and wages rising faster than in the previous year, consumer price growth remains moderate. The slightly higher annual CPI rate than in 2018 Q1 reflects mainly the growth in fuel prices. At the same time, inflation net of food and energy prices continues to be low.

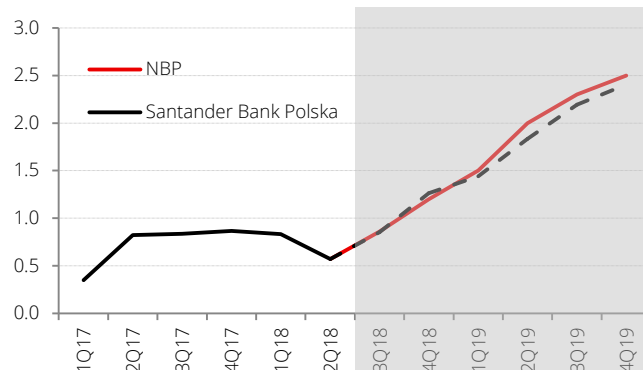
In the Council's assessment, current information point to a favourable outlook for economic growth in Poland, despite the expected slowdown in GDP growth in the coming years. In line with the available forecasts, inflation will remain close to the target in the monetary policy transmission horizon. As a result, the Council judges that the current level of interest rates is conducive to keeping the Polish economy on a sustainable growth path and maintaining macroeconomic stability

MPC members stance - results of PAP surveys



Source: PAP, Santander Bank Polska

Core inflation forecasts - NBP vs Santander Bank Polska, % y/y



Source: NBP, Santander Bank Polska

Fiscal Policy Watch

Relatively tight pre-election budget

According to government-approved draft budget for 2019, the state budget deficit will reach PLN28.5bn, making it one of the smallest deficits planned since 2009. The general government deficit is assumed at 1.8% of GDP, similar level to what we expect for 2018 and vs 1.7% in 2017.

Macroeconomic assumptions do not raise major concerns, with main variables, GDP and CPI, close to consensus, and safe enough from the budget planning perspective. Wage growth can be significantly higher than assumed, in our view, due to growing labour shortage. Taken together, the macroeconomic assumptions imply a chance of a higher tax base, creating a safety margin for planned budget revenues.

On the other hand, getting as high VAT revenues as the government had assumed for 2019 would require maintaining the effective tax rate at a level close to the local maximum from the mid-2018. Historical data point to a strongly cyclical behaviour of the rate and we expect a GDP slowdown. The decline of effective VAT rate might be prevented by a further reduction of the tax gap, which is what the government plans for 2019. It hopes to get PLN7.5bn of additional revenues – more than a half of total planned increase of VAT inflows, which is an ambitious goal, but new measures will be introduced.

Despite 2019 being the election year and the need to finance new cost items, planned spending growth is moderate (6.2% above expected 2018 spending and 4.6% above the initial 2018 budget plan), due to the limit imposed by the stabilising expenditure rule. The rise of “inelastic” spending items and those pre-set by other regulations consumes a big enough part of the rule-based quota, so there is very little room for any pre-election gifts. It is quite likely that during the parliamentary work on the budget there will be strong pressure to increase spending (e.g. by more generous wage hikes in the public sector). Apart from the rule-based limit, the parliament cannot increase the deficit above the limit set by the government, so any proposals to boost spending must be accompanied by indication of the source of extra revenues. However, if the political will to increase expenditures proves strong enough, one could imagine a sudden rise in optimism regarding the assumed effects of further tax gap reduction in 2019.

The fact that the election year fiscal deficit was planned at one of the lowest levels in history reduces the worries about a turn towards excessive fiscal expansion. On the other hand, bear in mind that the good fiscal performance in recent years was largely a result of exceptionally positive economic environment, while the structural GG balance of Poland is still one of the worst in the EU, and will remain so in 2019. More on 2019 budget in our [Economic Comment](#).

