



POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

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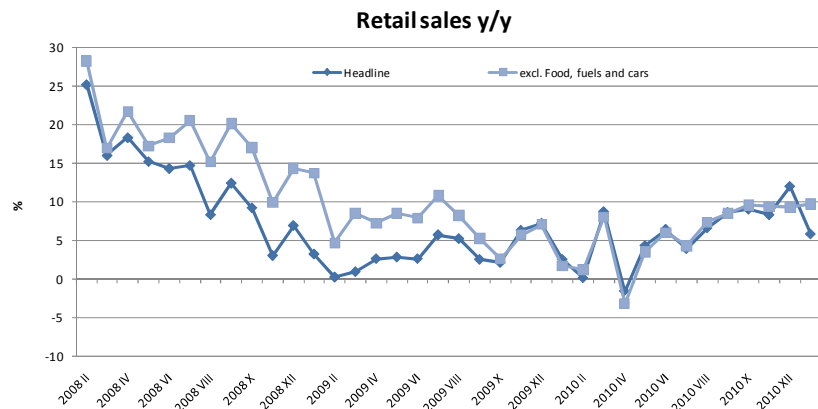
PREVIEW: The week of February 25th 2011 to March 3rd 2011

Indicator	Date of release	Pe-riod	BRE forecast	Consensus	Last	Comment
PMI	Mar 1	Feb	56.3pts	-	55.6pts.	Weaker zloty supports exporters. Plus better business activity indicators in Germany.
GDP growth	Mar 2	Q4	4.4%	4.3%	4.2%	We expect investment growth at 1.5% and consumption above 4.0%. Restocking continues.
MPC decision	Mar 2	-	3.75%	3.75%	3.75%	Although CPI inflation would easily speak for another hike aimed at anchoring expectations, MPC seems to have taken different stance. After interview with Belka we bet for flat rates.

In Focus / Macroeconomics

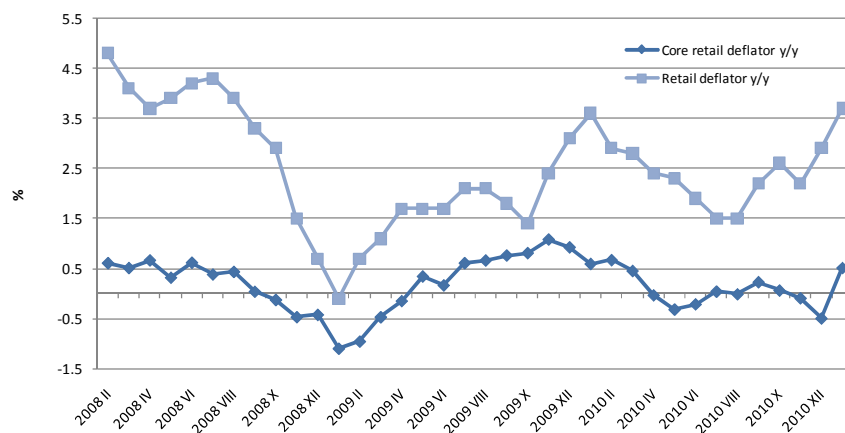
Retail sales decelerates on auto sales

Retail sales rose by 5.8% yoy in January. The main reason behind a drop in retail sales dynamic is higher VAT rate in January (resulting in substitution effects). As a result more durable goods were bought in December instead of in January. This factor together with abolition of light weight trucks benefit resulted in a 4.1% yoy drop in car sales (compared to 38.6% increase in December). Working days difference was neutral. The sales dynamics in many categories (e. g. clothing and shoes, furniture, TV and household appliances, pharmaceuticals) has remained unchanged or accelerated compared to December. Retail sales excluding food, fuels and cars have been growing around 10% yoy for a few months (see the graph). Therefore the reasons of the slowdown in retail sales growth are narrow-based. Improving conditions on the labor market (increasing wages and employment) speak for good prospects for retail sales and we expect retail sales growth to come back to recent trend in coming months (8-10%).



