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FINANCIAL MARKETS DEPARTMENT

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POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

PREVIEW: The week of October 10th to October 16th

Indicator	Date of release	Period	BRE forecast	Consensus	Last	Comment
C/A Balance (EUR)	**Oct 13**	Aug	**-0.86 bln**	-1.5 bln	-1.2 bln	Lower dynamics of exports and imports following softer readings of industrial output and retail sales. C/A deficit to GDP ratio at 4.3%.
M3 Supply y/y	**Oct 14**	Sep	**16.9%**	17.1%	16.8%	Higher annual dynamics due to base effects from the previous year. Still sound dynamics of household dynamics, supported by withdrawals from investment funds. Low growth rate of commercial deposits – 5% y/y.
CPI Inflation y/y	**Oct 14**	Sep	**4.3%**	4.4%	4.8%	Moderate growth of food prices (supported by the readings of CPI inflation in the Czech Republic) and lower fuel prices. We expect core "net" inflation at 4.1%, new core measure at 2.8% (to be released Oct 21).
Employment y/y	**Oct 15**	Sep	**3.9%**	4.0%	4.2%	Business tendency indicators falling at a rate similar to the last month (better in financial services and hotels, sharp deterioration in transport).
Wages y/y	**Oct 15**	Sep	**10.5%**	10.8%	9.7%	Upward pressure on wage dynamics exerted by the base effects and better industrial activity in September.

In Focus / Macroeconomics

Emergency call accelerated the „official" end of tightening phase in Poland

Inspired by the coordinated 50bp rate cut, Polish Central Bank called the emergency meeting late Wednesday. Only very short statement has been released: "The Committee is focused on the recent actions by world's Central Banks. Their effects on economic growth and inflation outlook in Poland are to be taken into account during the upcoming MPC meeting in October". Although the committee did not vote on a rate cut at the meeting the event may clearly propel expectations for sooner rate cuts (meanwhile the markets have priced in more than 150 bps cuts to come within the next 18 months).

These expectations have been supported by comments of the MPC members (Czekaj, Nieckarz, Slawinski) that followed the actions taken by leading central banks. These comments have clearly marked the end of tightening cycle. In a morning interview a moderate Slawinski explicitly admitted that the financial crisis may spill over to the Polish economy and the Committee may reconsider its stance on the monetary policy. We do see the rate cut as not a distant possibility. Although the Committee may well wait till, say, January, the odds are 50:50 for a cut to be delivered by the end of this year. As the euro adoption may well be delayed due to political issues, we stick to our view that entering euro zone will have only a minor impact on the ongoing monetary policy. The same view seems to be shared by influential MPC Member Wojtyna: "consultations on the euro adoption between government and the opposition have not started yet. For both sides the euro issues are still a red herring"… and it is not what may really attract the potential voter.

Only to briefly summarize our view on the Polish economy, the global slowdown and deteriorating consumer confidence (not visible in official indicators yet, but how come consumers stay immune to the avalanche of bad news transmitted by the media and even some state officials?) are to weigh substantially on the Polish growth prospects, bringing GDP expansion much below 4% mark in 2009. It is worth to note that widely cited bumper effects of EU funds may prove to be of minor importance right now – the bulk of expenditures may be spent around 2010 and later, hence: the impulse may come a little too late. Worrying signs also come from the FDI – their expected level in 2008 has been scaled down by about 5 bn USD. Should the growth prospects for the whole CEE region deteriorate further, foreign investors would be willing to reallocate their resources towards other markets.

MEDIUM-TERM FORECATS

Indicator	2006	2007	2008	2009
GDP y/y (%)	6.1	6.5	5.1	3.5
Inflation rate (%, avegage)	1.0	2.4	4.4	3.2
Current account (% of GDP, average)	-2.1	-4.5	-4.6	-5.3
Unemployment rate (end-of-year)	14.9	11.4	9.4	9.6
NBP repo rate (end-of-year)	4.00	5.00	6.00	5.00

Indicator	2008			2009	
	Q2	Q3	Q4	Q1	Q2
GDP y/y (%)	5.8	4.4	4.0	3.5	3.5
Inflation rate (%, average)	4.3	4.7	3.8	3.5	3.3
NBP repo rate (end-of-quarter)	6.00	6.00	6.00	5.75	5.25

Bold denotes chages from the last release with arrows showing the direction of chages

Fixed Income

No doubts?