2018 budget goes into deficit

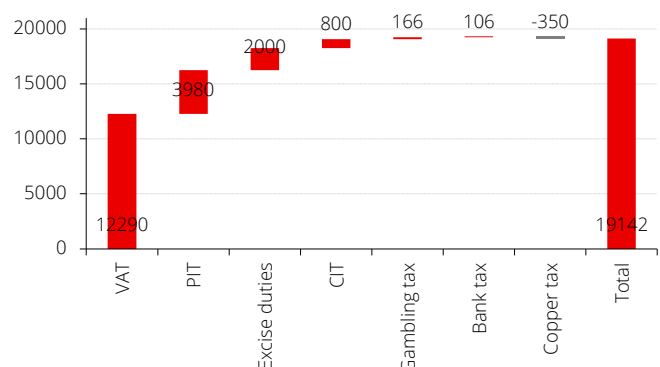
After July, the central budget recorded deficit for the first time this year in year-to-date terms: -PLN0.9bn vs +PLN9.5bn after June. The growth of tax income fell from 13.3% y/y in June to 0.8% in July mainly due to lower inflows from VAT. Expenditure rose strongly: only in July the expenses amounted to PLN40.5bn, i.e. PLN12.5bn more than in June. Higher expenses resulted from debt servicing costs, which grew by PLN11.7bn m/m (debt redemptions plus possibly some swap operations to shift the costs in time; this was a one-off jump of these costs). The MinFin officials suggested that in 2H18 the spending growth should accelerate due to the “unlocking” of big investment projects, which could see budget deficit growing relatively fast now. We also know from the media that tax authorities were told to front-load VAT returns in August to support firms’ liquidity and investments. To sum up, it is likely that full-year budget deficit could settle at PLN23.8bn mentioned in the 2019 budget draft. However, we have to closely follow the indirect taxes growth in the months to come.

Main parameters of 2019 budget (PLN bn)

	2018 plan (1)	2018 EO (2)	2019 plan (3)	change (3) / (2)
Total revenues	355.717	367.436	386.915	5.3%
Tax revenues	331.673	340.589	359.731	5.6%
VAT	166.000	167.310	179.600	7.3%
CIT	32.400	34.000	34.800	2.4%
PIT	55.500	60.320	64.300	6.6%
Excise	70.000	71.000	73.000	2.8%
Bank tax	4.569	4.445	4.551	2.4%
Non-tax revenues	21.923	24.739	24.987	1.0%
Total expenditures	397.209	391.197	415.415	6.2%
Balance	-41.492	-23.761	-28.500	19.9%

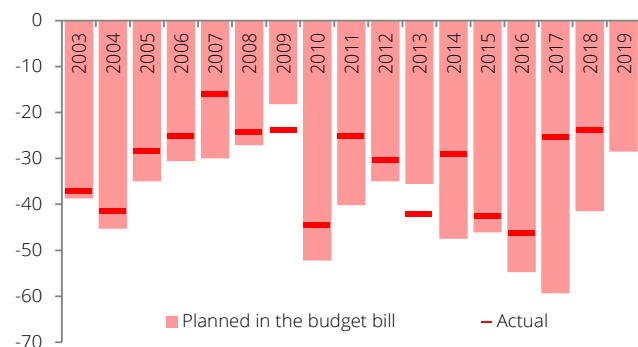
Source: Finance Ministry, Santander Bank Polska

Assumed rise in tax revenues: 2019 versus expected 2018 result



Source: Finance Ministry, Santander Bank Polska

Central budget balance, PLNbn



Source: Finance Ministry, Santander Bank Polska

Coverage of financing needs, PLNbn

	2018 plan (1)	2018 E (2)	2019 plan (3)	change PLN bn (3) - (2)	change % (3) / (2)
Net borrowing needs	63.32	39.71	45.99	6.28	15.8%
Financing of borrowing needs:					
Domestic, including	57.92	37.58	57.05	19.47	51.81%
- T-bonds	57.92	35.27	57.05	21.78	61.81%
- T-bills	-	-	-	-	-
- other	0.0	2.310	0.0	-2.31	-100.0%
Foreign financing	5.41	2.14	-11.06	-13.20	-642.1%
- T-bonds	-1.79	-3.28	-5.57	-2.29	-

Source: Finance Ministry, Santander Bank Polska

Interest Rate Market

Yields on the rollcaster

Over the summer, the core markets saw the short end of yield curves rise. The drop in prices of short-maturity bonds was a consequence of market players adjusting to the import tax imposed by the US (after the first shock which led to the fall of yields) as well as gradually decreasing market sensibility to the negative signals from Turkey and Argentina. Furthermore, the shorter yields were rising in response to strong data from the US labour market as well as the announcement of a higher supply of US Treasuries until the end of the year.

