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FINANCIAL MARKETS DEPARTMENT

PAGES: 8

WARSAW, DECEMBER 19, 2008

POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

PREVIEW: The week of December 19th to December 30th (two week edition)

Indicator	Date of release	Period	BRE forecast	Consensus	Last	Comment
Core "net" inflation, y/y	**22 Dec**	Nov	**4.7%**	4.7%	4.5%	Core "net" inflation lifted by regulated prices (gas and energy). The measure excluding food and energy flat at 2.9% y/y as demand softens, enterprises lose pricing power and cannot pass recent cost rises to consumers.
MPC Decision	**23 Dec**	-	**5.0%**	5.25%	5.75%	The unanticipated (by the MPC members) collapse of the real sphere of the economy speaks for more aggressive actions – it is likely a motion of 75bps cut will be cast into vote and accepted.
Retail sales y/y	**23 Dec**	Nov	**5.1%**	6.9%	7.9%	Two working-days less on annual basis. Business indicators concerning future sales under severe pressure. Expected Christmas expenses slightly depressed.

In Focus / Macroeconomics

Disinflation sets in

Polish headline inflation continues to fall dropping to 3.7% from 4.2% recoded in October. Lower inflation reading is to be attributed to benign food prices and a monthly drop of fuel prices (-5.8% m/m). Likewise, energy prices rose by less than expected. We estimate the 'net' core inflation to have gone up to 4.7% in November, while the new core inflation measure excluding food and energy is to stabilize at 2.9% y/y.

In coming months inflation is likely to fall further being driven by lower fuel prices and statistical base effects. The December figure is to be displayed in a range of 3.2-3.4% y/y, first time within the MPC target range since November 2007. Strong statistical base effects are likely to drag down the January reading as well – the delay of energy sector deregulation and postponing the introduction of new energy tariffs by February are to push inflation down to 2.9-3.2% y/y. The tendency is to extend into the coming months when mounting stocks of finished goods finally assure enterprises the times of easy upward correction of prices are gone.

Consumer demand is likely to be severely punished for extended period of exaggeration. November saw a considerable drop in employment which amounted to 12k and translated into a fall of annual growth of the figure to 3.1% (after 3.6% recorded in previous month). The drop of employment went hand in hand with softening growth rate of wages which decelerated to 7.4% y/y after 9.8% in October. We see the dynamics of employment and wages to stay extend falling trend in the coming months. Urging need to adjust amidst rising costs encourages firms to enter saving modes, group lay-offs and tempering the growth of wages including. Moreover, the growth of wages may be further limited by the lack of bonus payments explicitly linked to corporate earnings, which are likely to stay under water for some quarters as economy shifts into lower gear. This time, however, we expect the adjustment process to be more abrupt than in the previous cycles.

MPC heading for 75bp cut?

Industrial output growth came as a real shocker for the market. It tumbled in November by 8.9% y/y after dipping 0.1% in October. Seasonally adjusted figure amounted to -4.2% y/y. We expect this trend to continue and see seasonally adjusted growth rates of I/O to stay below zero for months to come. Our view is backed by falling foreign demand (already confirmed by the hard data, not only new export orders indices from business tendency indicators) and limited expenditures on new investment goods (it is highly likely that fixed capital formation reported in national accounts in Q3 reflected mainly the fallout from past investment decisions as current capacities more than compensate for contemporary demand). In addition, the December I/O figure is to be depressed by the hold-ups in the auto industry.

Swiftly decelerating industrial output poses serious threats to employment in this sector and, consequently, private consumption (not mentioning various other negative feedback effects between the manufacturing and other sections of the economy: distribution and foreign trade). We thus see downside risks to our (already pessimistic) growth forecast for 2009 at 1.8%. It is worth to note that tumbling manufacturing output goes hand in hand with falling producer prices. This trend is set to continue in coming months as demand deficiencies become more widespread.

Serious risks to the real sphere and progressing disinflation are likely to make MPC act forcefully. We thereby expect 75bp cut in December; let alone the developments of the exchange rate. It is not as unlikely as it seems at the first sight – recall that the "Minutes" revealed the 50bp cut was already discussed during the November meeting. Monetary easing will be densely distributed in the next 3 months with repo rate falling ultimately to 3.0% by the end of 2009.

MEDIUM-TERM FORECATS

Indicator	2006	2007	2008	2009
GDP y/y (%)	6,1	6,5	5,0	**<1.5**
Inflation rate (%, average)	1,0	2,4	4,3	**2.9↓**
Current account (% of GDP, average)	-2,1	-4,5	-5,3	-5,7
Unemployment rate (end-of-year)	14,9	11,4	9,5	12,2
NBP repo rate (end-of-year)	4,00	5,00	5,50	**3.00 ↓**

Indicator	2008			2009	
	Q2	Q3	Q4	Q1	Q2
GDP y/y (%)	5,8	4.7	3,0	**1,5 ↓**	**1.0 ↓**
Inflation rate (%, average)	4,3	4.7	3,8	**3.2↓**	**2.8↓**
NBP repo rate (end-of-quarter)	6,00	6,00	**5.00↓**	**3,75 ↓**	**3,25↓**

Bold denotes chages from the last release with arrows showing the direction of chages

Fixed Income

Very bad data. Very good!!!

