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FINANCIAL MARKETS DEPARTMENT

PAGES: 9

WARSAW, NOVEMBER 22, 2007

POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

PREVIEW: The week of November 23rd to November 30th

Indicator	Date of release	Period	BRE forecast	Consensus	Last	Comment
Retail sales y/y	**Nov 26**	**Oct**	**9.6% y/y**	16.7%	15.5%	We expect retail sales (in constant prices) to stick to short-term trend of about 14.5%. However, owing to a surge in CPI, prices of goods comprising the retail aggregate are about to grow fast as well, leaving a room for retail sales in current prices to increase in a pace close to 17%.
MPC decision on rates	**Nov 28**	**Nov**	**5.0%**	5.0%	4.75%	We see a 25 bps. Hike a done deal. Factors preventing some of MPC members from a hawkish voting have recently dried out, paving the way for hawkish movements. For

						now 50 bps. Rate hike is not our base line scenario as an urgent need for such a move has not been officially communicated yet.
GDP y/y	**Nov 30**	**Q 3**	**5.8% y/y**	5.9%	6.4%	Anticipated slowdown in GDP growth stems from two main observations: lower retail sales that negatively influenced consumption (for Q3 we see a 6.1% rise in consumption and regard the Q2 fall in dynamics as an outlier) together with flattened construction and industrial output: proxies for lower growth of fixed capital investment (we see 15% y/y rise).

In Focus / Macroeconomics

Wage and employment growth surprisingly buoyant

Growth rate of wages and employment in enterprise sector positively diverged from market consensus in October. The first figure reached 11.0% annually whereas the latter expanded at 5.0% pace.

We do not anticipate the wage pace of growth to cool down; quite to the contrary, recent dynamics is to be sustained (cross-sectoral convergence, thriving demand for labor), fuelling thereby the ULC growth and ultimately inflation.

Employment growth reached a pace much above the recent trend (about 4.6% y/y) in October. However, the figure may be inflated by one-off factors (what in case of stock variables implies an enduring jump in growth rate). First of all, it is likely that October saw a wave of graduates entering the job market after enjoying the last and prolonged holidays - as the job market becomes very tight, there is no need to accept the job just after graduation. Polish economy is slowly entering the period when it is the employer who awaits the worker, not the other way round. Second explanation for the abnormal growth of employment bases on the fact that it is October when the bulk of students begin the academic year and start searching for job, filling the vacancies especially in retailing and restaurants. Owing to the prolonged, substantial wage growth those posts have finally become attractive and worth the effort.

Large and sudden spike in employment can be easily reconciled with excessively high growth of wages. New workers entering the labor market were able to negotiate more favorable salary schemes (higher than those for already-employed workers) which inflated the overall level of wages, enabling the dynamics of this aggregate to surpass the short-term trend of about 10%. Naturally, high wage growth may result from bonuses paid e.g. in mining. We will be able to rule out such a possibility as soon as the detailed data are published (it is Monday).

Owing to the slowly decelerating demand for labor, we expect concomitant movement in employment. However, due to a large inflow of workers recorded in October, the growth of employment will be temporarily lifted upwards (base effects) and then slowly decline (fundamentals). As for wages, we do not anticipate their pace of growth to cool down; quite to the contrary, recent dynamics is to be sustained (cross-sectoral convergence, thriving demand for labor), fuelling thereby the ULC growth and ultimately inflation.

