BRE BANK SA

THE BEST FINANCIAL INSTITUTION FOR DEMANDING CUSTOMERS

FINANCIAL MARKETS DEPARTMENT

PAGES: 8

WARSAW, AUGUST 27, 2010

POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

PREVIEW: The week of August 27th 2010 to September 2nd 2010

Indicator	Date of release	Period	BRE forecast	Consensus	Last	Comment
GDP growth	Aug 30	Q2	**3.2%**	3.2%	3.1%	Our value-added based model points to significant improvement in GDP growth, even towards 3.8%. Thus we see a significant upward risk for 3.2% reading (although we do not contest it as there is high probability that Boni forecast is not solely based on his own calculations:).
FinMin's inflation forecast	Sep 1	Aug	**2.2-2.3%**	-	2.0%	Food prices slightly above seasonal pattern (some exuberance in wheat markets). Falling prices of fuels. Base effect from last months no longer valid.
PMI (pts)	Sep 1	Aug	**52.5**	-	52.1	Slightly better business tendency indicators in Germany (Ifo index). Worse industrial output and holiday season may have been weighing towards lower reading in July and we expect a kind of normalization in August.

In Focus / Macroeconomics

MPC will wait longer

No surprise from the MPC's side as repo rate was left intact. The statement should be regarded as no more than neutral (almost unchanged to the June's one). According to the comments uttered by the rate-setters, the MPC is split over the need of monetary tightening: the one wing stresses the adverse effects of hikes on economic growth, the other is pointing to slowly rising inflationary risks. Although we see inflationary risks as prevailing at the moment, global developments (and unwillingness to move against ECB in order to protect the zloty from strengthening) are likely to deter MPC members from swift decisions.

On the real sphere, the statement includes some hints on accelerating German economy, acknowledging risks for the world economy at the same time (common deleveraging). The state of Polish economy was favorably assessed, although with no indication in any direction. As for the details, the latest issues discussed focused on relatively slow growth of wages and subdued demand for credit. The discussion on fiscal policy resembles the one included in the former statement, no further attention was paid to the government's mid-term consolidation plans.

On the nominal side, the MPC acknowledged the risks concerning the possibility of CPI growth on food prices and higher VAT taxes, however, both factors were said to be of rather minor importance. During the conference, the governor mentioned that inflation may reach 2.5%, which seems overly conservative taking into account the cumulating risks concerning food prices.

A fresh piece of news in the statement is the support of the MPC given for the Polish Financial Supervision Authority (KNF) concerning actions aimed at limitd the growth rate of foreign currency denominated mortgages. It seems then that Polish rate-setters are somehow much interested in expanding safety net over Polish borrowers and shield them from currency risk (does it mean the MPC thinks the direction in EURPLN is not so obvious?).

The fresh macro data (moderate growth of inflation, close to consensus Q2 GDP growth announced by Mr. Boni (3.1-3.2%), and actions taken to further limit this year's budget deficit) and the global tendencies as well (easy ECB and Fed policy for longer) are unlikely to abruptly change the MPC stance and generate expectations for swift monetary tightening. Therefore inflation trades have lost their momentum. The MPC needs to see inflation accelerating beyond the levels associated with usual seasonal variation until it unleashes rate-setters' reaction (and then first hike). We thus expect the timing of the first hike to be put off and we do not advise to stick to October as the most possible date of a hike. At the same time do not exclude a scenario in which MPC behaves differently than it used to and consider December (and November) as a decision month.

MID-TERM FORECATS

Indicator	2007	2008	2009	2010	2011
GDP y/y (%)	6.5	4.8	1.7	3.6	4.2
Inflation rate (%, average)	2.4	4.3	3.5	2.8	3.5
Current account (% of GDP, average)	-4.5	-5.3	-1.6	-1.8	-2.9
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	3.75	**4.5**↓

Indicator	2009		2010			
	Q3	Q4	Q1	Q2	Q3	Q4
GDP y/y (%)	1.7	3.1	3.0	**3.2**↓	4.0	4.1
Inflation rate (%, average)	3.5	3.3	3.0	2.1	2.6	3.2
NBP repo rate (end-of-quarter)	3.50	3.50	3.50	3.5	3.5	3.75

