



TOP NEWS FROM THE POLISH MARKET

MACROECONOMICS

- Unemployment rate dropped to 14.9% in October
 - ULC rose by ca. 3.5% y/y in Q3, most likely exceeded 5% y/y excl. agriculture
 - Industry output rose by 14.6% y/y (12.5% after seasonal adjustment) in October. PPI dropped to 3.4% y/y in October
 - Retail sales in October at 13.3% y/y
 - Business indicator in manufacturing dropped in November by 1 pt
 - Outstanding financial results of enterprises in Q3. Net result in I-IX amounted to 51 bn PLN
 - Three core inflation measures dropped in October, two others remained unchanged. Net inflation fell to 1.3%
 - H. Wasilewska-Trenkner: inflationary pressure to rise by 2008
 - S. Nieckarz: outlook evaluation after Q1 2007
 - A. Sławiński: it is wrong to assume that no monetary policy adjustment will be made
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- Pay 9x12

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MACROECONOMICS

Unemployment rate dropped to 14.9% in October

The unemployment rate dropped to 14.9% in October. As in previous months the drop in the number of the unemployed was higher than in previous years. We think the unemployment rate may decrease yet again in November to 14.7%. Pure seasonality would imply stabilization of the rate, though we think that favourable weather conditions and the reluctance to lay off staff despite lower current orders (for the fear that problems will arise in spring with finding replacements). The seasonal rise in winter will be weaker than usual, the unemployment rate will peak at ca. 15.4 in February. Next year however the pace of drops may be lower; in 2-3 quarters time wage pressure may rise due to problems with finding skilled staff.

ULC rose by ca. 3.5% y/y in Q3, most likely exceeded 5% y/y excl. agriculture

After the Q3 BAEL data was published it became possible to calculate preliminary ULC in Q3. Assuming the value added growth in Q3 to be at 5.5% y/y (the data on that will be published on November 30th), in the whole economy the ULC rise rose by 3.0% y/y (3.2% y/y in Q2. The MPC however also looks at the ULC in the economy excl. individual agriculture. We are still waiting for the agricultural employment data, but making some preliminary assumptions on that, the rise probably exceeded 5% (4.5% in Q2, around 4% in previous quarters). In particular the latter indicator should be considered important, the MPC may point to that risk in the coming months.

Industry output rose by 14.6% y/y (12.5% after seasonal adjustment) in October

Industry output in October rose by 14.6% y/y (4.6% m/m). It was higher than market expectations, but it must be noted that the number of working days was higher this year – after seasonal adjustment the rise was smaller (12.5% y/y compared to 13.8% y/y in September). In our opinion the forthcoming months may bring a further drop in the seasonally adjusted dynamics, which should stabilize at around 10-11% y/y. This however hardly indicates economic slowdown. Construction output rose by 28.6% y/y, and we expect the high rises to be maintained.

PPI dropped to 3.4% y/y in October

PPI dropped by 0.3% m/m and rose by 3.4% y/y. The drop is attributable to lower mining and fuel prices, in other categories the changes did not exceed 1% m/m. With copper prices falling in November and fuel prices roughly stable we expect the PPI to drop to ca. 3% in November, but in December a rise to 3.5% may take place.

Retail sales in October at 13.3% y/y

Retail sales in current prices increased in October by 2.7% toward September and grew by 13.3% on the annual basis. This figure is worse than the market consensus (k=14.5%) and our forecast (15.2%). In constant prices retail sales rose by 13.9% which means deflation. The lower than expected retail sales result from lower sales of food and fuels. In other categories the annual growth rate of sales was higher than in September. The most significant improvement occurred in vehicles, where the annual dynamics were equal to 38.8% y/y.

Despite lower than expected retail sales growth the structure of data indicates strong domestic demand in Q4 which should result in GDP growth in Q4 at 5.0%.

Business indicator in manufacturing dropped in November by 1 pt

The business climate indicator for manufacturing published by GUS in November deteriorated to +16 from +15 pts in October. The fall of the indicator has been caused by seasonal factors and after seasonal adjustment the indicator improved by +1. The entrepreneurs assess the current and future order book slightly worse than in the previous month but they expect that the level of employment will remain unchanged.

In construction the business indicator dropped by 2 pts to +31 while in trade it remained unchanged. The business indicators stay in line with expectations and confirm the recovery in the Polish economy.

