



TOP NEWS FROM THE POLISH MARKET

MACROECONOMICS

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- MPC member Wasilewska-Trenkner: MPC should wait with decision till January projection
- We maintain our view that first cut occurs no earlier than April
- Unemployment rate in November dropped to 14.8%
- Contrary to expectations the seasonally adjusted figure for industrial output dropped to 10.2% y/y as compared to 12.5% in October. Producer prices dropped by 0.5% m/m in November resulting in an annual rate of 2.6%
- The data on retail sales in November were stronger as compared to those for October ...
- The Polish CSO sees the GDP growth rate at 6% for the 4th quarter
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MACROECONOMICS

MPC didn't change the rates

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Unemployment rate in November dropped to 14.8%

Contrary to expectations the seasonally adjusted figure for

According to expectations the MPC didn't change interest rates during its last meeting. Thus the statement was more hawkish than last month. The MPC wrote that *"the analysis of inflation outlook indicates that maintaining inflation close to the target of 2.5% in the medium term may require monetary policy tightening"*. Moreover in the statement there was a new phrase that *"some factors may arise in 2007 which can temporarily pull (CPI) inflation down in some periods"*. Unfortunately the MPC didn't reveal the financial markets in which these factors are. This change in the statement is a bit confusing because the last data: lower than expected CPI, moderate wages growth and balanced GDP growth don't seem to be a reason for the tightening. Lower than expected current inflation awakened such a reaction of the MPC that *"the latest data suggest that annual CPI inflation in 2006 Q4 will be lower than was indicated in the October projection. 'Net' core inflation will run close to the path expected in the projection"*. We think that by the announcement of monetary policy tightening the MPC wanted to show the market that after the retirement of Balcerowicz there will be no significant turnover in the monetary policy and the MPC will be able to hike the rates if needed.

MPC member Prof. Andrzej Slawinski expressed the view which stays in line with the more hawkish statement. He said that actual output is higher than the potential one, which in the short-term may result in an increase of inflationary pressure in spite of growing productivity. He didn't exclude that the MPC may be forced to hike the rates to maintain price stability. On the other hand he pointed out some factors which may lead to a decrease of the pressure in the longer-term. The first one is FDIs, which may increase the potential output. The second one is growing competitiveness as a result of a more open economy. And last but not least is the exchange rate, which in his opinion should be stable and diminish the inflationary pressure.

Another MPC member, Halina Wasilewska-Trenkner, said that high economic growth seen at 6.0% in the coming quarters may threaten the low inflation. However she emphasized some factors like lower food prices and the strong zloty, which may diminish inflationary pressure. In the opinion of Wasilewska-Trenkner the MPC should wait with a decision till the projection in January will be accessible.

Our comment: We believe that the MPC sees significant inflationary risks coming mostly from demand pressure and the labour market. On the contrary the effects of globalization and the strong zloty should diminish the consumer prices growth. In spite of the more hawkish statement confirmed by both members we believe that the first hike by 25 bps will occur no earlier than April.

The unemployment rate in November dropped to 14.8% from 14.9% in October. The decrease is slightly lower than we expected, but better than would result from the seasonal pattern – in November in previous years the unemployment rates were on average at the level from October. The number of unemployed fell by 14,500. We expect that in December the rate of unemployment will drop to 14.7%. Due to very favourable weather conditions the seasonal retirements in some branches (i.e. construction) will be limited. Moreover the enterprises are more willing not to decrease employment, because they will have problems finding workers in Spring. However in February unemployment may increase to 15% due seasonal factors.

The industrial output dropped by 2.9% m/m in November, which translated into an annual increase of 11.7%. Contrary to expectations the seasonally adjusted figure dropped to 10.2% y/y as compared to 12.5% in October. The breakdown showed that the output in manufacturing rose by 13.9% y/y, while the output in the mining industry and energy supply dropped by 3.8 and 2.1% respectively. It is puzzling that the data on the automobile industry that has been released

industrial output dropped to 10.2% y/y as compared to 12.5% in October.

by SAMAR and are widely perceived as a good indicator for manufacturing did not point to a slowdown in November. Strong figures have been recorded in construction, where the output rose by 23.4% annually.

While the annual rates of industrial production growth are expected to head down in December and January, this is due partly to the statistical effect of a low base, meaning the (seasonally adjusted) month on month figures might prove to go up.

Producer prices dropped by 0.5% m/m in November resulting in an annual rate of 2.6%

Producer prices dropped by 0.5% m/m in November resulting in an annual rate of 2.6%, which was lower than the expected 3.0%. This discrepancy can be partially explained by a downward revision of the data for October and lower than anticipated prices in the mining industry and oil. It should be noted that the annual PPI rate for manufacturing (1.3%) is significantly lower compared to the overall PPI figure, which can be read off as a sign that the demand driven pressure on producer prices is subdued

The data on retail sales in November were stronger as compared to those for October ...

