



TOP NEWS FROM THE POLISH MARKET

MACROECONOMICS

- MPC left interest rates unchanged. The medium term inflation outlook has not changed significantly from October • pages 2-3
- Stronger than expected GDP data for Q3. Investment expanded at a record rate of 19.8% y/y
- We do not, however, see the prospects of higher inflation pressure as resulting from domestic demand. The data on GDP do not change the view of the MPC on the economy and inflation
- MF: CPI rose to 1.5% y/y in November
- Excise rates to rise in January as expected, may raise CPI path by 0.2 pct pts
- Convergence Plan approved by the government, GG deficit below 3% GDP in 2009
- EUR-denominated bond placement in January

FIXED INCOME

- Yields drifting lower • page 3

FI RECOMMENDATION

- Stay pay 9x12

MONEY MARKET

- Cheap end of the reserve • page 4
- The MPC paused just as expected

MM RECOMMENDATION

- Sell 1 and 2m OIS above 3.95%

FOREIGN EXCHANGE

- Zloty stronger • page 4
- Volatility falling

FX RECOMMENDATION

- Zloty stronger
- Long Vega

MARKET PRICES CHARTS CALENDAR CONTACT LIST

- page 5
- page 6
- page 7
- page 8

MACROECONOMICS

MPC left interest rates unchanged

The medium term inflation outlook has not changed significantly from October

Stronger than expected GDP data for the third quarter

Investment expanded at a record rate of 19.8% y/y

We do not, however, see the prospects of higher inflation pressure as resulting from domestic demand

The data on GDP do not change the view of the MPC on the economy and inflation

The MPC didn't change the interest rates during its last meeting. The statement was rather "dovish". In the balance of risk the MPC didn't emphasise the significant drop of the BAEL unemployment rate in Q3 and growing unit labour costs in the economy. The MPC wrote that "the latest data signal that in 2006 Q4 the annual CPI inflation may prove lower than expected in the October projection, while the <net> inflation will be in line with the projection. Despite the fact that in 2006 Q4 the CPI inflation will most probably be lower than expected, in the Council's assessment, the medium term inflation outlook has not significantly changed as compared to that from October". Such a statement indicates that there is a majority in the MPC which will not opt for prompt interest rate hikes. From the speech of the NBP chairman we may conclude that the MPC voted for the hike at this meeting and this motion has been rejected. It is noteworthy that the MPC again distanced itself from the October inflation projection. In the assessment of the medium term inflation outlook the MPC related not to the projection from October but to the outlook from October.

Taking into account the current wages growth and our inflation forecasts we believe that interest rates will remain unchanged at least till April.

On Friday, the CSO released the data on GDP for the third quarter. The data showed GDP up by 5.8% y/y, which was well above the expected 5.5%. Furthermore, the seasonally adjusted figure (1.6% q/q) along with the revised data for the second quarter (1.2% q/q) indicate that the pace of economic growth accelerated. On the demand side, private consumption rose by 5.5% y/y as compared to 4.9% in Q2. Investment expanded at a record rate of 19.8% y/y. Contribution of net exports was negative but given the huge domestic market it cannot be seen as a sign of weakness of the Polish economy. On the supply side, the value added was up by 5.7% y/y. When compared with the first half of 2006 the major difference we note in the figure is for the construction sector. The value added accelerated there to 14.8% y/y. In our opinion, the construction sector, as well as the vast majority of remaining sectors, will also continue to perform very well in the fourth quarter.

The genuine boom in investment is an indication that the long-run growth rate of the Polish economy (or potential GDP growth rate) might be higher, which should also offset the danger of closing the output gap. Typically, investment precedes higher consumption growth by a few quarters. However, we do not see the prospects of higher inflation pressure as resulting from higher domestic demand. We rather link this phenomenon to the so-called Balassa-Samuelson effect. We are revising our forecast of GDP growth for the whole year 2006 upwards to 5.5%.

