

**Bureau of Economic Analysis**
(research)

Ernest Pytlarczyk, PhD, CFA
chief economist
 tel. +48 22 829 01 66
ernest.pytlarczyk@brebank.pl

Marcin Mazurek, PhD
senior analyst
 tel. +48 22 829 01 83
marcin.mazurek@brebank.pl

Paulina Ziembinska
analyst
 tel. +48 22 829 02 56
paulina.ziembinska@brebank.pl

Artur Pluska
analyst
 tel. +48 22 526 70 34
artur.pluska@brebank.pl

Financial Markets Department
(business contacts)

Lukasz Barwicki
head of trading
 tel. +48 22 829 01 93
lukasz.barwicki@brebank.pl

Inga Gaszkowska-Gebska
institutional sales
 tel. +48 22 829 01 67
inga.gaszkowska-gebska@brebank.pl

Bartlomiej Malocha, CFA
money market
 tel. +48 22 829 01 77
bartlomiej.malocha@brebank.pl

Jaroslawn Stolarczyk
structured products
 tel. +48 22 829 01 67
jaroslawn.stolarczyk@brebank.pl

Marcin Turkiewicz
fx market
 tel. +48 22 829 01 67
marcin.turkiewicz@brebank.pl

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BRE Bank S.A.
 18 Senatorska St.
 00-950 Warszawa
 P. O. BOX 728
 tel. +48 22 829 00 00
 fax. +48 22 829 00 33
<http://www.brebank.pl>

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Comment on the upcoming data and forecasts

On Wednesday GDP for 3rd quarter will be published. We expect slight 0.3pp deterioration compared to 4.3% in 2nd quarter with explicitly lower consumption (2.8%). Weaker construction growth pace indicate slightly lower investment growth pace (6.2%) against 2nd quarter. Automatic stabilizers of Polish economy like export are coming on. On Thursday PMI for Polish manufacturing sector will be published. PMIs in the euro zone and Germany decreased forth and second month in a row respectively. Therefore we expect PMI to drop after September upward adjustment (in line with weakening industrial production data), but remain above boundary 50 pts. as releases from Polish real sphere are still surprisingly good.

Polish data to watch: November 28 to December 2

Publication	Date	Period	BRE	Consensus	Prior
GDP y/y (%)	30.11	Q3	4.0	4.0	4.3
Inflation expectation y/y (%)	30.11	Oct			4.2
PMI	1.12	Oct	50.2		51.7

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 PS1016	-	2500	5.147	11/16/2011
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 (%)	5.1	1.6	3.8	3.8	2.8
CPI Inflation y/y (average %)	4.3	3.5	2.8	4.0	3.6
Current account (%GDP)	-5.3	-1.6	-4.5	-4.9	3.6
Unemployment rate (end of period %)	9.5	12.1	12.4	12.6	12.8
Repo rate (end of period %)	5.0	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	4.0	3.6
CPI Inflation y/y (average %)	2.6	2.9	3.7	4.2	4.2	4.2
Repo rate (end of period %)	3.5	3.5	4.0	4.5	4.5	4.5

F - forecast



Economics

Prime Minister expose - great potential, but necessity of swift implementation.

Prime Minister in his inaugural speech presented the program of structural reforms in the horizon of government term. Proposals that were announced can be divided into two groups affecting budgetary balance in short and medium term.

Changes that will be implemented since Q2 2012 and take effects in short term are as follows:

- Raise of tax from extraction of copper and silver,
- Cancellation of tax reliefs for first child and state expenses connected with child birth for wealthier families,
- Increase in taxation for artists and authors,
- Cancellation of tax relief for internet,
- Limit on bank deposits avoiding yield taxation,
- Increase of „disability contribution” by 2 pp. paid by employers,
- Increase of „wealth contribution” for peasants,
- Quota indexation of pension and retirement.

In 2012 increase of „disability contribution” by 2 pp. paid by employers according to government assumptions will give to social security additional revenues of PLN 7bn. Since 2013 this change will decrease social security deficit by PLN 13bn. Cancellation of tax relief for internet will give savings at PLN 0.4bn and rise of tax from extraction of copper as well as silver will give for State Treasury additional revenues of PLN 2bn. Summarizing all of these effects, since 2013 it should amount to PLN 10bn affecting improve of government balance.

