



TOP NEWS FROM THE POLISH MARKET

MACROECONOMICS

- C/A deficit in October at EUR 448mn. High dynamics of exports and imports • pages 2-3
- Money supply in November grew by 1.5% m/m and by 14.4% y/y
- An increase of the annual inflation rate in November to 1.4% from 1.2% in October due to statistical effect. No signs of stepping up inflationary pressure visible in detailed data on CPI. CPI in December and Q1 lower than in NBP inflation projection
- The average wage in enterprise sector grew 3.1% y/y
- MPC member Professor Noga indicates that the Council should act as soon as inflation breaches the level of 2%
- Deficit execution at 60.7% after November. Reserve of 2.1 b PLN as non-expiring spending transferred to next year
- 2007 Budget Act approved by the Sejm

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- Not much activity expected this week

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MM RECOMMENDATION

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- Zloty stronger
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MACROECONOMICS

C/A deficit in October at EUR 448mn

High dynamics of exports and imports

Money supply in November grew by 1.5% m/m and by 14.4% y/y

An increase of the annual inflation rate in November to 1.4% from 1.2% in October due to statistical effect

No signs of stepping up inflationary pressure visible in detailed data on CPI

CPI in December and Q1 lower than in NBP inflation projection

The average wage in enterprise sector grew

According to NBP the C/A deficit in October amounted to EUR 448m (k= EUR -271mn. BRE forecast = EUR -605mn) and the trade deficit was equal to EUR 269mn. Exports increased by 24% on the annual basis while imports grew by 27.8%. Both dynamics are higher than in the previous three months which confirm that the GDP growth in Poland is balanced with high export and strong domestic demand. The high deficit in October was caused by lower transfers from the EU than in the previous months. The transfer balance was negative and amounted to EUR 85mn. Moreover the revenues balance was strong negative at EUR -931mn which is almost EUR 300mn more than the 3M-average. The ratio of C/A deficit to nominal GDP was equal to 1.9%. The FDIs in October amounted to EUR 1,087mn, slightly less than in September but more than in the previous months.

We expect that after the weaker October in the coming months the inflow of EU transfers will return to the high level observed in the previous months. At a moderate trade gap the inflow of EU funds and private transfers will maintain the C/A to GDP ratio at a low level. We believe that this ratio at the end of 2007 will be at 2.0%.

The representative of the NBP Statistics Department said that high turnovers in foreign trade allow the pace of GDP growth in Q4 to be forecasted, and it will not be less than in Q3 (5.8%). We share this view, our forecast for Q4 DGP growth is 5.8%.

The money supply M3 in November grew as compared with October by 1.5% and by 14.4% on the annual basis. This growth is higher than market and our expectations. The annual growth rate of enterprises loans amounted to 11.6% while growth rate of households loans to 31.4%, which stay in line with the previous figures. On the passive side of money the annual dynamics of deposits of enterprises was equal to 23.5% and the dynamics of households to 7.2%. Both dynamics are higher than in October and than the 3M-average. Moreover in non-monetary financial institutions (stock brokers) there was an extraordinary increase of deposits by PLN 3bn caused by stocks – issue on the primary market. These figure stay in line with our forecast of high GDP growth in Q4.

The consumer price index stabilized in November at its October level. This translates into an annual CPI inflation of 1.4% (expectations stood at 1.5%). The wedge between the expected and actual figure has been mainly driven by lower food prices (0.2% m/m) as well as a 2.5% m/m drop in fuel prices. Prices of the remaining categories in the inflation basket did not change significantly as compared to October, or change in line with the corresponding seasonal patterns. An increase of the annual inflation to 1.4% from 1.2% in October and, further, an estimated increase of the net inflation to 1.6% primarily originate from purely statistical low base effect; in November 2005 a sharp drop in food prices was recorded and the fees for internet and cable TV were cut. The only category which might currently reflect an increasing labour cost driven inflationary pressure is "restaurants and hotels". We expect that inflation, mainly due to the aforementioned statistical effects, will rise to 1.7% in December. In the 1st quarter of 2007 inflation should not breach the level of 2.1-2.2% y/y. The upcoming figures will likewise be much lower than those anticipated in the Central Bank's inflation projection.

As there are no signs of increasing inflationary pressure visible in the detailed breakdown of the CPI, the MPC will closely watch the data on labour the market, and the unit labour costs in particular.

