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Comment on the upcoming data and forecasts

On Wednesday PMI for Polish manufacturing sector will be published. PMIs in the euro zone i Germany decreased below 50 pts. first and third month in a row respectively. Therefore we expect PMI to drop only slightly below 50 pts. as releases from Polish real sphere are still surprisingly good and we assess divergence between industrial production and PMI readings to result mainly from negative sentiment (which in the months to come may reverse upwards).

Polish data to watch: October 31 to November 4

Publication	Date	Period	BRE	Consensus	Prior
PMI (pts.)	2.11.	Oct	49.7		50.2

Treasury bonds and bills auctions

Paper	Next auction	Last Offer	Last yield (%)	Prev auction
52-week T-Bills	-	600	4.578	5/30/2011
2Y T-bond OK0114	-	3000	4.469	8/10/2011
5Y T-bond PS0416	-	3600	5.105	10/19/2011
10Y T-bond DS1021	-	3000	5.803	7/21/2011
20Y T-bond WS0429	-	250	6.246	1/12/2011

Macroeconomic forecasts

Wskaźnik	2008	2009	2010	2011 F	2012 F
GDP y/y (%)	4.8	1.7	3.8	3.8	3.2
CPI Inflation y/y (average %)	4.3	3.5	2.8	4	3.4
Current account (%GDP)	-5.3	-1.6	-4.5	-4.9	-3.6
Unemployment rate (end of period %)	9.5	11.9	12.3	12.6	12.8
Repo rate (end of period %)	5.00	3.5	3.5	4.5	4.0

	2010	2010	2011	2011	2011	2011
	Q3	Q4	Q1	Q2	Q3 F	Q4 F
GDP y/y (%)	4.2	4.5	4.4	4.3	3.9	3.4
CPI Inflation y/y (average %)	2.6	2.9	3.7	4.2	4.1	3.8
Repo rate (end of period %)	3.5	3.5	4.0	4.5	4.5	4.5

F - forecast

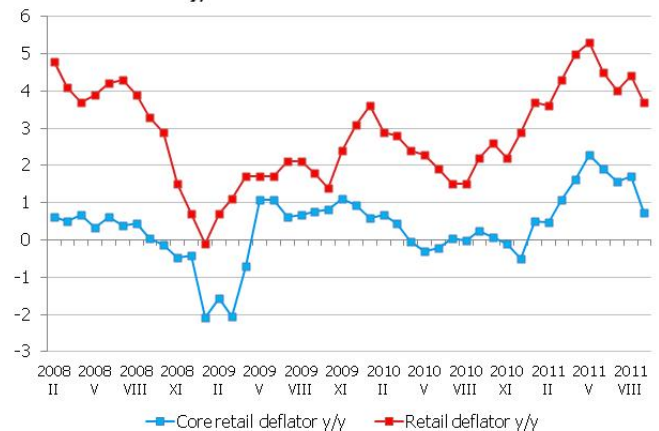
Economics

Decent retail sales growth. Deposit war is about to begin.

Retail sales growth in September reached 11.4% on yearly basis - even higher than in the previous month. In real terms increase was also higher amounting 7.7% y/y after 6.9% y/y in August.

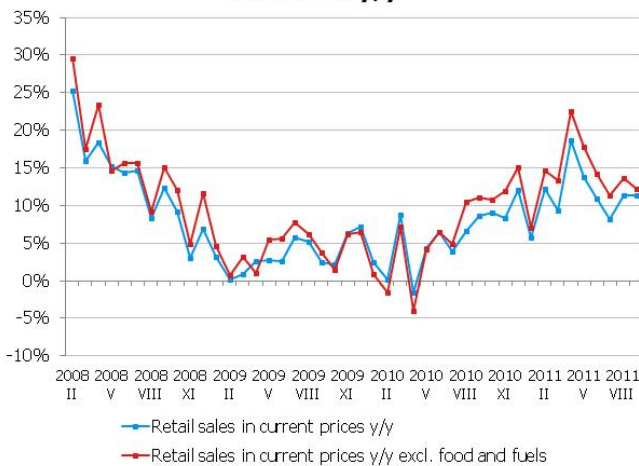
Although headline itself may be seen as positive surprise which fits into the picture portrayed by encouraging industrial output, decomposition of sales casts a shadow on it. Most of all high headline's growth results from strong food sales (again around 5% y/y), high growth in „others" category (17.2% y/y after 18% in the previous month) and skyrocketing fuel sales (21% y/y in nominal terms and 8.1% y/y in real terms). These categories are highly volatile and therefore - even with no trend change signal - they may surprise either negatively or positively. On the other hand, durable goods sales remain weak (5.8% growth of „furniture, radio, TV and household appliances" category results mostly from statistical base effect), motor vehicles and clothing sales (0% and 3.2% respectively) remained in downward trend. The data seems best described by core retail sales (excluding food and fuels), which reversed downwards (see chart).

