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FINANCIAL MARKETS DEPARTMENT

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WARSAW, SEPTEMBER 17, 2010

POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

PREVIEW: The week of September 17th 2010 to September 23rd 2010

Indicator	Date of release	Period	BRE forecast	Consensus	Last	Comment
Industrial output	Sep 17	Aug	**13.1%**	13.1%	10.3%	One working day more and solid PMI may be not enough to offset severe drop in auto production. We stick to our forecast, but with a downward risk.
Producer prices	Sep 17	Aug	**4.0%**	4.1%	3.9%	Stronger EURPLN triggers a correction in monthly prices. Price expectations still on a high level, though.
Core inflation	Sep 21	Aug	**1.2%**	1.2%	1.2%	Pressure in core inflation still moderate, reflecting past developments. We look for a change in 2011.
MPC "Minutes"	Sep 23					Important to watch as the statement seems too dovish compared to the rate-setters statements and the fact there was a rate hike motion in August.

In Focus / Macroeconomics

CPI Inflation flat, labor market stable

Both inflation and labor market data seems neutral for the monetary policy. We think the MPC is still focused on an idea of preemptive rate hike (of probably higher magnitude) which continuously has still a lot of advantages and solid footing. We stick to our scenario that the MPC will decide on such a hike in September or October. Till the end of the year the main interest rate is going to jump to 4.0%.

CPI inflation remained flat in August, at 2.0% y/y, missing market expectations. Price developments were driven solely by food prices which dropped by 1.4% on a monthly basis (matching exactly the seasonal pattern). Thereby, the main risk concerning the food prices which we mentioned lately (higher prices of wheat, flour, cereals and consequently vegetables, fruits and meat) has not materialized yet, but remain in the pipeline for the coming months. We expect inflation in September is likely to hit 2.4-2.5% on higher food prices (so far we identified rises of bread and flour; supply driven price movements in vegetables and fruits are yet to be confirmed) and we are likely to approach 3.0% mark in the year end. Although this fact alone (as a supply driven in nature) in normal circumstances should not trigger monetary tightening, the combination of rising inflation expectations (with very influential food prices in this field) and solid growth of domestic demand (supported by infrastructure investments and loose fiscal policy) carries, however, a lot of potential.

Labor market data were received as neutral. Although the growth of wages accelerated to 4.2% (doubling the growth rate from the last month), employment came a bit softer, 0.1pp. below market consensus at 1.7% y/y. Although the deceleration in employment seems worrying at first glance, we think it is mostly a result of seasonal variation right now as seasonal-sensitive sections boosted employment at the start of holiday season. We expect the next months to bring some unexciting figures of this sort (growth accelerating by 0.1pp. on annual basis), as companies are likely to slow down the hiring process on global uncertainties. As soon as they fade away (beginning of 2011), the more solid momentum in employment will kick in again, and is likely to be more persistent. That is why we think the next months on the labor market (even roughly flat) should be more or less ignored (if pointing downwards) in order minimize the risk of missing forest for the trees.

MID-TERM FORECASTS

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	4.00	4.50

Indicator	2009		2010			
	Q3	Q4	Q1	Q2	Q3	Q4
GDP y/y (%)	1.7	3.1	3.0	3.5	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	4.00

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

Fixed Income

Pressure on short rates to reappear.

Market has been relatively stable during last week with rates fluctuating within narrow range. As CPI data published on Tuesday did not support previous weakening, rates started to drift slightly lower. Later on however, some pressure on yields started to build up in the long end of the curve, as yields in the core market moved higher. Front end on the other hand held quite well, supported both by macro data and stable Wibor rates, with short FRAs trading some 5bp lower than previous week.

Wednesday 10y bond auction attracted very good demand, with b/c ratio close to 3, the Finance Ministry successfully placed 3bio of DS1020.

We consider recent action on the market rather as some correction than a stable tendency. We think pressure on higher rates in front end will start again, as support from macro data was rather temporary and could be easily reversed for instance by next week's publication of minutes from August MPC meeting. These should be more hawkish than the statement, possibly explaining some background for the rate hike motion proposed during that meeting. We're neutral for the long end of the curve, main risk there comes from the Bund, which further selling-off would likely have stronger impact on PolGBs, especially that so far that impact has been limited, yet 5y5y fwd to Euro already tightened by 40bp this month.

Summing up, after slight correction front end is likely to resume pushing higher ahead of next MPC meeting, which together with neutral/positive outlook for longer maturities, should result in flattening of the curve.