The data on GDP have triggered some comments from the MPC members. According to Professor Filar the GDP growth rate was by far better than expected, which he saw as a sign that the Council should reconsider the interest rate hike at its meeting in December. Much more dovish was Professor Pietrewicz, who pointed to the favourable GDP breakdown and no necessity of tightening the monetary policy in the nearest future. Somewhere in between we find the statement of Mrs. Wasilewska-Trenkner, who upheld her view regarding prospects for inflation. In Mrs. Wasilewska-Trenkner's opinion higher GDP growth will not translate into higher inflation immediately and the official Central Bank's inflation projection remained in force, at least in terms of mid-run forecasts.

Summarizing, the data on GDP do not change the view of the MPC on the economy and inflation, in particular. We also uphold our view that the interest rate hike will take place not earlier than in April 2007.

The MF forecasts that the CPI in November rose by 0.1% m/m and 1.5% y/y. Both figures are in line with our forecast, slightly lower than preliminary estimates made after October data was

**MF: CPI rose to 1.5%
y/y in November**

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January as expected,
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**Convergence Plan
approved by the gov-
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below 3% GDP in 2009**

**EUR-denominated
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January**

**MF sees further PLN
strengthening**

published. This leads to lower CPI path in the coming months, CPI will rise to 1.8% in December (according to our and MF forecasts). The MF expects the peak in CPI is to be reached in March (2.2-2.3%), then after a seasonal drop the CPI is to slightly exceed 2% at the end of the year. The next year's CPI path presented by the MF is slightly below our expectations, though we also see the CPI to stay below 2.5% next year.

As expected the Ministry of Finance decided to raise the gasoline excise rate by 0.25 PLN/l. The rise will start from January 1 and may increase the CPI by 0.1 pct pt. Also cigarettes' excise rate will be raised by 13%, which may increase cigarette prices by up to 10%. The latter effect however will be spread over time, as in previous years the rises in cigarette prices due to excise hikes was observed as late as March or April. The delayed effect may add an additional 0.1 pct pt to the CPI path. The excise hikes will raise budget income by some 2.5 b PLN (this was already included in the Budget Act).

The government approved the updated Convergence Plan. The GG deficit in 2007 is to reach 3.4% GDP (this includes pension reform costs). If this was to happen, EDP procedure against Poland may be stopped as we are allowed to deduct part of pension reform costs if the total GG deficit is close to 3% GDP. The reduction of deficit below 3% is to occur in 2009 (2.9%). The forecast's major weakness is the high pace of GDP growth (above 5% in every year). Apart from that, Zyta Gilowska is reinstating her plans to lower labour costs by cutting social insurance rates (by 16% in 2008-09), though no precise source of financing these cuts has been specified.

Deputy Finance Minister Piotr Soroczyński stated that the January EUR-denominated bonds issue is to exceed 1 bn EUR. The lower boundary is fairly low compared to previous EUR issues (e.g. 3 bn EUR at the beginning of this year), and Soroczyński stated that if the total offer is not high, the MF may consider further placements on other markets (CHF, JPY or USD). He added that the PLN is to appreciate in the coming months and may break the 3.70 threshold (vs EUR) in February. He did not give reasons for that, but it must be mentioned that this is the second statement by a government member that points to forecasted PLN strengthening (earlier this week the PM J. Kaczyński stated that the PLN is undervalued). This is in line with our view, we think the EUR/PLN will reach 3.70 in the first half of next year.

FIXED INCOME

Yields drifting lower

Last week we observed yields moving down across the curve. MPC's comment was quite neutral for the market and didn't change the rates outlook. Also GDP data, higher than consensus and followed by MPC Filar's comments calling for a reaction, didn't change the positive sentiment. This week most important issue is the 2Y bond auction to be held on Wednesday. We expect the supply to be in the middle of proposed range of 3-4bio, which should be placed without any problems - considering central bank reluctance to hike rates, it still seems attractive at current levels. We think the market is still in range and close to the lower band at the moment. Therefore slight rebound from current levels is quite likely. However, as liquidity gradually fades away towards the year-end and as there are no economic data releases scheduled for this week, we do not expect any significant moves. There is now less than 50bp hikes priced in the FRA curve within a year, so the risk seems to be asymmetrical there, with potential strengthening very limited, thus we sustain our recommendation to pay 9x12 FRA.