Friday's data indicate however that the average wage in the enterprise sector was only 3.1% higher in November compared to the previous year, which was also well below the consensus (3.9% y/y) but close to our forecast of 3.4% y/y. The figure adjusted for extraordinary effects (such as special premiums in the mining industry) is in line with the mid-term trend and does not change our view on the nature of inflationary processes in the Polish economy. Hence, we up-

3.1% y/y**MPC member Professor Noga indicates that the Council should act as soon as inflation breaches the level of 2%****Deficit execution at 60.7% after November****Reserve of 2.1 b PLN as non-expiring spending transferred to next year****2007 Budget Act approved by the Sejm**

hold our view that the rates will be not raised till April 2007.

According to MPC member Jan Czekaj, an interest rate hike would be necessary only if the actual rate of inflation were higher than 2.5% or if there were a threat that inflation would permanently increase. He also admitted that it would be irrational for the MPC to react on temporary peaks in inflation. In his opinion interest rate hikes are more likely than cuts given the economic situation, but the record expansion of investment will expand the potential output and offset pressure on the prices. Much more hawkish was the statement of Professor M. Noga. In his opinion the MPC should be more forward looking, and inflation breaching the level of only 2.0% would be a signal to raise the rates. Professor Noga sees the inflationary pressure coming from the domestic demand as well as the labour market and reiterates that the data on GDP clearly indicates that the output gap is closing. In his opinion starting in Q4 2007 inflation will be in line with the Central Bank's forecast.

After November the deficit reached 60.7% of the annual limit (18.6 of 30.5 b PLN). In November itself the deficit amounted to 1.9 b. As in October, monthly indirect tax income were higher than in the first 3 quarters, in other income the volume was similar or slightly higher than in previous months. Spending is still well below the schedule (88% after November), even after including the non-expiring spending of 2.1 b (this will constitute a budget reserve and be rescheduled until next year) the MF's forecast of the deficit at 27.5 b PLN in December is under no threat. Current high budget income also allows to look with optimism at next year's budget execution.

Moreover The Sejm approved the Budget Act for 2007. Compared to government proposal income and spending was increased by ca. 1 b PLN, with the deficit kept at 30 b. The Budget Act was now sent to the Senate and will return to the Sejm after some (most likely minor) amendments are proposed. The constitutional deadline for budget approval is January 28.

FIXED INCOME

Last week with volatility

It has been relatively active week, with decent volatility and turnover. Most of those movements were caused by core markets' reaction to US retail sales and inflation data. Impact of local economic releases was quite limited, even though both CPI and wages were slightly supportive for the market. This week main events will be industrial output and PPI data scheduled for tomorrow (our estimates are 15.8% y/y and 3.0% y/y respectively) and the MPC rate decision on Wednesday, where we expect no change. We do not expect much activity this week, as with the holiday season ahead the liquidity is fading away. Merry Christmas.

RECOMMENDATION:

We do not expect much activity this week

MONEY MARKET

Stable liquidity with possible disorder just before the Christmas

Easy not to say boring week behind us. Stable carry nearby the main market rate, balanced market plus good open market operation (17 vs 17.1 billion pln) give us chances for another few days without any volatility boosts. Then just before Christmas it should be nervous and rather cheap.

As for longer terms there were some good reasons for action but the market took it surprisingly easy. As for good figures (lower CPI and wages) we can say it was more or less discounted. But

Good figures discounted, mess with CB's new possible leader already forgotten... now still waiting

there was also no reaction for showing up and immediate resignation of the unknown firm candidate for the president of the CB. People did not manage to find out who he is and it was already off for some strange reasons. Right now there is again one big question mark, and time is passing very fast...

RECOMMENDATION:

Sell short Polonia OISs.

FOREIGN EXCHANGE

Zloty stronger

Last week the Zloty strengthened - in EUR/PLN we saw a low of 3.7790. On Friday, after US lower-than-expected inflation data (0.0%), the EUR/USD jumped up temporarily from 1.3110 to 1.3190 and then – towards the end of the session stepped down back below 1.3100.

Volatility lower

The EUR/PLN volatilities have been stable through the week till Friday. On Friday close the 1M EUR/PLN traded at 6.7 (down by 0.1), 1Y at 7.2 (down by 0.1) but the overnight volatilities traded as low as 2.75 / 3.25. The USD/PLN volatilities remained stable: 1M at 8.7; 1Y at 9.7.

RECOMMENDATION :

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Zloty stronger

Spot:
Main supports / resistances:
EUR/USD: 1.3030 / 1.3200
EUR/PLN: 3.7750 / 3.8200
USD/PLN: 2.8500 / 2.9200

We still recommend long Zloty positions the following week and see EUR/PLN declining towards 3.7500 in the mid-term.

Options:

Long Vega

We still recommend long Vega positions at current levels, especially as the post-holiday period (e.g. first weeks of January) historically saw increase in Spot volatilities.