The main goal of current government is to ensure decrease of general government deficit below GDP 3% and public debt to GDP 52% in 2012. Therefore, beside program from expose, government decided to raise revenues (already submitted to legislature procedures) from excise tax, which will amount to PLN 2,5bn. Limiting deficit below GDP 3% allow later to remove the excessive deficit procedure imposed in 2009 by European Commission. Poland has been obliged to reduce excessive deficit to 2012. In medium term to 2015 the deficit will further decrease to GDP 1% (medium term objective appointed by European Commission for polish budget position) and public debt to GDP 47%.

Structural reforms which will improve long term stability of public finance are as follows:

- Changes in taxation system for agriculture sector (introduction of financial accounting for farms),
- Gradual evolving of State Agriculture Social Security (KRUS) towards common Social Security System,
- Gradual increase and equalization of retirement age for man and woman (since 2013 start of gradual increase of retirement age which will finally reach 67 years for men in 2020 and woman in 2040),
- Cancellation and reduction of pension privileges for uniformed forces, miners and priests.

In long term horizon structural reforms according to government projections will allow to maintain deficit at the level of GDP 1%, afterwards decrease public debt to GDP 44% in 2020, 40% in 2030 and 35% in 2040.

After inaugural speech Prime Minister reaction of main three rating agencies (Moody's, Fitch Ratings, Standard&Poor's) was quite positive. According to analysts' comments of agencies credit rating upgrade possibly can take place after implementations of structural reforms and its positive effects on stability of polish public finance.

Ruling coalition, which has majority in parliament can account for support of two other opposition parties for structural reforms (two left wings parties). Thus possible short time of legislature process should insure from softening proposals of structural reforms. We expect that swift implementation process will improve market sentiment to polish assets, which significantly deteriorated during last week as a result of unfavorable global factors. Last but not least, the proposed fiscal consolidation will also create more room for monetary easing starting in 2012.

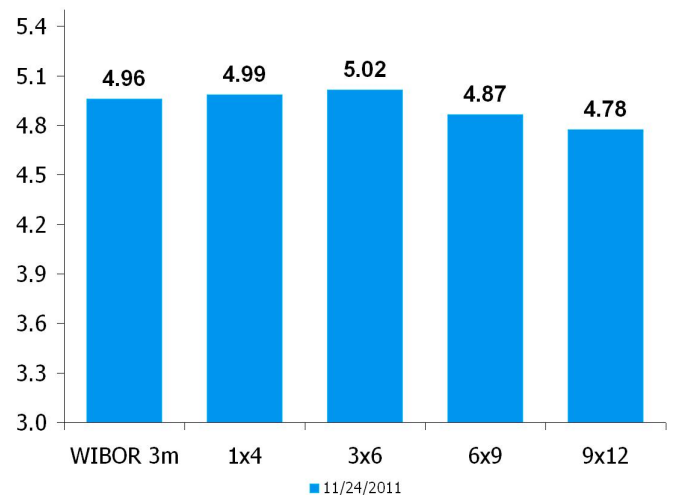
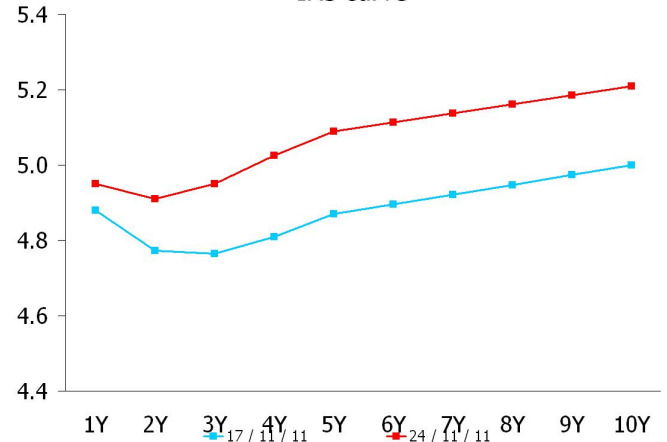


