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FINANCIAL MARKETS DEPARTMENT

PAGES: 8

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POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

PREVIEW: The week of December 31st to January 8th

Indicator	Date of release	Period	BRE forecast	Consensus	Last	Comment
MinFin's inflation forecast y/y	**Jan 2**	Dec	**3.3%**	-	3.7%	Moderate growth of food prices accompanied by substantial drop in fuels. Core inflation (excluding food and energy) at 2.8% y/y, down from 2.9% recorded last month.
PMI (pts.)	**Jan 2**	Dec	**38.2**	-	40.5	Large falls of business activity indicators, domestic and foreign as well. We expect sharp correction of current production index and employment measure partially offset by build up of stocks and slower delivery times.

In Focus / Macroeconomics

Polish MPC cut the rates by 75 bps

A 75bps rate cut came as a surprise for both analysts, who had forecast the rates to be lowered by 50bps, and the market. It was 2001 when the Committee agreed to use this large caliber weapon for the last time. The statement itself, not surprisingly given the scale of the easing, proved to be dovish. The Committee pointed to a wide range of risks to economic growth including weakening investment demand, deteriorating business tendency indicators and recession going on among Poland's major trading partners.

Turning to inflation perspectives, the MPC envisaged inflation to return to the targeted interval both in short- and mid-term. Among the factors working towards lower inflationary pressures it listed sub-potential GDP dynamics and wage growth which has been recently falling short of expectations. Note that the November corporate wages at least partially confirmed the MPC's view – wages in manufacturing slowed down to 5.2% y/y. In addition, there is some anecdotal evidence that major companies have already reached agreements with trade unions which allow them to freeze or even cut salaries in 2009. List of risks for inflation has been actually shortened to controlled prices and zloty depreciation. The latter seems, however, very unlikely to outweigh the effects coming from lower demand and falling oil prices in the months to come.

The statement was traditionally followed by the comments of MPC members. NBP governor Skrzypek envisaged the most probable paths of GDP and inflation as sliding below the levels drawn in the last NBP projection. He also indicated that MPC is now very likely to continue monetary easing next month. The same line of reasoning has been followed by Pietrewicz, who conditioned further monetary easing on weak economic growth data. Even Filar sounded less hawkish; he stressed that bringing inflation back to the target range, due to the effects related to higher energy prices, should be deciphered as meeting the target itself. Influential Slawinski, in turn, paid attention to the mechanics of the zloty exchange rate, indicating (fully in line with our view) that it may be driven primarily by some one-off factors (FX options in particular); interest rate disparity drives the currency to a much lesser extent.

Immediately after the MPC decision the zloty remained stable proving that interest rates are not the ones to be blamed for its excessive volatility. Contrary to some opinions expressed by the MPC members, money market reacted abruptly depressing WIBOR rates from 6.4% to 5.9%. The behavior of market participants proved then that the NBP rates are indeed the right tool to be used to ease the credit crunch and stimulate the economy (wiping out concerns of alleged standard monetary policy tools ineffectiveness).

Briefly speaking, we expect the Committee to cut the rates aggressively (by at least 50bps) at its January meeting. Such a move and the consecutive cuts to be delivered in the next months (REPO rate is to fall to 3% by the end of 2009) will be triggered by a series of weaker economic data and tenable arguments for ongoing disinflation, including falling headline inflation (3.2-3.3% in December 2008 and below 3% in January 2009) and subdued wage dynamics.

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

Market inactive

Market has been totally inactive in the passing week. Most important issue recently would be the move on Wibor fixings, seems that after another rate cut by MPC, expectations for rates going lower start to have some impact on the rates and that neutralises a bit liquidity premia priced in short rates. We expect this trend to continue in the beginning of the next year, especially that players always used to be reluctant to lend cash over end-of-year, and that factor will vanish in a few days. As we expect monetary policy easing to continue in the first quarter of 2009, there is still some value in the very front of the curve, but as final level of the main rate is currently priced in at 3.00%, it's difficult to expect it below that, longer tenors do not present much value. If any, cash instrument should overperform derivatives significantly - we like t-bills especially (decent supply should keep yields at attractive levels, cash market should stay low). We also think curve should steepen from current levels (lower growth can bring some attention to potential deficit-financing problems). However, as the market is not very likely to recover full liquidity soon, we don't plan to start next year with big position, would rather look for nice opportunities.

