BRE BANK SA

THE BEST FINANCIAL INSTITUTION FOR DEMANDING CUSTOMERS

POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

FINANCIAL MARKETS DEPARTMENT

PAGES: 8 *WARSAW, JANUARY 20, 2011*

PREVIEW: The week of January 20th 2011 to January 27th 2011

Indicator	Date of release	Pe-riod	BRE forecast	Consen-sus	Last	Comment
NO SIGNIFICANT RELEASES						

In Focus / Macroeconomics

MPC hikes rates by 25bp

In line with market expectations the MPC decided to hike interest rates by 25bps – currently the reference rate is at 3.75%.

The assessment of situation in the world economy remains positive. Admittedly, there are some references to the monetary tightening in emerging economies (determined to pursue the policy of "constraints for growing macroeconomic imbalances"), however the previous risk factors (present in the December after-meeting statement) were sustained: effects of large fiscal imbalance in the developed economies and the announcement of its reduction, results of monetary expansion and unconventional measures taken by central banks. The nominal side of the world economy remains under the influence of commodity prices: oil and food. Improvement of financial market sentiment was noted (it is a new element of the MPC statement), however risk factors concerning peripheral eurozone countries remained valid.

As for the real side of the Polish economy, it was pointed out that Q4'2010 GDP growth remained at the level close to Q3'2010. Nevertheless, demand for corporate loans remains constrained, whereas demand for household loans rises (remarks about the importance of the measures aimed at limiting FX loan portfolio in the household segment were sustained). In turn, the nominal side was dominated by exogenous factors – mainly fuel prices. The MPC confirmed that due to commodity prices and VAT rate hike inflation may remain elevated in the next months.

The key part of the MPC statement informs that the January rate hike was caused by acceleration of GDP growth, which may (the conditional mode seems important here) lead to rising wage and inflation pressure in the mid-term. At the same time exogenous factors (commodity prices) may generate increase of inflation expectations. Further signals of rising inflation pressure will be closely monitored by the MPC.

We expect that the January hike is not a one-off event and is the first of 2-3 hikes that shall materialize this year. The whole tightening cycle will be smaller than in the previous cycles - max. 100bps. MPC acts more cautiously than in the previous periods of monetary tightening (the gradual character of the MPC policy is proved by the schedule of the MPC actions that was mentioned by the NBP Governor Belka during the press conference: at first, hike of required reserve ratio, now reference rate hike) and although the March rate hike is currently fully priced in by the market, it will depend on the inflation projection, decomposition of Polish GDP growth, inflation expectations and PLN exchange rate (materialization of expected zloty appreciation). It is the latter component that is crucial right now.

After the MPC statement yields even dropped and the curve slightly flattened as the rate hike had been fully priced in. It may be however only a temporary correction. GDP and wage growth acceleration as well as inflation risks will not let the market to diverge from the aggressive cycle of rate hikes. Moreover, the aforementioned zloty appreciation would have to considerable (at least close to Governor Belka's expectations) as otherwise the market will price in that the MPC is late, and the Council may be forced then to front-load rate hikes. The analysis of the MCI (Monetary Conditions Index) shows that if the zloty appreciation expected by Governor Belka takes place (10% appreciation from 4.00/EUR sets the target at 3.60/EUR) and the rates are hiked by 75bps, the level of monetary policy restrictiveness may reach the 2008 level. Therefore, the bet about the scale of tightening seems to be more secure than the bet about the timing of specific steps.

Macro data on stronger side

This week's data did constitute a meaningful proof that inflationary pressures in monetary horizon are rising, confirming thereby the fundamental necessity of rate hikes (mind the comments above, though). Although consumption may lose some momentum in Q1 (the fallout of substitution effects from Q4 2010), manufacturing, construction and investment activity should remain within well defined upward trends, thereby reducing the potential for rate hike expectations to recede.

Employment In the corporate sector was at 5379k in December, slightly less than in the previous month. This result is a notch better than one that can be derived from seasonal factors in the corresponding phase of the business cycle. In relation to business sentiment indices we think that in the next months employment growth (in monthly terms) will slow down (vs. the lately registered average growth by 11-12k monthly). However, due to high increase of labor productivity such a situation cannot last long (strong tendency to return to the average, physical barriers to the use of the currently employed) and in the second half of 2011 employment may rise at the annual rate of 3%. Wage dynamics also accelerated, from 3.6% from 5.4%YoY. The basis for wage growth is above all higher number of working days and further surge of economic activity – factors that are responsible for acceleration of wage dynamics in the manufacturing sector (we think that the trend in the manufacturing sector is already at 6%YoY). Further wage growth will be supported by the ongoing economic recovery, strong fiscal stimulus and infrastructural investment.