Core retail sales deflator (excl. food and fuels), and headline sales deflator

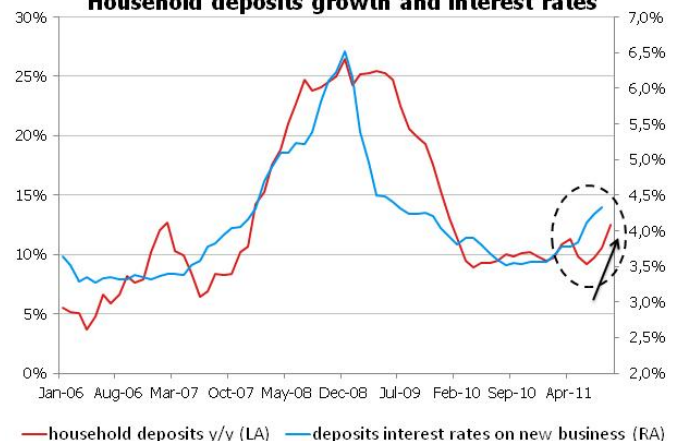


Since June household deposits grew by 19.6 mld PLN (while in previous year corresponding volume was only 7.8 mld PLN). September was second month in a row with double digit deposits growth (12.2% y/y, also when excluding FX effect, which added 0.8 pp.) in line with the rise of deposits interest rate on new business growth (see chart).

Retail sales y/y



Household deposits growth and interest rates



Traditionally we calculated retail sales deflators. Prices calculated from headline grew by 3.7% y/y after 4.4% in the previous month while core deflator decreased by 0.7% on annual basis (see chart).

Retail sales data are in line with other positive surprises from Polish real sphere. However, even though slowdown in Poland will be for sure less rapid than the one from 2008-09, we do see signs that indeed the slowdown is coming. FX effects affecting disposable income are still in force, the situation on labor market is visibly worsening (employment decrease, faster growth of unemployment rate) and we see more and more signs from monetary aggregates that savings rate is increasing (and all attempts of hoarding money in banks may encounter fertile ground owing to the overall situation in the banking sector). Let's take a closer look at that issue.

What is more, we observe now similar pattern of deposits distribution as was seen in the Autumn 2008. More specifically, overnight deposits growth rate in August became lower than growth rate of deposits with agreed maturity (see chart). Although deposits growth rates are lower than in 2008, tendency clearly points to growing household savings rate along with rising concerns of economic outlook (weakening consumer confidence, funds outflow from TFI). It does not seem to be a coincidence that such a behavior of deposits matches visibly higher rate offered on deposits (8% interest rate at a time when 3M WIBOR stays at 4.9% level); the reminiscence of deposit wars from 2008 seems obvious, at least for us.

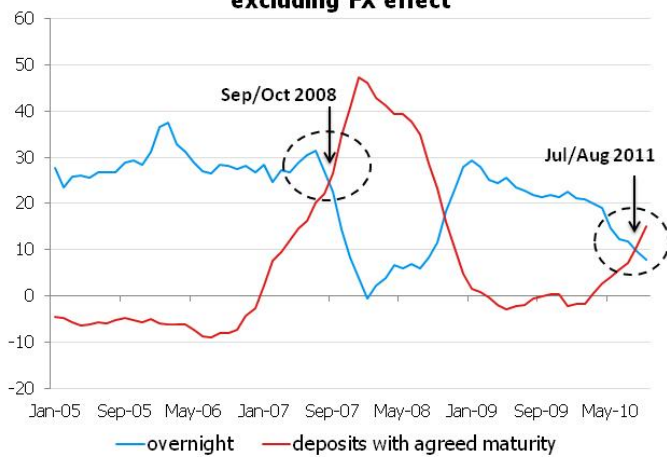
Worse consumer sentiment is seen also in lower loan demand (consumer loans volume deteriorated by 121.3 mln PLN from the beginning of this year, half of the mortgage growth rate results from FX effect and excluding it growth rate is steadily declining). Furthermore it seems that it is just the beginning of banks' competition on deposits market as with Greek bonds haircut European banks (with daughters in Poland) need



recapitalization and external financing will be limited. Hence, loans activity will need to be preceded by deposits aggregation.