AUCTIONS

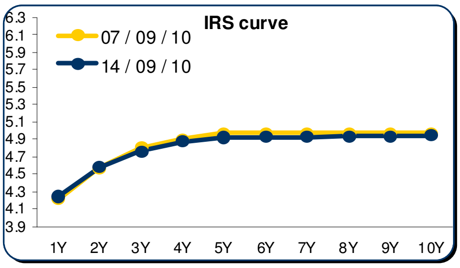
	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	6.142%	12/9/2008
26 Week T-bills	-	-	4.456%	5/4/2009
52 Week T-bills	9/20/2010	-	3.939%	8/30/2010
2Y T-bond OK1012	10/6/2010	-	4.672%	9/1/2010
5Y T-bond PS0415	10/13/2010	-	5.431%	9/6/2010
10Y T-bond DS1020	10/20/2010	-	5.456%	9/15/2010
20Y T-bond WS0429	9/15/2010	-	6.170%	9/23/2009

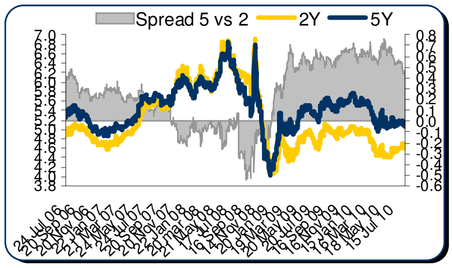
Money Market

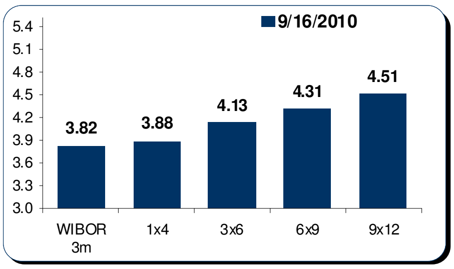
Demand lower than CB offer

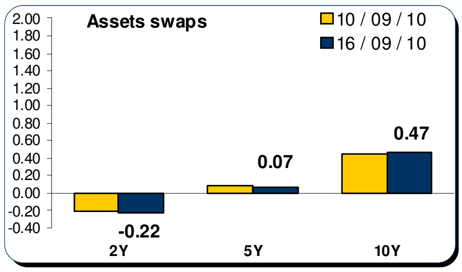
Short term depo rates during last two weeks were quiet stable in the range 2.6-2.9%. Last Friday CB offered PLN 84 bln bills but banks bid only 81.5 bln. Therefore reserve requirements for system is overbuilt at the moment by almost 1.5 bln. We believe that it will be difficult for CB to square the market and that today’s tender will not change much.
This week there is PLN 400 mio maturing from 6M repo that will not be rollover. However this amount is insignificant for the system. (Total amount of repo in the system is also insignificant and equal 175 mio).
CPI data lower than expected decreased OIS curve, mainly 3M and 6M.

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

Zloty stable

On early Wednesday we have faced, first since 2004 year, BOJ intervention. The Yen lost more than 3% to EUR and USD. Zloty reaction? None. For Zloty it was another quiet week. Despite higher core market volatility 3.92/3.96 trading range was well defended. Question "If PLN is really immune for external shocks and (especially) for how long" remains.

Volatility untouched

Volatility curve has stayed untouched. Untouched despite 5% weekly realized volatility this week and 6% in the previous. To illustrate the difference, curve was traded: 1M about 10.35, 3M 11.25, 1Y 12.0%. Other Zloty benchmarks were also traded at same levels as week ago: 3M 25D EURPLN RR at 3.0%, 3M EURPLN vs. USDPLN spread at 6.75%. Conclusion that market does not really believe in stronger Zloty, is a natural consequence.

Short-term forecasts:

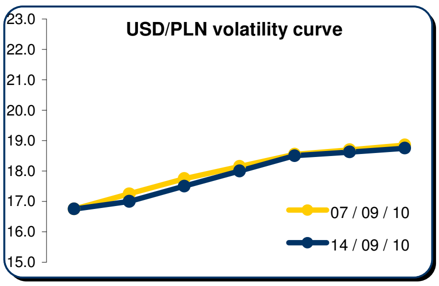
SPOT

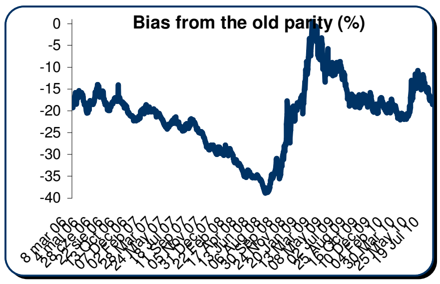
Main supports / resistances:
EUR/PLN: 3.9000 / 4.0500
USD/PLN: 2.9800. / 3.1500