The data on industrial production proved relatively strong. Although 11.5% was a notch below market consensus, 11.5% in seasonally adjusted terms it is encouraging and within a sustainable trends. Also construction activity proved relatively strong (especially taking account the adverse weather conditions) and speaks in favor of another pick-up in investment activity in the year end.

On the nominal side, we saw a decent growth of producer prices towards 6.1% y/y which reflects primarily the after-effects of commodity shock and PLN depreciation. The component connected with the pace of domestic activity (reflected in producer price expectations) strengthens which may affect the pricing behavior at the very end of supply chain (retail and consumer prices). We do not expect this tendency to change in the near future. As for core inflation, we saw some pickup to 1.6% y/y from 1.2% in November, although – as for now – it reflects primarily base effects. The more fundamental growth of core inflation is expected in the coming months.

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	-3.1	-3.8
Unemployment rate (end-of-year)	11.4	9.5	11.9	12.3	10.9
NBP repo rate (end-of-year)	5.00	5.00	3.50	3.50	4.25

Indicator			2010		2011	
	Q1	Q2	Q3	Q4	Q1	Q2
GDP y/y (%)	3.0	3.5	4.2	4.5	4.2	3.8
Inflation rate (%, average)	3.0	2.1	2.6	2.9	3.3	3.4
NBP repo rate (end-of-quarter)	3.50	3.5	3.5	3.50	3.75	4.00

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

Fixed Income

First hike

So the MPC has delivered a hike after all. As the market had managed to fully price in such decision after previous hawkish comments from NBP's Governor Belka, as a result rates pulled back by some 3bp after the decision and another 3-4bp next day after it turned out that 3M and 6M Wibors only moved by 10 and 6 bp respectively. Statement and press conference didn't really clear the picture much - rate setters will further monitor the situation and left the possibility for further tightening if that proves necessary. As we have 25bp hike on March meeting already priced in, and more than one in April/June, that's not really something that could impact the market significantly. It does seem that the recently popular strategy of paying Polish rates in the front end has lost it's potential. MPC started hiking, which decreases the risks of them falling behind the curve and also decreases chances of bigger than 25bp moves to almost none. Wibors reaction to the hikes is reasonable now, so this market is very unlikely to overreact in the future. Yet we still price in another 100bp this year and another 50 next year. 1y1y forward is becoming an obvious receive, also 9x12 doesn't really have much fundamental potential. Even the front end, having priced in everything can only surprise on the downside in case hike doesn't happen. On the other hand, hiking cycle has just started, next eceonomic data will be rather pointing to further tightening, CPI is on the growing path and highest readings in terms of level and timing, likely to happen at 3.5-3.6 in May/June, yet still means some risk. Therefore there is probably lots of volatility ahead, and market will follow economic releases, watch EURPLN, listen to further comments from the MPC. We're skewed to the bullish side and think receiving tops will be much better strategy than paying bottoms.

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	2/2/2011	-	4.056%	10/25/2010
2Y T-bond OK1013	2/9/2011	-	4.984%	1/5/2011
5Y T-bond PS0416	2/9/2011	-	5.642%	1/5/2011
10Y T-bond DS1020	2/16/2011	-	6.210%	1/12/2011
20Y T-bond WS0429	2/16/2011	-	6.246%	1/12/2011

Money Market

The MPC hiked all the rates by 25 bps

6M T-bills cheaper during the next tender

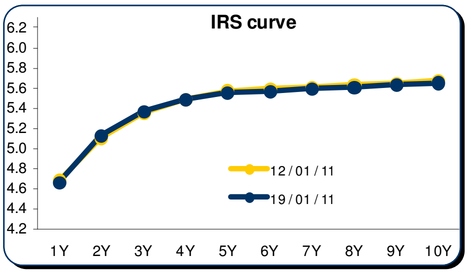
This time market bought less than pln 80 billion of money bills which was around 5 billion less than the amount squaring the market. Shortest rates dropped down but still to relatively expensive levels. Seems that the market wanted to build the reserve before the hike and it was a reasonable strategy. Tomorrows OMO (assuming no additional ones) will determine whether the last week of the reserve is cheap or only the very end of the settlement period.