RECOMMENDATION:

Good luck for the 2009

AUCTIONS

	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	6.142%	12/9/2008
26 Week T-bills	-	-	6.197%	12/9/2008
52 Week T-bills	1/12/2009	-	6.211%	12/9/2008
2Y T-bond OK0711	1/7/2009	-	5.470%	12/10/2008
5Y T-bond PS0413	1/7/2009	-	5.616%	12/17/2008
10Y T-bond DS1019	1/14/2009	-	5.724%	12/17/2008
20Y T-bond WS0429	1/14/2009	-	5.992%	9/10/2008

Money Market

No activity except for the shortest liquidity

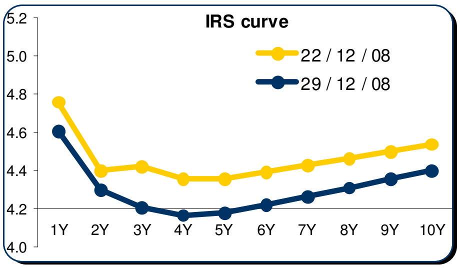
All the rates down by 75 bps

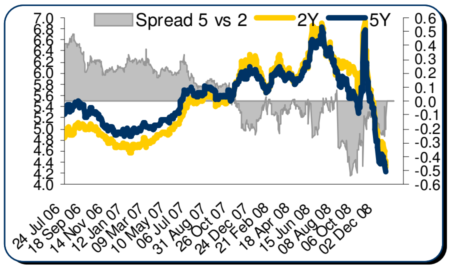
Christmas and New Year ahead made the market literally dead. Only shortest liquidity was in play and this was not a problem at all since huge surplus of the cash was easily available for shorts. So boring and very cheap days behind. In the mean time the MPC cut all the rates by 75 bps. This was surprising for majority of the market since the consensus vas 50 bps. Now interest rates are as follow: the main rate at 5%, Lombard rate at 6.5%, deposit rate at 3.5 and rarely used discount rate at 5.25%. Another cut will take place in January probably by 50 bps.

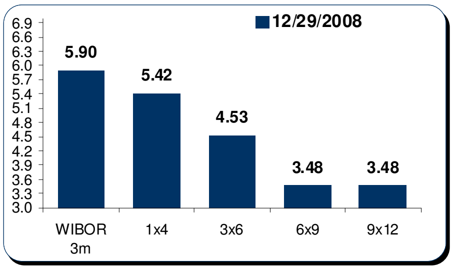
RECOMMENDATION:

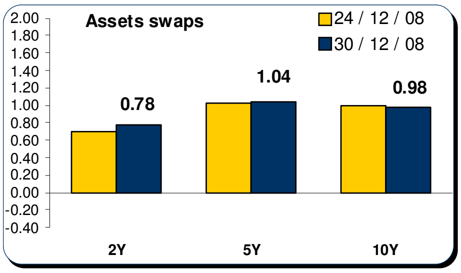
Happy New Year.

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

Zloty weaker

Low liquidity is a key reason behind wild zloty swings this week. Plus a large number of cash settled options which have crated a good demand for EUR from banks which wanted to stay delta neutral. Most of the market players are not active till new year.

Volatility still high

Non existing market. The few runs that were shown suggested no change from last week, so both volatility curves EUR/PLN and USD/PLN still extremely high.

RECOMMENDATION:

SPOT

Main supports / resistances:
EUR/PLN: 4.000 / 4.2500
USD/PLN: 2.7000 / 3.1000

Stay away

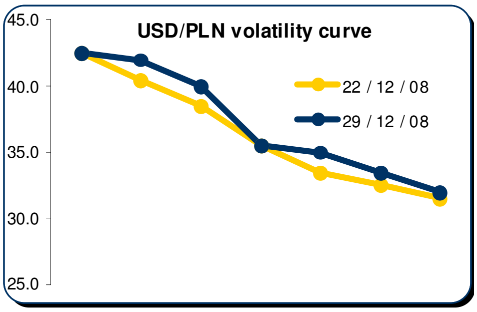
The market is illiquid. The moves are wild and random, it is best not to get involved. We think new year should fuel same optimism and create same room for a moderate zloty rise.