On the other hand, deposit structure drifting towards higher growth of term accounts reveals also slowing economy - correlation coefficient of overnight deposits annual growth rate with GDP growth equals 57%, while the same coefficient with long-term deposits is -46%. Therefore despite relatively strong retail sales and industrial production headline data, further analysis supports our GDP forecasts with lower consumption. We remind the reader though, that private consumption is not the sole GDP driver. We remain optimistic on private and public investment (see the positive momentum in corresponding credit aggregates) and this will allow GDP to stay around 3% in 2012.

Distribution of household deposits y/y (%) - excluding FX effect

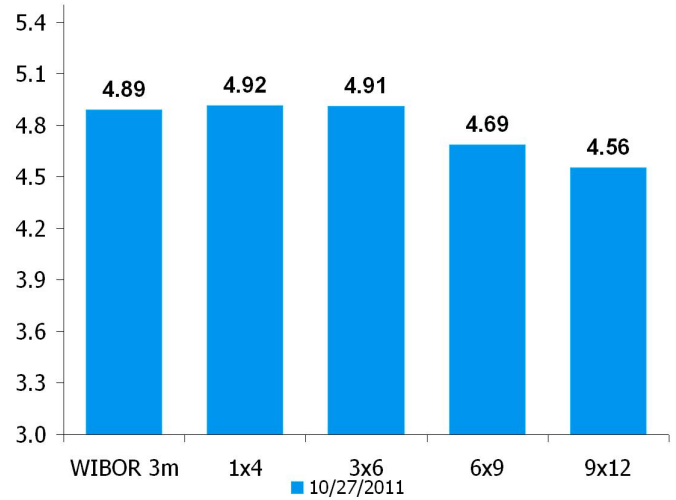




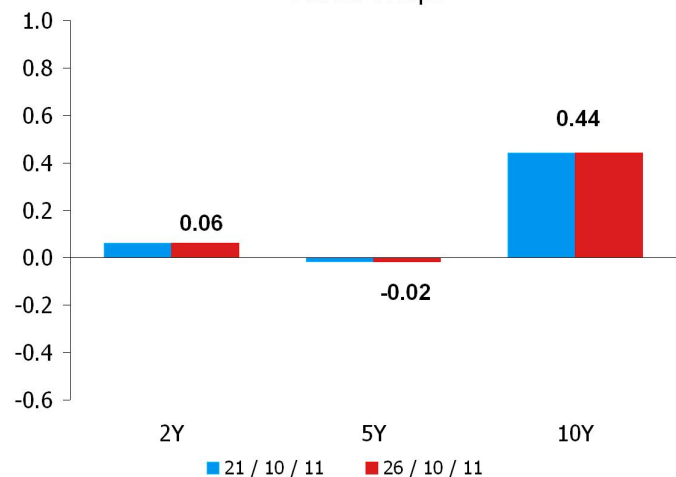
Fixed income

Bullish flattening

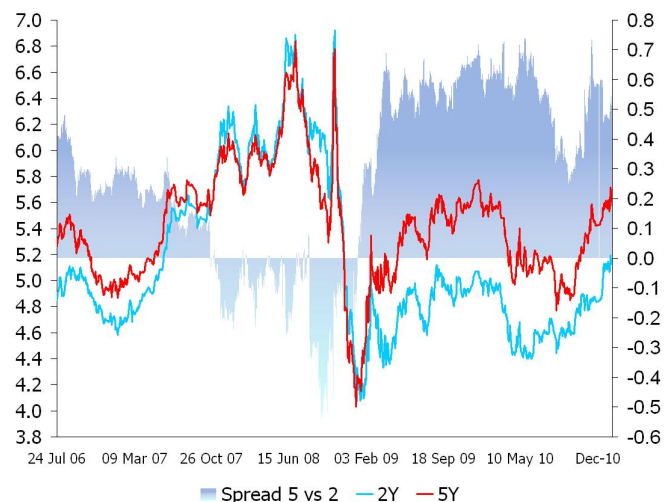
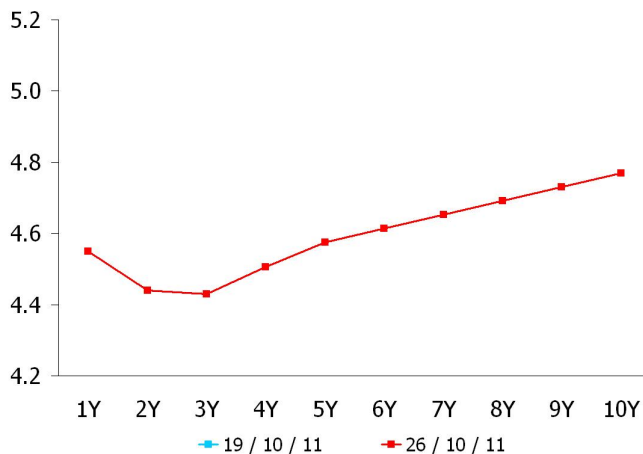
Last's week main highlight was EU summit decision concerning solution for banks and Greek bonds haircut. PLN rates and bonds were trading in rather positive mood, apart from very short dated FRA which moved higher on the back of the Wibor move. Curve flattened massively in 2y5y sector in rates and we saw big outperformance of 10y bonds this week, 5y5y forward PLN to EUR narrowed yet