Outstanding financial results of enterprises in Q3. Net result in I-IX amounted to 51 bn PLN

Three core inflation measures dropped in October, two others remained unchanged

Net inflation fell to 1.3%

H. Wasilewska-Trenkner: inflationary pressure to rise by 2008

S. Nieckarz: outlook evaluation after Q1 2007

A. Sławiński: it is wrong to assume that no monetary policy adjustment will be made

We stick to our view: first hike may take place in April

PiS: NBP candidate to be announced in 2 weeks' time

The net result of the enterprises sector in the first three quarters of 2006 amounted to 51 bn PLN. It means a growth by 25% as compared with the analogous period of the previous year. Net sales increased in all sections (by 14.5% on average). The most significant growths occurred in construction (19.7%), hotels and restaurants (16.4%) and trade (15.7%). It is noteworthy to emphasise the improvement of almost all economic indicators (i.e. return ratio and liquidity).

This data show very a good financial condition of enterprises, which may delay the pass through of growing labour costs onto prices.

In October net inflation dropped to 1.3% y/y from 1.4% in the previous month. Two other core inflation measures fell as well while two remained unchanged. The core inflation measures are at a low level but we expect that in November net inflation due to an unfavourable statistical base effect will grow to 1.5%. In the next month we forecast moderate growth of net inflation in line with growing demand but in our opinion net inflation should stay below 2.0%.

MPC members:

Halina Wasilewska-Trenkner stated that inflationary pressure will rise and CPI will surely exceed 2.5% in 2008. The MPC still gathers information, but "soon the time to act will come". She thinks the Q3 GDP growth data will be crucial as it will allow the inflationary projection starting point to be verified. She admitted that the present pace of economic growth does not exert excessive pressure, though it will surely generate demand pressure by 2008. At the same time she stresses factors that allow for lower inflation – better harvest in 2007, globalization, strong zloty, high productivity growth, lower oil prices.

Stanisław Nieckarz thinks that an exact evaluation of the economic outlook will be necessary after Q1 2007, particularly the inflation outlook for 2008 needs to be made. He added that the fear of rising labour market pressure is excessive, and he sees unemployment rate above the natural level, which should also keep the ULC rise in check.

Andrzej Sławiński reckons the economic growth to be permanent and this should cause CPI to rise steadily. The general path of future inflation is in line with the inflationary projection (though he indicated that the exact level may not be met). Prof. Sławiński admits core inflation is low, but he adds that other factors should be taken into consideration. He sees wages growth to be rather elevated, but kept under control by rising productivity. This makes it easier to conduct monetary policy, but "it is wrong to assume that no adjustment of monetary policy will take place".

Our comment: The MPC clearly remains divided as to the need to raise interest rates. Whereas the NBP President Leszek Balcerowicz admits that the vote on raising interest rates was held in October, the motion however was not approved by the majority of the MPC. We think this situation will last until at least the end of Q1 2007. We think the first rise in interest rates may take place in April.

PiS representatives announced that the NBP President candidate will be presented within 2 weeks. The unofficial list from which the candidate is to be chosen, presented by the press includes 6 names – Urszula Grzełowska, Zyta Gilowska, Stanisław Kluza, Wojciech Kuryłek, Jerzy Kropiwnicki and Cezary Mech. In our opinion the choice of NBP President should not have any significant influence on interest rates policy. His stance on exchange rate policy is not certain, though we think it is the F/X policy presented by the central bank.

MF: the deficit in December may near the annual limit, but with higher budget income will not exceed 28.5 bn PLN

Piotr Soroczyński of the MF stated that the December budget deficit may rise closer to the annual limit (30.5 bn PLN) than would be suggested by the October data (only 54.4% of the limit). The income is to be higher by some 2 bn PLN, which means that the deficit will not exceed 28.5 bn. The exact level depends on the pace of spending. Piotr Soroczyński indicated that in the yearend spending usually rises (public investments are invoiced), though it must be added that the MF will probably decide to reschedule some spending to next year (by creating reserves in this year's budget). In previous years 3-4 bn PLN were transferred this way between years. Altogether, while the budget deficit may reach 28 bn PLN in December, a significant part of it will only be an accounting trick and should not influence MF's financing needs.