Contrary to the weaker data for industrial output the data on retail sales in November were stronger than those for the previous month. Retail sales rose by 13.6% y/y. In real terms the annual rate accelerated to 14.1% as compared to 13.9% in October. What can we deduce from this figure? First, for the second month in a row there was a deflation in retail sales prices. As the retail price index approximately corresponds to the demand part of the inflation basket the data confirm our finding that the demand driven inflationary pressure remains subdued. Secondly, the strong data suggest that the GDP figure for the 4th quarter might likewise be strong.

The Polish CSO sees the GDP growth rate at 6% for the 4th quarter

At this point we note that our forecast for GDP growth in the 4th quarter is a notch lower than the one anticipated by the Central Statistical Office. Mrs Dmochowska suggested on Friday that the GDP growth can in the 4th quarter outpace that for the 3rd quarter, i.e. it can be close to 6%. Although the CSO has already collected the data for October and November, the fact that there are 2 days fewer in December 2006 as compared to December 2005 might result in an annual growth rate of GDP at around 5.5%.

All measures of core inflation were up in November as compared to October

The Central Bank released the data on core inflation for November. All measures of core inflation, including net inflation, 15 pct trimmed mean, inflation excluding the most volatile prices, controlled prices and fuel prices, were up as compared to October. The net inflation rose to 1.6% (1.3% in October). The increase in core inflation measures is mainly due to a low base effect originating from lower prices on internet and cable TV in 2005. We uphold our forecast of net inflation below 2% at the end of 2007.

FIXED INCOME

All the best wishes for New Year

Last week was very quiet on the PLN curve, action was very limited due to closing Xmas period. Some bits of interesting news for market came on Friday, after core CPI rising to 1.6 and downgrade of Hungary and still missing post of new head of NBP we look for nervous opening in the market. But that will all happen in New 2007 year. Till then we look forward calm period, and we wish everybody all the best in the New Year.

RECOMMENDATION:

Stay pay in 9x12 FRA

MONEY MARKET**Cheap end of the reserve ahead****No change by the MPC****T-bills stable during the tender****RECOMMENDATION:**

Very cheap end of the week indicates similar scenario at the end of the reserve next week. The CB offered 16.3 billion pln of money bills (17 billion was maturing at the same date), which left a little surplus. Yet, this was enough to push the carry below 3.5%. Week ahead will be very quite and cheap.

As for longer terms not too much action despite of the figures. Weaker PPI, lower IO- these do not change our view. Rates hike at the end of next quarter if any.

The MPC did nothing just like expected by everyone.

The average yield on Polish benchmark 52-week T-bill stood stable at to 4.212%. The Ministry sold all 1 billion pln of 52-week papers plus 2.2 billion pln of 5-week maturity. This unusual offer was priced at 3.914%.

Sell OISs up to 3M.

FOREIGN EXCHANGE**Zloty stable****Volatility lower****RECOMMENDATION:****Zloty stronger****Long Vega**

Last week the Zloty remained stable due to pre-Christmas mood on most of the markets. EUR/PLN traded close to 3.8000, USD/PLN around 2.9000 and the EUR/USD around 1.3100.

The EUR/PLN volatilities have been at their supports for a long time. Even the seasonal period of quite markets before holidays did not move volatilities down. On Friday 1 week EUR/PLN (encompassing 4 holiday days) was offered at 7.0 – even higher than 1 month! (1M traded at 6.7). 1Y still traded at 7.2 . The USD/PLN volatilities remained stable: 1M at 8.7; 1Y at 9.7.

Spot:

Main supports / resistances:

EUR/USD: 1.3080 / 1.3250

EUR/PLN: 3.7950 / 3.8350

USD/PLN: 2.8500 / 2.9200

We still recommend long Zloty positions the following week and see EUR/PLN declining towards 3.7500 in the mid-term.

Options:

We still recommend long Vega positions at current levels, especially as the post-holiday period (e.g. first weeks of January) historically saw increase in Spot volatilities.