Fixed income

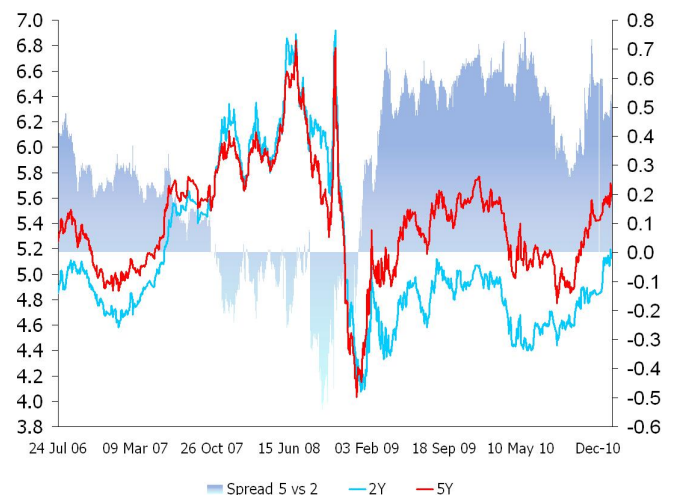
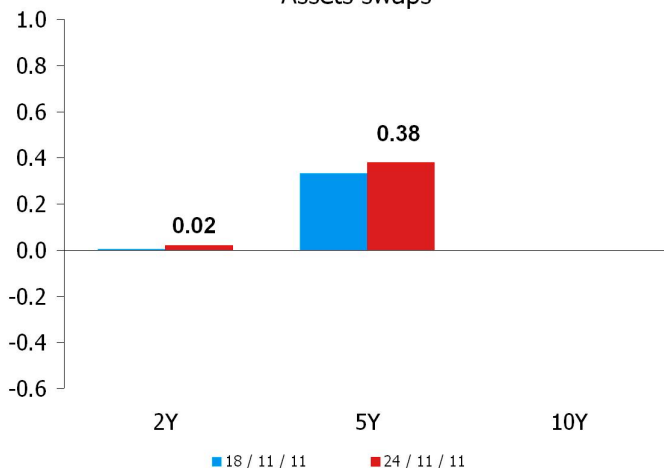
Interesting week on PLN rates

Last week was rather interesting on PLN rates. Figures gave mixed signals, as IP came lower to expected, but retail sales came touch higher. All in all it looks polish economy is heading for soft landing. We also had NBP intervention which aim was to smooth volatility rather than to push PLN lower, also Wibors were pushing higher as still demand for cash over year end is rather high especially from internationals. Market got two hits despite positive news flow from local market (better to expected PM Tusk expose). First was very poor bund auction which pushed long term yields higher, and after that downgrades on Hungarian debt. Curve pushed massively higher 2y marking 40 bp move, Friday 2y traded at 5.00, 5y moved to 5.20 also some 40 bp higher. Bonds widen massively to swaps as 5y bonds lost 200 cents, 10y bonds more than 300 cents. Sentiment was very weak and we saw wave of stops going through in 5y and 10y bonds. Market right now is pricing scenario of possible rate hike in 1Q 2012 and rates stable afterwards. There is Ms. Szymborska poem, that says „nothing happens twice in ones life”, we see clear parallels to 2008 late autumn. All driven by external factors, Hungary downgrade, stress in USD funding, collapsing eurpln due to foreign banks deleveraging (2008 was Huf downgrade, stress in USD funding and collapsing eurpln due to polish corporate exposure on the basis swaps). What is different (in favorable way) is three things. First it is experience of NBP and ability to introduce right tools faster and in more efficient way. Secondly, fiscal situation is much more favorable at moment than it was in 2008 with structural reform in the pipeline. Third thing is FCL... which we think Minfin and NBP will not hesitate to use. So while market keeps flying and we see liquidation of positions and talks about emergency rate hikes, we remain skeptical to that scenario. Eurpln will not be obstacle to cut rates once economy turns the corner and we will start to see slowdown, NBP and Minfin are ready to use all available tools. We like to sell 1y1y versus 3x6 thinking rates eventually will be going down, if rates will be going higher still, we will be receiving 5y on tops, from 5.20% to 5.50%. If 2008 is to be repeated, rates next year will be trading closet to 4% than to 6%.

