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FINANCIAL MARKETS DEPARTMENT

PAGES: 8

WARSAW, NOVEMBER 28, 2008

POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

PREVIEW: The week of November 28th to December 4th

Indicator	Date of release	Pe-riod	BRE forecast	Consen-sus	Last	Comment
GDP growth y/y	**Nov 28**	Q3	**4.7%**	4.8%	5.8%	Still the figures far form a sharp descent. We expect this to change in the coming quarters. Business tendency indicators suggest the deceleration may be quite rapid with the most negative scenario including a trough at 0-1% y/y.
MinFin's inflation forecast y/y	**Dec 1**	Nov	**3.8 / 3.9%**	4.0%	4.2%	Moderate growth of food prices accompanied by sharp drop of fuels (-5% m/m) and another round of deregulation (gas and electricity prices exerted upward pressure on housing maintenance). Core "net" inflation at 4.8% whereas the new core measure (excl. food and energy) at 2.9%.

In Focus / Macroeconomics

Real sphere slowing faster than commonly expected

Retail sales growth amounted to 7.9% in November vs. 11.6% in October, matching our (below consensus) estimate. Business activity slowed down in all sections (partially reflecting the difference in working days) with auto sales being a notable, downward exception (the fallout of tighter credit conditions and brakes placed on overall durable goods demand).

We see this tendency to be continued in coming moths but, at the same time, sustain our long promoted view that consumption will be the last in this cycle to give way. Consumer confidence is fading slowly but these are still high wages and easily accessible consumer credit which prevent retail trade from faltering. This state cannot last forever, though. As soon as conditions deteriorate (and this may be quite rapid, as always when the slowdown seizes) the contraction of consumption may come along.

The passing month (with statistical data to be published in December) may be another bucket of cold water on overly optimistic heads. Strong contraction of business orders and business indicators on current production suggest the downward tendency of industrial output has been recently strengthened. It is then possible that industrial production will post a 7% annual decline in November (it is not as striking number as it seems when we count the working days deficit: two on annual basis and even four month on month). We expect changes in labor market to follow suit (it is possible that employment in enterprise sector declined on monthly basis: apart from anecdotal evidence on group lay-offs, business indicators are horrible), which influence on consumption softening is hardly questionable.

Polish MPC in easing mode

Polish MPC cut rates by 25bps to 5.75%. The decision, though anticipated by the market and in line with our forecast, came as surprise to majority of analysts and commentators.

Turning to the statement, the issues related to the economic slowdown and easing of inflationary pressures are the dominant ones. Committee indicates that inflation, though disturbed by state-controlled prices, is set to decline in the mid-term on the back of much lower GDP growth, weaker corporate profits and tight credit conditions. During the Q&A session MPC members agreed that the euro agenda may somehow impact the interest rate path (the Committee seems to be more and more aware that Poland may at least temporarily not conform to inflation convergence criterion) but we expect the prospects of weaker growth to dominate the rate outlook in the short term.

This month's statement includes one more interesting remark; Committee conditions the monetary easing on responsible fiscal policy. We link this passage to the view of some influential MPC members who claim that currency crisis and macroeconomic stability has to be associated nowadays with fiscal policy and not the rate disparity *per se*. Finance Minister Rostowski claims that the coming revision of the next year's budget macroeconomic assumptions is not going to weigh on the level of the deficit. If these declarations prove correct, there may be much more space for instantaneous monetary easing.

To conclude, we expect the Committee to cut rates again at its December meeting. This time the timing of the easing may be a crucial as the market may continue to price in massive rate cuts (remember that December is not, traditionally, a month in which the MPC wants to surprise anyone). Among the factors justifying our scenario is the sequence of macroeconomic data, to be released in December (strongly negative industrial output reading in particular), which are going to indicate a sharp slowdown of the economy. Also the expected ECB cut and widening of the rate disparity (the baseline scenario assumes the easing of at least 50 bps.) may be supportive. We expect Polish MPC to ease by about 200bps in total in the current easing cycle.