FIXED INCOME

Rather quiet week despite data, curve moves higher

Last week we had Industrial Production, PPI and Retail Sales which came more less in line with expectations. We had also switch auction on which Ministry of Finance added some long bonds into market. Over all market was trading rather on the weaker side, we saw some real money reducing positions especially in the longer part of the curve. 10Y bonds underperformed the rest of the curve. We expect further weakness into market, and we think it can be coming from the from end. The data that market put little attention to, while we think it will be very important is the data from the labour market. BAEL dropped this quarter to 13% from 14.1%, the labour cost excluding farming is growing, and the polls show that more then 70% of entrepreneurs struggle to find employees, plus they have to offer higher wages. We think that wage pressure is building into economy and it is just a matter of time when it will transfer into CPI. We expect RPP to make comment about that in their statement which is expected on Wednesday.

RECOMMENDATION:

Pay 9x12

MONEY MARKET

Stable carry

Really boring week with stable carry nearby the main market rate. It will definitely stay this way next week since the open market operation was just good enough to square the market (19,5 vs 17,8 billion pln of money bills). It is a bit too early to predict the end of the reserve but there were many players on Friday selling short Polonia OISs at relatively low levels.

Nothing new to break the range

As for longer terms nothing concrete showed up. Sentiment is positive for the whole region so PLN is taking advantage of it. Mixed comments from the MPC members, still nothing new in politics plus a bit lower then expected CPI. All this is not enough to break the range for good.

T-bills down at the tender

The average yield on Polish benchmark 52-week T-bill fell to 4.259% from 4.328% at previous tender. The Ministry sold all 0,8 billion pln of 52-week papers. Bids totaled PLN 1,89 billion giving a bid-to-cover ratio of 2.4, down from 2,5 Nov. 6. Poland's next T-bill auction will be held Dec. 4.

RECOMMENDATION:

Sell short OISs.

FOREIGN EXCHANGE

Zloty weaker

Last week's main FX event was the rise of EUR/USD from 1.2930 to 1.3080 on the news that China's foreign reserves may be at risk if not properly diversified (away from the Dollar into other currencies, including Euro). Consequently, volatilities across almost all crosses increased from the many-year lows. We saw a correction of the Zloty (EUR/PLN traded at 3.8453 on top). USD/PLN fell due to EUR/USD rise up to 2.9250, triggering some minor barriers on the way.

Volatility rising

We saw a short squeeze on EUR/PLN and USD/PLN vols. 1M EUR/PLN increased from 6.2 to 6.9, 1Y from 7.2 to 7.5. USD/PLN 1M up from 7.8 to 8.25 and 1Y stayed almost the same at 9.7. We saw a significant rise in Risk Reversals in all tenors – 1Y EURPLN increased from 1.1 to 1.45 on Friday and USD/PLN 1Y RR traded at 1.3 (up from 1.0).

RECOMMENDATION:

Zloty stronger

Spot:
Main supports / resistances:
EUR/USD: 1.2950 / 1.3250
EUR/PLN: 3.8000 / 3.8500
USD/PLN: 2.9000 / 2.9500

It seems the correction on the Zloty has finished and the appreciating trend is back. That is why we recommend long Zloty positions the following week.

Long Vega

Options:

Even after the (temporary as we see it) rise of the volatilities across the curves, we see volatility underpriced and we still recommend long Vega positions at current levels.

MARKET PRICES UPDATE**MONEY MARKET RATES**

Money market rates (Closing mid-market levels)						
date	3M		6M		1Y	
	FXSW	WIBOR	FXSW	WIBOR	FXSW	WIBOR
20-11-06	4.13%	4.20%	4.25%	4.33%	4.49%	4.56%
21-11-06	4.14%	4.19%	4.25%	4.33%	4.49%	4.56%
22-11-06	4.13%	4.19%	4.25%	4.32%	4.48%	4.55%
23-11-06	4.13%	4.20%	4.25%	4.33%	4.47%	4.54%
24-11-06	4.12%	4.20%	4.26%	4.33%	4.49%	4.54%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
	20-11-06	4.22%	4.35%	4.53%	4.67%
21-11-06	4.22%	4.35%	4.54%	4.68%	4.62%
22-11-06	4.24%	4.36%	4.55%	4.69%	4.63%
23-11-06	4.25%	4.38%	4.56%	4.70%	4.64%
24-11-06	4.23%	4.36%	4.53%	4.68%	4.63%