IRS curve



Assets swaps



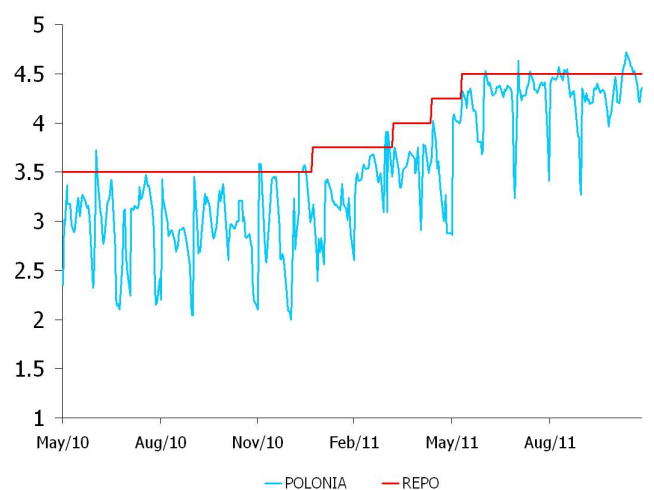
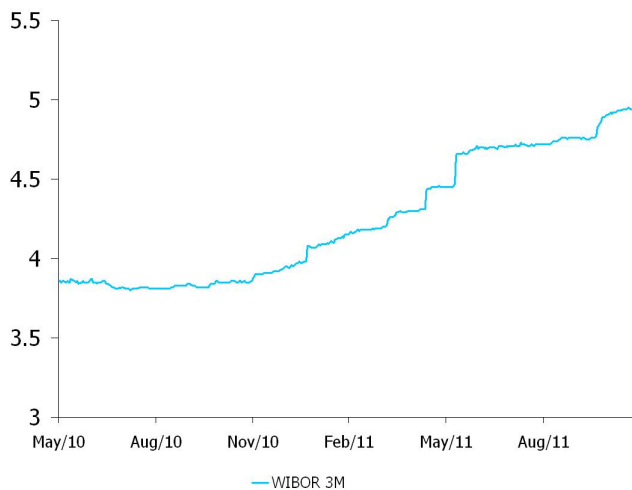
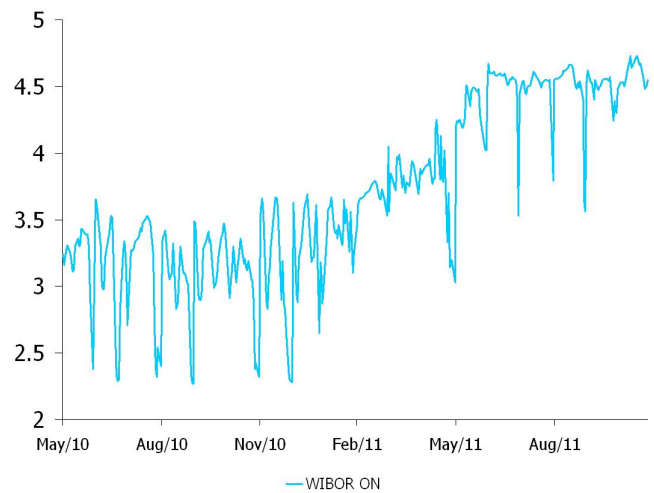
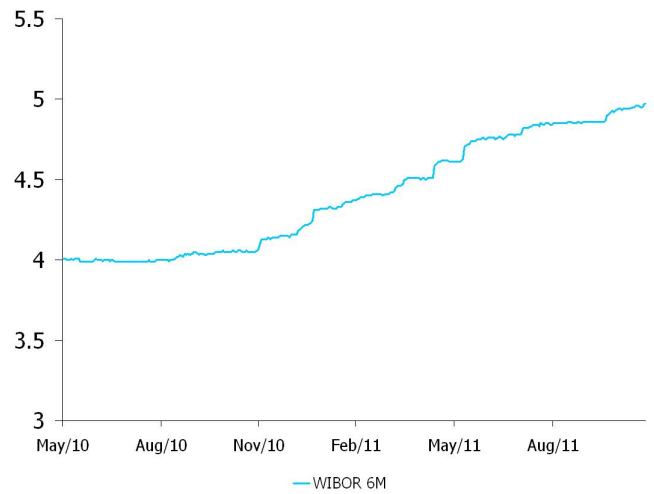