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

Fixed Income

Summer trade part II

Last week Polish bonds were aggressively bid by offshore names which triggered stops at quite obsessed with a negative fiscal story Polish investors (OFE, banks and mutual funds). This week, after only a minor setback at the long end on Monday (10Y bond lost one figure in price), Polish names were literally forced to buy back much then dearer bonds. That is why the Wednesday switch auction saw a decent demand of PLN 4.2bn leading the prices of 10 and 5 year bonds higher. It seems now that fiscal story has suddenly evaporated and Polish bonds do nothing more than co-move with German bunds. One has to acknowledge that from technical perspective Polish long rates seem to be well supported by the lower band of the downward channel. We do not see, however, much support for higher rates from fundamentals and flows. As a matter of fact, due to positive economic growth Polish bonds continuously attract international yield pickers. In addition, inflation trades have lost their momentum and are very unlikely to be on the agenda before late Autumn (inflation will rise only gradually in August, MPC is neutral at most, as opposed to its Hungarian counterpart it supports the government and is quite happy with the current zloty levels). As the government is very likely to improve on the 45bn 2011 deficit figure in September, the market will rather welcome it as a good fiscal news and not contest the mid-term fiscal strategy. So will do the MPC. In short, bullish sentiment towards Polish bonds is going to take its toll in the weeks to come.

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	8/30/2010	-	3.946%	8/23/2010
2Y T-bond OK1012	9/1/2010	-	4.759%	8/4/2010
5Y T-bond PS0415	9/1/2010	-	5.373%	8/4/2010
10Y T-bond DS1020	9/15/2010	-	5.790%	6/16/2010
20Y T-bond WS0429	9/15/2010	-	6.170%	9/23/2009

Money Market

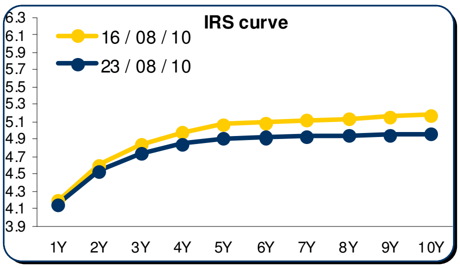
Very cheap end of the reserve

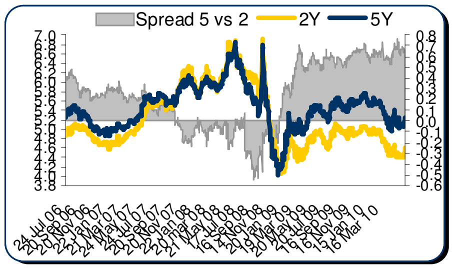
Very cheap end of the reserve is a fact. Market bought PLN 2 billion pln less money bills, however surplus grew much bigger. With very high probability tomorrow's OMO will not change much but only till Monday. Then the new reserve will shift the carry up again.

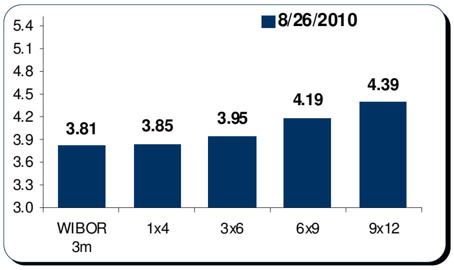
Bullish supported by the global factors

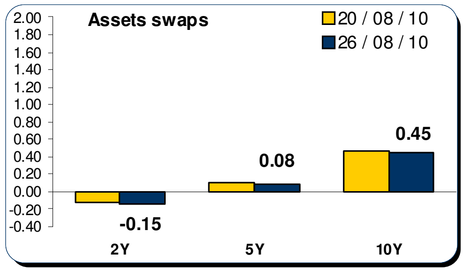
The MPC did not change the rates and the statement was neutral, which was in fact bullish since many expected more hawkish comments. Low retail sales (3.9 vs 6.4 expected) plus weak economic data from the core markets pushed longer MM rates down. It looks like market consensus postpones the beginning of the tightening cycle to next year. If we add pro-government character of the current MPC it starts to make sense.