RECOMMENDATION:

Stay pay 9x12.

MONEY MARKET**Cheap end of the reserve**

Last days of the reserve were very cheap. At the end of the last reserve day the market placed in the CB over 5 billion pln, which best visualizes the scale of surplus. Open market operation was 20.8 billion pln (19.5 during the previous auction) which was fair enough to push the carry up at the beginning of the new reserve. Hence, next week shortest rates around the main market rate.

The MPC paused just as expected

As for longer terms range trading all the week, however the sentiment is very positive after much better than expected CPI forecast by the MinFin. It is not only good for this year but also for the first quarter of the year 2007.

The MPC did not change any parameters of the monetary policy just as expected. It should stay that way till the end of the Q1 2007 or maybe even longer.

RECOMMENDATION:

Sell 1 and 2m OIS above 3.95%.

FOREIGN EXCHANGE**Zloty stronger**

Last week the EUR/USD climbed further to 1.3300. The main adjustment took place through USD/PLN, which traded today morning as low as 2.8580. The Zloty strength is mostly reflected by EUR/PLN, which on Monday open traded at 3.8055 (-20.8% on the appreciating side of the old parity).

Volatility rising

The EUR/PLN volatilities have been gradually declining through the week: on Friday close the 1M EUR/PLN traded at 6.6 (down from 7.0 last Monday), 1Y stayed flat at 7.45. On the other hand, the USD/PLN volatilities significantly rose, especially on the short end of the curve - 1M up from 8.0 to 8.7; 1Y stayed unchanged at 9.7.

RECOMMENDATION:

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Zloty stronger

Spot:
Main supports / resistances:
EUR/USD: 1.3150 / 1.3400
EUR/PLN: 3.8000 / 3.8500
USD/PLN: 2.8500 / 2.9200

We recommend long Zloty positions the following week.

Long Vega

Options:

We still recommend long Vega positions at current levels.

MARKET PRICES UPDATE**MONEY MARKET RATES**

Money market rates (Closing mid-market levels)						
date	3M		6M		1Y	
	FXSW	WIBOR	FXSW	WIBOR	FXSW	WIBOR
27-11-06	4.12%	4.19%	4.26%	4.32%	4.49%	4.53%
28-11-06	4.12%	4.19%	4.26%	4.33%	4.49%	4.52%
29-11-06	4.14%	4.20%	4.26%	4.34%	4.48%	4.53%
30-11-06	4.14%	4.20%	4.25%	4.33%	4.48%	4.53%
01-12-06	4.12%	4.20%	4.23%	4.34%	4.43%	4.53%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
	27-11-06	4.23%	4.35%	4.53%	4.66%
28-11-06	4.23%	4.36%	4.53%	4.66%	4.62%
29-11-06	4.23%	4.35%	4.53%	4.65%	4.62%
30-11-06	4.23%	4.35%	4.53%	4.67%	4.63%
01-12-06	4.23%	4.35%	4.52%	4.64%	4.62%

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
27-11-06	4.53%	4.24%	4.79%	4.54%	5.04%	4.94%	5.11%	5.19%
28-11-06	4.52%	4.23%	4.78%	4.50%	5.02%	4.92%	5.09%	5.16%
29-11-06	4.53%	4.20%	4.78%	4.48%	5.02%	4.90%	5.08%	5.14%
30-11-06	4.53%	4.20%	4.78%	4.51%	5.00%	4.88%	5.04%	5.13%
01-12-06	4.53%	4.18%	4.74%	4.49%	4.95%	4.86%	5.00%	5.10%