MARKET PRICES UPDATE**MONEY MARKET RATES**

Money market rates (Closing mid-market levels)						
date	3M		6M		1Y	
	FXSW	WIBOR	FXSW	WIBOR	FXSW	WIBOR
18-12-06	4.11%	4.20%	4.25%	4.31%	4.47%	4.51%
19-12-06	4.10%	4.20%	4.25%	4.31%	4.46%	4.51%
20-12-06	4.09%	4.20%	4.23%	4.31%	4.47%	4.51%
21-12-06	4.11%	4.21%	4.24%	4.31%	4.46%	4.52%
22-12-06	4.10%	4.20%	4.23%	4.30%	4.48%	4.52%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
18-12-06	4.25%	4.37%	4.54%	4.64%	4.63%
19-12-06	4.25%	4.38%	4.55%	4.66%	4.63%
20-12-06	4.25%	4.38%	4.53%	4.64%	4.62%
21-12-06	4.24%	4.35%	4.53%	4.63%	4.62%
22-12-06	4.24%	4.36%	4.53%	4.64%	4.63%

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
18-12-06	4.51%	4.21%	4.69%	4.36%	4.93%	4.83%	5.02%	5.13%
19-12-06	4.51%	4.18%	4.69%	4.37%	4.94%	4.85%	5.03%	5.14%
20-12-06	4.51%	4.18%	4.68%	4.33%	4.92%	4.80%	5.02%	5.11%
21-12-06	4.52%	4.18%	4.68%	4.28%	4.92%	4.80%	5.01%	5.10%
22-12-06	4.52%	4.19%	4.69%	4.29%	4.93%	4.80%	5.02%	5.10%

PRIMARY MARKET RATES

Last Primary Market Rates							
	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	06-12-04	07-12-05	95.915	4.21%	1000	1556	1000
OK1208	06-12-06	08-12-12	91.311	4.62%	3800	10428	3800
PS0511	06-11-15	11-05-24	97.047	4.99%	2000	4852	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
18-12-06	8.35	8.65	9.20	9.40	0.90	1.25	0.40	0.45
19-12-06	8.35	8.70	9.40	9.50	0.90	1.25	0.40	0.45
20-12-06	8.35	8.70	9.20	9.50	0.90	1.25	0.40	0.45
21-12-06	8.35	8.70	9.20	9.50	0.90	1.25	0.40	0.45
22-12-06	8.35	8.70	9.30	9.50	0.90	1.25	0.40	0.45

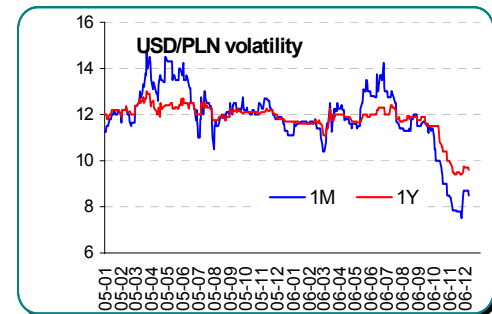
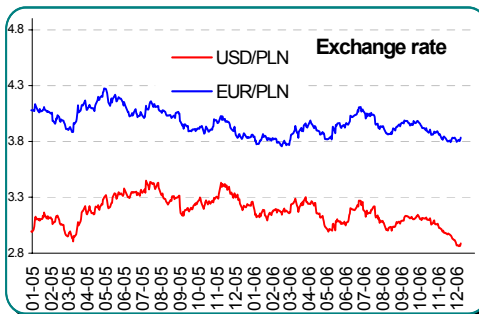
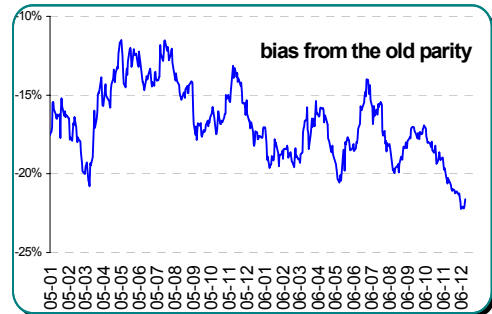
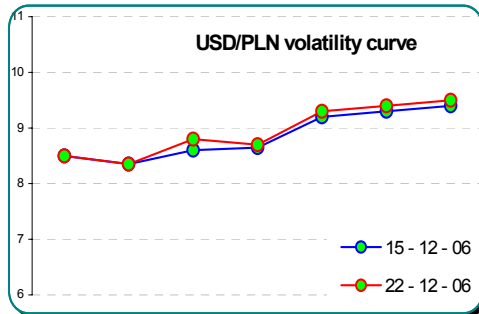
PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
18-12-06	2.8951	3.7938	-22.00%
19-12-06	2.8896	3.8026	-21.96%
20-12-06	2.8849	3.8140	-21.88%
21-12-06	2.8796	3.8003	-22.10%
22-12-06	2.8908	3.8163	-21.78%