Money market

Local market under huge global pressure

Cost of carry relatively high comparing to the surplus in the system, which almost for the whole week was around PLN 5bn. The additional OMO on Tuesday did not change that fact, neither today's regular operation (PLN 96bn bought out of PLN 99bn on offer). Since not much time left to the reserve end, this month will be quite expensive despite the over liquidity of the system left on accounts not in the central bank. This should be subject for further analysis of the liquidity risk on the local market.

Front end under huge pressure of the global environment. Not only euro zone but also Hungary. All highly unfavourable for the polish currency, which very fast is being reflected in rates. Out of global outlook current levels suggest that the next MPC movement should be rates hike, which we consider as highly unlikely scenario.





Forex

Zloty above 4.50! (again) The optimism in CEE space was very short lived. The strongest Zloty this week was marked by 4.4250 early Monday morning, and from this point the situation was changing from bad to worse. The EUR/PLN resumed its march up, taking 4.5230 high on Thursday night. The only interruption was Central Bank intervention conducted on Wednesday, which gave our currency 3 groszy dip, but later it was reversed due to poor auction in Germany. The global crisis is in the driving seat!

Creeping higher The front end of the curve was heavily offered due to holiday in USA, as the result the 1 week was given well below the 1 month vole. In the middle/back end of the curve the situation was reverse, the 6 month and 1Y EURPLN ATM was traded at 14.00% (13.75 mid last week), and the market is bid on. The risk reversals and currency spread (the difference between EUR/PLN and USD/PLN), both higher by 0.25 1y 25D RR mid is 5.4% and 1y currency spread is 10.50%.

Short-term forecasts

Main supports and resistances

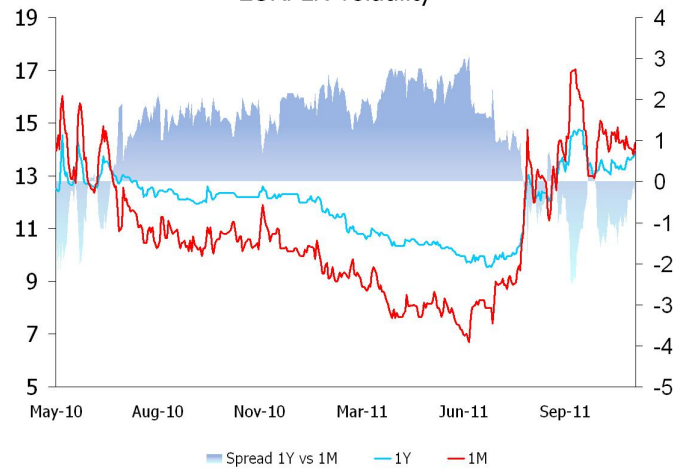
EUR/PLN: 4.4050 / 4.5500

USD/PLN: 3.2500 / 3.5000

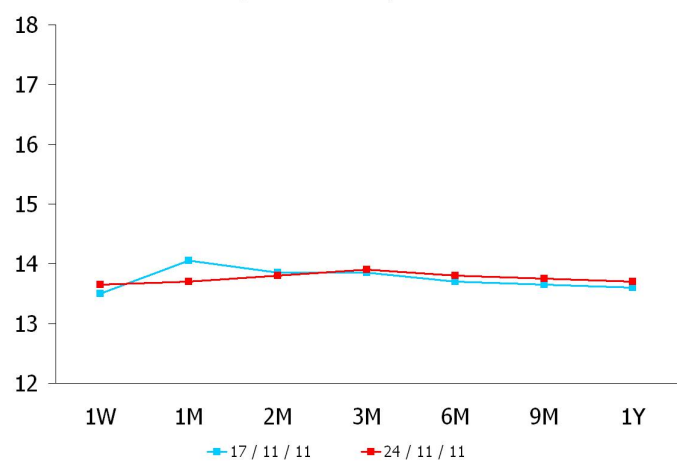
Spot. We are now in the eye of the cyclone, and it may look calm but it is far from being so. In our opinion the NBP should wait till the positive news and intervene with the trend rather than standing on the way of the well established trend. The 4.50/4.53 zone is pivotal and we would rather buy EUR/PLN next day, after larger scale intervention or sell EUR/PLN if risk off pushes the cross to fresh highs. In 4.50/4.53 zone, both sides have even probability...