again to 170 bp from 210 early during the week. On Thursday Poland managed to place 2 bio of 10y USD bonds with spread of 280 bp over Tsy (lower range of expectations). We are currently entering period of two weeks with plenty of events which can „shake” market. Following week we will have ECB with new governor and we may expect further softening of the language, even a rate cut cannot be ruled out. After that we will have final decision about shape of the government and prime minister Tusk giving speech to the parliament (Rostowski (Ministry of Finance) and Bielecki (Chief Aid to PM) both indicated we can expect announcements about „significant” structural reforms to be introduced). ECB decision should be - if anything - both EURPLN and rates supportive, PM speech can provide only positive surprise, as market is now expecting rather limited activity on the fiscal side, MPC gave recently series of the hawkish statements, which might indicate determination to keep rates high until inflation is back to target. All in all we are looking for positive developments for bonds in 5y10y sector and further curve flattening.



Assets swaps



IRS curve

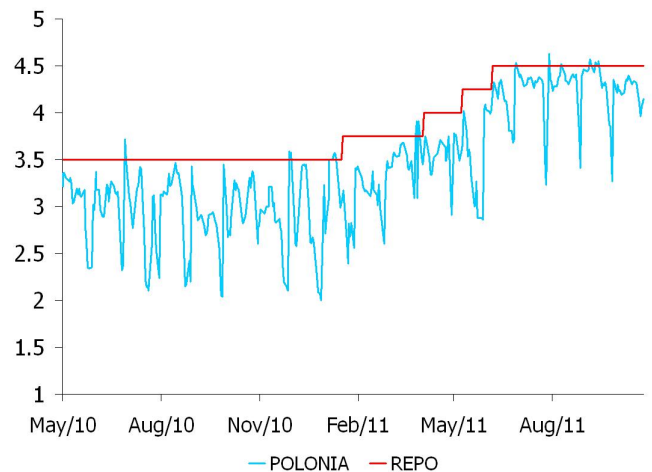
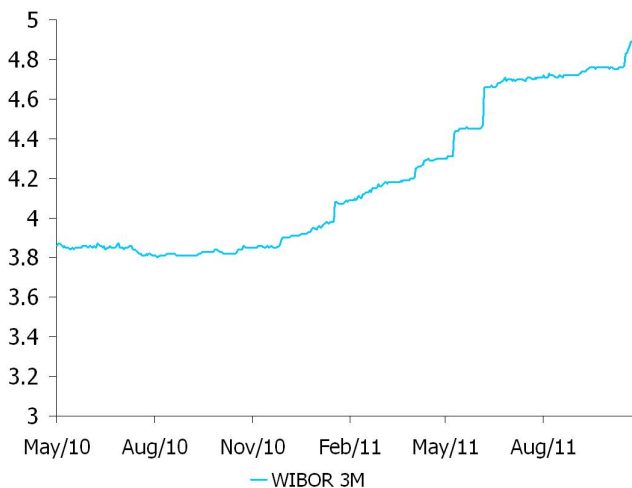
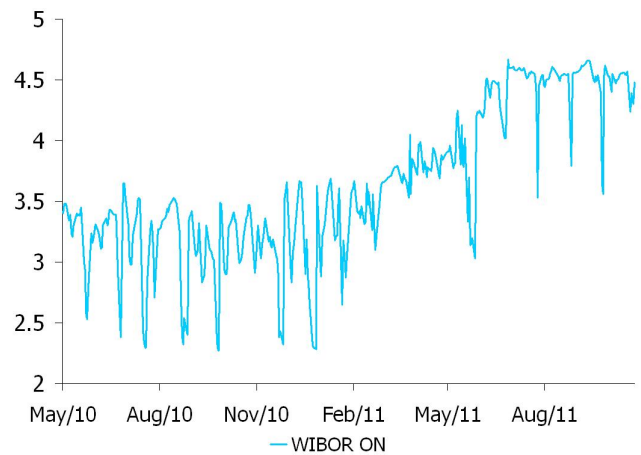
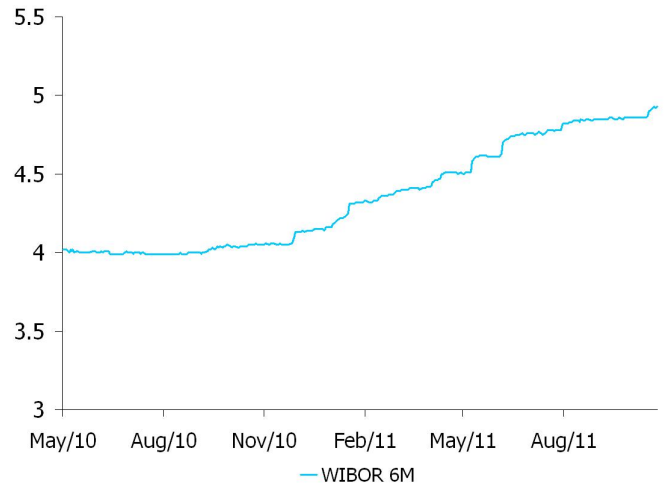