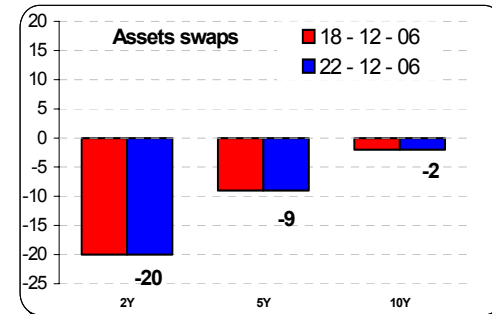
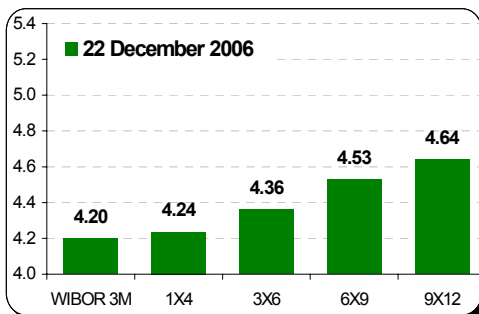
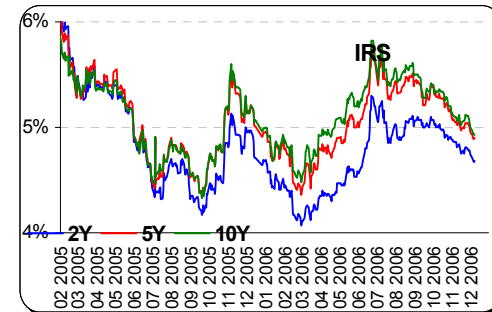
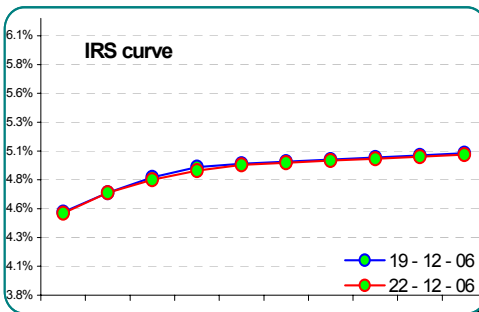
Note: parity on 11/04/00 – USD= 4.3806, EUR=4.2196, basket share 50:50
Mid-market volatility of vanilla option strategies

CHARTS

Foreign Exchange



Fixed Income



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CALENDAR

Macro

	October	November	December	Data Release	BRE Bank forecast
CPI m/m	0.1%	0.0%		15-01-07	
CPI y/y	1.2%	1.4%		15-01-07	
PPI m/m	-0.5%	-0.5%		19-01-07	
PPI y/y	3.2%	2.6%		19-01-07	
Industrial production growth m/m	4.3%	-2.9%		19-01-07	
Industrial production growth y/y	14.8%	11.7%		19-01-07	
Average wages in enterprise sector [PLN]	2658.0	2759.7		16-01-07	
Average wages in enterprise sector y/y	4.7%	3.1%		16-01-07	
Unemployment	14.9%	14.8%		23-01-07	
Budget realisation (%)	54.4%	60.7%		15-01-07	
Current account [EUR mn]	-482			16-01-07	
Balance of foreign trade in goods (transaction basis) [EUR mn]	-269			16-01-07	
Exports growth y/y (transaction basis)	24.0%			16-01-07	
Imports growth y/y (transaction basis)	27.7%			16-01-07	
Current account [% of GDP]	-1.9%			16-01-07	
Money supply (M3)	458.6	465.6		12-01-07	
Money supply growth y/y	12.3%	14.4%		12-01-07	
Total PLN loans [PLN bn]	353.0	361.6		12-01-07	
Households PLN loans	183.0	183.4		12-01-07	
Corporate PLN loans	139.6	141.4		12-01-07	
Total PLN deposits [PLN bn]	378.4	385.3		12-01-07	
Households PLN deposits	214.3	214.8		12-01-07	
Corporate PLN deposits	113.8	117.0		12-01-07	
NBP intervention rate	4.00%	4.00%	4.00%	31-01-07	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	-	-	4.212%	18-12-06
2Y T-bond OK1208	-	-	4.617%	06-12-06
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

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.com.pl

Forex (BREX) - FX Spot & Options

*Marcin Turkiewicz (+48 22 829 01 84) Marcin.turkiewicz@brebank.com.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.com.pl
Paweł Białczyński (+48 22 829 01 86)*

MM (BREP) - MM, FX Swaps

*Tomasz Wołosz (+48 22 829 01 74) Tomasz.wolosz@brebank.com.pl
Bartłomiej Małocha (+48 22 829 01 77)*

Structured Products (BREP)

*Jarosław Stolarczyk (+48 22 829 01 67) Jaroslaw.stolarczyk@brebank.com.pl
Jacek Dereziński (+48 22 829 01 69)*

Institutional Sales (BRES)

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

Research

*Jacek Kołowski (+48 22 829 01 83) Research@brebank.com.pl
Ernest Pytlarczyk (+48 22 829 01 66)
Artur Ulbrich (+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 (+48 22 829 13 49)