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FINANCIAL MARKETS DEPARTMENT

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WARSAW, APRIL 23, 2010

POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

PREVIEW: The week of April 23rd 2010 to April 29th 2010

Indicator	Date of release	Period	BRE forecast	Consensus	Last	Comment
Retail sales	Apr 23	Mar	**3.6%**	4.1%	0.1%	The acceleration of sales after the hang-up during the harsh winter times is quite hard to accurately asses. Strong auto sales and better VAT for March pose upside risk to our forecast.
MPC decision	Apr 28	-	**3.5%**	3.5%	3.5%	Probably better assessment of the real sphere but current falling inflation (both headline and core) somehow chloroforms the MPC members (mind the discussion of cuts in recent Minutes). We do not expect any change in stance until the June's projections confirms threats in medium-term.

In Focus / Macroeconomics

Strengths of the Polish economy once again confirmed … but MPC discussed cuts at March meeting.

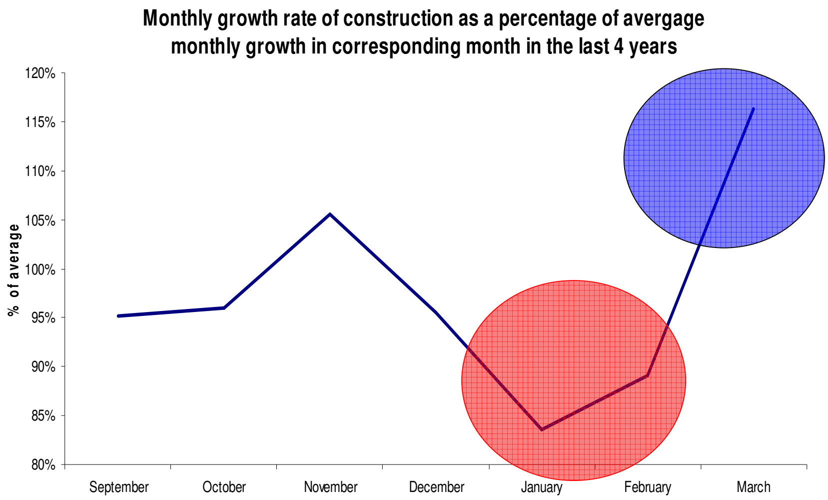
Last week brought some important publications regarding the strength of the real sphere of the economy. We had encouraging news of employment and wages, accompanied by a solid growth of industrial output and rebound in construction. What is more, the GDP data for 2009 were revised upwards to 1.8% form previously reported 1.7%. Along with the hard data, NBP published the fresh and encouraging data on business activity. As the real sphere is booming, the market almost completely ignored the data on general government deficit and debt (ESA'95). General government deficit reached 7.1% of GDP in 2009, and public debt – 51% of GDP. For now the more important is the perspective of Polish economy to grow out of deficit (owing to stronger growth) and debt, whereas the latter belongs to the lowest in EU.

Wages. March saw corporate wages rising at an impressive rate of 4.8% y/y vs. 2.9% y/y recorded in February (consensus forecast at 3.0%). The data seem to be only marginally affected by special effects (+1 working day y/y) and rather reflect a systematic steepening of the trends in the labor market (most visible in manufacturing). Solid growth of wages confirms there are no signs of wage deflation in the Polish economy and thus no immediate risk to our upbeat private consumption outlook. On the back of stabilizing labor market, we expect wages to rise steadily at the rates close to 4-5% in the months to come.

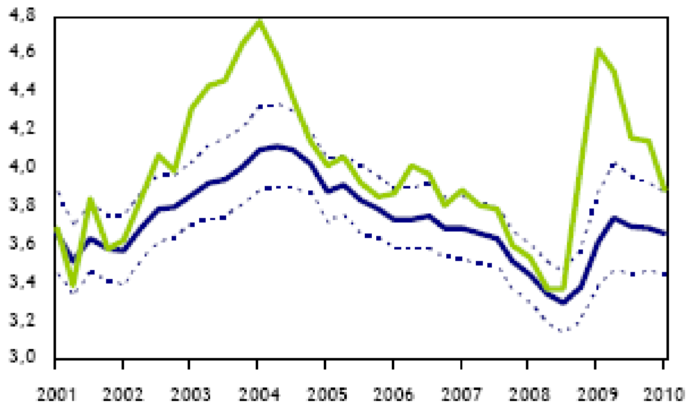
Employment. Employment in enterprise sector was stronger than market consensus (-0.7% y/y). 0.6% drop on annual basis is consistent with a slight increase of employment in absolute terms (about 0.5k jobs created). Latest reading confirms the labor market in really stabilizing, just as we have been expecting for several months. We expect this trend to continue in coming months on the back of more encouraging business tendency indicators and overall increase of business confidence.

