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FINANCIAL MARKETS DEPARTMENT

PAGES: 8

WARSAW, DECEMBER 2, 2010

POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

PREVIEW: The week of December 3rd 2010 to December 9th 2010

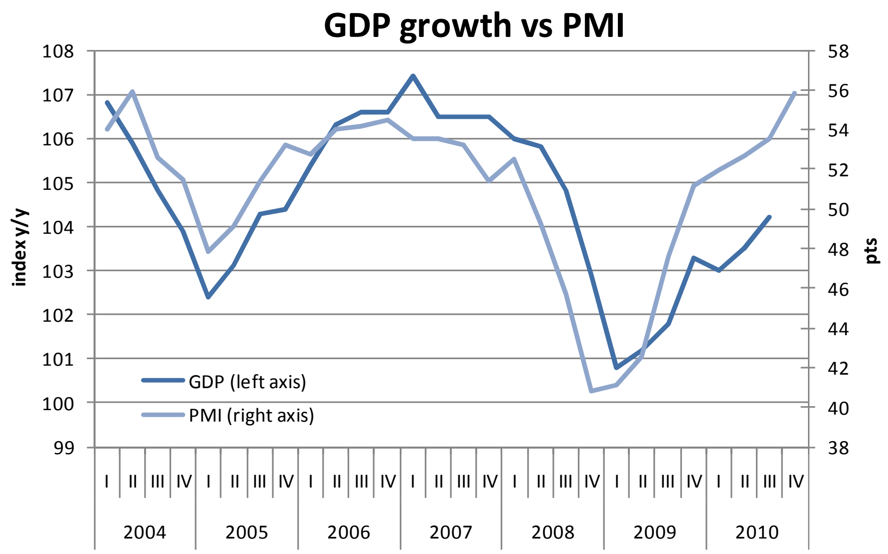
Indicator	Date of release	Period	BRE forecast	Consensus	Last	Comment
NO SIGNIFICANT RELEASES						

In Focus / Macroeconomics

GDP confirms the solid turnaround is taking place

Q3 GDP surprised to the upside reaching +4.2% y/y (our call +3.9%, market consensus +3.6%). Private consumption remained the main engine of growth (+3.5% versus +3.0% in Q2); the data also confirmed the acceleration of public consumption (+4.3% y/y vs +2.2% in Q2). To our surprise, investment growth almost stagnated (+0.4% y/y vs -1.7% in Q2) – contrary to the acceleration posted by investment of enterprises (more than +10pp. over the annual growth in Q2…) and higher value added in construction (+6.1% vs 3.8% in Q2). It seems much of the pent up investment demand was registered under consumption durable goods. As for the residual components, we saw pretty decent net exports contribution (+0.0% versus -0.9% posted by our quite accurate model based on real time data) and ongoing re-stocking (+1.2pp.).

We expect the Q4 results to be more or less close to Q3 with more upside risk stemming from public consumption and investment. Surging PMI yield the risk of even higher reading (see the graph for visual inspection of the underlying correlation).



The data convey inflationary message in medium-term as economy is operating close to pre-crisis capacities and the final demand comprises mainly of consumption (50% of generated growth is attributable to private consumption, 20% goes to public consumption, and only 2% (yes, two) is fixed capital formation). We think this poses a serious risk as economy is operating near its full capacities, making use of intensive labor utilization. Such a combination seems a prologue to future employment rises, wage pressures and ultimately rising core inflation. Moreover, relatively high headline inflation readings (on the more and more tight labor market) may further empower employees in wages negotiations. In the meantime, however, the MPC may be focusing more on the fragility of investment (and the ensuing fragility of the overall GDP growth) and would prefer to stick to wait-and-see approach, and effective exchange-rate channel invoked along with the probable Ministry of Finance activity in the year end.

FinMin points to stable inflation print

The Ministry of Finance announced CPI inflation may have stayed at 2.8% in November. As for the breakdown, only +0.4% m/m growth of food prices was released. Although we agree the effects of the last shock are fading, our call for food prices is higher (econometric model posts +0.6% whereas calculation basing on wholesale prices suggest +1.0%). Therefore we also bet on slightly higher inflation at 2.9%. We also expect core inflation to edge up a bit to 1.3%.