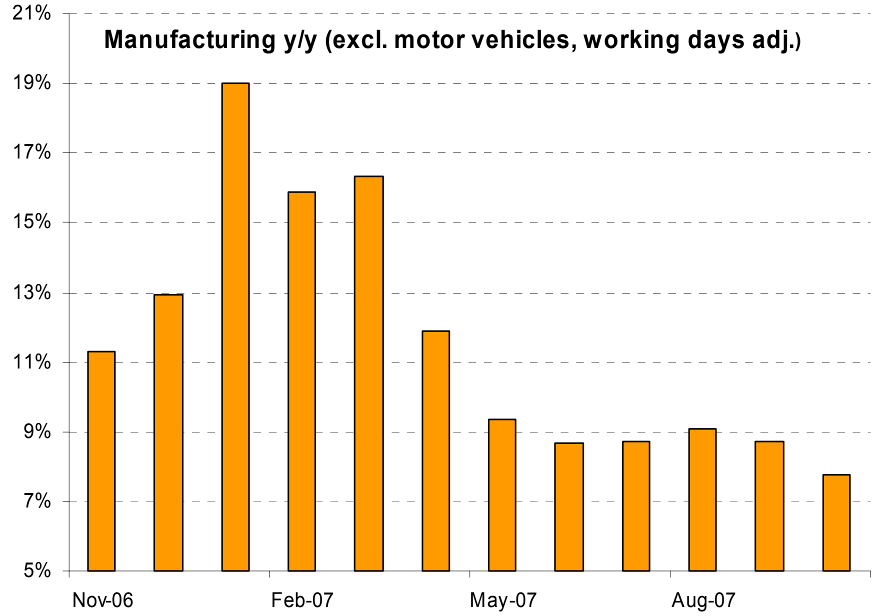
Surprising industrial output and PPI data - not really

Polish PPI rose in October to 2.2% vs. widely expected 2.5%. On month to month basis the Producer Price Index dropped by 0.2%, mainly on lower prices in manufacturing. The only, but moderate, price increase has been recorded in mining. The discrepancy between forecasts and the actual figure resulted from the revisions of the September data (by the way: revisions are the most common reasons for inaccurate short-term forecasts of the annual PPI). Notwithstanding the above, despite higher oil and commodity prices the prices in manufacturing have not been affected. There are at least two possible explanations: financial situation in manufacturing-oriented firms is very good and they are able to accommodate rising costs painlessly or/and fear of losing the price competitiveness of goods (among export oriented firms) simply discourages them from rising prices (strategic decision). We expect PPI to slowly accelerate (base effects+dearer commodities and stable zloty), although the transmission to CPI is likely to be lim-

The results of manufacturing excluding sections of volatile automotive industry were even a bit lower than in September confirming our view of a slowly decelerating output of manufacturers

ited.

Industrial output rose in October by 10.6% y/y, way above market consensus. However, in seasonally adjusted terms, 8.6% pace of growth reached in October is consistent with mid-term trend. Seasonal acceleration resulted partially from substantial rise in utilities (11.8% y/y) which added about 1.2 pp. to the dynamics of the headline figure. Extraordinary rise can be easily connected with lower (than all-year mean) temperatures in October which increased the demand for heat and energy. As for manufacturing, it rose by 10.8% y/y. Among the factors that triggered a rise it is car manufacturing that pops into the foreground. The results of manufacturing excluding sections of volatile automotive industry were even a bit lower than in September (see the chart below) confirming our view of a slowly decelerating output of manufacturers. Substantial rise was recorded in mining (11.3% m/m) – apart from a favorable working days configuration, part of the rise can be attributed to rising demand for Polish coal. We see industrial output growth to remain in mid-term trend, however, owing to base effect the annual dynamics will slowly decelerate.



MEDIUM-TERM FORECATS

Indicator	2006	2007	2008
GDP y/y (%)	6.1	6.5	5.4
Inflation rate (%)	1.0	2.4	**3.5**
Current account (% of GDP)	-2.1	-4.5	-5.3
Unemployment rate (end-of-year)	14.9	11.5	9.8
NBP repo rate (end-of-year)	4.00	5.00	**>5.5**

Source: GUS, NBP, BRE Bank, ***bold*** *change on last week*

Fixed Income

Panic reaction on the short end after wages, production point for economic upswing.