Last week on financial markets was like no other week. Coordinated cuts by most of CB, emergency meeting by Polish MPC (no decision was made but we had little excitement after all). Shape of the curve is quite wild now, with WIBOR rates pushing higher (3M is now at 6.80!!!)

while the lowest point on the curve is 21x24 some 200 bp lower. The curve has the steepest decline between 2x5 and 3x6 FRA, as they fix across the year. There are many things that are not working on the market but it seems it is just a sign of the crisis. Market is over liquid in cash yet O/N trades above repo rate, the best offered place on the curve is front end FRA, while WIBOR rates are pushing higher everyday, and ASW are trading at record levels. We decided to close all our receive positions, we also reduced our bonds holdings. Right now the biggest puzzle we see is how MPC decisions will impact the market. We think that market consensus is that RPP will cut rates sooner or later, but rather sooner, and still WIBORS go higher. How really system is liquid if 3 bn PLN of surplus cannot make money market go lower? Will we have crisis worsening as year end looks and liquidity will be more and more precious? And will the 2009 year will bring salvation to all money market dealers and liquidity will return to market? We start to think that Poland is exceptional in this respect. There have been many steps taken by ECB and UE authorities and other bodies in EU to solve banking problem in EU, but in Poland the main stream of discussion seems to be ERM entry and how Polish economy will be unaffected by crisis and how strong the Polish banking system is. Is it? We take now spectator stance and we will look with great interest at market. For us many things are looking less obvious now as they were month or even week ago, it is very easy to make mistake now. We don't want to make it. We have many doubts.

RECOMMENDATION:

Recommendation: close all receive positions at current levels, reduce bonds.

AUCTIONS

	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	6.061%	7/28/2008
26 Week T-bills	-	-	6.409%	9/15/2008
52 Week T-bills	10/13/2008	-	6.395%	10/6/2008
2Y T-bond OK0710	12/3/2008	-	6.471%	8/6/2008
5Y T-bond PS0413	11/5/2008	-	5.926%	10/1/2008
10Y T-bond DS1019	TBA	-	6.054%	4/9/2008
20Y T-bond WS0429	12/9/2008	-	5.992%	9/10/2008

Money Market

Expensive carry on global crunch basis

Redistribution of liquidity is the key to avoid further turmoil

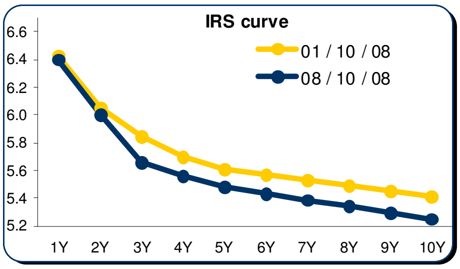
Cash curves still rising when other curves dropped massively

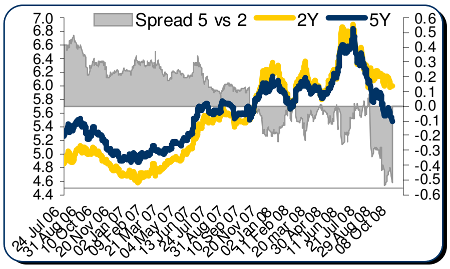
Despite of the fact that there was nice cash surplus in the system, global crunch made local players very cautious. Rates were high and even though some more risk averse dealers were giving money to the central bank (around 2 figures lower). This behaviour does not help at all. Liquidity premium is growing rapidly and cash curves are still rising sharply when other curves are discounting about 100 bps rates cut in the nearest future. This looks quite reasonable when the main world central banks are cutting their rates aggressively. We think that there is no chance for any hikes here no matter what, and that polish MPC will start catching up with the rest of the world no later then at the beginning of the next year. Nevertheless, the biggest question is liquidity redistribution. Tomorrow's OMO demand may vary depending on real market needs considering of course credit lines of the over liquid entities. If redistribution works efficiently enough plus emotions come down a bit, cheap end of the reserve is very likely.
As for trading, OIS curve dropped down massively ex. 1Y 30 bps in 1 day. Market is really confused at the moment. Although there is consensus for the scale of possible cuts (100-125 bps) the timing is a coin throw as of now.

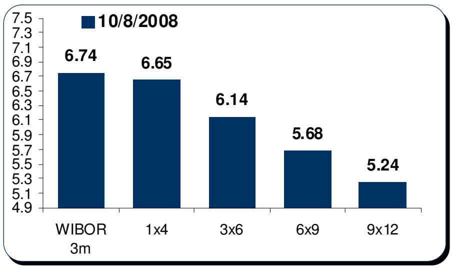
RECOMMENDATION:

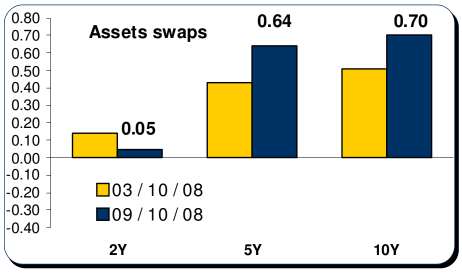
Stay neutral for a while.