MEDIUM-TERM FORECASTS

Indicator	2006	2007	2008	2009
GDP y/y (%)	6.1	6.5	5.2	**1.8**
Inflation rate (%, average)	1.0	2.4	4.3	3.3
Current account (% of GDP, average)	-2.1	-4.5	-4.6	**-5.7**
Unemployment rate (end-of-year)	14.9	11.4	9.4	**11.2**
NBP repo rate (end-of-year)	4.00	5.00	5.50	4.25

Indicator	2008			2009	
	Q2	Q3	Q4	Q1	Q2
GDP y/y (%)	5.8	4.7	**3.5**	**2.1**	**1.6**
Inflation rate (%, average)	4.3	4.7	3.8	3.5	3.3
NBP repo rate (end-of-quarter)	6.00	6.00	**5.50**	**5.00**	4.50

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

Fixed Income

Back to economy again.

Last week we completed 200-250 bp. rally from the last month highs. We also had expected/unexpected 25 bp rate cut, first in the cycle. In first reaction Wibor rates dropped some 7-10 bp. still staying relatively high to policy rate. In our opinion market is pricing currently repo rate at around 3.5-4% territory in 6-9 months time. While we don't exclude such an outcome, and most likely we will see cut coming already this month, it is rather shape of the curve we will be placing bets on rather than outright views. We still favour our 1y10y steepener, we also like 3x6/6x9 FRA steepener. We think that rate cuts will be front end loaded, and concentrated in first half of the year, if not first quarter of the year. Later we will be seeing unpleasant picture painted by growing deficits (both C/A and fiscal), still highish CPI, especially core CPI, most likely we will be not fulfilling Maastricht criteria for a while, which would put pressure both on PLN as well as question mark about further scope of easing. All in all, we stay receive in front end, we see steeper curve and we see high probability of unfavorable bonds scenario to unfold in next 3-6 month time.

RECOMMENDATION:

Stay pay 1y10y at current level, pay 3x6/6x9 spread at -100 bp

AUCTIONS

	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	6.561%	11/24/2008
26 Week T-bills	-	-	6.409%	9/15/2008
52 Week T-bills	12/8/2008	-	6.714%	11/24/2008
2Y T-bond OK0710	12/3/2008	-	6.471%	8/6/2008
5Y T-bond PS0413	2/6/2009	-	5.926%	10/1/2008
10Y T-bond DS1019	2/13/2009	-	6.054%	4/9/2008
20Y T-bond WS0429	12/9/2008	-	5.992%	9/10/2008

Money Market

Cheap cash for everyone

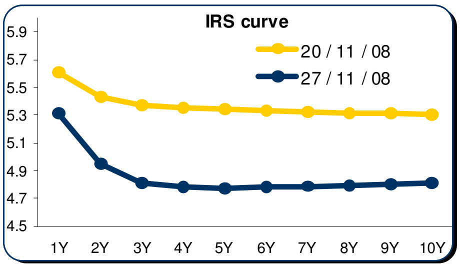
Another very cheap week and another very cheap end of the reserve requirements settlement period. Regular open market operation could not absorb the huge surplus of the cash in the system, hence the Central Bank decided to provide additions one on Tuesday. And here we get to the point that can not be explained by any reasonable means. Despite of the surplus amounting to 10 billion pln, market bought bills only for 190 mio pln during additional auction. Instead of buying NBP-bills at 6%, we saw huge deposit in the Central Bank at 4.5% every single day. Is lack of trust spreading over the safest and shortest NBP papers?