As usually we extracted retail sales deflators, including core retail sales deflator. Interestingly, the latter deflator suggests an increase in demand-driven inflation (1 pp increase compared to December). It is a food for thought whether it is such a fast result of VAT increase on prices of this group or postponed and cumulated increase in retailers' sales prices.

Core retail sales deflator, and retail sales deflator



Worse than expected retail sales data had some potential of easing interest rate hikes expecta-

MID-TERM FORECASTS

tions. This is also the way it may affect MPC members. In our opinion Monday's interview with Polish National Bank's head is symptomatic and also suggests that interest rate will remain unchanged. Mr. Belka does not seem to be scared by the recent spike in inflation and suggests postponing the next interest rate increase. Therefore, we believe that there is higher probability of no change in interest rates during the march meeting.

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	3.7
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	11.9
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	3.7	3.7
NBP repo rate (end-of-quarter)	3.50	3.5	3.5	3.50	3.75	4.25

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

Fixed Income*Hike? No hike!*

Last week, after dramatically surprising CPI data, the market tried to find its new equilibrium around the highest levels this year. The shape of the yield curve remained unchanged though some profit taking moved up 2Y10Y spread a bit trading from 34 to 37 points and 5Y10Y spread from -5 to -2 (still negative awaiting any MinFin selling action).

As mentioned last week, we decided to stay on the sidelines to find a new trigger or some new value on the curve. The main question was if that 3.8% Jan inflation data could have been justified by the next economic releases or it seemed to be an one-off event. Neither Industrial Output at 10.3% nor Retails Sales at 5.8% supported the bearish mood and suggested the higher CPI number might have an external source that couldn't have been managed by tightening the domestic monetary policy. Even monthly wages at 5.0% (below the market consensus) released on Feb16th didn't show the economy might face a second round effects in the near future. Taking into consideration the latest comments from central bank's governor Belka and the MPC member Glapinski were quite dovish and similar to our view presented above, we conclude the MPC may restrain from tightening in March. Concluding, as we see a 50-50 chance of a rate hike on march 2nd there could be an opportunity to take some value receiving the FRA contracts at current levels as the hike has been fully priced in already.

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	2/28/2011	-	4.291%	1/31/2011
2Y T-bond OK1013	3/9/2011	-	5.031%	2/9/2011
5Y T-bond PS0416	3/9/2011	-	5.642%	1/5/2011
10Y T-bond DS1020	3/16/2011	-	6.210%	1/12/2011
20Y T-bond WS0429	3/16/2011	-	6.246%	1/12/2011

Money Market

Cheaper carry at the end of the reserve

Low retail sales supports dovish wing of the MPC

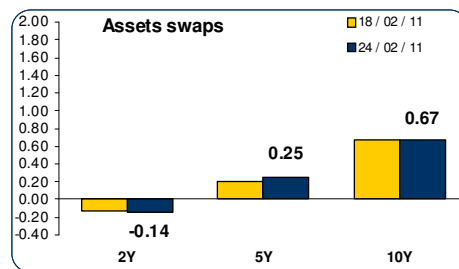
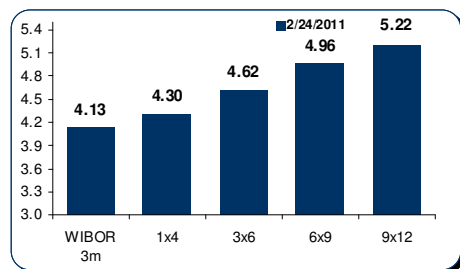
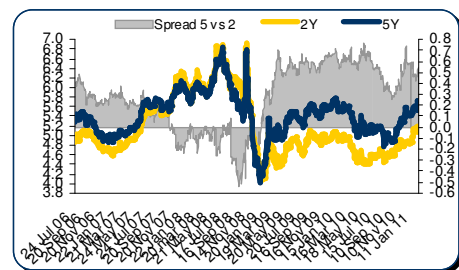
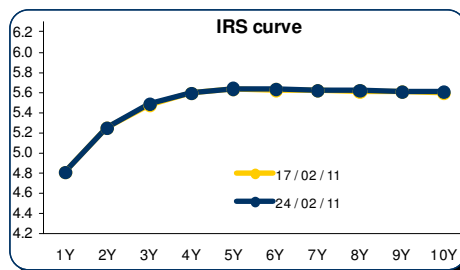
T-bills cheaper at weekly tender

Growing surplus of the cash in the system pushed the cost of carry down to 3%. Last day of the reserve will be much cheaper despite the OMO this day. Additional OMO on Tuesday was not successful at all since the bids were only for pln 500 mln, which was substantially below the 5 bln offer. It shows precisely that banks like to be long cash at the end of the reserve and the central bank can still stay in a "wish" mode.