In July, the yields on the domestic bonds market were decreasing. This move was driven by bond redemptions and the low level of bonds supply (lower than the outstanding amount of maturing PS0718 bonds). In August yields started to increase, mainly in the 5-10Y segment. The yields surge was driven by domestic factors. Most of the yields increases were determined by sovereign bonds sell-off plus by some local asset management firms due to large redemptions. However, the yields increases were not so big due to the low level of bonds supply on the regular auctions (cPLN11bn in 3Q18 vs. cPLN11.8bn redemptions), as well as the signals that the bonds supply until the end of the year will be lower than Ministry of Finance had informed previously. As a result, over the last two month the domestic curve was shifted up by 5bp on the long end, and by 2bp in the 2-5Y segment. At the same time, Polonia rate slid by c10bp while the long position of the banking sector in the NBP bills decreased by cPLN11bn.

Bonds may remain under little pressure

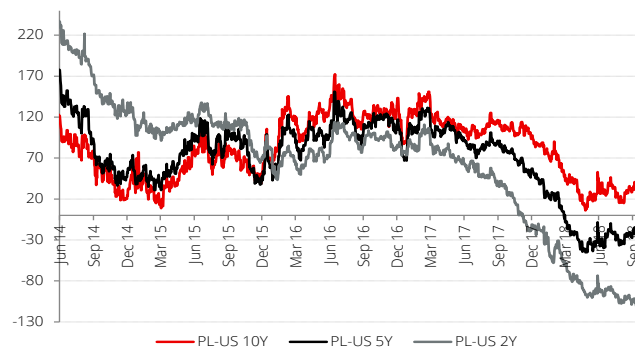
In the next 4-5 weeks we expect the upward yield pressure to maintain. The upward move will be supported by the global mood. Some negative shock will be generated by FOMC decision (26 September), where market priced the interest rates hike. In the longer perspectives the market will be shadowed by higher US treasuries supply in 3Q18 (if the debt ceiling is raised), German bonds (net supply) and in Poland (net supply). On the domestic market we expect PLN21bn on the regular auction vs. cPLN11bn in 3Q18. In addition, in our opinion, the market volatility may be increased by further turbulences of domestic asset management companies and resulting changes in their bonds portfolio.

Furthermore, the market will be under the pressures of the announcement of a higher debt supply in the next year. In 2019 the Ministry of Finance plans to increase domestic financing to the detriment of foreign financing (the criterion of the issue currency). It will translate into higher emissions on the domestic wholesale market. According to the Ministry of Finance, the net debt supply is planned at PLN57.1bn, compared with the estimated actual of PLN35.3bn for this year (gross borrowing needs are planned at the similar level to 2018, PLN 163.71 bn, vs. PLN 159.5 this year). Nevertheless, we believe that yields in the perspective of early October will not increase by more than 5-10bp in the 5-10Y segment and will stabilise in the 2Y segment. Stronger yields growths will be limited by the weaker domestic macro data release (for August). We expect a decline in industrial output dynamics to 5.3% y/y (from 10.3% in July), and retail sales to 6.5% y/y (from 7.1% y/y). On top of that, the stronger yields increase will be limited by the rhetoric of European central banks, which are not in a hurry to declare rate hikes (ECB) or do not see enough room for raising interest rates (NBP).

Switch auction

There is only one switch auction scheduled for September (at 20). At that auction the Ministry of Finance is going to offer OK0720, PS0123, WZ0524, WS0428 and WZ0528 in return for OK1018 (outstanding amount: PLN11.9bn), WZ0119 (PLN13.7bn) and OK0419 (PLN19.8bn). The Ministry is considering canceling this auction.