Just before the Ministry forecast, the MPC published its news schedule of meeting for 2011. The main takeaway from it that there is no decision meeting in February (there is an interim period about which Belka already mentioned earlier) and inflation projection will be published in March (in contrast to usual February). Below you find the complete list of meeting from NBP website.

Month	Date
January	18-19
February	15*
March	1-2, 15
April	4-5, 19
May	10-11, 17
June	7-8, 14
July	5-6
August	23*
September	6-7, 20
October	4-5, 18
November	8-9, 15
December	6-7, 20

Although no official information has been disseminated yet, with probability close to 100% **meetings marked with a star (*) are non-decision meetings**. Other, decision meetings, are held at the start of the month and are scheduled to be two-day ones.

MID-TERM FORECATS

Indicator	2007	2008	2009	2010	2011
GDP y/y (%)	6.5	4.8	1.7	**3.8**↑	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	-2.8	-3.8
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	3.50	4.50

Indicator	2009		2010			
	Q3	Q4	Q1	Q2	Q3	Q4
GDP y/y (%)	1.7	3.1	3.0	3.5	4.2	**4.5**↑
Inflation rate (%, average)	3.5	3.3	3.0	2.1	2.6	2.8
NBP repo rate (end-of-quarter)	3.50	3.50	3.50	3.5	3.5	3.50

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

Fixed Income

All we know about contagion

Recent moves on Polish FI market were caused mainly by external factors, i. e. debt crisis in Eurozone periphery. As situation there improved in the beginning of the week, it also had some positive impact on the PLN curve. Bonds, that have sold off strongly, jumped back significantly (DS1020 recover by almost 150 ticks from 93.30 to 94.70). Also the swap curve steepening tendency reversed, 2y-5y and 2y-10y spreads narrowed by some 7-8bp over the week. Local economic data published this week were also rates supportive - GDP that surprisingly jumped to 4.2% and Ministry of Finance inflation forecast at 2.8% y/y (stable from last month). On back of the improved sentiment, Wednesday 2y bond auction was quite a successful one - bid-to-cover ratio exceeded 2 and whole 4bio of announced supply were sold. Comments from MPC members this week didn't really change current outlook for policy tightening. Zielinska-Glebocka identified need for a rate hike 'soon - in December or 1Q', however as a whole the Council seem to have eased their stance, and still expect first hike in 1Q 2011, most likely in March.

Overall it still seems that external factors will keep weighing on PLN curve; we're leaning more towards positive outcome. Recent sell-off was somehow panic, much of the positions have been reduced, so even in case sentiment in EMU worsens, the impact shouldn't be that big this time, on the other hand further normalization would have positive impact on local market.

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	12/25/2010	-	4.056%	10/25/2010
2Y T-bond OK1013	-	-	4.798%	12/1/2010
5Y T-bond PS0416	-	-	5.137%	10/13/2010
10Y T-bond DS1020	-	-	5.772%	11/17/2010
20Y T-bond WS0429	-	-	6.170%	9/15/2010

Money Market

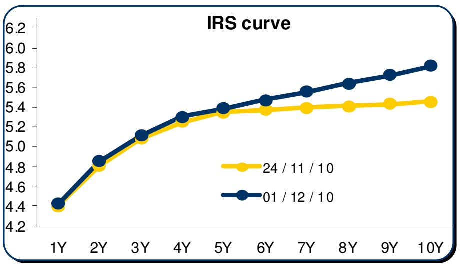
Huge swing on carry

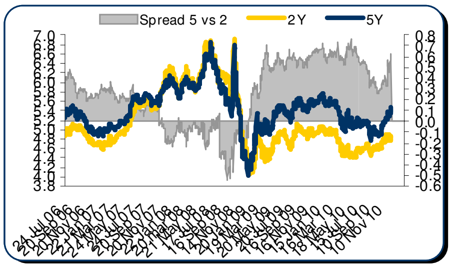
Global factors in play

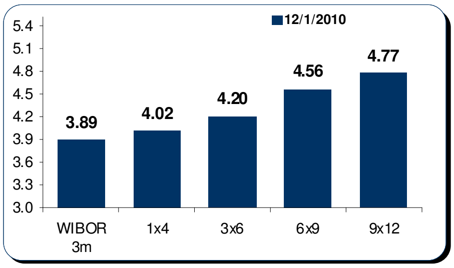
Very cheap end of the reserve with substantial deposit in the central bank followed by the very expensive beginning of the new reserve with polonia index above the main rate. This should be corrected during tomorrow's OMO and we should be back to cost of carry somewhere around 3%. We see high probability of under-bid money bills.