PRIMARY MARKET RATES

Last Primary Market Rates							
	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	06-10-23	07-10-24	95.800	4.34%	800	1814	800
OK1208	06-11-02	08-12-12	90.758	4.72%	1400	4154	1400
PS0511	06-10-18	11-05-24	95.670	5.33%	2000	4251	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
27-11-06	8.50	8.20	8.80	9.50	0.90	1.30	0.40	0.45
28-11-06	8.70	9.00	9.30	9.75	0.90	1.30	0.40	0.45
29-11-06	8.70	9.00	9.40	9.75	0.90	1.30	0.40	0.45
30-11-06	8.70	9.00	9.40	9.70	0.90	1.30	0.40	0.45
01-12-06	8.70	9.00	9.40	9.70	0.90	1.30	0.40	0.45

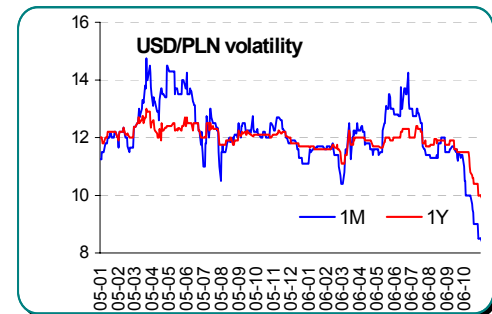
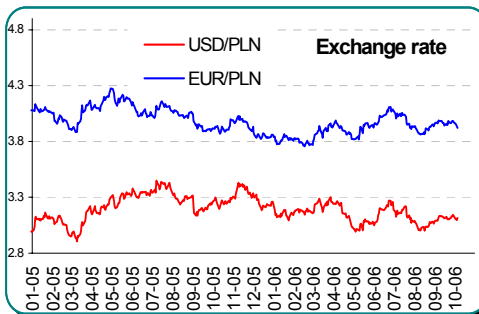
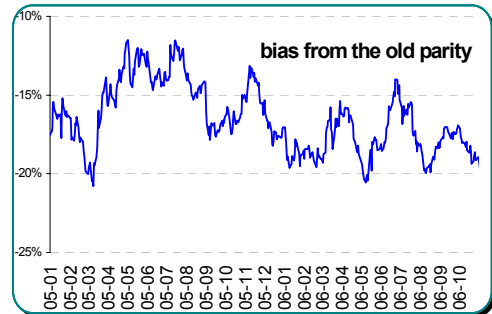
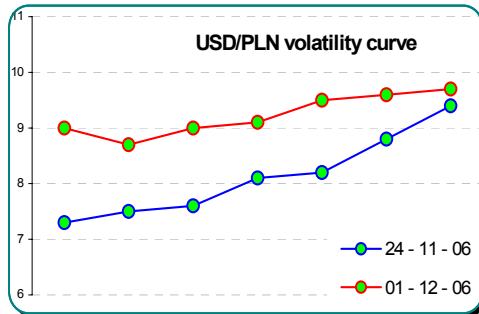
PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
27-11-06	2.9176	3.8308	-21.31%
28-11-06	2.9176	3.8355	-21.25%
29-11-06	2.9035	3.8235	-21.55%
30-11-06	2.8911	3.8166	-21.78%
01-12-06	2.8700	3.7982	-22.24%