Spreads between Polish and US bonds



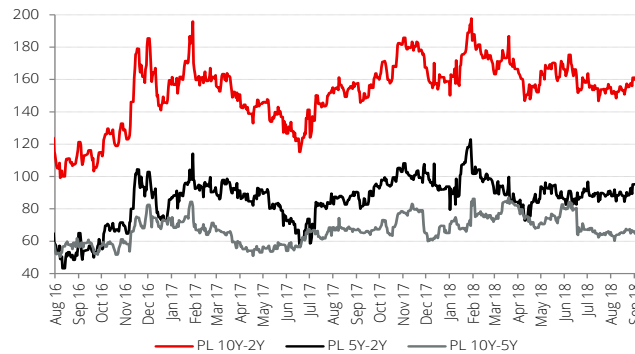
Source: Finance Ministry, Santander Bank Polska

Spreads between Polish and German bonds



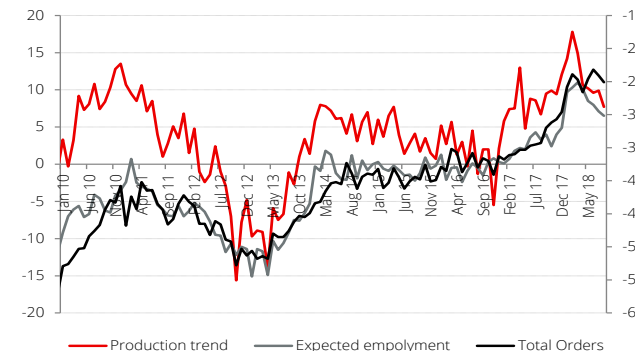
Source: Finance Ministry, Santander Bank Polska

Bond curves slope



Source: Finance Ministry, Santander Bank Polska

Poland ESI-manufacturing



Source: Finance Ministry, Santander Bank Polska

Foreign Exchange Market

Calm summer on the Polish FX market

Summer months have been pretty calm on the Polish FX market and we saw zloty performing better than in the previous years during this statistically negative period. In July, the Polish currency was gaining vs the euro, dollar, franc and pound as the European stock indexes were on the rise amid decent macro data. However, in August the sentiment on the emerging markets deteriorated as the tensions between the US and Turkey intensified sending the lira to its all-time low. High risk aversion pushed EURPLN to 4.34 from 4.24. Nevertheless, August rise of 0.79% was below the average increase of 1.4% in the previous 13 years.

Ruble underperforms, koruna backed by rate hike

Over the last two months, USD/RUB skyrocketed above 70 from c62 in response to the tensions between the US and Russia (risk that more sanctions could be imposed), temporary stronger dollar and cheaper oil. Also, the Russian politicians are questioning the central bank intention of hiking rates which might take some support from off the ruble.

The Czech koruna gained thanks to the 25bp rate hikes delivered by the central bank in August (taking the main rate to 1.25%) and a suggestion that the next one may happen as soon as in September. As a result, EURCZK fell to 25.55 from 26.1.

On the political front, in early July, PM Andrej Babis' minority government won a confidence vote in the Czech parliament. His ANO party and the Social Democrats hold 93 seats in the 200-seat parliament and will rely on support from the communists. During the pre-election campaign, ANO said it would raise pensions and wages in the public sector and reduce VAT. Czechia ended 2017 with debt/GDP ratio of 1.6% and public debt/GDP of 34.6%, so there seems to be little risk that generous fiscal policy will generate any serious tension in the market.

In mid-September, the Turkish central bank hiked rates to 24% from 17.75% in response to the lira depreciation and inflation running at c18% y/y. The bank said more hikes are likely if needed staying in the opposition to the political pressure to ease monetary policy.

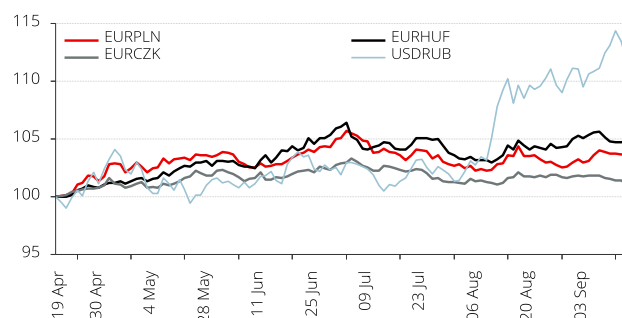
Zloty may stay stable in the short term

We think there is still some little room for the Polish currency to gain in the remainder of the year. Internal environment should be at least neutral (with economic data showing only gradual slowdown) while external could provide some support. In the short term, however, room for lower EURPLN looks to be limited.

All the turmoil on emerging market currencies plus the protectionist rhetoric do not feel like the environment that could strengthen the zloty. The positive side to this is that all this should already be priced-in. The zloty was quite resilient to the Turkish lira, Brazilian real and Argentina peso meltdown as well as to the sharp reaction of US Treasuries after the strong August NFP report.