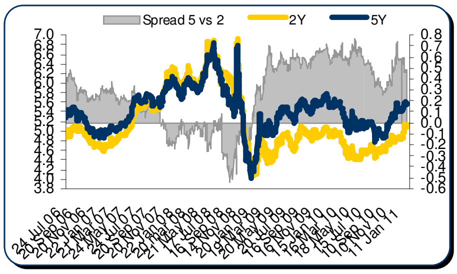
The MPC did hike the rates by 25 bps as majority of the market expected. Since it was completely priced in plus we will not be wrong much saying that the whole cycle was already priced in, it resulted in a little drop of the curve (around 5 bps for terms over 3M). Again it was reasonable.

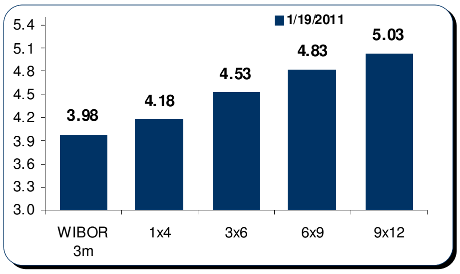
Wages much above expectations 5.4 vs 3.8%, which only supported the MPC in their decision. Since no decision will be made in February (as it was said before in the central bank's statement) the market started to bet for another hike in March.

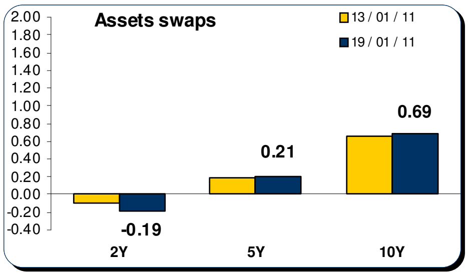
6M T-bills average yield was 4.05%. On Monday we can bid the same issue and the papers should be much cheaper.

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

Zloty weaker

This week EURPLN cross has opened about 3.86 and has started trading weaker side while waiting for MPC meeting. Although decision was in line with expectations and statement was neutral, decent, long PLN, market positioning has overweighted and EURPLN has touched 3.9150 high on back of position closing. Nevertheless PLN stays in strengthening trend, both short (resistance 3.92-3.93) and medium term (up line about 4.06)

Implied curve lower

Despite slightly weaker Zloty, decreasing realized volatility (last week about 9%) has pressured implied curve and has provoked some selloff. As a result 1M was traded at 9.7 (10.25 week ago), 3M at 10.9 (11.2) and 1Y at 12.1 (12.2). Sold was also smile, were 3M an 1Y benchmarks were traded respectively at 2.2 (2.4 week ago) and 3.2 (3.4). Another week of low EURUSD vs EURPLN correlation continues pressures on USDPLN vs EURPLN currency spread – its traded about 7.35 now (8% week ago).

Short-term forecasts:

SPOT

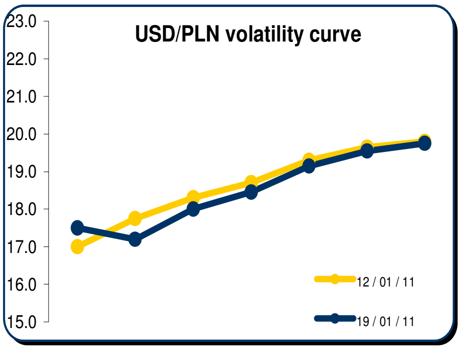
Main supports / resistances:
EUR/PLN: 3.8000 / 3.9800
USD/PLN: 2.8400 / 3.0200

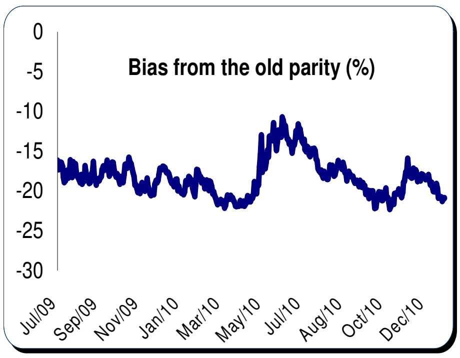
Nothing has surprised market but clearly positioning must be lighted before heading lower. We leave 3.93-3.96 area as short EURPLN entry with T/P at 3.80 and S/L 4.01.

