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FINANCIAL MARKETS DEPARTMENT

PAGES: 8

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POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

IN FOCUS / MACROECONOMICS	• *Q2 GDP data: momentum definitely improves*	• *pages 2-3*
FIXED INCOME	• *Bearish trend continues*	• *page 3*
FI RECOMMENDATION	• *Awaiting correction. Reduce pay positions in 2y*	
MONEY MARKET	• *Cheap end of the reserve* • *No more rate cuts in the cycle*	• *pages 3-4*
MM RECOMMENDATION	• *Pay 3*6 spread ois.*	
FOREIGN EXCHANGE	• *Zloty testing the lower band of the range* • *Implied volatility significantly lower*	• *pages 4-5*
FX RECOMMENDATION	• *4.0650 pivotal level* • *Buy risk reversals*	
MARKET PRICES		• *page 6*
CONTACT LIST		• *page 7*
DISCLAIMER		• *page 8*

PREVIEW: The week of August 31st to September 3rd

Indicator	Date of release	Period	BRE forecast	Consensus	Last	Comment
PMI	Sep 1	Aug	**48.1pts**	-	46.5pts.	Stronger business activity abroad, better leading indicators for Poland. Possibility of high new orders and current output evaluation.
MinFin's inflation forecast	Sep 1	Aug	**3.6%**	-	3.6%	Food prices slightly below seasonal pattern. Moderate falls in fuels. Core inflation at 2.9%.

In Focus / Macroeconomics

Q2 GDP data: momentum definitely improves

Polish GDP for Q2 came in at +1.1%y/y, in line with our forecast and a way above market consensus of 0.5% y/y. In SA terms GDP rose by 0.5% q/q vs. 0.3% q/q recorded in Q1, which clearly points to a stronger momentum for the Polish economy achieved already in the second quarter. This momentum clearly coincides with the much better readings coming out both for German and French economy.

This time the GDP breakdown proved to be in line with our estimates, on which we have been extensively commenting in the Polish Weekly Review for some weeks. Individual consumption growth dropped to 1.9% y/y vs. 3.3% recorded in Q1. Private investments fell by 2.9% vs. 1.2% growth recorded in Q1. The main boost for the economy came from net exports (positive contribution rose to 3.1pp. up from 1.9pp. recorded in Q1). The negative contribution from destocking process shrank to -2.7pp. from -4.8pp. realized in Q1.

Turning to the supply side of the economy, the Q2 saw a slight improvement in industrial production (y/y dynamics amounted to -5.1% vs. -5.9 recorded in Q1) and construction (up by 4.5% y/y vs. 3.4% in Q2). Services decelerated a bit to 2.8% y/y from 3.1% seen in Q1. The non-market services, however, saw a pronounced deterioration which may be directly related to budget spending cuts and lower wages dynamics in Q2. Strikingly, Polish economy experience a significant acceleration in transports (3.3% y/y up from 0.3% recorded in Q1). As transports constitutes a broader measure of business activity and the ongoing data for this section point to an increase in employment and wages, stronger momentum will stay in the economy in the months to come.

Relative tightness of the labor market (business activity indicators are trending unanimously upwards) may cause consumption to turnaround in coming quarters (or at least stabilize); this way the latest reading may have marked a trough in the ongoing cycle. Such a scenario is backed by the recent retail sales figures; even though the reading may be positively skewed by seasonal factors and correct a bit after the holiday season, the momentum it brings to the data (and to consumer confidence which has risen in August for the 5 consecutive time) will be enough to carry the economy over (mind the possibility of positive feedback loops!). Despite expected positive contribution from consumer's side, investment may still stay below the surface through the year (last recession episode brought it under water for 9 quarters in a row; this time we expect this period of investment slump to be shorter on EU financed investment projects). On the supply side, we expect industry to outperform in Q3 although net exports contribution may falter a bit (on base effects and EURPLN appreciation – we rely here mainly on algebra, not causal relations). It may be more than offset by grater change of inventories contribution; causal relations and comparisons with the last cycle speak for a definite improvement on this field. Summing up, Q3 GDP growth may match the Q2 reading, although we see some space for positive surprise. Growth path is likely to get steeper in Q4 when high elasticity of Polish GDP with respect to its counterparts in western peers (Germany, France) is going to take its toll.