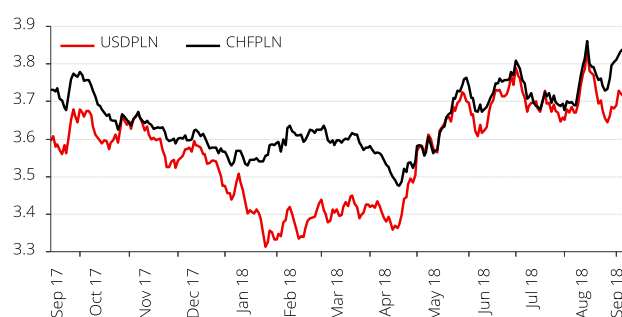
In September, the FOMC is expected to hike rates third time this year and the updated forecasts will be published. We do not expect any negative pressure to be generated on the zloty from the dollar front. In June, the FOMC said that total four rate hikes might be delivered this year and this scenario is already priced in the market. We do not think that any material changes in this regard after the updated forecasts will be released at the September meeting. At the same time, the ECB has just confirmed that the bond purchases will cease later this year which boosted the euro. We still expect EURUSD to move higher in the months to come which should generate a downside pressure on EURPLN, should the correlation between these exchange rates hold.

CEE currencies (April 17 = 100)



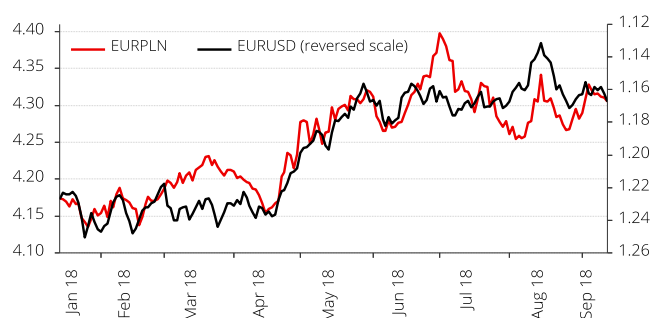
Source: Thomson Reuters Datastream, Santander Bank Polska

USDPLN and CHFPLN



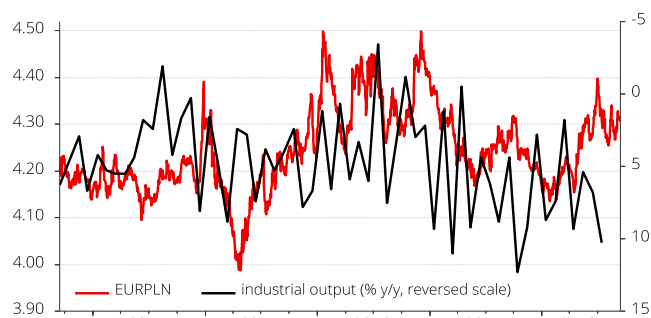
Source: Thomson Reuters Datastream, Santander Bank Polska