The most important event on the market was publication of wages data for October. Figure came out at 11%, way above market expectations. After initial 4 bp move up in yields, market opened next day with 5 bp gap and then moved sharply. Top levels were reached on Wednesday after rather poor 5y bond auction totaling some 15-18 bp move in 3 days. (new 5y benchmark bond was sold at minimal price 96.67 with 2.7 bio demand). 2y IRS was paid at 6.08, prinicing in full 100 bp tightening and 85% probability rates would top at 6%. Curve shape stayed very inverted with 12x15 starting to be the highest point on the curve at 6.10%. 2y10y spread is currently trading at -27bp. Some oil to the fire was added by RPP member Filar, who said that council have to act decisively in order to keep CPI in check. He pointed out that moves by 25 bp are far to little and frequency has to change from current routine to more aggressive moves. Position of he the desk now is square. We took opportunity to close our pay position, but we will add on any pull-back. What market is not pricing in is the possibility of two hikes in a row (we think November December combo is very likely) so for aggressive investors we recommend paying very front of the curve. As far as the bond market, we see bonds getting very attractive, especially in the 5y sector, additionally with curves very steep in core markets (especially US) we are rather 5y10y payer then receiver.

RECOMMENDATION:

Pay very front of the curve, buy 0412 on dip, pay 5y10y spread.

AUCTIONS

	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	4.208%	1/16/2006
26 Week T-bills	-	-	3.943%	4/24/2006
52 Week T-bills	1/14/2008	-	5.312%	11/5/2007
2Y T-bond OK1209	12/5/2007	-	5.676%	11/5/2007
5Y T-bond PS0412	2/6/2008	-	5.943%	11/21/2007
10Y T-bond DS1017	2/13/2008	-	5.699%	10/25/2007
20Y T-bond WS0922	1/9/2008	-	5.796%	9/12/2007

Money Market

Tomorrow's OMO crucial for the end of the reserve

Stable carry all the week nearby the main market rate. It is quite unusual since there was a nice surplus of the cash in the system, hence shortest rates should have been a bit lower. Tomorrow's open market operation will be crucial as far as liquidity at the end of the reserve is concerned. More and more signs are for the cheap scenario. However, having in mind last unexplained squeeze with huge surplus of cash, we suggest being cautious.

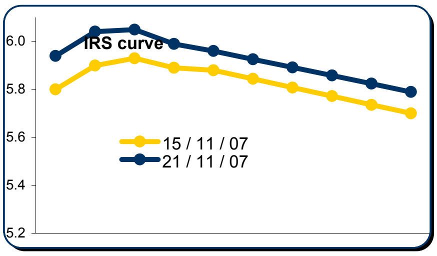
Bearish wages shortened time lag for hikes and built in some more expectations for the scope of the whole movement

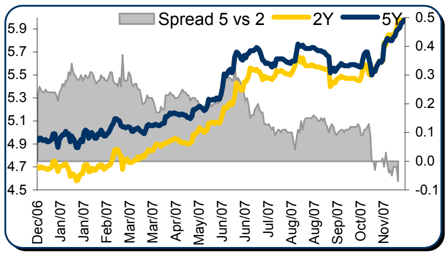
As for longer terms bearish and once again bearish. We did not see the chance for the wages to be above 10%, and the real figure was even higher (11%). This was really surprising and pushed the MM curves much higher. Rates hike expectations stayed the same as for the scope, but the time lag shortened. After this, one more (5th) hike was built in the curve. Just to give some break quite bullish PPI figure showed up, and then very bearish statement from the MPC member prof. Filar killed any hopes for those still being bullish. Not only shorter time lag for the hikes, but also 50 bps steps were suggested. As of now 6% for the repo rate in 1y time is the cap, November hike is certain and one can not exclude another one in December. However, our base scenarios today are 25 bps November, 25 bps January, 50 bps February, then wait and see bias for a while.