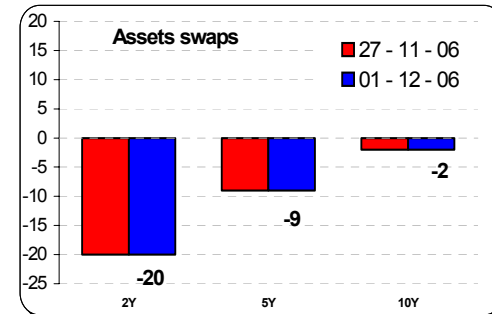
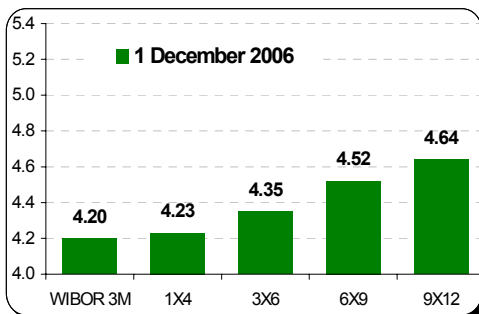
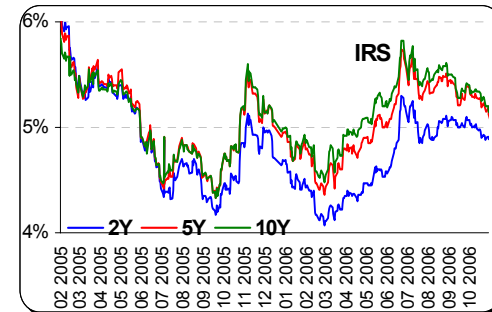
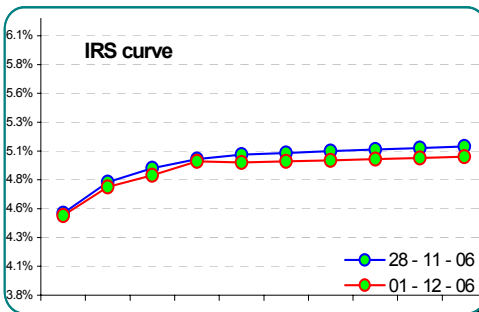
Note: parity on 11/04/00 – USD= 4.3806, EUR=4.2196, basket share 50:50
Mid-market volatility of vanilla option strategies

CHARTS

Foreign Exchange



Fixed Income



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CALENDAR

Macro

	August	September	October	Data Release	BRE Bank forecast
CPI m/m	0.3%	0.2%	0.1%	14-12-06	
CPI y/y	1.6%	1.6%	1.2%	14-12-06	
PPI m/m	-0.1%	0.0%	-0.3%	19-12-06	
PPI y/y	3.3%	3.6%	3.4%	19-12-06	
Industrial production growth m/m	2.4%	9.3%	4.1%	19-12-06	
Industrial production growth y/y	12.6%	11.7%	14.6%	19-12-06	
Average wages in enterprise sector [PLN]	2611.9	2611.2	2658.0	15-12-06	
Average wages in enterprise sector y/y	5.3%	5.1%	4.7%	15-12-06	
Unemployment	15.5%	15.2%	14.9%	22-12-06	
Budget realisation (%)	47.5%	47.4%	54.4%	15-12-06	
Current account [EUR mn]	-584	195		13-12-06	
Balance of foreign trade in goods (transaction basis) [EUR mn]	-438	-299		13-12-06	
Exports growth y/y (transaction basis)	23.1%	17.3%		13-12-06	
Imports growth y/y (transaction basis)	23.7%	19.1%		13-12-06	
Current account [% of GDP]	-2.1%	-1.9%		13-12-06	
Money supply (M3)	447.2	453.1	458.8	14-12-06	
Money supply growth y/y	12.9%	13.0%	12.3%	14-12-06	
Total PLN loans [PLN bn]	339.1	346.2	353.0	14-12-06	
Households PLN loans	170.1	175.3	178.9	14-12-06	
Corporate PLN loans	136.4	138.1	137.8	14-12-06	
Total PLN deposits [PLN bn]	370.6	374.1	378.5	14-12-06	
Households PLN deposits	213.2	214.4	214.3	14-12-06	
Corporate PLN deposits	108.7	111.0	113.8	14-12-06	
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	04-12-06	1000	4.259%	20-11-06
2Y T-bond OK1208	06-12-06	-	4.723%	02-11-06
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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