Today's data practically wipes out the possibility of further rate cuts in coming months. Such an assessment is also backed by recent comments of MPC members. We especially favor here pivotal Czekaj, who turned hawkish, Pietrewicz and Owsiak – both regarded as ultimate doves and both unlikely to support any rate cuts after the surprising GDP growth. Although the monetary easing cycle is over, the MPC is likely to wait until October (new inflation projection with higher GDP and possibly higher mid-term inflation) before it switches to neutral mode. In conjunction with better real sphere data, such a scenario is likely to drive yields upwards, especially on the front end of the curve.

MID-TERM FORECATS

Indicator	2006	2007	2008	2009	2010
GDP y/y (%)	6.1	6.5	4.8	**1.1-1.5↑**	2.0-3.0
Inflation rate (%, average)	1.0	2.4	4.3	3.5	>1.8
Current account (% of GDP, average)	-2.1	-4.5	-5.3	0.2	-2.9
Unemployment rate (end-of-year)	14.9	11.4	9.5	**12.3↓**	**12.8↓**
NBP repo rate (end-of-year)	4.00	5.00	5.00	3.50	4.00

Indicator	2008		2009			
	Q3	Q4	Q1	Q2	Q3	Q4
GDP y/y (%)	4.7	2.9	0.8	1.1	**1.2↑**	**2.7↑**
Inflation rate (%, average)	4.7	3.8	3.2	3.7	3.5	3.6
NBP repo rate (end-of-quarter)	6.00	5.00	3.75	3.50	3.50	3.50

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

Fixed Income

Bearish trend continues.

Weakness on the market continued over the past week and yields kept moving up across the curve. 2nd quarter GDP data published on Friday (+1.1%) was higher than consensus, therefore didn't support the rates either. Instant comments from MPC members confirmed our view that the cutting cycle is over. In longer perspective our view stays the same, upside potential for the rates is higher than the downside. Next week MinFin is about to publish their CPI forecast (we see it 3.6-3.7%, which should be neutral for the market, at these levels at least). Nevertheless the recent move was sharp and quite large; therefore we decided to take some profit on our pay positions and reduced it by half. Levels above 5.50% on 1y1y fwd and 21x24 around 5.85-90% seem a bit elevated, at least from short-term trading perspective, we think some pullback from here is likely, if that actually happens, we will use it to rebuild our positions.

RECOMMENDATION: Awaiting correction. Reduce pay positions in 2y.

AUCTIONS

	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	6.142%	12/9/2008
26 Week T-bills	-	-	4.456%	5/4/2009
52 Week T-bills	9/1/2009	-	4.233%	8/24/2009
2Y T-bond OK0112	9/2/2009	-	4.974%	8/5/2009
5Y T-bond PS0414	9/2/2009	-	5.550%	8/12/2009
10Y T-bond DS1019	9/9/2009	-	6.340%	5/20/2009
20Y T-bond WS0429	9/9/2009	-	6.340%	5/20/2009

Money Market

Cheap end of the reserve

Very cheap end of the reserve with the last OMO amounting to 41.2 billion pln of the papers purchased. The new reserve starts with the cash surplus of about 1 billion pln. Despite of the fact shortest rates should go up a figure.