Much lower than expected retail sales (5.8% vs 8.7%) put off expectations for the rates hike in March. The only thing that lefts after this figure and an interview with prof. Belka (much attention to the retail sales and wages) is weakening zloty. As of now we see probability of no hike to be 65/35.

T-bills much cheaper at weekly tender with an average yield of 4.48%. It looks very nice from our perspective to be long this paper. New issue on Monday with similar yields level.

FIXED INCOME & MONEY MARKET CHARTS



Foreign Exchange

Zloty weaker

Implied vols traded at low levels

This week EURPLN fueled by series of dovish statements from MPC members and growing global concerns about Middle East/Africa situation has started to trade weaker side. PLN sellers encouraged by above mentioned reasons has step into market and EURPLN's rate has headed up to 4.00 easily breaking 3.96 (last top) and 3.9860 (200 MA). Most of PLN longs were washed out and market has started to build PLN short positions. Although we already have traded 4.00 psychological level, resistance lays above it - 4.0050/4.01 (Fibonacci and Dec top).

Before EURPLN has started its 3.92 to 4.00 move we have traded new implied volatilities low – 1M 9.0, 3M 9.7, 1Y 11.0. Bounce from these levels, driven by higher spot, was not really impressive – respectively 9.8, 10.1 and 11.1 levels were paid. Simply, monotonous (0.5% daily) has not resulted with higher realized performance – 9.0% weekly vol. Bit surprising is fact that USDPLN vs EURPLN currency spread and smile has not reacted at all.

Short-term forecasts:

SPOT

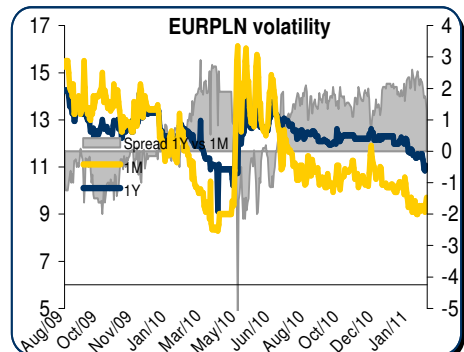
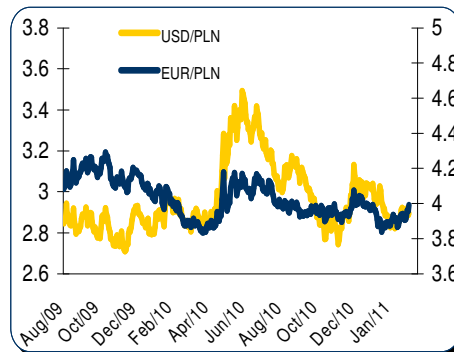
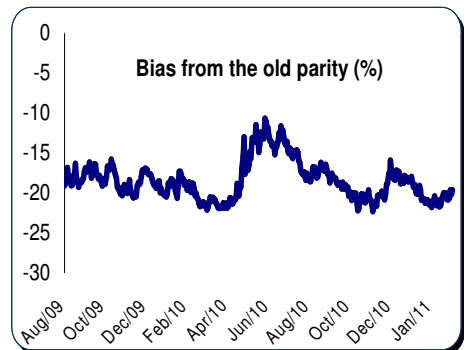
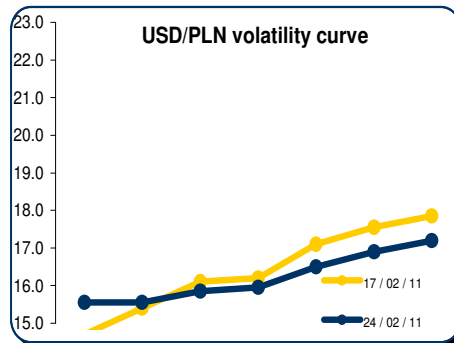
Main supports / resistances:
 EUR/PLN: 3.9400 / 4.0100
 USD/PLN: 2.8400 / 2.9700