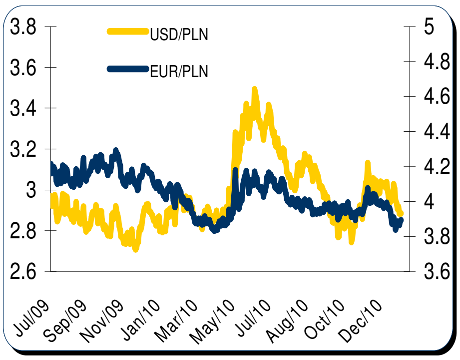
OPTIONS

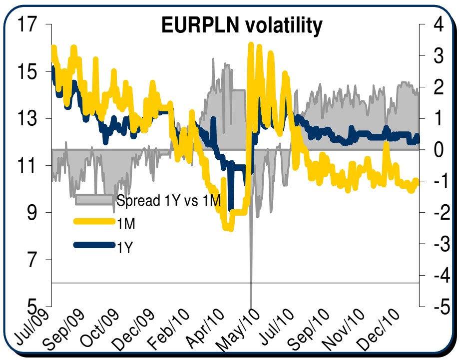
Low realized volatility on long PLN positions closing, close possible top of move. We believe next move lower will be softer – we suggest short gamma position.

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
13/01/11	3.90%	3.98%	4.10%	4.11%	4.31%	4.32%
14/01/11	3.87%	3.98%	4.15%	4.12%	4.31%	6.59%
17/01/11	3.85%	3.98%	4.12%	6.49%	4.32%	4.33%
18/01/11	3.93%	3.98%	4.10%	4.12%	4.32%	4.34%
19/01/11	3.86%	3.98%	4.24%	4.14%	4.49%	4.34%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
13/01/11	4.18%	4.56%	4.88%	5.07%	5.03%
14/01/11	4.18%	4.50%	4.82%	5.01%	4.98%
17/01/11	4.20%	4.53%	4.83%	5.03%	5.02%
18/01/11	4.20%	4.55%	4.84%	5.03%	5.00%
19/01/11	4.18%	4.55%	4.85%	5.05%	5.00%

FIXED INCOME MARKET RATES

Fixed Income Market Rates (Closing mid-market levels)

date	1Y		2Y		5Y		
	WIBOR	TB	IRS	OK0112	IRS	PS0511	IF
13/01/11	4.32%	4.18%	5.11%	5.02%	5.59%	5.77%	5.7
14/01/11	6.59%	4.19%	5.13%	4.99%	5.62%	5.76%	5.7
17/01/11	4.33%	4.11%	5.10%	4.99%	5.58%	5.75%	5.6
18/01/11	4.34%	4.19%	5.09%	4.94%	5.57%	5.76%	5.6
19/01/11	4.34%	4.19%	5.13%	4.94%	5.55%	5.76%	5.6

PRIMARY MARKET RATES

Last Primary Market Rates

	au. date	maturity	avg price	avg yield	supply	demand	sc
52W TB	10/09/27	11/09/27	96.189	3.92%	600	1150	58
OK0113	10/12/01	13/01/26	90.550	4.80%	4000	9322	40
PS0416	10/10/13	16/04/25	99.300	5.14%	3000	3414	24
DS1020	11/01/12	19/04/25	93.022	6.21%	2250	4252	22

FX VOLATILITY

	USD/PLN 0-delta stradle				25-delta RR		2
date	1M	3M	6M	1Y	1M	1Y	1
13/01/11	17.80	18.70	19.30	19.80	2.30	4.55	0.
14/01/11	17.70	18.75	19.30	19.80	2.20	4.50	0.
17/01/11	17.90	18.75	19.30	19.80	2.20	4.45	0.
18/01/11	17.75	18.75	19.30	19.80	2.25	4.45	0.
19/01/11	17.20	18.45	19.15	19.75	2.25	4.45	0.

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
13/01/11	2.9353	3.8613	-20.7%
14/01/11	2.9048	3.8833	-20.8%
17/01/11	2.9181	3.8692	-20.8%
18/01/11	2.8848	3.8656	-21.3%
19/01/11	2.8879	3.8860	-21.0%

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

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.