FIXED INCOME MARKET RATES

Fixed Income Market Rates (Closing mid-market levels)								
date	1Y		2Y		5Y		10Y	
	WIBOR	TB	IRS	OK1208	IRS	PS0511	IRS	DS1017
20-11-06	4.56%	4.26%	4.78%	4.53%	5.00%	4.92%	5.06%	5.16%
21-11-06	4.56%	4.25%	4.75%	4.52%	4.99%	4.93%	5.06%	5.17%
22-11-06	4.55%	4.24%	4.80%	4.53%	5.03%	4.94%	5.08%	5.20%
23-11-06	4.54%	4.24%	4.81%	4.56%	5.04%	4.97%	5.12%	5.22%
24-11-06	4.54%	4.25%	4.81%	4.55%	5.04%	4.95%	5.11%	5.20%

PRIMARY MARKET RATES

Last Primary Market Rates							
	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	06-10-23	07-10-24	95.800	4.34%	800	1814	800
OK1208	06-11-02	08-12-12	90.758	4.72%	1400	4154	1400
PS0511	06-10-18	11-05-24	95.670	5.33%	2000	4251	2000
DS1017	06-10-11	17-10-25	98.072	5.48%	2000	4861	2000

FX VOLATILITY

date	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
	1M	3M	6M	1Y	1M	1Y	1M	1Y
20-11-06	7.80	8.30	8.90	9.50	1.20	1.30	0.40	0.45
21-11-06	7.80	8.30	8.90	9.40	0.90	1.30	0.40	0.45
22-11-06	7.80	8.20	8.70	9.40	0.90	1.30	0.40	0.45
23-11-06	7.65	8.20	8.60	9.40	0.90	1.30	0.40	0.45
24-11-06	7.50	8.10	8.20	9.40	0.90	1.30	0.40	0.45

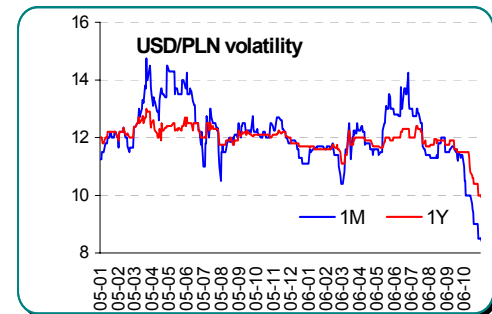
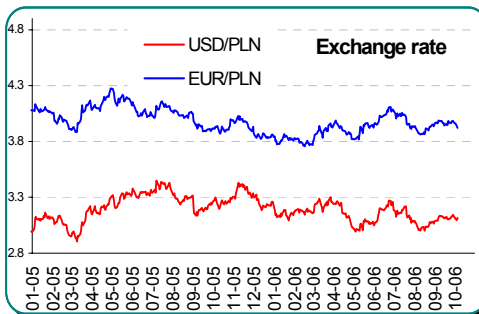
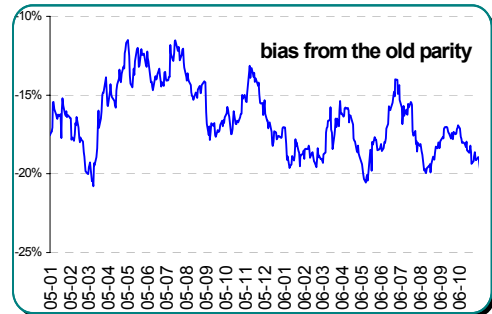
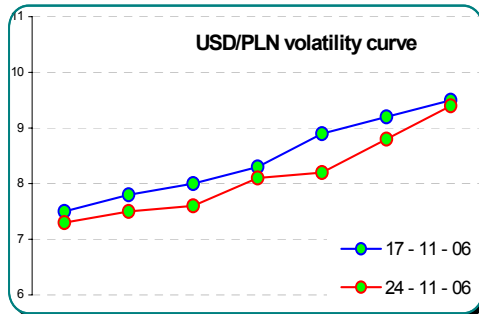
PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
20-11-06	2.9639	3.8083	-21.04%
21-11-06	2.9608	3.7958	-21.23%
22-11-06	2.9554	3.8036	-21.20%
23-11-06	2.9450	3.8200	-21.12%
24-11-06	2.9325	3.8315	-21.13%