Industrial output. March saw a decent growth of industrial production (12.3% y/y up from 9.2% y/y in February). Higher annual figure is to be attributed to some working day effects. In seasonally adjusted terms y/y dynamics stabilized in March at 9.2% (2.3% m/m). Rising output have been seen in 29 out of total 34 sections indicating that the recovery is broad based. Continuously the production is skewed towards exports-oriented sectors (auto industry, electronics) and is likely to sustain such a composition in the coming months.

Construction. Construction output fell in March by 10.8% after 24.7% in February. We see this as a normalization after January-February weather-related drop (see the graph). The above-normal monthly growth rates are likely to be sustained in the next 1-2 months as firms are reporting the willingness to make up the foregone orders.



NBP Business tendency indicators. The latest NBP report brought encouraging news. The expansion of Polish economy continues. Particularly we see a solid rebound in the labor market (employment and the rising share of firms their willingness to pay higher wages), accoompanied by an uptrend in production and sales (although somehow disrupted by severe weather conditions). Although firms are not intending to sharply accelerate investment, such a behavior is normal in the current phase of the business cycle and perfectly matches the pile up of corporate deposits. As for exchange rate considerations, EURPLN is still above the threshold guaranteeing the break-even in exports (see the graph: dark blue line – the threshold exchange rate, green line – current exchange rate).



Source: NBP.

Bottom line. Apart from upward revision of historical GDP data for 2009 (stemming from higher growth in Q3 and Q4), fresh industrial production and construction figures point to better than widely expected Q1 GDP numbers. **Based on our econometric model we would even bet on economy growing by more than 3.0% y/y in Q1**.

Turning to monetary policy, we advise to separate two different scenarios: short and medium term. Short-term scenario should take into consideration that investors ceased to believe in any kind of monetary tightening. Such a view was efficiently backed up by the MPC “Minutes” (some MPC members discussed rate cut as an effective tool to ease monetary conditions in times of PLN appreciation). Downward slopping inflation path (affected by statistical base form 2009) and the threat of further FX intervention are factors which are likely to damp on short-term tightening speculations further. In the mid-term, though, we stick to our view that economic recovery is poised to continue and should eventually necessitate more careful and accommodative monetary policy. Accelerating economy and mounting inflationary tensions within monetary policy horizon (the June’s inflation is likely to do nothing than confirm higher 2011/2012 inflation outlook) raise doubts whether market is right pricing in no more than a risk of a 25 bps tightening in the whole cycle.

MID-TERM FORECATS

Indicator	2007	2008	2009	2010	2011
GDP y/y (%)	6.5	4.8	1.7	3.0+	4.5
Inflation rate (%, average)	2.4	4.3	3.5	2.3	2.9
Current account (% of GDP, average)	-4.5	-5.3	-1.6	-2.7	-3.7
Unemployment rate (end-of-year)	11.4	9.5	11.9	12.1	10.9
NBP repo rate (end-of-year)	5.00	5.00	3.50	4.00	5.50

Indicator	2009				2010	
	Q1	Q2	Q3	Q4	Q1	Q2
GDP y/y (%)	0.8	1.1	1.7	3.1	3.0+↑	3.3
Inflation rate (%, average)	3.2	3.7	3.5	3.5	3.3	2.1
NBP repo rate (end-of-quarter)	3.75	3.50	3.50	3.50	3.50	3.50

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

Fixed Income

The change of plan

Last week we saw good volatility on the FI market. Economic releases all came on the stronger side still pointing for a recovery scenario. We had auction in 0415 bonds, which drew good demand, but supplementary auction failed to sell (third auction in a row). Bonds traded generally very well marking year highs in terms of prices (PS0415 traded sub 5% mark and DS1019 traded well above par). Some impact on the market had continuously deteriorating situation in Greece, which triggered temporary selling from local clients. Another piece of interesting information came from RPP minutes, suggesting that some members argued for the rate cuts to curb recent zloty strengthening. The trend of falling Wibor rates is somewhat slowing down as the rate fell only 2 bp. over the week.

Possibility of eventually higher yields on the short end of the yield curve is supported by local economic situation (faster growth, falling unemployment). It may also move together with rising risk aversion and external risks. In short term we do not expect the rates to be hiked though. This view is supported still by falling spot CPI figure as well as recent comments from NBP, and goes well with falling WIBOR rate (not mentioning the risk of a rate cut … though we are not convinced).

As far as Polish bonds are concerned, the positioning is rather heavy and recent auctions development suggests that the majority of buyers here are not dedicated ones. Lack of demand on the supplementary auction is not a coincident then. Asset swaps are not wide either. We also now see curve starting to be more vulnerable to steepening (which we saw much flatter in the beginning of the year). We are in a strange place where MPC is considering rate cuts to weaken EURPLN exchange rate when the economy is clearly in the recovery phase. The fuel to the fire can be external risk connected with EU peripherals developments.