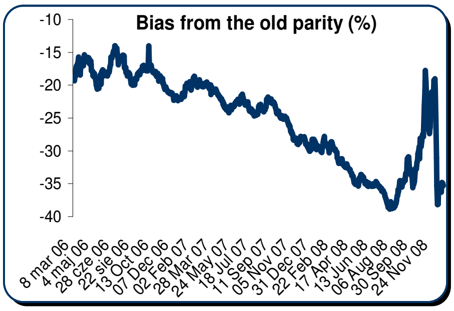
Short Vega

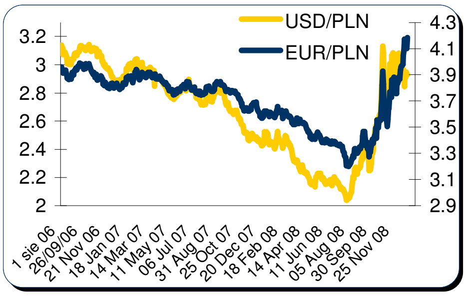
OPTIONS

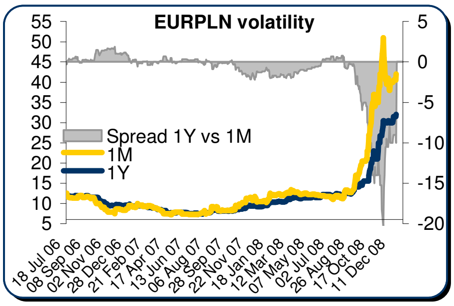
Because of the growing discrepancy between historic and implied volatility we believe in short Vega on both crosses. High implied volatility creates nice theta for relatively low gamma.

FX CHARTS


USD/PLN volatility curve
22 / 12 / 08
29 / 12 / 08


Bias from the old parity (%)


USD/PLN
EUR/PLN


EURPLN volatility
Spread 1Y vs 1M
1M
1Y

MARKET PRICES UPDATE

MONEY MARKET RATES

Money market rates (Closing mid-market levels)

date	3M		6M		1Y	
	FXSW	WIBOR	FXSW	WIBOR	FXSW	WIBOR
19/12/08	6.30%	6.45%	6.36%	6.38%	6.35%	6.42%
22/12/08	6.31%	6.44%	6.34%	6.37%	6.39%	6.41%
23/12/08	5.75%	6.41%	5.75%	6.49%	5.60%	6.59%
24/12/08	5.75%	5.92%	5.80%	5.89%	5.80%	5.91%
29/12/08	5.80%	5.90%	5.80%	5.85%	5.80%	5.89%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
19/12/08	5.71%	4.74%	3.73%	3.73%	3.85%
22/12/08	5.70%	4.73%	3.73%	3.73%	3.85%
23/12/08	5.66%	4.56%	3.57%	3.57%	3.78%
24/12/08	5.66%	4.48%	3.57%	3.57%	3.78%
29/12/08	5.42%	4.53%	3.48%	3.48%	3.64%

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
19/12/08	6.42%	5.08%	5.57%	5.29%	5.72%	5.69%	5.73%	5.76%
22/12/08	6.41%	5.05%	5.57%	5.29%	5.71%	5.68%	5.72%	5.76%
23/12/08	6.59%	5.05%	5.57%	5.34%	5.71%	5.67%	5.71%	5.76%
24/12/08	5.91%	5.05%	5.56%	5.30%	5.71%	5.65%	5.72%	5.75%
29/12/08	5.89%	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
19/12/08	40.50	35.50	33.50	31.50	8.50	8.50	1.40	1.40
22/12/08	40.50	35.50	33.50	31.50	8.50	8.50	1.40	1.40
23/12/08	40.50	35.50	33.50	31.50	8.50	8.50	1.40	1.40
24/12/08	40.50	35.50	33.50	31.50	8.50	8.50	1.40	1.40
29/12/08	42.00	35.50	35.00	32.00	8.50	8.50	1.40	1.40

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
19/12/08	2.9130	4.1132	-36.24%
22/12/08	2.9081	4.1037	-35.18%
23/12/08	2.9476	4.1176	-34.83%
24/12/08	2.9313	4.1025	-34.90%
29/12/08	2.9293	4.1848	-35.25%

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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