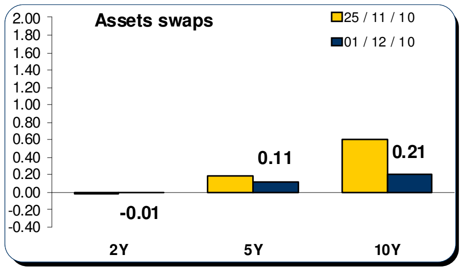
Global threats plus weakening zloty keep the curves relatively high and better than expected (2.8 vs 2.9%) CPI projection had no influence. Much depends on the currency for the coming days.

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

Zloty volatile

Just an order or squeeze of long PLN positions provoked by European debt selloff? As a result of decent PLN's supply Zloty in two days had lost 3.2% to EUR. Move, bounded by 3.98 - 4.11 rates, has made PLN underperforming other CE3. But thin is the line between underperformer and overperformer. Since midweek, driven by improved regional sentiment, Zloty has started to gain, trading 3.9870 early Thursday.

Curve higher

EURPLN's implied curve, especially short end, was traded higher this week. 1M tenor, traded at 10.5 early Friday had bounced to 12.0 just to retrace to 11.4 at end of week. Other tenors ranges were 11-12.3 for 3M and 12.2-12.5 for 1Y. While compared to realized, one may say cheap buy. Weekly realized was about 24% (for benchmark - "Greece" realized was about 45%) for EURPLN cross. Response on smile and USDPLN run was also limited. 1M 25D RR was traded in 1.5-2.8 and 1M currency spread in 7.8 – 9.0 ranges while longer tenors has reacted softer.

Short-term forecasts:

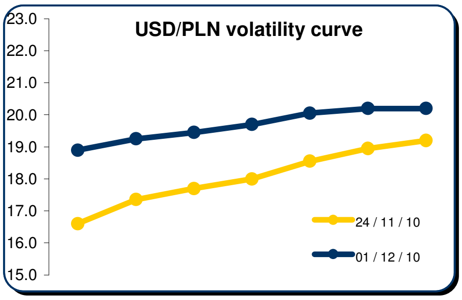
SPOT

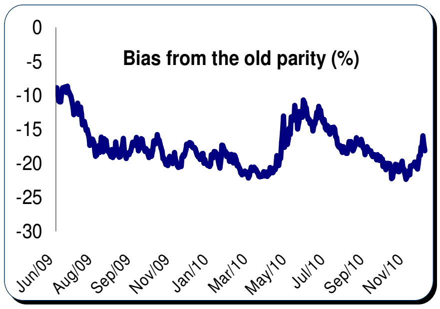
Main supports / resistances:
EUR/PLN: 3.9500 / 4.0800
USD/PLN: 2.8750. / 3.1500

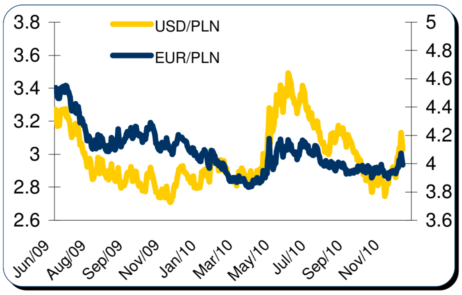
Recent price action has limited already lower Zloty liquidity. We expect 3.95-4.08 wide range trading where tone will be set by European debt market and EURUSD spot.

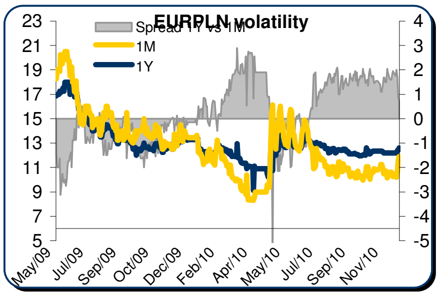
OPTIONS
Lowered liquidity and volatile core markets. We think long gamma is “hard to lose” bet.