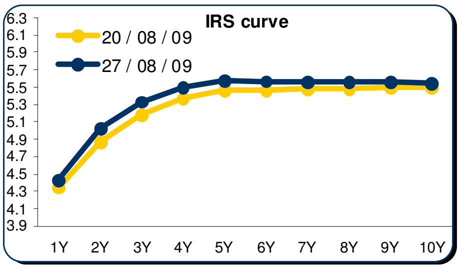
No more rate cuts this cycle

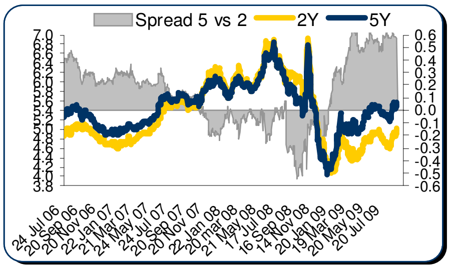
Excellent figures leave no doubt for the rate cut possibility. Retail sales 5.7% vs 0.7 expected and quarter GDP 1.1% vs 0.5% expected are clear enough to start betting on timing of the rate hikes next year.

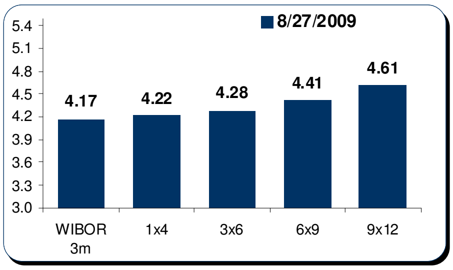
T-bills stable during the last tender and should be cheaper on Monday.

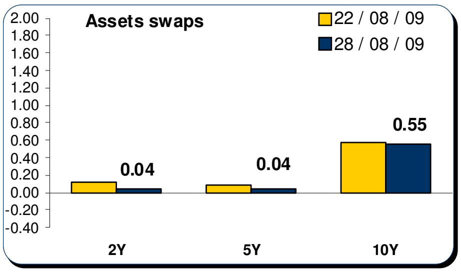
RECOMMENDATION: Pay 3*6 spread ois.

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

Zloty testing the lower band of the range

This week zloty has been testing the lower band of the range. Today s GDP number (+ 1.1 % in the second quarter), gave a fresh spark for the zloty bulls. But the picture is still unclear, strong support 4.0500/4.0650 is intact, and till we will not close below that level, technically we are still in the 4.0650-4.2100 range.

Implied volatility significantly lower

The historic volatility is now much more in support of the Vega sellers, and the selling of Vega has dominated this week. 1 month EUR/PLN has dropped from 15.25 mid % to 13.50 %, 1 year is now 13.50 % mid in comparison to 14.00% week ago.

RECOMMENDATION:

SPOT

4.0650 pivotal level

Main supports / resistances:
EUR/PLN: 4.0650 / 4.2250
USD/PLN: 2.8000 / 3.0600

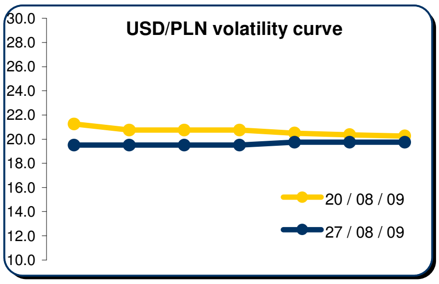
One may choose to go long in currency against the złoty just above that really strong support 4.0650 and play for the move back to the middle of the range 4.13/4.15. The clear break of the 4.0500/4.0650 support will open the way to 3.8800.