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

Zloty bit weaker

Marking out this summer EURPLN's low (3.9250 in previous week) was closely followed by both regional (Hungary GDP forecast) and global (U.S. data) worsening of trading sentiment. As a result cross has climbed back to 4.0ish levels and has found good resistance at 4.03 level where good turnover was traded. Improved performance of risky assets by end of week has strengthen Zloty down to 3.98 level. Zloty invariably remains driven by outer signals.

Volatility bit higher

On the back of weaker Zloty, the curve was traded bit higher, especially short end – 1W ATM has jumped from 9.5 to 12.25, 1M from 10.25 to 11.75, 1Y spike was only by 0.25, up to 12.5. Strengthening has provoked selloff on short end, so once again 1W at 9.5 was given. Just to compare - weekly realized volatility during whole story faced value 10%. Other Złoty benchmarks were traded: 3M 25D EURPLN RR at 3.5%, EURPLN vs. USDPLN spread at 7%.

Short-term forecasts:

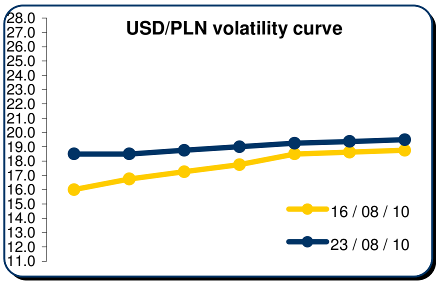
SPOT

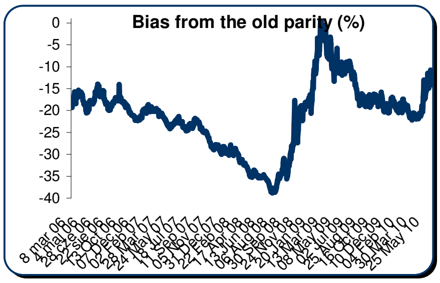
Main supports / resistances:
EUR/PLN: 3.9000 / 4.0500
USD/PLN: 2.9800. / 3.1500

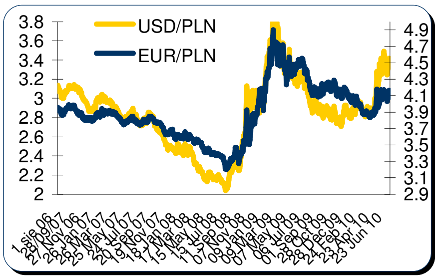
As the Zloty is almost exclusively driven by external factors, one may use the EUR/PLN or USD/PLN (for the brave ones) trades to imply the risk on or risk off strategy . But we don't see any highly probable trade at the moment.

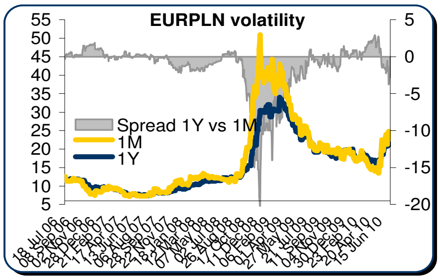
OPTIONS
Zloty implied curve is highly correlated with current spot level (3M vol about 0.85). All the above plus current implied level may encourage to add to our already long Vanna position. We expect the significant jump in volatility, while breaking the 3.80/4.05 range (lower to the downside, higher at the 4.05). Long Vanna seems a reasonably cheap way to enter that position for a little bit of curve theta and slightly negative gamma (easy to cover at current cheap frontend volatility).