EURPLN and EURUSD



Source: Thomson Reuters Datastream, Santander Bank Polska

EURPLN and Poland industrial output



Source: Thomson Reuters Datastream, Santander Bank Polska

Economic Calendar

MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY
17 September EZ: CPI (Aug)	18 PL: Employment in corporate sector (Aug) PL: Wages in corporate sector (Aug) HU: Central bank decision	19 PL: Industrial output (Aug) PL: Construction and assembly output (Aug) PL: PPI (Aug) US: House starts (Aug)	20 US: Philly Fed index (Sep) US: Home sales (Aug)	21 DE: Flash PMI – manufacturing (Sep) DE: Flash PMI – services (Sep) EZ: Flash PMI – manufacturing (Sep) EZ: Flash PMI – services (Sep) PL: Retail sales (Aug)
24 PL: Money supply (Aug) DE: IFO (Sep)	25 PL: Unemployment rate (Apr) US: Conference Board (Sep)	26 CZ: Central bank decision US: New home sales (Aug) US: FOMC decision	27 EZ: ESI (Sep) DE: HICP (Sep) US: Durable goods orders (Aug) US: GDP (Q2)	28 EZ: Flash HICP (Sep) US: Personal spending (Aug) US: Personal income (Aug) US: PCE (Aug) US: Michigan index (Sep)
1 October PL: PMI – manufacturing (Sep) DE: PMI – manufacturing (Sep) EZ: PMI – manufacturing (Sep) PL: Flash CPI (Sep) US: ISM – manufacturing (Sep)	2 CZ: GDP (Q2)	3 PL: MPC decision DE: PMI – services (Sep) EZ: PMI – services (Sep) US: ADP report (Sep) US: ISM – services (Sep)	4	5 DE: Industrial orders (Aug) HU: Industrial output (Aug) US: Non-farm payrolls (Sep) US: Unemployment rate (Sep)
8 CH: PMI – services (Sep) DE: Industrial output (Aug) CZ: Industrial output (Aug)	9 DE: Exports (Aug) CZ: CPI (Sep) HU: CPI (Sep)	10 DE: PMI – services (Jun) EZ: PMI – services (Jun)	11 US: CPI (Sep)	12 EZ: Industrial output (Aug) DE: CPI (Sep) US: Michigan index (Sep) PL: Rating review by S&P
15 PL: CPI PL: Balance of payments US: Retail sales	16 PL: Employment in corporate sector (Sep) PL: Wages in corporate sector (Sep) DE: ZEW (Oct) HU: Central bank decision PL: Core CPI (Sep) US: Industrial output (Sep)	17 PL: Industrial output (Sep) PL: Construction and assembly output (Sep) PL: PPI (Sep) EZ: HICP (Sep) US: House starts (Sep)	18 US: Philly Fed index (Sep)	19 PL: Retail sales. (Sep) US: Home sales (Sep)

Source: GUS, NBP, Ministerstwo Finansów, Bloomberg

Calendar of MPC meetings and data releases for 2018

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
ECB decision	25	-	8	26	-	0	26	-	13	25	-	13
MPC decision	10	7	7	11	16	-46	11	-	5	3	7	5
MPC minutes	-	22	29	27	-	-11	-	23	20	25	22	20
Flash GDP*	30	14	-	-	15	-16	-	14	-	-	14	-
GDP*	-	28	-	-	30	-12	-	31	-	-	30	-
CPI	15	15	15	12	11	-15	12	10	11	12	12	11
Core inflation	16	-	16	13	14	4	13	13	12	15	13	12
PPI	19	20	19	19	21	-4	18	20	19	17	20	19
Industrial output	19	20	19	19	21	0	18	20	19	17	20	19
Retail sales	19	20	20	20	22	0	19	21	20	18	21	20
Gross wages, employment	17	16	16	18	18	-7	17	17	18	16	19	18
Foreign trade	about 50 working days after reported period											
Balance of payments*	-	-	30									
Balance of payments	15	13	16	13								
Money supply	23	22	22	24								

* Quarterly data. a preliminary data for January. b January and February.

Source: GUS, NBP.