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

Zloty bit weaker

Zloty's market has faced high volatility within wide sideways trading. This week EURPLN has found low at 3.4050 and high at, four-time tested, 3.5050. Similary USDPLN has been trapped in 10 figures range with 2.4780 bottom and 2.5820 top. Its global driven market where EURUSD and EURJPY crosses might be treated as indicators.

Volatility still high

It was another week of high volatility. Curve remained at extreme high levels – EUR/PLN 1M was quoted at 15.00 and 1Y at 8.50 while week before quotations had been at 12.0 and 8.0. USD/PLN 1M moved from 19.00 to 23.00 and respectively 1Y from 14.50 to 15.50.

RECOMMENDATION:

SPOT

Main supports / resistances:
EUR/PLN: 3.3500 / 3.5550
USD/PLN: 2,2150 / 2.6700

Long PLN

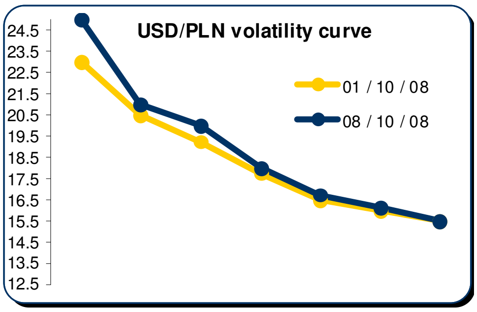
Despite some CB's actions calming markets we believe EURPLN will be traded within volatile 3.37-3.50 range.

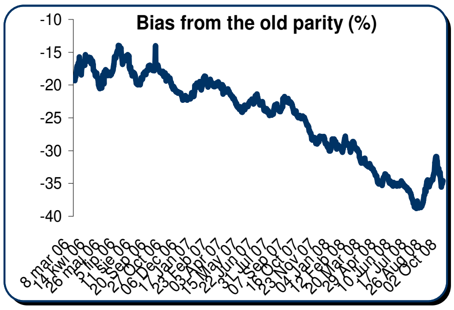
Short vega, short gamma

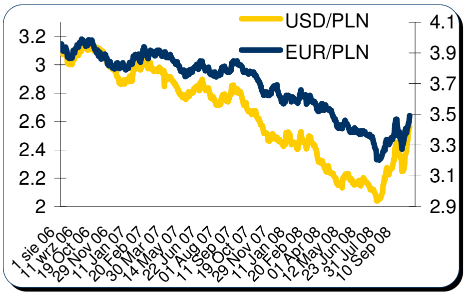
OPTIONS

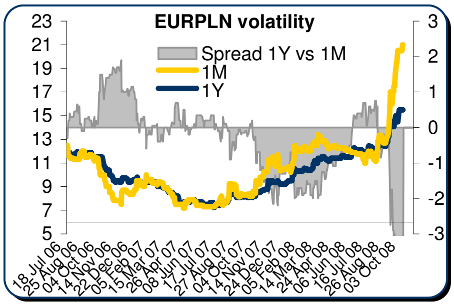
We believe in receiving some benefits from short vega, both on flattening and lowering of volatility curve.

FX CHARTS


USD/PLN volatility curve
01 / 10 / 08
08 / 10 / 08


Bias from the old parity (%)


USD/PLN
EUR/PLN


EURPLN volatility
Spread 1Y vs 1M
1M
1Y

MARKET PRICES UPDATE

MONEY MARKET RATES

Money market rates (Closing mid-market levels)

date	3M		6M		1Y	
	FXSW	WIBOR	FXSW	WIBOR	FXSW	WIBOR
02/10/08	6.54%	6.67%	6.56%	6.60%	6.58%	6.63%
03/10/08	6.45%	6.70%	6.55%	6.62%	6.65%	6.64%
06/10/08	6.70%	6.72%	6.70%	6.63%	6.70%	6.67%
07/10/08	6.60%	6.74%	6.68%	6.67%	6.68%	6.70%
08/10/08	6.61%	6.75%	6.66%	6.70%	6.69%	6.73%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
02/10/08	6.63%	6.41%	6.05%	5.72%	5.93%
03/10/08	6.65%	6.42%	6.05%	5.66%	5.94%
06/10/08	6.63%	6.33%	5.95%	5.58%	5.81%
07/10/08	6.65%	6.29%	5.90%	5.50%	5.78%
08/10/08	6.65%	6.14%	5.68%	5.24%	5.53%