FI market is stabilizing a bit after finding new lows of the year; we have traded in a range for the past few days. Bonds market is remaining heavily bid despite handsome supply coming out from Ministry of Finance. On the other hand Wibor rates are staying stubbornly high, pricing a lot of credit premium above both implied rates as well as OIS curve. After recent economic releases (CPI, wages, IP, PPI) cut in December is a deal done and we start to expect a surprise move of more than 50bp. We also see rates cuts being delivered at all meetings in first quarter of next year bringing repo rate towards the level of 3% soon...very soon.

RECOMMENDATION:

Since it is the last Weekly before Xmas we hope you have all enjoyed the “rates ride” during 2008, we also hope that our views were worth reading and putting trades on. We wish you all Merry Christmas, all the best from the BREBank’s FI team.

AUCTIONS

	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	6,142%	2008-12-09
26 Week T-bills	-	-	6,197%	2008-12-09
52 Week T-bills	-	-	6,211%	2008-12-09
2Y T-bond OK0711	TBA	-	5,470%	2008-12-10
5Y T-bond PS0413	TBA	-	5,616%	2008-12-17
10Y T-bond DS1019	TBA	-	5,724%	2008-12-17
20Y T-bond WS0429	2008-01-09	-	5,992%	2008-09-10

Money Market

Cheap carry continues

Still very cheap, even despite of the fact that market bought 15.5 billion pln in money bills (against 10 maturing at the same date). Settlement of the T-bills was squared with the flow from Tuesday’s repo operation, hence no additional impact was observed. Historically December was cheap so we would not count that just before Christmas two OMO (5-day on Friday and 9-day on Wednesday) will change a lot.

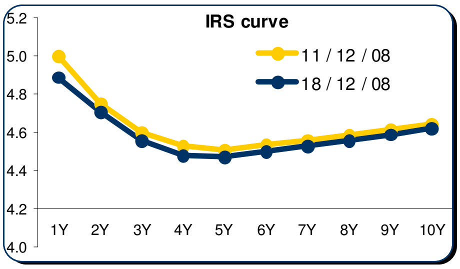
Bullish figures and more rate cuts abroad

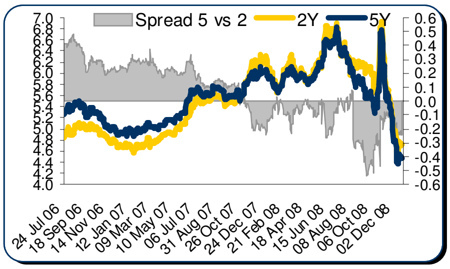
Bullish figures on Monday (CPI 3.7 vs 3.8% expected, and wages 7.4 vs 8.6% expected) just proved that the cut coming will be definitely more then 25 bps. Furthermore, two European banks reduced the rates substantially (Czech by 50 bps and Norway 175 bps) plus Fed lower the rates to the range of 0-25 bps. We think that 75 bps can not be ruled out next week in Poland.

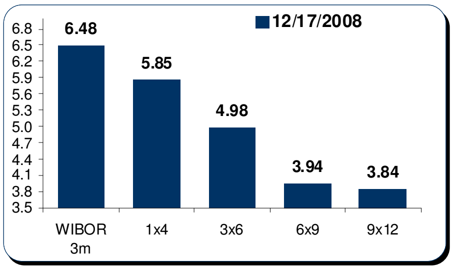
RECOMMENDATION:

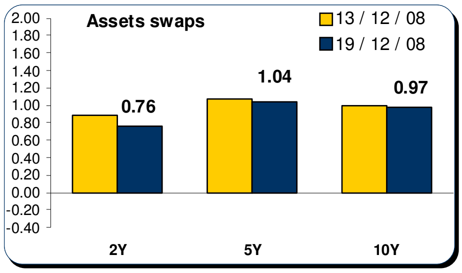
Still some value in selling 3 and 6M polonia OISs.

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

Zloty weaker

This week zloty opened at 3.9200 and weakened toward 4.1900. We have observed demand for EURPLN from both, local and foreign market

Volatility slightly higher

Breaking of 4.05 has moved market mids from 27 to 31 for 1M and from 19 to 21 for 1Y pricing.

RECOMMENDATION:

SPOT

Stay away

Main supports / resistances:
EUR/PLN: 3.9500 / 4.2500
USD/PLN: 2.7000 / 3.1100

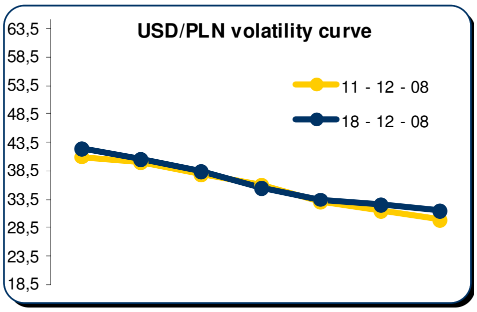
Because of end-of-year effect market has become highly illiquid, in consequence at most average demand is resulting with such rapid moves. Our advice is stay away, probability of correction is rising.