Derivatives. We stick to our core Vega long in 3 months / 6 month window. We have bought back the front end and also add same gamma to the book. We are now outright long Vega, Gamma, In EUR/PLN but we are square in Volga and Vanna. We are hoping, that revisit of this years highs in volatility (15.5% 3 months, 14.75 6 months) is on its course.

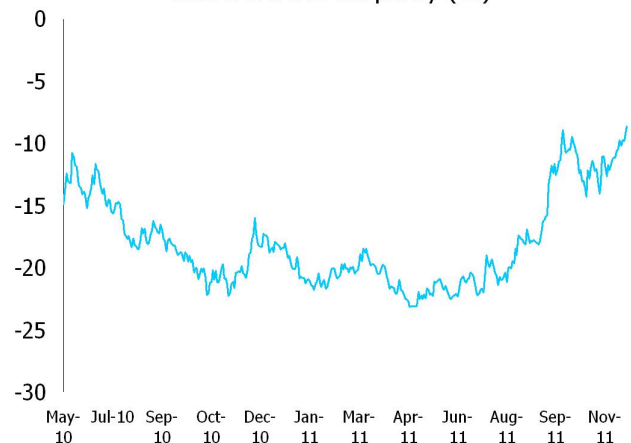
EURPLN volatility



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
11/18/2011	4.72	4.95	4.95	6.49	4.80	6.59	4.96	4.91	4.74	4.65	4.57	4.79
11/21/2011	4.72	4.94	4.76	4.85	4.74	4.86	4.93	4.90	4.75	4.67	4.63	4.79
11/22/2011	4.77	4.94	4.96	4.85	4.81	4.86	4.96	4.91	4.77	4.67	4.63	4.82
11/23/2011	4.74	4.94	4.95	4.86	4.80	4.86	4.97	5.00	4.83	4.73	4.75	4.87
11/24/2011	4.80	4.96	4.98	4.87	4.82	4.87	4.99	5.02	4.87	4.78	4.78	4.92

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
OK0114	8/10/2011	1/25/2013	89.58	4.58	5000	4934	1889
PS1016	10/19/2011	10/25/2016	98.44	5.11	3600	11200	3638
DS1021	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
11/18/2011	6.590	4.425	4.750	4.754	4.840	5.172	4.980
11/21/2011	4.860	4.425	4.770	4.782	4.870	5.205	5.000
11/22/2011	4.855	4.425	4.790	4.782	4.880	5.208	4.990
11/23/2011	4.860	4.425	4.870	4.848	5.000	5.392	5.129
11/24/2011	4.870	4.425	4.910	4.931	5.090	5.471	5.210

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1M	1Y
11/18/2011	14.05	13.70	13.70	13.60	13.60	4.63	0.44	0.71
11/21/2011	14.00	13.85	13.80	13.70	13.70	4.63	0.44	0.71
11/22/2011	13.80	13.75	13.80	13.70	13.70	4.63	0.42	0.71
11/23/2011	14.25	14.00	13.95	13.90	13.90	4.73	0.51	0.82
11/24/2011	13.70	13.90	13.80	13.70	13.70	4.68	0.84	1.02

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
11/18/2011	4.4283	3.2718	3.5812	4.2654	1.4338	0.1737
11/21/2011	4.4366	3.2984	3.5841	4.2934	1.4516	0.1737
11/22/2011	4.4447	3.2880	3.5985	4.2735	1.4554	0.1743
11/23/2011	4.4637	3.3191	3.6233	4.3086	1.4529	0.1744
11/24/2011	4.4855	3.3486	3.6460	4.3416	1.4492	0.1748

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