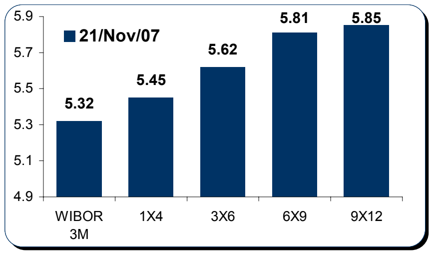
RECOMMENDATION:

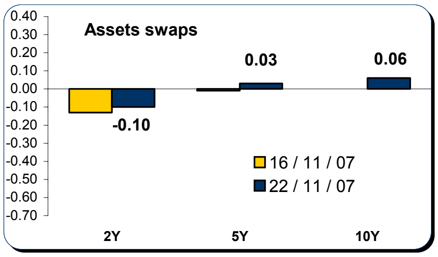
Offer 3M Polonia.

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

Zloty slightly weaker

This week złoty was traded between 3.6640 and 3.7000. Weak global sentiment and decent customers orders pushed zloty under pressure. It was a good local sentiment that calmed the market. Some stop-losses are placed above 3.70 with 3.74 providing next resistance.

Volatility curve still re-versed

Demand for long gamma and vega keeps short end on high levels, especially 2M. 1M was traded at 7.1-7.3 and 3M at 6.4-6.6.

RECOMMENDATION:

Spot:
Main supports / resistances:
EUR/PLN: 3.6500 / 3.7400
USD/PLN: 2.4500 / 2.5600

Look for upticks to sell EURPLN

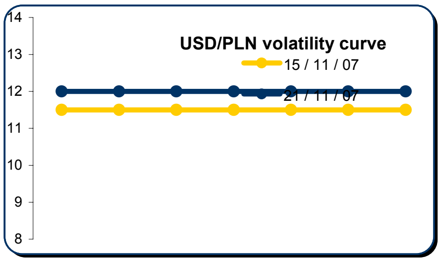
We see PLN as much stronger in medium term, so sell around 3.7200 with S/L at 3.7400.

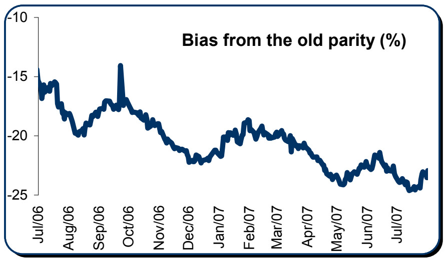
Options:

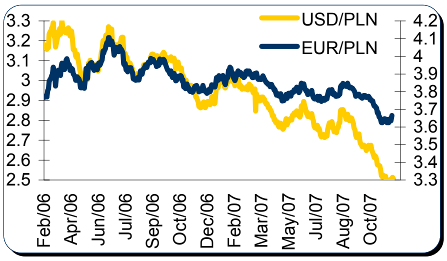
Sell mid-curve vega

We see 2M and 3M present levels as opportunities to take some short vega/gamma, especially due to Christmas being part of options life.

FX CHARTS


USD/PLN volatility curve
15 / 11 / 07
21 / 11 / 07
14
13
12
11
10
9
8


Bias from the old parity (%)
-10
-15
-20
-25
Jul/06
Aug/06
Sep/06
Oct/06
Nov/06
Dec/06
Jan/07
Feb/07
Mar/07
Apr/07
May/07
Jun/07
Jul/07


USD/PLN
EUR/PLN
3.3
3.2
3.1
3
2.9
2.8
2.7
2.6
2.5
4.2
4.1
4
3.9
3.8
3.7
3.6
3.5
3.4
3.3
Feb/06
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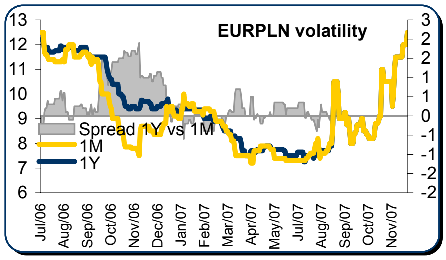
EURPLN volatility
Spread 1Y vs 1M
1M
1Y
13
12
11
10
9
8
7
6
Jul/06
Aug/06
Sep/06
Oct/06
Nov/06
Dec/06
Jan/07
Feb/07
Mar/07
Apr/07
May/07
Jul/07
Aug/07
Sep/07
Oct/07
Nov/07