FIXED INCOME MARKET RATES

Fixed Income Market Rates (Closing mid-market levels)

date	1Y		2Y		5Y		10Y	
	WIBOR	TB	IRS	OK0709	IRS	PS0511	IRS	DS1017
02/10/08	6.63%	5.08%	5.57%	5.29%	5.72%	5.69%	5.73%	5.76%
03/10/08	6.64%	5.05%	5.57%	5.29%	5.71%	5.68%	5.72%	5.76%
06/10/08	6.67%	5.05%	5.57%	5.34%	5.71%	5.67%	5.71%	5.76%
07/10/08	6.70%	5.05%	5.56%	5.30%	5.71%	5.65%	5.72%	5.75%
08/10/08	6.73%	5.03%	5.56%	5.34%	5.70%	5.68%	5.70%	5.75%

PRIMARY MARKET RATES

Last Primary Market Rates

	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	08/10/06	08/10/07	93.927	6.40%	1500	2506	1500
OK0710	08/08/06	10/07/25	88.390	6.47%	1800	3724	1830
PS0413	08/10/01	13/04/25	99.132	5.93%	1800	4924	1856
DS1017	08/10/08	19/10/26	97.121	5.86%	2500	4472	2500

FX VOLATILITY

	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
date	1M	3M	6M	1Y	1M	1Y	1M	1Y
02/10/08	20.50	17.75	16.50	15.50	1.50	1.50	0.30	0.35
03/10/08	20.50	17.75	16.50	15.50	0.00	0.00	0.00	0.00
06/10/08	20.50	17.75	16.50	15.50	0.00	0.00	0.00	0.00
07/10/08	21.00	18.00	16.50	15.50	0.00	0.00	0.00	0.00
08/10/08	21.00	18.00	16.75	15.50	0.00	0.00	0.00	0.00

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
02/10/08	2.4470	3.4025	-34.02%
03/10/08	2.4676	3.4188	-35.53%
06/10/08	2.5291	3.4370	-35.11%
07/10/08	2.5451	3.4515	-35.07%
08/10/08	2.5648	3.4923	-34.63%

Note: parity on 11/04/00 – USD= 4.3806, EUR=4.2196, basket share 50:50

Mid-market volatility of vanilla option strategies

Contact Details

BRE BANK SA

Ul. Senatorska 18
00-950 Warszawa
P.O. Box 728
Poland

Reuters Pages: BREX, BREY, and BRET

Bloomberg: BRE

SWIFT: BREXPLPW

www.brebank.pl

Forex (BREX) - FX Spot &Options
Marcin Turkiewicz (+48 22 829 01 84) Marcin.turkiewicz@brebank.pl
Jakub Wiraszka (+48 22 829 01 73)
Tomasz Chmielarski (+48 22 829 01 78)

Fixed Income (BREP) - FRA, IRS, T-Bonds, T-Bills
Łukasz Barwicki (+48 22 829 01 93) Lukasz.barwicki@brebank.pl
Paweł Białczyński (+48 22 829 01 86)

MM (BREP) - MM, FX Swaps
Bartłomiej Małocha (+48 22 829 01 77) Bartlomiej.malocha@brebank.pl
Tomasz Wołosz (+48 22 829 01 74)

Structured Products (BREX)
Jaroslaw Stolarczyk (+48 22 829 01 67) Jaroslaw.stolarczyk@brebank.pl
Jacek Derezinski (+48 22 829 01 69)

Institutional Sales (BRES)
Inga Gaszkowska-Gębska (+48 22 829 12 05)

Research
Ernest Pytlarczyk (+48 22 829 01 66) Research@brebank.pl
Marcin Mazurek (+48 22 829 0183)
Radosław Cholewiński (+48 22 829 12 07)

Financial Markets Department
Phone (+48 22 829 02 03)
Fax (+48 22 829 02 45)

Treasury Department
Phone (+48 22 829 02 02)
Fax (+48 22 829 02 01)

Financial Institutions Department
Phone (+48 22 829 01 20)
Fax (+48 22 829 01 21)

Back Office
Phone (+48 22 829 04 02)
Fax (+48 22 829 04 03)

Custody Services
Phone (+48 22 829 13 50)
Fax

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