In fact, in weekly-to-weekly time, we have closed our 3.94 short position (Belka gave impulse...). What's now? Sell at 4.01 with 4.03 S/L and 3.94 P/T. Why? Outflow seems to be exhausted a bit (some end of month fixing settlements), some privatization inflows at horizon, long PLN positioning has been washed out..

OPTIONS

Vega is priced lower (1Y tenor 12.3 to 11.1 since 1st of Jan!) and its hard to convince us to catch running train. We would be a buyer of it if PLN weakness will extend. Gamma is still priced above realized – 9.8% implied, 9.0 realized but this is the price of anxious times.

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
18/02/11	4.00%	4.12%	4.23%	4.23%	4.41%	4.42%
21/02/11	4.05%	4.12%	4.25%	4.25%	4.40%	6.59%
22/02/11	4.06%	4.13%	4.26%	6.49%	4.42%	4.42%
23/02/11	4.06%	4.13%	4.36%	4.26%	4.13%	4.42%
24/02/11	4.05%	4.13%	4.26%	4.26%	4.41%	4.42%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
18/02/11	4.29%	4.55%	4.92%	5.13%	5.10%
21/02/11	4.32%	4.60%	4.95%	5.20%	5.14%
22/02/11	4.35%	4.65%	4.97%	5.21%	5.16%
23/02/11	4.35%	4.64%	4.97%	5.20%	5.15%
24/02/11	4.33%	4.63%	4.95%	5.20%	5.13%

FIXED INCOME MARKET RATES

Fixed Income Market Rates (Closing mid-market levels)							
date	1Y		2Y		5Y		
	WIBOR	TB	IRS	OK0112	IRS	PS0511	IF
18/02/11	4.42%	4.51%	5.25%	5.12%	5.64%	5.85%	5.6
21/02/11	6.59%	4.50%	5.23%	5.08%	5.62%	5.86%	5.5
22/02/11	4.42%	4.50%	5.23%	5.08%	5.63%	5.87%	5.5
23/02/11	4.42%	4.47%	5.21%	5.08%	5.61%	5.84%	5.5
24/02/11	4.42%	4.50%	5.23%	5.09%	5.64%	5.88%	5.6

PRIMARY MARKET RATES

Last Primary Market Rates							
	au. date	maturity	avg price	avg yield	supply	demand	sc
52W TB	11/01/31	12/01/31	95.841	4.35%	2000	2968	19
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

date	USD/PLN 0-delta stradle				25-delta RR		2
	1M	3M	6M	1Y	1M	1Y	
18/02/11	14.85	15.65	16.40	17.15	1.80	3.75	0.
21/02/11	14.80	15.65	16.35	17.15	1.80	3.75	0.
22/02/11	15.10	15.75	16.40	17.15	1.90	3.70	0.
23/02/11	15.15	15.80	16.40	17.15	1.95	3.70	0.
24/02/11	15.55	15.95	16.50	17.20	2.20	3.80	0.

PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
18/02/11	2.8803	3.9105	-20.8%
21/02/11	2.8755	3.9295	-20.6%
22/02/11	2.9198	3.9632	-19.7%
23/02/11	2.8868	3.9575	-20.2%
24/02/11	2.8941	3.9916	-19.7%

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

Lukasz 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) bartlomiej.malocha@brebank.pl
Bogumił Modzelewski bogumil.modzelewski@brebank.pl

Structured Products (BREX)

Jarosław Stolarczyk (+48 22 829 01 67) jaroslaw.stolarczyk@brebank.pl
Jacek Dereziński (+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
Paulina Ziemińska (+48 22 829 02 56) paulina.ziembinska@brebank.pl
Maciej Pielaszkiewicz (+48 22 829 90 34) maciej.pielaszkiewicz@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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