MARKET PRICES UPDATE

MONEY MARKET RATES

Money market rates (Closing mid-market levels)

date	3M		6M		1Y	
	FXSW	WIBOR	FXSW	WIBOR	FXSW	WIBOR
15/11/07	5.31%	5.32%	5.41%	5.54%	5.63%	5.69%
18/11/07	5.35%	5.33%	5.45%	5.54%	5.69%	5.70%
19/11/07	5.35%	5.33%	5.45%	5.54%	5.69%	5.70%
20/11/07	5.53%	5.39%	5.52%	5.62%	5.80%	5.84%
21/11/07	5.55%	5.42%	5.52%	5.62%	5.80%	5.84%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
15/11/07	5.45%	5.62%	5.81%	5.85%	5.88%
18/11/07	5.47%	5.70%	5.90%	5.93%	5.95%
19/11/07	5.50%	5.71%	5.92%	5.97%	5.99%
20/11/07	5.52%	5.75%	5.95%	5.99%	6.01%
21/11/07	5.55%	5.80%	5.99%	6.03%	6.04%

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
15/11/07	5.69%	5.08%	5.57%	5.29%	5.72%	5.69%	5.73%	5.76%
18/11/07	5.70%	5.05%	5.57%	5.29%	5.71%	5.68%	5.72%	5.76%
19/11/07	5.70%	5.05%	5.57%	5.34%	5.71%	5.67%	5.71%	5.76%
20/11/07	5.84%	5.05%	5.56%	5.30%	5.71%	5.65%	5.72%	5.75%
21/11/07	5.84%	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	07/10/22	08/10/22	95.056	5.14%	500	1177	500
OK0709	07/11/07	09/07/25	90.993	5.68%	1700	3622	1700
PS0412	07/11/21	13/04/25	96.810	5.94%	2200	2611	2200
DS1017	07/10/10	17/10/25	96.607	5.70%	1800	5061	1800

FX VOLATILITY

	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
date	1M	3M	6M	1Y	1M	1Y	1M	1Y
15/11/07	10.25	9.30	8.90	8.78	0.50	0.55	0.30	0.35
18/11/07	11.25	10.20	9.90	9.50	0.50	0.55	0.30	0.35
19/11/07	11.25	10.20	9.90	9.40	0.60	0.75	0.30	0.35
20/11/07	11.00	10.10	9.80	9.20	0.60	0.75	0.30	0.35
21/11/07	11.00	10.30	9.70	9.40	0.60	0.75	0.30	0.35

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
15/11/07	2.5130	3.6720	-27.81%
18/11/07	2.5057	3.6670	-27.95%
19/11/07	2.4933	3.6848	-27.88%
20/11/07	2.4902	3.6860	-27.90%
21/11/07	2.4855	3.6855	-33.23%

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

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.pl

Forex (BREX) - FX Spot &Options
Marcin Turkiewicz (+48 22 829 01 84) Marcin.turkiewicz@brebank.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.pl
Paweł Białczyński (+48 22 829 01 86)

MM (BREP) - MM, FX Swaps
Bartłomiej Małocha (+48 22 829 01 77) Bartlomiej.malocha@brebank.pl
Tomasz Wołosz (+48 22 829 01 74)

Structured Products (BREX)
Jaroslaw Stolarczyk (+48 22 829 01 67) Jaroslaw.stolarczyk@brebank.pl
Jacek Derezinski (+48 22 829 01 69)

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

Research
Ernest Pytlarczyk (+48 22 829 01 66) Research@brebank.pl
Marcin Mazurek (+48 22 829 0183)
Radosław Cholewiński (+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

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