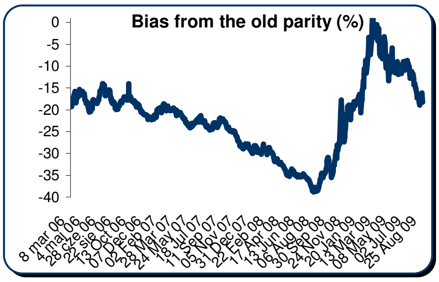
Buy risk reversals

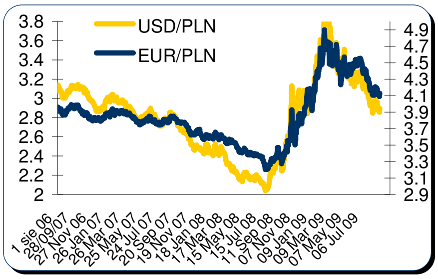
OPTIONS

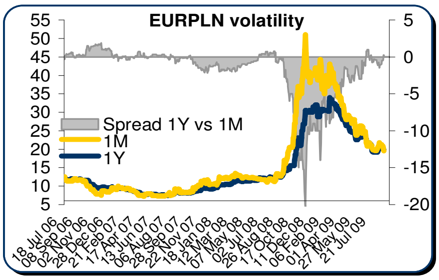
We still like the idea of being long Vanna via risk reversal. The correlation of the level of volatility and spot is one of the strongest in the złoty world. The current volatility levels are the lowest this year but still significantly higher then the year ago. That's why we want to be long Vega above 4.2000 but short Vega below 4.0000. The long risk reversals can produce such a Vega profile but at the expense of higher theta.

FX CHARTS


USD/PLN volatility curve
20 / 08 / 09
27 / 08 / 09


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
21/08/09	4.03%	4.16%	4.20%	4.23%	4.38%	4.38%
24/08/09	4.00%	4.16%	4.28%	4.23%	4.38%	6.59%
25/08/09	4.05%	4.15%	4.28%	6.49%	4.38%	4.38%
26/08/09	4.05%	4.16%	4.25%	4.24%	4.38%	4.37%
27/08/09	4.10%	4.17%	4.24%	4.24%	4.34%	4.38%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
21/08/09	4.22%	4.25%	4.34%	4.52%	4.54%
24/08/09	4.19%	4.19%	4.29%	4.47%	4.49%
25/08/09	4.20%	4.22%	4.29%	4.48%	4.52%
26/08/09	4.20%	4.21%	4.28%	4.46%	4.50%
27/08/09	4.19%	4.19%	4.29%	4.46%	4.50%

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
21/08/09	4.38%	4.23%	4.86%	4.97%	5.45%	5.54%	5.49%	6.07%
24/08/09	6.59%	4.27%	4.85%	4.93%	5.44%	5.54%	5.47%	6.06%
25/08/09	4.38%	4.28%	4.92%	4.98%	5.49%	5.57%	5.53%	6.08%
26/08/09	4.37%	4.27%	4.96%	5.03%	5.52%	5.58%	5.52%	6.09%
27/08/09	4.38%	4.27%	5.02%	5.06%	5.57%	5.61%	5.55%	6.10%

PRIMARY MARKET RATES

Last Primary Market Rates

	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	09/08/17	10/08/17	95.885	4.25%	1000	2213	835
OK0112	09/08/05	12/01/25	88.708	4.97%	4500	11232	4502
PS0414	09/08/12	14/04/26	100.759	5.55%	3500	4967	3500
DS1017	09/04/08	19/10/25	94.460	6.22%	2500	4846	1820

FX VOLATILITY

	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
date	1M	3M	6M	1Y	1M	1Y	1M	1Y
21/08/09	20.75	20.75	20.50	20.25	2.75	4.25	1.00	1.10
24/08/09	20.75	20.75	20.50	20.25	2.75	4.25	1.00	1.10
25/08/09	20.50	20.00	20.30	20.10	2.75	4.25	1.00	1.10
26/08/09	19.75	19.70	20.00	20.00	2.75	4.25	1.00	1.10
27/08/09	19.50	19.50	19.75	19.75	2.75	4.25	1.00	1.10

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
21/08/09	2.8848	4.1241	-18.34%
24/08/09	2.8791	4.1163	-17.75%
25/08/09	2.8714	4.0996	-16.17%
26/08/09	2.8558	4.0883	-18.17%
27/08/09	2.8975	4.1277	-18.27%

Note: parity on 11/04/00 – USD= 4.3806, EUR=4.2196, basket share 50:50

Mid-market volatility of vanilla option strategies

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