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	4/26/2010	-	3.757%	4/19/2010
2Y T-bond OK0712	5/5/2010	-	4.541%	4/7/2010
5Y T-bond PS0415	5/12/2010	-	5.778%	4/21/2010
10Y T-bond DS1019	6/16/2010	-	5.586%	4/14/2010
20Y T-bond WS0429	6/16/2010	-	6.170%	9/23/2009

Money Market

Cheap end of the reserve very likely

Balanced liquidity in the sector should increase the cost of carry much more then what could be observed. The explanation for this would be discounting another very cheap end of the reserve, therefore the majority of the market used the situation to underweight their balances comparing to the requirements. Today's maturing 6M repo and subsequent net cash outflow of PLN 5.2 billion should not disturb the liquidity of the sector much, since tomorrow it can be covered by the smaller demand during the open market operation.

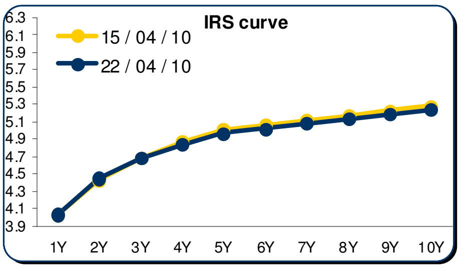
Good real economy figures stopped the bulls

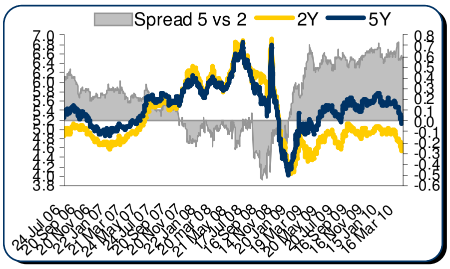
The bullish sentiment was stopped by the excellent industrial output (12.3%) and significant growth in wages (4.8%). Nonetheless, falling CPI and the strong currency still play a key role in the anticipation of the nearest MPC decisions. We sustain our forecast that any rate hikes will occur no sooner then late autumn.

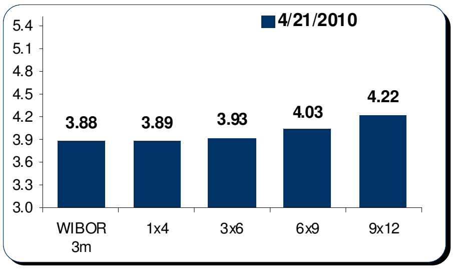
Debt hits the possible floor

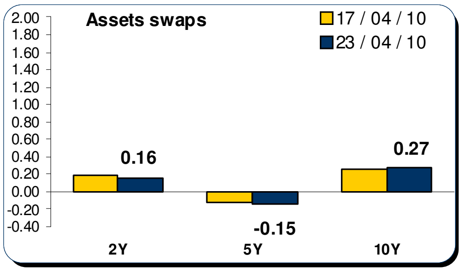
Treasury debt seems to hit the floor as of now. The benchmark T-bill average yield fell to 3.76% (we see the minimum level at 3.7%) and the 5 year bond fell below 5%.

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

Zloty traded in tight range

EUR/PLN has been trapped in the extremely tight range 3.8550/3.9150 for the second week. The 3.8550 is a strong resistance for Zloty, as it may trigger central bank intervention. 3.9150 is an attractive sell level for investors, which enter polish IPOs and SPOs. Possible risk factors are definitely outside Poland, namely: Greece, Portugal…and other EMU peripheries.

Implied volatility slightly lower

Volatility curves are strongly correlated to spot. During Monday's risk aversion (spot 3.9100) the 3 month EURPLN was traded 9.65%, there were bids 10.50% for 1 year. On Thursday (spot 3.8750) the 3 months are 9.3 % offered while the 1 year was offered at 10.50%. The risk reversals were also offered, closing on average 0.25% lower in comparison to the last week.