Money market

End of the reserve period

Last week of reserve period caused lower polonia fixing, even after additional OMO (6.3 bio was given to NBP on Tuesday). Since Friday we are getting back to 4.30+ lvls, as new month starts. Since Monday we had another move up in wibors. 3M wibor is 4.90 and we think it should top somewhere around here, although there is no chance to get back lower till the January 2012.





Forex

Zloty stronger What a difference a week makes...European Leaders have announced, what the market generally expected, but the market reaction was a huge risk rally! It was probably because the market was expecting a big failure. The EUR/PLN has dropped as a stone from 4.3950 before the announcement to 4.2810 this week's low a day after.

Volatility lower The correlation weaker Zloty - higher volatility curve (and the other way around) is working as usual. Stronger PLN caused the selloff of roughly 1% in the front end and 0.5 % in the backend (14.0 mid 1m , 13.0 mid 1y now). The risk reversals lower around 0.25

Short-term forecasts

Main supports and resistances

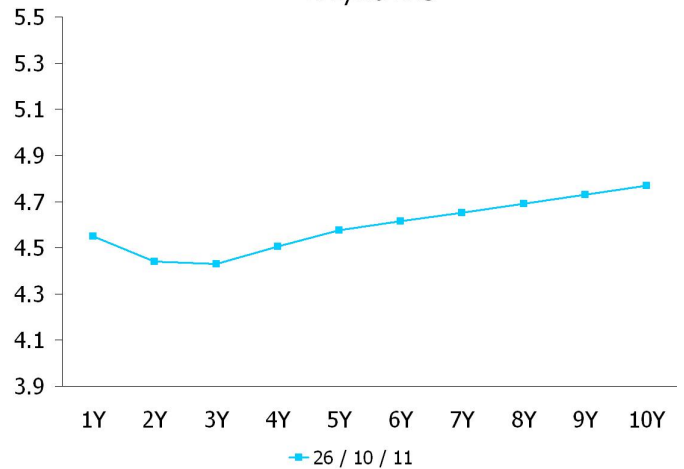
EUR/PLN: 4.2500 / 4.4250

USD/PLN: 3.0000 / 3.2700

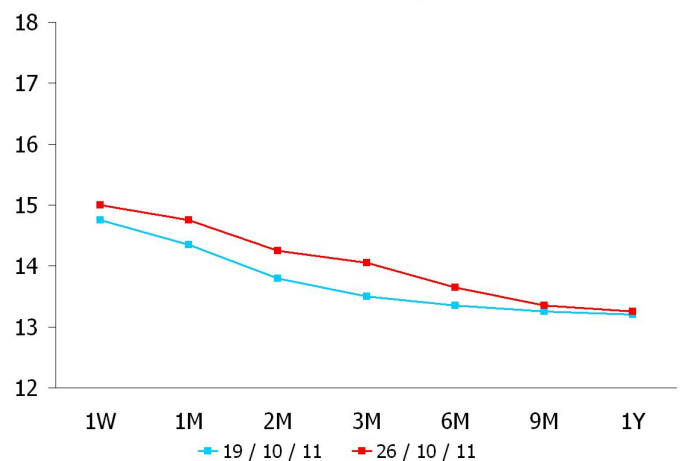
Spot. The bigger picture favours a range for EUR/PLN - 4.25/4.45. As a result we are opportunistically skewed to the upside for a short term bet. We will try to buy EUR/PLN in the 4.27/4.30 space with a stop loss at 4.2500 and hoping for the revisit of 4.37/4.40 and profit taking.

Derivatives. View unchanged. The ideal position to have is to be long Vega in 3m-6m and short out of the money call for December. The net effect is the long Vega and long Gamma and only tiny theta. EUR/PLN should be protected from rising too high too fast as our CB and Ministry of Finance are the potential sellers till the year end. Then we will be at the markets mercy, and with no clear solution to Greece problems we should keep the core long in Vega.

Krzywa IRS