FX CHARTS


USD/PLN volatility curve
16 / 08 / 10
23 / 08 / 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
19/08/10	3.75%	3.82%	3.89%	3.89%	4.15%	4.14%
20/08/10	3.70%	3.82%	3.90%	3.89%	4.15%	6.59%
23/08/10	3.70%	3.82%	3.90%	6.49%	4.15%	4.14%
24/08/10	3.70%	3.81%	3.90%	3.89%	4.15%	4.14%
25/08/10	3.68%	3.81%	3.90%	3.89%	4.10%	4.14%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
19/08/10	3.85%	3.95%	4.25%	4.44%	4.40%
20/08/10	3.85%	3.95%	4.24%	4.42%	4.41%
23/08/10	3.85%	3.92%	4.20%	4.40%	4.38%
24/08/10	3.84%	3.94%	4.15%	4.34%	4.33%
25/08/10	3.85%	3.95%	4.18%	4.37%	4.36%

FIXED INCOME MARKET RATES

Fixed Income Market Rates (Closing mid-market levels)

date	1Y		2Y		5Y		10Y	
	WIBOR	TB	IRS	OK0112	IRS	PS0511	IRS	DS1017
19/08/10	4.14%	3.92%	4.54%	4.35%	4.90%	4.99%	4.99%	5.48%
20/08/10	6.59%	3.94%	4.44%	4.31%	4.77%	4.87%	4.80%	5.26%
23/08/10	4.14%	3.95%	4.53%	4.35%	4.91%	4.93%	4.96%	5.37%
24/08/10	4.14%	3.92%	4.48%	4.39%	4.83%	4.95%	4.81%	5.34%
25/08/10	4.14%	3.92%	4.48%	4.33%	4.82%	4.90%	4.84%	5.29%

PRIMARY MARKET RATES

Last Primary Market Rates

	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	10/08/23	11/08/23	96.163	3.95%	800	2680	800
OK1012	10/08/04	12/10/24	90.185	4.76%	3000	7762	3719
PS0415	10/08/04	15/04/25	100.236	5.43%	2000	4741	2281
DS1019	10/06/16	19/04/25	95.807	5.79%	3000	2965	2430

FX VOLATILITY

	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
date	1M	3M	6M	1Y	1M	1Y	1M	1Y
19/08/10	16.75	17.75	18.50	18.75	3.25	5.00	0.75	0.95
20/08/10	17.75	18.50	19.25	19.35	3.25	5.15	0.75	0.95
23/08/10	17.50	18.25	19.10	19.25	3.75	5.25	0.75	0.95
24/08/10	18.75	19.00	19.25	19.50	4.00	5.25	0.75	0.95
25/08/10	18.50	19.00	19.25	19.50	4.00	5.50	0.75	0.95

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
19/08/10	3.0848	3.9506	-17.67%
20/08/10	3.1110	3.9719	-17.95%
23/08/10	3.1354	3.9850	-18.52%
24/08/10	3.1737	4.0104	-17.68%
25/08/10	3.1492	3.9946	-16.81%

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, CFA (+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

Disclaimer

Distribution and use of this publication

The review note is based on the information available to the public. This review creates exclusively a marketing information as defined in Paragraph 9 Section 1 of the Decree of Minister of Finance dated November 20, 2009 on procedures and conditions to be followed by investment firms and banks mentioned in Article 70 Section 2 of Law on Trading in Financial Instruments dated July 29, 2005 as well as by custody banks. This review note is provided to you for information purposes only and is not intended as advice on any particular matter or as recommendation, offer or solicitation for purchase of sale of any financial instrument and should not be taken as such. BRE Bank SA, its directors, officers, executives, managers, servants or agents expressly disclaim all liability to any person in respect of any-thing, and in respect of the consequences of anything, done or omitted to be done, wholly or partly, in reliance upon the whole or any part of the contents of this review note. The opinions and estimates contained herein reflect the current judgment of the author(s) on the date of this document and are subject to change without notice. The opinions pointed in review do not necessarily correspond to the opinions of BRE Bank SA. The past performance of financial instruments is not indicative of future results. No assurance can be given that any financial instrument or issuer described herein would yield favourable investment results. BRE Bank and/or its principals or employees may have a long or short position or may transact in the financial instrument(s) and/or securities referred to herein or may trade in such financial instruments with other customers on a principal basis. No client or other reader should act or refrain from acting on the basis on any matter contained in it without taking specific independent professional advice on the particular facts and circumstances in issue. Copyright protection exists in this publication and it may not be, even partially, reproduced of distributed without the prior written agreement with BRE Bank SA.