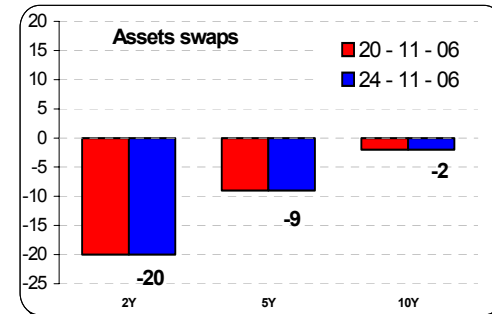
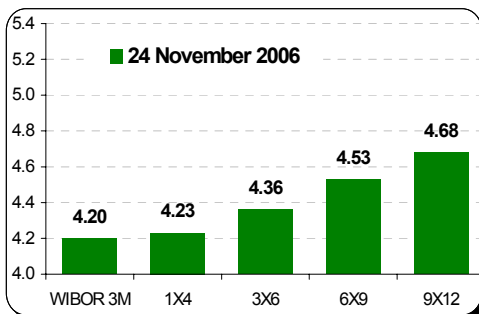
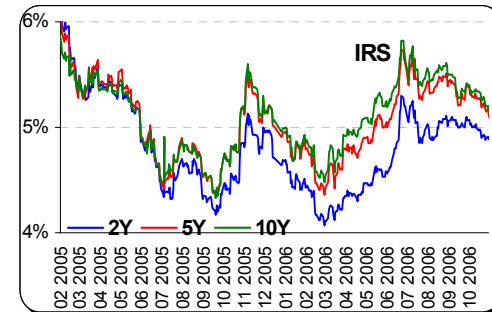
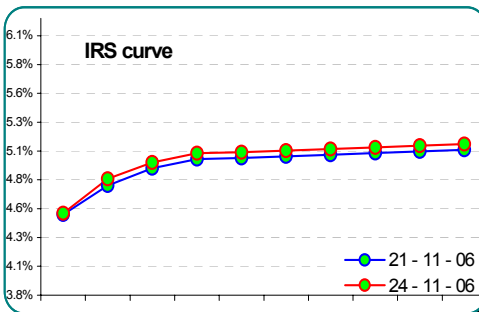
Note: parity on 11/04/00 – USD= 4.3806, EUR=4.2196, basket share 50:50
Mid-market volatility of vanilla option strategies

CHARTS

Foreign Exchange



Fixed Income



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CALENDAR

Macro

	August	September	October	Data Release	BRE Bank forecast
CPI m/m	0.3%	0.2%	0.1%	14-12-06	
CPI y/y	1.6%	1.6%	1.2%	14-12-06	
PPI m/m	-0.1%	0.0%	-0.3%	19-12-06	
PPI y/y	3.3%	3.6%	3.4%	19-12-06	
Industrial production growth m/m	2.4%	9.3%	4.1%	19-12-06	
Industrial production growth y/y	12.6%	11.7%	14.6%	19-12-06	
Average wages in enterprise sector [PLN]	2611.9	2611.2	2658.0	15-12-06	
Average wages in enterprise sector y/y	5.3%	5.1%	4.7%	15-12-06	
Unemployment	15.5%	15.2%	14.9%	22-12-06	
Budget realisation (%)	47.5%	47.4%	54.4%	15-12-06	
Current account [EUR mn]	-584	195		13-12-06	
Balance of foreign trade in goods (transaction basis) [EUR mn]	-438	-299		13-12-06	
Exports growth y/y (transaction basis)	23.1%	17.3%		13-12-06	
Imports growth y/y (transaction basis)	23.7%	19.1%		13-12-06	
Current account [% of GDP]	-2.1%	-1.9%		13-12-06	
Money supply (M3)	447.2	453.1	458.8	14-12-06	
Money supply growth y/y	12.9%	13.0%	12.3%	14-12-06	
Total PLN loans [PLN bn]	339.1	346.2	353.0	14-12-06	
Households PLN loans	170.1	175.3	178.9	14-12-06	
Corporate PLN loans	136.4	138.1	137.8	14-12-06	
Total PLN deposits [PLN bn]	370.6	374.1	378.5	14-12-06	
Households PLN deposits	213.2	214.4	214.3	14-12-06	
Corporate PLN deposits	108.7	111.0	113.8	14-12-06	
NBP intervention rate	4.00%	4.00%	4.00%	29-11-06	4.00%

Auctions

	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	4.208%	16-01-06
26 Week T-bills	-	-	3.943%	24-04-06
52 Week T-bills	04-12-06	-	4.259%	20-11-06
2Y T-bond OK1208	06-12-06	-	4.723%	02-11-06
5Y T-bond PS0511	-	-	4.987%	15-11-06
10Y T-bond DS1017	-	-	5.483%	11-10-06
20Y T-bond WS0922	-	-	5.707%	13-09-06

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