MARKET PRICES UPDATE**MONEY MARKET RATES**

Money market rates (Closing mid-market levels)						
date	3M		6M		1Y	
	FXSW	WIBOR	FXSW	WIBOR	FXSW	WIBOR
11-12-06	4.14%	4.20%	4.26%	4.31%	4.47%	4.51%
12-12-06	4.14%	4.19%	4.26%	4.31%	4.47%	4.51%
13-12-06	4.13%	4.19%	4.25%	4.29%	4.46%	4.50%
14-12-06	4.13%	4.20%	4.26%	4.31%	4.47%	4.51%
15-12-06	4.13%	4.20%	4.26%	4.31%	4.47%	4.51%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
11-12-06	4.23%	4.35%	4.51%	4.64%	4.62%
12-12-06	4.23%	4.34%	4.52%	4.63%	4.63%
13-12-06	4.23%	4.35%	4.51%	4.61%	4.62%
14-12-06	4.24%	4.37%	4.52%	4.63%	4.63%
15-12-06	4.24%	4.36%	4.53%	4.63%	4.61%

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
11-12-06	4.51%	4.22%	4.71%	4.44%	4.94%	4.86%	4.98%	5.10%
12-12-06	4.51%	4.22%	4.70%	4.44%	4.93%	4.84%	5.00%	5.09%
13-12-06	4.50%	4.22%	4.69%	4.39%	4.95%	4.81%	5.03%	5.14%
14-12-06	4.51%	4.22%	4.70%	4.39%	4.95%	4.86%	5.05%	5.15%
15-12-06	4.51%	4.23%	4.69%	4.37%	4.93%	4.83%	5.02%	5.13%

PRIMARY MARKET RATES

Last Primary Market Rates							
	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	06-12-04	07-12-05	95.915	4.21%	1000	1556	1000
OK1208	06-12-06	08-12-12	91.311	4.62%	3800	10428	3800
PS0511	06-11-15	11-05-24	97.047	4.99%	2000	4852	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
11-12-06	8.50	9.10	9.40	9.60	0.90	1.25	0.40	0.45
12-12-06	8.50	9.10	9.40	9.40	0.90	1.25	0.40	0.45
13-12-06	8.50	9.10	9.40	9.40	0.90	1.25	0.40	0.45
14-12-06	8.35	8.65	9.20	9.40	0.90	1.25	0.40	0.45
15-12-06	8.35	8.65	9.20	9.40	0.90	1.25	0.40	0.45

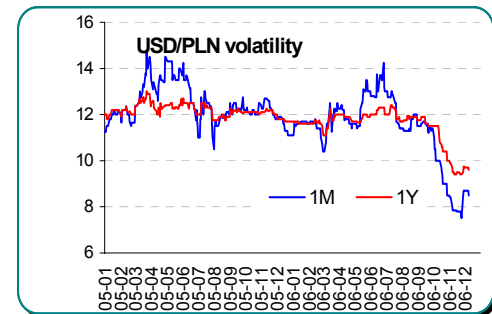
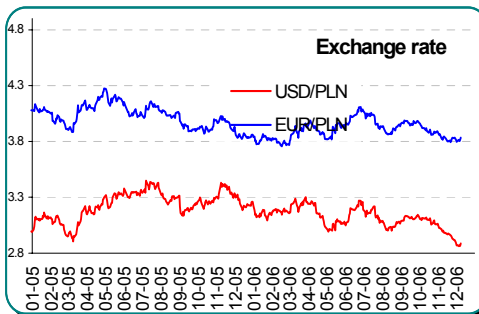
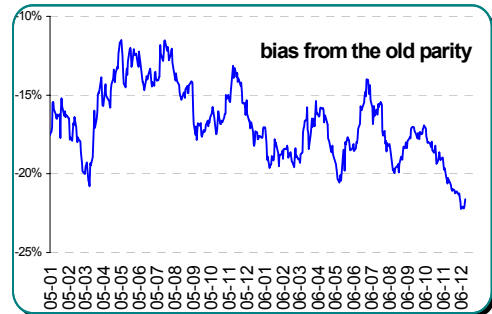
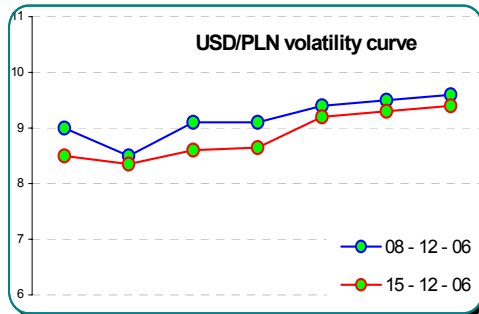
PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
11-12-06	2.8927	3.8165	-21.76%
12-12-06	2.8763	3.8106	-22.02%
13-12-06	2.8639	3.8000	-22.28%
14-12-06	2.8738	3.8014	-22.15%
15-12-06	2.8925	3.7900	-22.08%