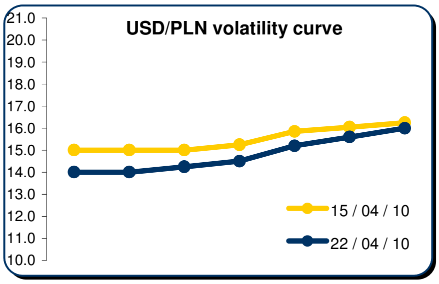
Short-term forecasts

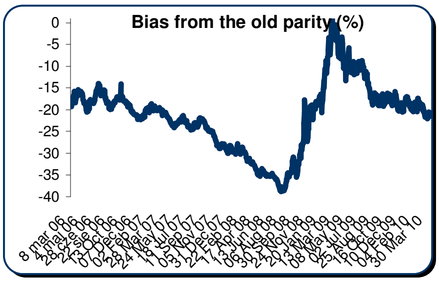
SPOT
Main supports / resistances:
EUR/PLN: 3.8000 / 3.9500
USD/PLN: 2.8000 / 3.0000

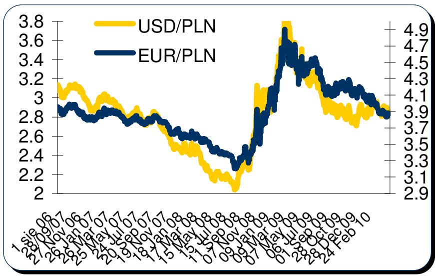
The picture is blurred, on one hand, recovering global economy (especially German!) but on the other, uncured cancer of extremely high budget deficits in UE periphery. Especially the Greece story may develop in the way which is hard to predict at the moment. Adding local factors, investors may sell EUR/PLN at current level and then re-enter position higher, at 3.95 level with stop loss at 3.98/4.02 and profit taking still at 3.70.

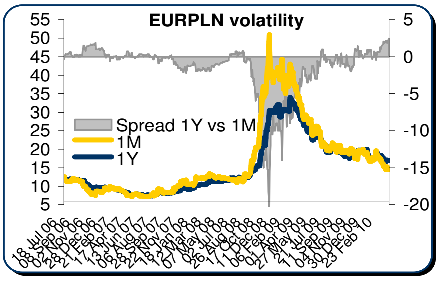
OPTIONS (unchanged from last week)
The historical volatility is still much below the implied volatility, even with the current lower implied volatility levels; back end volatility have reached the lowest levels this year! Not much to say right now, we wait for further developments.

FX CHARTS


USD/PLN volatility curve
15 / 04 / 10
22 / 04 / 10


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
16/04/10	3.84%	3.92%	3.99%	4.02%	4.21%	4.22%
17/04/10	3.82%	3.90%	4.01%	3.99%	4.21%	6.59%
20/04/10	3.80%	3.89%	3.97%	6.49%	4.25%	4.19%
21/04/10	3.84%	3.88%	3.98%	3.97%	4.20%	4.18%
22/04/10	3.72%	3.88%	3.95%	3.95%	4.19%	4.18%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
16/04/10	3.93%	3.92%	4.05%	4.25%	4.25%
17/04/10	3.91%	3.86%	3.96%	4.16%	4.20%
20/04/10	3.89%	3.88%	4.00%	4.18%	4.17%
21/04/10	3.86%	3.86%	3.96%	4.15%	4.17%
22/04/10	3.90%	3.86%	3.96%	4.17%	4.17%

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
16/04/10	4.22%	3.80%	4.45%	4.20%	4.98%	4.86%	5.25%	5.51%
17/04/10	6.59%	3.80%	4.45%	4.20%	4.98%	4.86%	5.25%	5.51%
20/04/10	4.19%	3.80%	4.44%	4.21%	4.99%	4.85%	5.26%	5.53%
21/04/10	4.18%	3.80%	4.45%	4.20%	4.97%	4.82%	5.24%	5.50%
22/04/10	4.18%	3.80%	4.43%	4.20%	4.97%	4.82%	5.23%	5.50%

PRIMARY MARKET RATES

Last Primary Market Rates

	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	10/04/19	11/04/19	96.341	3.76%	800	3941	750
OK0712	10/04/07	12/07/25	89.301	4.54%	3000	6726	2999
PS0415	09/04/21	15/04/25	102.209	4.99%	3000	6623	3000
DS1019	10/04/14	19/04/25	97.311	5.59%	3500	7980	3505

FX VOLATILITY

	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
date	1M	3M	6M	1Y	1M	1Y	1M	1Y
16/04/10	14.00	14.50	15.20	16.00	2.75	3.75	0.50	0.80
17/04/10	14.00	14.50	15.20	16.00	2.75	3.75	0.50	0.80
20/04/10	13.75	15.00	15.20	16.35	2.75	3.75	0.50	0.80
21/04/10	13.50	14.75	15.20	16.25	2.50	3.60	0.50	0.80
22/04/10	13.50	14.75	15.20	16.15	2.50	3.50	0.50	0.80

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
16/04/10	2.8325	3.8659	-21.45%
17/04/10	2.8325	3.8659	-21.45%
20/04/10	2.8325	3.8659	-21.45%
21/04/10	2.8325	3.8659	-21.45%
22/04/10	2.8325	3.8659	-21.45%

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, PhD, CFA (+48 22 829 01 66) Research@brebank.pl
Marcin Mazurek (+48 22 829 0183)

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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