Economic data and forecasts for Poland

Monthly economic indicators

		Aug 17	Sep 17	Oct 17	Nov 17	Dec 17	Jan 18	Feb 18	Mar 18	Apr 18	May 18	Jun 18	Jul 18	Aug 18	Sep 18
PMI	pts	52.5	53.7	53.4	54.2	55.0	54.6	53.7	53.7	53.9	53.3	54.2	52.9	51.4	52.0
Industrial production	% y/y	8.8	4.4	12.3	9.2	2.8	8.7	7.3	1.6	9.3	5.2	6.7	10.3	5.2	1.6
Construction production	% y/y	23.6	15.3	20.2	19.9	12.8	34.7	31.3	16.1	19.7	20.7	24.7	18.7	19.0	13.8
Retail sales ^a	% y/y	7.6	8.6	8.0	10.2	6.0	8.2	7.9	9.2	4.6	7.6	10.3	9.3	8.5	8.4
Unemployment rate	%	7.0	6.8	6.6	6.5	6.6	6.9	6.8	6.6	6.3	6.1	5.9	5.9	5.8	5.8
Gross wages in corporate sector	% y/y	6.6	6.0	7.4	6.5	7.3	7.3	6.8	6.7	7.8	7.0	7.5	7.2	6.9	7.3
Employment in corporate sector	% y/y	4.6	4.5	4.4	4.5	4.6	3.8	3.7	3.7	3.7	3.7	3.7	3.5	3.4	3.4
Exports (€)	% y/y	13.4	11.5	15.8	15.5	2.6	12.1	5.9	-1.6	8.9	2.7	9.0	9.8	5.0	1.0
Imports (€)	% y/y	8.7	8.9	15.4	15.9	10.9	16.7	8.1	1.4	11.1	1.5	10.2	11.6	9.4	6.6
Trade balance	EUR mn	288	479	284	208	-1,175	-164	-520	-205	176.0	119.0	-413.0	-432.0	-386	-460
Current account balance	EUR mn	311	218	206	54	-847	1,955	-782	-785	-90.0	169.0	-240.0	-809.0	-502	-767
Current account balance	% GDP	0.0	0.3	0.3	0.3	0.2	0.0	-0.1	-0.2	-0.3	-0.2	0.0	-0.1	-0.3	-0.5
Budget balance (cumulative)	PLN bn	4.9	3.8	2.7	-2.4	-25.4	8.6	4.5	3.1	9.3	9.6	9.5	-0.9	-2.0	-3.0
Budget balance (cumulative)	% of FY plan	-8.2	-6.4	-4.5	4.1	42.7	-20.6	-10.8	-7.5	-22.5	-23.1	-23.0	2.1	4.8	7.1
CPI	% y/y	1.8	2.2	2.1	2.5	2.1	1.9	1.4	1.3	1.6	1.7	2.0	2.0	2.0	1.8
CPI excluding food and energy	% y/y	0.7	1.0	0.8	0.9	0.9	1.0	0.8	0.7	0.6	0.5	0.6	0.6	0.9	1.0
PPI	% y/y	3.0	3.2	3.0	1.8	0.3	0.2	-0.1	0.5	1.0	3.0	3.7	3.4	2.8	2.4
Broad money (M3)	% y/y	5.4	5.4	5.7	4.5	4.6	4.8	4.9	5.8	5.7	6.6	7.3	7.3	7.4	7.3
Deposits	% y/y	5.0	5.0	5.3	4.2	4.1	4.5	4.6	5.1	5.1	6.0	6.7	6.8	6.4	6.4
Loans	% y/y	5.0	5.1	4.7	3.7	3.6	4.0	4.2	4.3	3.9	5.5	5.6	5.6	6.2	6.2
EUR/PLN	PLN	4.26	4.27	4.26	4.23	4.20	4.16	4.16	4.21	4.19	4.28	4.30	4.33	4.29	4.29
USD/PLN	PLN	3.61	3.59	3.63	3.60	3.55	3.41	3.37	3.41	3.42	3.63	3.69	3.70	3.71	3.69
CHF/PLN	PLN	3.74	3.73	3.69	3.63	3.60	3.55	3.61	3.60	3.53	3.64	3.73	3.72	3.75	3.76
Reference rate ^b	%	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
3M WIBOR	%	1.73	1.73	1.73	1.73	1.72	1.72	1.72	1.71	1.70	1.70	1.70	1.70	1.70	1.70
Yield on 2-year T-bonds	%	1.80	1.73	1.71	1.60	1.69	1.62	1.73	1.56	1.52	1.57	1.60	1.63	1.61	1.55
Yield on 5-year T-bonds	%	2.67	2.61	2.69	2.62	2.64	2.63	2.73	2.46	2.33	2.49	2.48	2.52	2.50	2.51
Yield on 10-year T-bonds	%	3.35	3.27	3.39	3.40	3.29	3.34	3.51	3.27	3.08	3.23	3.23	3.18	3.15	3.19

Note: ^a in nominal terms, ^b at the end of the period.

Source: GUS, NBP, Finance Ministry, Santander Bank Polska estimates.