FX CHARTS









MARKET PRICES UPDATE

MONEY MARKET RATES

Money market rates (Closing mid-market levels)

date	3M FXSW	3M WIBOR	6M FXSW	6M WIBOR	1Y FXSW	1Y WIBOR
25/11/10	3.75%	3.85%	3.95%	3.95%	4.18%	4.17%
26/11/10	3.72%	3.85%	3.95%	3.95%	4.17%	6.59%
29/11/10	3.75%	3.86%	3.95%	6.49%	4.17%	4.18%
30/11/10	3.80%	3.89%	3.95%	6.49%	4.15%	4.23%
01/12/10	3.77%	3.89%	3.95%	3.98%	4.15%	4.23%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
25/11/10	3.97%	4.18%	4.52%	4.73%	4.68%
26/11/10	3.97%	4.17%	4.50%	4.71%	4.67%
29/11/10	3.95%	4.20%	4.52%	4.72%	4.68%
30/11/10	3.95%	4.18%	4.53%	4.72%	4.67%
01/12/10	3.93%	4.14%	4.48%	4.71%	4.65%

FIXED INCOME MARKET RATES

Fixed Income Market Rates (Closing mid-market levels)

date	1Y WIBOR	1Y TB	2Y IRS	2Y OK0112	5Y IRS	5Y PS0511	10Y IRS	10Y DS1017
25/11/10	4.17%	4.08%	4.79%	4.78%	5.36%	5.54%	5.47%	6.07%
26/11/10	6.59%	4.08%	4.78%	4.84%	5.36%	5.57%	5.50%	6.12%
29/11/10	4.18%	3.97%	4.86%	4.86%	5.47%	5.59%	5.63%	6.18%
30/11/10	4.23%	4.01%	4.83%	4.87%	5.41%	5.53%	5.53%	6.05%
01/12/10	4.23%	4.01%	4.85%	4.84%	5.38%	5.50%	5.81%	6.02%

PRIMARY MARKET RATES

Last Primary Market Rates

	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	10/09/27	11/09/27	96.189	3.92%	600	1150	580
OK0113	10/12/01	13/01/26	90.550	4.80%	4000	9322	4076
PS0416	10/10/13	16/04/25	99.300	5.14%	3000	3414	2491
DS1020	10/09/15	19/04/25	98.383	5.46%	3000	8953	3000

FX VOLATILITY

date	USD/PLN 0-delta stradle 1M	USD/PLN 0-delta stradle 3M	USD/PLN 0-delta stradle 6M	USD/PLN 0-delta stradle 1Y	25-delta RR 1M	25-delta RR 1Y	25-delta FLY 1M	25-delta FLY 1Y
25/11/10	17.35	18.05	18.55	19.20	2.70	4.20	0.65	0.88
26/11/10	17.90	18.45	18.95	19.40	2.75	4.30	0.65	0.87
29/11/10	18.30	18.85	19.10	19.40	3.05	4.50	0.65	0.88
30/11/10	19.55	19.95	20.15	20.15	3.40	4.75	0.65	0.88
01/12/10	19.25	19.70	20.05	20.20	3.40	4.75	0.65	0.88

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
25/11/10	2.9881	3.9747	-18.8%
26/11/10	3.0363	4.0248	-17.7%
29/11/10	3.0441	4.0278	-17.5%
30/11/10	3.1308	4.0734	-16.0%
01/12/10	3.0753	4.0205	-17.3%

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) jakub.wiraszka@brebank.pl
Tomasz Chmielarski (+48 22 829 01 78) tomasz.chmielarski@brebank.pl

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) pawel.bialczynski@brebank.pl

MM (BREP) - MM
Bartłomiej Małocha, CFA (+48 22 829 01 77) bartłomiej.malocha@brebank.pl
Bogumił Modzelewski bogumil.modzelewski@brebank.pl

Structured Products (BREX)
Jaroslaw Stolarczyk (+48 22 829 01 67) jaroslaw.stolarczyk@brebank.pl
Jacek Derezinski (+48 22 829 01 69) jacek.derezinski@brebank.pl

Institutional Sales (BRES)
Inga Gaszkowska-Gębska (+48 22 829 12 05) inga.gaszkowska-gebska@brebank.pl

Research
Ernest Pytlarczyk, PhD, CFA (+48 22 829 01 66) ernest.pytlarczyk@brebank.pl
Marcin Mazurek (+48 22 829 0183) marcin.mazurek@brebank.pl
Piotr Piękoś (+48 22 829 0185) piotr.piękoś@brebank.pl

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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