EUR/PLN volatility curve



Bias from the old parity (%)





Market prices update

Money market rates (mid close)							FRA rates (mid close)					
Date	FXSW 3M	WIBOR 3M	FXSW 6M	WIBOR 6M	FXSW 1Y	WIBOR 1Y	1x4	3x6	6x9	9x12	12x15	6x12
10/20/2011	4.63	4.83	4.68	4.77	4.63	4.81	4.75	4.72	4.57	4.43	4.38	4.64
10/21/2011	4.61	4.83	4.73	4.80	4.65	4.77	4.75	4.75	4.62	4.47	4.37	4.69
10/24/2011	4.66	4.87	4.85	6.49	4.83	4.82	4.85	4.83	4.70	4.56	4.51	4.78
10/25/2011	4.66	4.89	4.85	4.82	4.80	4.83	4.84	4.84	4.67	4.56	4.51	4.76
10/26/2011	4.69	4.89	4.84	4.83	4.79	4.82	4.88	4.90	4.75	4.63	4.58	4.78

Last primary market rates							
Paper	Au. date	Maturity	Avg. price	Avg. yield	Supply	Demand	Sold
52W TB	5/30/2011	5/30/2012	95.57	4.58	600	2667	505
OK0113	8/10/2011	1/25/2013	89.58	4.58	5000	4934	1889
PS0416	10/19/2011	4/25/2016	98.44	5.11	3600	11200	3638
DS1020	7/21/2011	10/25/2021	99.53	5.80	3000	5608	3000

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0113	5Y IRS	PS0416	10Y IRS	DS1019
10/20/2011	4.810	4.570	4.730	4.717	5.162	5.183	5.302	5.883
10/21/2011	6.590	4.530	4.690	4.661	5.162	5.094	5.302	5.790
10/24/2011	4.820	4.530	4.690	4.661	5.162	5.094	5.302	5.790
10/25/2011	4.830	4.570	4.690	4.661	5.162	5.094	5.302	5.790
10/26/2011	4.820	4.570	4.690	4.661	5.162	5.094	5.302	5.790

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1M	1Y
10/20/2011	15.05	14.20	13.90	13.60	13.60	4.61	0.30	0.62
10/21/2011	15.05	14.20	13.90	13.60	13.60	4.61	0.30	0.62
10/24/2011	14.60	13.80	13.55	13.35	13.35	4.60	0.51	0.76
10/25/2011	14.60	13.90	13.55	13.20	13.20	4.61	0.51	0.77
10/26/2011	14.75	14.05	13.65	13.25	13.25	4.61	0.51	0.76

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
10/20/2011	4.3628	3.1779	3.5197	4.1405	1.4688	0.1753
10/21/2011	4.3960	3.1969	3.5893	4.1694	1.4657	0.1754
10/24/2011	4.3934	3.1705	3.5810	4.1628	1.4768	0.1759
10/25/2011	4.3787	3.1445	3.5781	4.1320	1.4736	0.1760
10/26/2011	4.3856	3.1498	3.5999	4.1491	1.4686	0.1758

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