Quarterly and annual economic indicators

		2016	2017	2018E	2019E	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	3Q19	4Q19
GDP	PLN bn	1,858.5	1,982.1	2,090.3	2,206.9	485.4	503.1	516.2	585.6	509.7	532.2	545.4	619.7
GDP	% y/y	3.0	4.6	4.7	3.7	5.2	5.1	4.6	4.0	3.8	4.1	3.6	3.5
Domestic demand	% y/y	2.2	4.7	5.3	4.0	6.8	4.8	5.0	4.8	3.9	4.1	3.9	4.0
Private consumption	% y/y	3.9	4.8	4.9	4.5	4.8	4.9	5.0	5.0	4.8	4.6	4.4	4.2
Fixed investments	% y/y	-8.2	3.4	5.6	4.0	8.1	4.5	6.0	4.9	4.0	4.0	4.0	4.0
Industrial production	% y/y	2.9	6.5	5.1	3.7	5.5	7.0	5.5	2.4	2.8	3.1	5.0	3.9
Construction production	% y/y	-14.5	13.7	17.5	2.0	25.6	21.9	17.0	11.2	3.4	3.1	0.3	2.0
Retail sales ^a	% y/y	3.9	8.2	8.1	8.2	8.4	7.5	8.7	7.8	6.4	8.8	9.2	8.1
Unemployment rate ^b	%	8.2	6.6	5.9	5.5	6.6	5.9	5.8	5.9	5.9	5.4	5.3	5.5
Gross wages in the national economy ^a	% y/y	3.8	5.7	7.2	8.0	6.2	7.3	6.5	7.7	8.0	7.3	8.2	8.3
Employment in the national economy	% y/y	2.3	3.7	2.8	1.1	2.8	2.7	2.5	2.4	1.4	1.1	0.9	0.6
Exports (€)	% y/y	3.1	12.0	5.3	3.3	5.1	6.8	5.1	4.4	4.7	4.3	3.5	0.6
Imports (€)	% y/y	2.7	13.4	8.0	4.8	8.3	7.5	9.1	7.3	6.2	5.8	5.0	2.2
Trade balance	EUR mn	2,935	821	-4,510	-7,864	-888	-118	-1,278	-2,226	-1,725	-879	-2,122	-3,138
Current account balance	EUR mn	-1,254	896	-2,627	-5,414	378	-161	-2,078	-766	-307	-778	-2,797	-1,533
Current account balance	% GDP	-0.3	0.2	-0.5	-1.1	-0.2	0.0	-0.5	-0.5	-0.7	-0.8	-0.9	-1.1
General government balance	% GDP	-2.3	-1.7	-1.7	-1.8	-	-	-	-	-	-	-	-
CPI	% y/y	-0.6	2.0	1.7	2.3	1.5	1.7	1.9	1.7	2.1	2.4	2.4	2.5
CPI ^b	% y/y	0.8	2.1	1.7	2.5	1.3	2.0	1.8	1.7	2.4	2.5	2.3	2.5
CPI excluding food and energy	% y/y	-0.2	0.7	0.9	2.0	0.8	0.6	0.9	1.3	1.4	1.8	2.2	2.4
PPI	% y/y	-0.2	2.9	2.0	2.5	0.2	2.6	2.9	2.3	2.7	1.9	2.3	3.2
Broad money (M3) ^b	% y/y	9.6	4.6	7.1	7.4	5.8	7.3	7.9	7.1	7.2	7.2	7.3	7.4
Deposits ^b	% y/y	9.1	4.1	7.0	7.4	5.1	6.7	7.4	7.0	7.1	7.2	7.3	7.4
Loans ^b	% y/y	4.7	3.6	7.9	6.5	4.3	5.6	6.6	7.9	7.6	7.2	6.8	6.5
EUR/PLN	PLN	4.36	4.26	4.25	4.29	4.18	4.26	4.30	4.26	4.27	4.29	4.30	4.31
USD/PLN	PLN	3.95	3.78	3.57	3.46	3.40	3.58	3.70	3.61	3.50	3.47	3.45	3.44
CHF/PLN	PLN	4.00	3.84	3.65	3.48	3.59	3.63	3.75	3.64	3.50	3.49	3.47	3.45
Reference rate ^b	%	1.50	1.50	1.50	1.75	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.75
3M WIBOR	%	1.70	1.73	1.70	1.76	1.72	1.70	1.70	1.70	1.70	1.70	1.72	1.91
Yield on 2-year T-bonds	%	1.66	1.89	1.60	1.71	1.64	1.57	1.60	1.59	1.56	1.61	1.79	1.89
Yield on 5-year T-bonds	%	2.37	2.78	2.52	2.55	2.61	2.43	2.51	2.53	2.59	2.60	2.50	2.52
Yield on 10-year T-bonds	%	3.05	3.44	3.24	3.40	3.37	3.18	3.17	3.24	3.31	3.39	3.43	3.46

Note: ^a in nominal terms, ^b at the end of period. Source: GUS, NBP, Finance Ministry, Santander Bank Polska estimates.

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