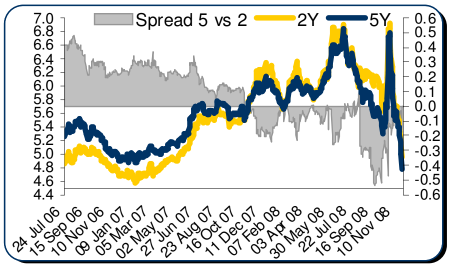
The MPC cut all the rates by 25 bps

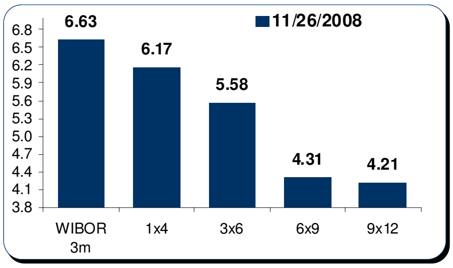
Still no real trading. Even after unexpected, at least for majority of market participants, decision made by the MPC (all rates down by 25 bps), just a few trades moved the curves down. Wibor rates reacted in a limited way. Market is discounting high probability of the next cut in December.

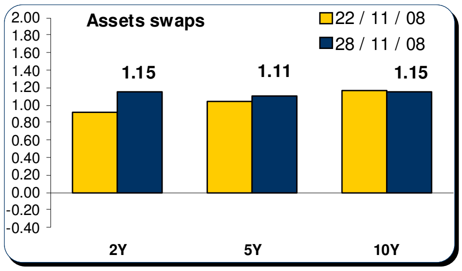
RECOMMENDATION: Keep cash through the year break.

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

Zloty stronger

This week zloty opened around 3.8900 levels and headed down toward 3.7500. Finally, all recovery plans were optimistically viewed by investors, so Polish Zloty strengthen with improving global sentiment.

Volatility lower

Stronger Zloty drove volatility curve lower so 1M was traded at 28 (recent high 43) and 1Y at 18 (high at 22).

RECOMMENDATION:

SPOT

Main supports / resistances:
EUR/PLN: 3.6500 / 3.9000
USD/PLN: 2.6700 / 3.1000

Play range

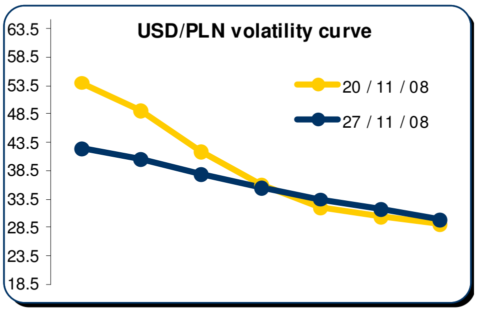
We suggest playing wide EURPLN range. Its likely to keep in 3.65-3.85 levels.

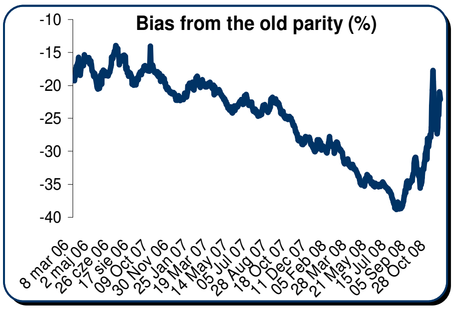
OPTIONS

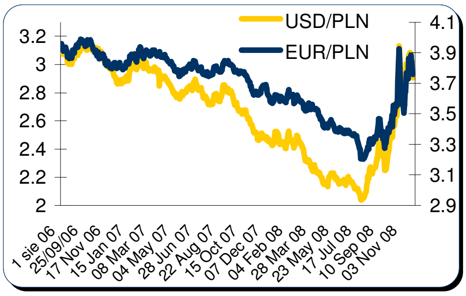
Short gamma

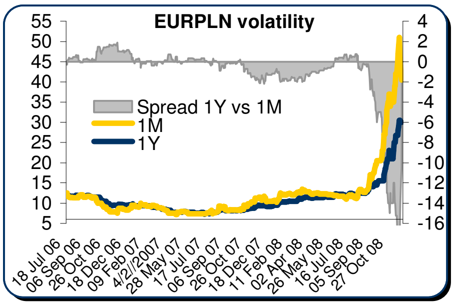
We believe in receiving some benefits from short gamma as curve is still steep.