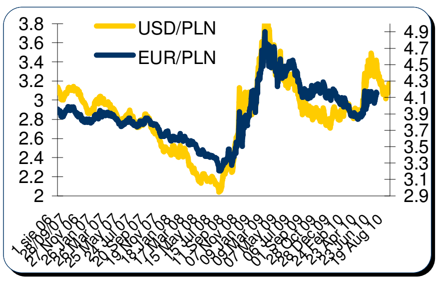
Decent supply with PLN we may explain why USDPLN cross traded near 3.0000 – it is simply profit taking area. Anyhow, so far we see momentum for PLN as neutral/positive. Technically, entry point 4.03 with S/L at 4.06 and P/T at 3.90.

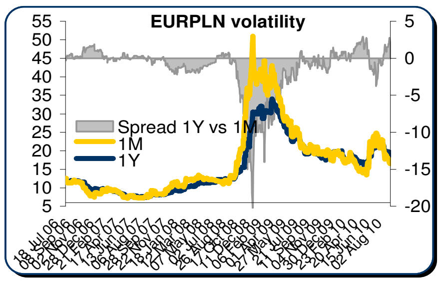
OPTIONS
We wrote: "Historically Zloty gains are much softer than losses and that way we see potential Zloty appreciation. Gamma has downside potential." Still nothing to add here.
Moving underlying market is the trigger which our long vanna needs. Although it seems stable for now, we feel that global sentiment, which stays vulnerable, will provide enough chances to vega hedge in future. We expect the significant jump in volatility, while breaking the 3.80/4.05 range (lower to the downside, higher at the 4.05).

FX CHARTS









MARKET PRICES UPDATE

MONEY MARKET RATES

Money market rates (Closing mid-market levels)						
date	3M		6M		1Y	
	FXSW	WIBOR	FXSW	WIBOR	FXSW	WIBOR
10/09/10	3.71%	3.81%	3.88%	3.89%	4.08%	4.14%
13/09/10	3.71%	3.81%	3.90%	3.90%	4.15%	6.59%
14/09/10	3.75%	3.81%	3.90%	6.49%	4.11%	4.15%
15/09/10	3.70%	3.82%	3.93%	3.90%	4.17%	4.16%
16/09/10	3.70%	3.82%	3.90%	3.92%	4.15%	4.16%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
10/09/10	3.90%	4.06%	4.29%	4.49%	4.47%
13/09/10	3.91%	4.13%	4.34%	4.54%	4.51%
14/09/10	3.92%	4.14%	4.33%	4.55%	4.50%
15/09/10	3.91%	4.12%	4.35%	4.54%	4.49%
16/09/10	3.92%	4.14%	4.34%	4.54%	4.51%

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
10/09/10	4.14%	3.97%	4.62%	4.41%	4.95%	5.04%	4.98%	5.43%
13/09/10	6.59%	3.92%	4.61%	4.42%	4.98%	5.03%	5.01%	5.45%
14/09/10	4.15%	3.92%	4.58%	4.41%	4.92%	5.00%	4.94%	5.44%
15/09/10	4.16%	3.93%	4.56%	4.37%	4.90%	4.96%	4.94%	5.41%
16/09/10	4.16%	3.91%	4.59%	4.37%	4.90%	4.97%	4.94%	5.41%

PRIMARY MARKET RATES

Last Primary Market Rates							
	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	10/08/30	11/08/30	96.170	3.94%	700	2592	550
OK1012	10/09/01	12/10/24	90.670	4.67%	4000	6603	4000
PS0415	10/08/08	15/04/25	101.123	5.21%	3000	7500	3000
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
10/09/10	17.10	18.00	18.40	18.75	3.60	5.15	0.75	0.90
13/09/10	17.00	18.00	18.40	18.75	3.60	5.15	0.75	0.90
14/09/10	17.00	18.00	18.40	18.75	3.60	5.15	0.75	0.90
15/09/10	17.10	18.00	18.40	18.75	3.60	5.15	0.75	0.90
16/09/10	17.00	18.00	18.50	18.75	3.60	5.15	0.75	0.90

PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
10/09/10	3.0867	3.9316	-17.25%
13/09/10	3.0745	3.9407	-16.51%
14/09/10	3.0637	3.9493	-16.99%
15/09/10	3.0347	3.9361	-17.68%
16/09/10	3.0131	3.9345	-17.77%

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

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