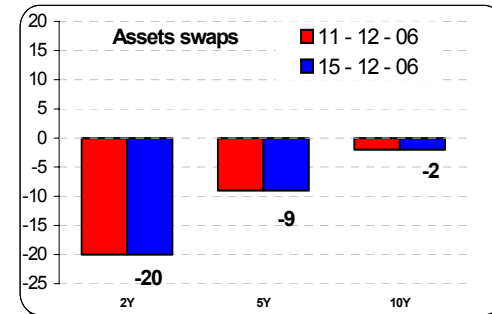
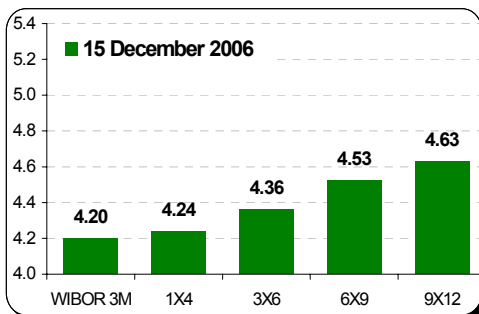
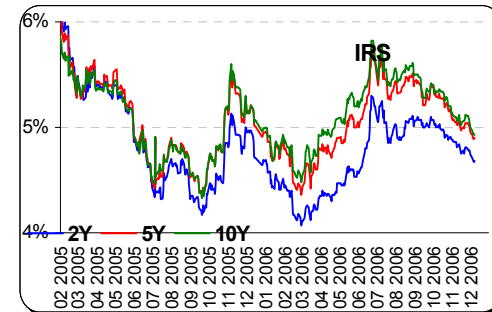
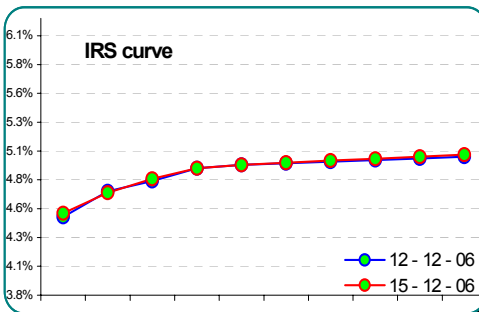
Note: parity on 11/04/00 – USD= 4.3806, EUR=4.2196, basket share 50:50
Mid-market volatility of vanilla option strategies

CHARTS

Foreign Exchange



Fixed Income



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CALENDAR

Macro

	September	October	November	Data Release	BRE Bank forecast
CPI m/m	0.2%	0.1%	0.0%	15-01-07	
CPI y/y	1.6%	1.2%	1.5%	15-01-07	
PPI m/m	0.0%	-0.3%		19-12-06	-0.4%
PPI y/y	3.6%	3.4%		19-12-06	3.0%
Industrial production growth m/m	9.3%	4.1%		19-12-06	2.5%
Industrial production growth y/y	11.7%	14.6%		19-12-06	15.8%
Average wages in enterprise sector [PLN]	2611.2	2658.0	2759.7	16-01-07	
Average wages in enterprise sector y/y	5.1%	4.7%	3.1%	16-01-07	
Unemployment	15.2%	14.9%		22-12-06	14.7%
Budget realisation (%)	47.4%	54.4%	60.7%	15-01-07	
Current account [EUR mn]	195	-482		16-01-07	
Balance of foreign trade in goods (transaction basis) [EUR mn]	-299	-269		16-01-07	
Exports growth y/y (transaction basis)	17.3%	24.0%		16-01-07	
Imports growth y/y (transaction basis)	19.1%	27.7%		16-01-07	
Current account [% of GDP]	-1.9%	-1.9%		16-01-07	
Money supply (M3)	453.1	458.6	465.6	12-01-07	
Money supply growth y/y	13.0%	12.3%	14.4%	12-01-07	
Total PLN loans [PLN bn]	346.1	353.0	361.6	12-01-07	
Households PLN loans	175.2	183.0	183.4	12-01-07	
Corporate PLN loans	138.0	139.6	141.4	12-01-07	
Total PLN deposits [PLN bn]	374.1	378.4	385.3	12-01-07	
Households PLN deposits	214.5	214.3	214.8	12-01-07	
Corporate PLN deposits	111.0	113.8	117.0	12-01-07	
NBP intervention rate	4.00%	4.00%	4.00%	20-12-06	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	18-12-06	1000	4.212%	04-12-06
2Y T-bond OK1208	-	-	4.617%	06-12-06
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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