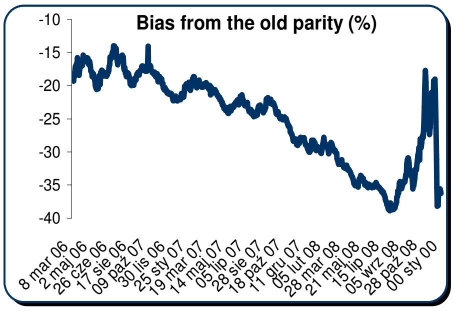
Short RR

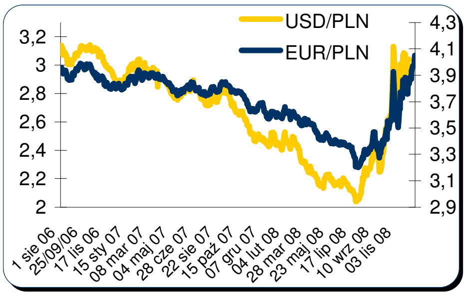
OPTIONS

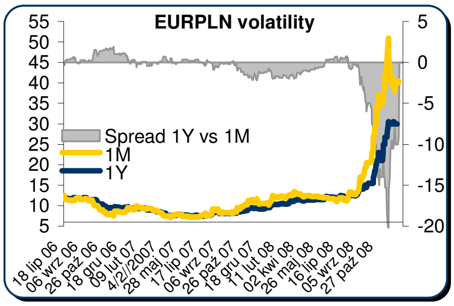
We believe in receiving some benefits from selling Risk Reversals on EURPLN.

FX CHARTS


USD/PLN volatility curve
11 - 12 - 08
18 - 12 - 08
63,5
58,5
53,5
48,5
43,5
38,5
33,5
28,5
23,5
18,5


Bias from the old parity (%)
-10
-15
-20
-25
-30
-35
-40


USD/PLN
EUR/PLN
3,2
3
2,8
2,6
2,4
2,2
2
4,3
4,1
3,9
3,7
3,5
3,3
3,1
2,9


EURPLN volatility
Spread 1Y vs 1M
1M
1Y
55
50
45
40
35
30
25
20
15
10
5
5
0
-5
-10
-15
-20

MARKET PRICES UPDATE

MONEY MARKET RATES

Money market rates (Closing mid-market levels)

date	3M		6M		1Y	
	FXSW	WIBOR	FXSW	WIBOR	FXSW	WIBOR
12/12/08	6.35%	6.48%	6.40%	6.49%	6.42%	6.59%
15/12/08	6.39%	6.49%	6.41%	6.41%	6.45%	6.45%
16/12/08	6.35%	6.49%	6.40%	6.41%	6.41%	6.45%
17/12/08	6.35%	6.48%	6.35%	6.40%	6.35%	6.44%
18/12/08	6.39%	6.48%	6.39%	6.39%	6.42%	6.43%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
12/12/08	5.99%	5.19%	4.15%	4.01%	4.30%
15/12/08	6.01%	5.20%	4.16%	3.98%	4.29%
16/12/08	5.98%	5.08%	4.03%	3.88%	4.33%
17/12/08	5.90%	5.03%	3.98%	3.88%	4.15%
18/12/08	5.85%	4.98%	3.94%	3.84%	4.10%

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
12/12/08	6.59%	5.08%	5.57%	5.29%	5.72%	5.69%	5.73%	5.76%
15/12/08	6.45%	5.05%	5.57%	5.29%	5.71%	5.68%	5.72%	5.76%
16/12/08	6.45%	5.05%	5.57%	5.34%	5.71%	5.67%	5.71%	5.76%
17/12/08	6.44%	5.05%	5.56%	5.30%	5.71%	5.65%	5.72%	5.75%
18/12/08	6.43%	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	08/12/09	09/12/09	94.091	6.21%	1800	6800	1910
OK0711	08/12/09	11/07/25	86.996	5.47%	2500	8037	2930
PS0413	08/12/17	19/10/25	100.558	5.62%	2500	3578	1742
DS1017	08/12/17	19/10/25	98.186	5.72%	4500	3521	2340

FX VOLATILITY

	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
date	1M	3M	6M	1Y	1M	1Y	1M	1Y
12/12/08	40.00	36.00	33.00	30.00	8.50	8.50	1.40	1.40
15/12/08	40.00	36.00	33.00	30.00	8.50	8.50	1.40	1.40
16/12/08	40.00	36.00	33.00	30.00	8.50	8.50	1.40	1.40
17/12/08	40.00	36.00	33.00	30.50	8.50	8.50	1.40	1.40
18/12/08	40.50	35.50	33.50	31.50	8.50	8.50	1.40	1.40

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
12/12/08	2.9709	3.9689	-36.36%
15/12/08	2.9561	3.9804	-36.44%
16/12/08	2.9683	4.0489	-36.25%
17/12/08	2.8948	4.0834	-35.62%
18/12/08	2.8463	4.1740	-35.75%

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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