FX CHARTS


USD/PLN volatility curve
20 / 11 / 08
27 / 11 / 08
63.5
58.5
53.5
48.5
43.5
38.5
33.5
28.5
23.5
18.5


Bias from the old parity (%)
-10
-15
-20
-25
-30
-35
-40
8 mar 06
2 maj 06
26 cze 06
17 sie 06
09 Oct 07
30 Nov 06
25 Jan 07
19 Mar 07
14 May 07
05 Jul 07
28 Aug 07
18 Oct 07
11 Dec 07
05 Feb 08
28 Mar 08
21 May 08
15 Jul 08
05 Sep 08
28 Oct 08


USD/PLN
EUR/PLN
3.2
3
2.8
2.6
2.4
2.2
2
4.1
3.9
3.7
3.5
3.3
3.1
2.9
1 sie 06
25/09/06
17 Nov 06
15 Jan 07
08 Mar 07
04 May 07
28 Jun 07
22 Aug 07
15 Oct 07
07 Dec 07
04 Feb 08
28 Mar 08
23 May 08
17 Jul 08
10 Sep 08
03 Nov 08


EURPLN volatility
Spread 1Y vs 1M
1M
1Y
55
50
45
40
35
30
25
20
15
10
5
4
2
0
-2
-4
-6
-8
-10
-12
-14
-16
18 Jul 06
06 Sep 06
26 Oct 06
18 Dec 06
09 Feb 07
4/2//2007
28 May 07
17 Jul 07
06 Sep 07
26 Oct 07
18 Dec 07
11 Feb 08
02 Apr 08
26 May 08
16 Jul 08
05 Sep 08
27 Oct 08

MARKET PRICES UPDATE

MONEY MARKET RATES

Money market rates (Closing mid-market levels)

date	3M		6M		1Y	
	FXSW	WIBOR	FXSW	WIBOR	FXSW	WIBOR
21/11/08	6.65%	6.72%	6.60%	6.49%	6.73%	6.59%
22/11/08	6.64%	6.71%	6.50%	6.70%	6.76%	6.74%
25/11/08	6.60%	6.69%	6.69%	6.69%	6.70%	6.72%
26/11/08	6.65%	6.69%	6.70%	6.68%	6.70%	6.71%
27/11/08	6.56%	6.63%	6.60%	6.66%	6.60%	6.69%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
21/11/08	6.44%	5.83%	4.88%	4.78%	5.06%
22/11/08	6.43%	5.83%	4.83%	4.65%	4.90%
25/11/08	6.41%	5.73%	4.71%	4.56%	4.81%
26/11/08	6.32%	5.68%	4.48%	4.38%	4.65%
27/11/08	6.17%	5.58%	4.31%	4.21%	4.53%

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
21/11/08	6.59%	5.08%	5.57%	5.29%	5.72%	5.69%	5.73%	5.76%
22/11/08	6.74%	5.05%	5.57%	5.29%	5.71%	5.68%	5.72%	5.76%
25/11/08	6.72%	5.05%	5.57%	5.34%	5.71%	5.67%	5.71%	5.76%
26/11/08	6.71%	5.05%	5.56%	5.30%	5.71%	5.65%	5.72%	5.75%
27/11/08	6.69%	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	08/11/24	09/11/24	93.643	6.71%	1800	4335	1815
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
21/11/08	51.00	38.00	34.00	30.50	9.00	8.50	1.20	1.20
22/11/08	51.00	38.00	34.00	30.50	9.00	8.50	1.20	1.20
25/11/08	44.00	36.00	33.50	30.00	8.50	8.50	1.40	1.40
26/11/08	42.00	36.00	33.50	30.00	8.50	8.50	1.40	1.40
27/11/08	40.50	35.50	33.50	30.00	8.50	8.50	1.40	1.40

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
21/11/08	3.0151	3.7984	-24.33%
22/11/08	3.0151	3.7984	-24.33%
25/11/08	2.9891	3.8411	-21.02%
26/11/08	2.9197	3.7888	-21.27%
27/11/08	2.9047	3.7578	-22.12%

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

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